DRAFT DECISION
Evoenergy
Distribution Determination

2019 to 2024

Attachment 11

Demand management incentive schemes

September 2018

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Evoenergy for the 2019–2024 regulatory control period. 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 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

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Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme

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Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CESS	Capital expenditure sharing scheme
DMIA	Demand management innovation allowance
DMIAM	Demand management innovation allowance mechanism
DMIS	Demand management incentive scheme
EBSS	Efficiency benefit sharing scheme
F&A	Framework and Approach
NER	National Electricity Rules
opex	operating expenditure
STPIS	Service Target Performance Incentive Scheme

11 Demand management incentive schemes

Under clauses 6.6.3 and 6.6.3A 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.

This attachment sets out how we will apply the DMIS and DMIAM to Evoenergy for the 2019–24 regulatory control period.

AER's DMIS and DMIAM

On 13 December 2017, we published a new DMIS[1] and a new DMIAM.[2] These will replace the current DMIS and demand management innovation allowance (DMIA) in the forthcoming regulatory control periods for all electricity distributors.

11.1 Draft decision

In accordance with our framework and approach (F&A) position,[3] our draft decision is to apply the new DMIS[4] and DMIAM[5] to Evoenergy for the 2019–24 regulatory control period, without any modification.

The DMIS contains three elements:[6]

- a cost uplift on 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
- an overall incentive constraint, which limits the total incentive in any year to one per cent of the distributor's allowed revenue for that year.

In accordance with the DMIS, the AER's distribution determination will provide that the cost multiplier (uplift) applicable to any eligible project will be the cost multiplier specified in the version of the DMIS that is in effect under clause 6.6.3 of the NER at the time the eligible project becomes a committed project.[7]

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

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

3 AER, *Final framework and approach for ActewAGL*, July 2017, p. 62.

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

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

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

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

The DMIAM comprises:[8]

- a fixed allowance of $200,000 (real 2017), plus 0.075 per cent of the annual allowed revenue for each regulatory year, as set out in AER's Post-Tax Revenue Model for Evoenergy
- project eligibility requirements
- compliance reporting requirements.

11.2 Evoenergy's proposal

Evoenergy stated that it is 'generally supportive' of the AER approach in the F&A to apply the incentive schemes, including the DMIS and DMIAM, to the 2019–24 regulatory control period.[9]

On DMIS, Evoenergy will participate in the scheme in the 2019–24 regulatory control period and will consider eligible projects over time as part of its network planning process.[10] The outcomes of this process to determine credible options (including non-network options for demand management) to meet identified needs in its network are documented in its 2017 Annual Planning Report.[11] To identify whether a project is applicable under the DMIS, Evoenergy must either undertake a RIT-D (if applicable) or follow other minimum project evaluation requirements.[12]

Evoenergy also proposed that the DMIS cap on incentive payments should apply over the length of the regulatory period rather than on an annual basis.[13]

Evoenergy supported the continued application of the DMIA with a larger annual innovation allowance.[14] Evoenergy proposed a provisional calculation of its DMIAM allowance to be $310,000 (in 2018–19 dollars) every year for the 2019–24 regulatory control period. This is based on the DMIAM guideline that annual funding will be equivalent to $200,000 (in 2016–17 dollars) plus 0.075 per cent of the distributor's annual revenue requirement.[15]

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

9 Evoenergy, *Overview of the regulatory proposal, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 25.

10 Evoenergy, *Attachment 10: Incentive schemes, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 17.

11 ActewAGL, *Annual Planning Report 2017 version 1.0*, 22 December 2017.

12 Evoenergy, *Attachment 10: Incentive schemes, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 17.

13 Evoenergy, *Overview of the regulatory proposal, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 25.

14 Evoenergy, *Overview of the regulatory proposal, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 25.

15 AER, *Demand Management Innovation Allowance Mechanism, Electricity distribution network service providers*, December 2017, p. 8.

11.3 AER's assessment approach

We are required to make a decision on how the DMIS and DMIAM are to apply to Evoenergy.[16] We outlined our proposed approach to, and reasons for, the application of the DMIS and DMIAM in our F&A for Evoenergy. Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by Evoenergy and by stakeholders.

11.3.1 Interrelationships

The DMIS will encourage demand management initiatives which 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 the deferral of, or removal of the need for, network augmentation or replacement/refurbishment expenditures, such as by 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 the Efficiency Benefit Sharing Scheme (EBSS), Capital Expenditure Sharing Scheme (CESS) and Service Target Performance Incentive Scheme (STPIS), and vice versa.

We currently operate two incentive schemes designed to encourage efficient decision making by distributors: the CESS and the EBSS. These 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.

We expect the DMIS will encourage distributors to undertake more demand management activities where it is efficient to do so. Since demand management typically consists of opex rather than capex, the DMIS might result in distributors receiving higher penalties or lower rewards under the EBSS. The EBSS penalties would, in isolation, severely reduce the incentive for demand management projects as they have to accept 30 per cent of the opex increase.

When the EBSS is considered in tandem with the CESS, however, efficient demand management is encouraged. The CESS will allow for 30 per cent of any savings on capex to be retained by the distributor for the regulatory control period. As all eligible projects require a reduction in costs, the increase in opex should be lower than the decrease in capex. This will effectively negate the detriment of the EBSS penalty. Moreover, given the CESS, 30 per cent of the total difference in cost, or cost savings, between the network and non-network option will be awarded to the distributor, in addition to the DMIS cost uplift. This provides an incentive structure that flexibly rewards distributors for creating the greatest cost savings.

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[16] NER, cl.6.3.2(a)(3) and 6.12.1(9).

We will not exempt projects from the STPIS under the DMIS, as we consider this would negatively affect consumers in two ways. Firstly, not applying the STPIS to demand management solutions would transfer the risk of solution failure onto consumers, who have little opportunity to mitigate that risk. Secondly, exempting demand management from performance targets may increase the perception that demand management is less reliable than network solutions, furthering any potential cultural bias against demand management. This would not serve to further the objective of the DMIS scheme, which is to promote efficient investment in non-network demand management options.[17]

11.4 Reasons for draft decision

The new DMIS is designed to provide more incentives for the distributors and consumers to adopt more demand management measures, which should put greater downward pressure on prices, benefitting the whole community.

Along with the new DMIS scheme, the AER has improved the DMIAM. The improved allowance provides more funding to networks to undertake further research on demand management initiatives and to share these learnings across industry and consumers.

On the DMIS, Evoenergy proposed that the DMIS's cap to incentive payments should apply over the length of the regulatory period, rather than on an annual basis. However, when finalising the new DMIS in 2017, after extensive consultation over several months with distributors and stakeholders, we decided that the total financial incentive should be capped annually to protect retail customers from price shocks in any year.[18] We remain of this view. Accordingly, the AER will determine the total financial incentive available to Evoenergy under the scheme for each regulatory year of a regulatory control period.[19]

On the DMIAM, we will determine the allowance for Evoenergy based on its annual revenue requirement in our final distribution determination. This allowance will be based on our DMIAM guideline that annual funding will be equivalent to $200,000 (in 2016–17 dollars) plus 0.075 per cent of the distributor's annual revenue requirement.

We note that Evoenergy did not show an allocation of its proposed DMIAM funding to specific projects, nor sought upfront consideration of projects that are likely to comply with the mechanism. However, Evoenergy referred to examples of the range of demand management projects it will undertake in the 2019–24 period: its trials of demand management techniques include SMS curtailment requests, virtual power

17 NER, cl. 6.6.3(b)

18 AER, *Explanatory statement*, *Demand Management Incentive Scheme, Electricity distribution network service providers*, December 2017, pp. 52-53..

19 AER, *Demand Management Incentive Scheme, Electricity distribution network service providers*, December 2017, p. 6.

plant trials, and demand reduction contracts.[20] The AER will determine the eligibility and specific incentive payments for each project according to the criteria specified in the new DMIS and DMIAM. Evoenergy will have to provide supporting documents as required under the new DMIS and DMIAM.

Evoenergy's opex forecast includes a step change of $1.8 million for what it terms as "an efficient trade-off between capex and opex for demand management in a new urban development area."[21] The AER Consumer Challenge Panel (CCP10) stated in its written submission on Evoenergy's proposal that the AER should decide whether to assess the demand management capex/opex trade off as a proposed step change or proposed demand management. We have decided to assess this as a proposed step change in opex. This is discussed in our draft decision opex attachment.[22]

[20] Evoenergy, *Attachment 1: Asset management and governance, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 21.

[21] Evoenergy, *Overview of the regulatory proposal, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 21; *Attachment 6: Operating expenditure, Regulatory proposal for the ACT electricity distribution network 2019–24,* January 2018, p. 17.

[22] AER, *Draft Decision Evoenergy distribution determination 2019 to 2014, Attachment 6 Operating expenditure*, September 2018.