

 PRELIMINARY DECISION

AusNet Services distribution determination

 2016 to 2020

Attachment 12 – Demand management incentive scheme

October 2015

© Commonwealth of Australia 2015

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

* the Commonwealth Coat of Arms
* the ACCC and AER logos
* any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 4141, Canberra ACT 2601

or publishing.unit@accc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

1. Note
2. This attachment forms part of the AER's preliminary decision on AusNet Services' revenue proposal 2016–20. It should be read with all other parts of the preliminary decision.
3. The preliminary decision includes the following documents:
4. 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 mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

Attachment 18 - f-factor scheme

1. Contents

[Note 12-2](#_Toc425340177)

[Contents 12-3](#_Toc425340178)

[Shortened forms 12-4](#_Toc425340179)

[12 Demand management incentive scheme 12-6](#_Toc425340180)

[12.1 Preliminary decision 12-7](#_Toc425340181)

[12.2 AusNet Services' proposal 12-7](#_Toc425340182)

[12.3 AER’s assessment approach 12-7](#_Toc425340183)

[12.4 Reasons for preliminary decision 12-8](#_Toc425340185)

1. Shortened forms

| 1. Shortened form
 | 1. Extended form
 |
| --- | --- |
| 1. AEMC
 | 1. Australian Energy Market Commission
 |
| 1. AEMO
 | 1. Australian Energy Market Operator
 |
| 1. AER
 | 1. Australian Energy Regulator
 |
| 1. AMI
 | 1. advanced metering infrastructure
 |
| 1. augex
 | 1. augmentation expenditure
 |
| 1. capex
 | 1. capital expenditure
 |
| 1. CCP
 | 1. Consumer Challenge Panel
 |
| 1. CESS
 | 1. capital expenditure sharing scheme
 |
| 1. CPI
 | 1. consumer price index
 |
| 1. DRP
 | 1. debt risk premium
 |
| 1. DMIA
 | 1. demand management innovation allowance
 |
| 1. DMIS
 | 1. demand management incentive scheme
 |
| 1. distributor
 | 1. distribution network service provider
 |
| 1. DUoS
 | 1. distribution use of system
 |
| 1. EBSS
 | 1. efficiency benefit sharing scheme
 |
| 1. ERP
 | 1. equity risk premium
 |
| 1. Expenditure Assessment Guideline
 | 1. Expenditure Forecast Assessment Guideline for electricity distribution
 |
| 1. F&A
 | 1. framework and approach
 |
| 1. MRP
 | 1. market risk premium
 |
| 1. NEL
 | 1. national electricity law
 |
| 1. NEM
 | 1. national electricity market
 |
| 1. NEO
 | 1. national electricity objective
 |
| 1. NER
 | 1. national electricity rules
 |
| 1. NSP
 | 1. network service provider
 |
| 1. opex
 | 1. operating expenditure
 |
| 1. PPI
 | 1. partial performance indicators
 |
| 1. PTRM
 | 1. post-tax revenue model
 |
| 1. RAB
 | 1. regulatory asset base
 |
| 1. RBA
 | 1. Reserve Bank of Australia
 |
| 1. repex
 | 1. replacement expenditure
 |
| 1. RFM
 | 1. roll forward model
 |
| 1. RIN
 | 1. regulatory information notice
 |
| 1. RPP
 | 1. revenue and pricing principles
 |
| 1. SAIDI
 | 1. system average interruption duration index
 |
| 1. SAIFI
 | 1. system average interruption frequency index
 |
| 1. SLCAPM
 | 1. Sharpe-Lintner capital asset pricing model
 |
| 1. STPIS
 | 1. service target performance incentive scheme
 |
| 1. WACC
 | 1. weighted average cost of capital
 |

# 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]](#footnote-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]](#footnote-2) for AusNet Services’ distribution determination for the 2011–15 regulatory control period.

The current DMIS for AusNet Services includes the demand management innovation allowance (DMIA).[[3]](#footnote-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]](#footnote-4) in the previous year, which we then assess against specific criteria.[[5]](#footnote-5)
* Part B compensates distributors for any foregone revenue demonstrated to have resulted from demand management initiatives approved under Part A. We applied this to AusNet Services during the 2011–15 regulatory control period. However, Part B will no longer be applicable to AusNet Services during the 2016–20 regulatory control period given the move to a revenue cap form of control.

Under the scheme, we return any underspend against the allowance to customers. Also, once we know the approved DMIA expenditure for each year of the current period, we compensate distributors for approved foregone revenue. We implement this as an adjustment to each distributor's innovation allowance in the following regulatory control period.

## Preliminary decision

1. We have determined to continue Part A of the DMIS for AusNet Services in the 2016–20 regulatory control period (that is, the DMIA component). We will not apply Part B of the DMIS to AusNet Services for the 2016–20 regulatory control period because we have decided to apply a revenue cap form of control. This is consistent with our proposed approach in our final framework and approach (F&A).[[6]](#footnote-6)
2. The current DMIA (Part A of the DMIS) amount of $0.6 million ($2015) per annum will continue in the 2016–20 regulatory control period.

## AusNet Services' proposal

1. AusNet Services supported the proposed approach set out in our final F&A to continue applying Part A (the DMIA) of the DMIS while noting the COAG Energy Council are considering a number of rule changes proposed by the AMEC in its Power of Choice review. However, AusNet Services proposed an increase in the scale of the allowance to $10 million ($2 million per annum).[[7]](#footnote-7)
2. AusNet Services proposed to increase their DMIA to $10 million to run a number of projects aimed at reducing the risks associated with developing new demand management techniques to be utilised in the next and future regulatory periods.

## AER’s assessment approach

1. The rules require us to have regard to several factors in developing and implementing a DMIS for AusNet Services.[[8]](#footnote-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.
1. We had regard to these factors in considering the proposed approach to the DMIS for AusNet Services as set out in our final F&A[[9]](#footnote-9) and we have again taken these factors into account in making our preliminary decision.

## Reasons for preliminary decision

We have determined that the current innovation allowance amount of $0.6 million ($2015) per annum (or $3 million over the period) will continue in the 2016–20 regulatory control period.

Our final F&A stated that our intention to develop and implement a new DMIS for the 2016–20 regulatory control period was dependent on the progress of the rule change process arising from the AEMC’s Power of Choice review.[[10]](#footnote-10) On 20 August 2015, the AEMC released the final rule change determination.[[11]](#footnote-11)

1. We received submissions from the Victorian Greenhouse Alliances (Alliance), the Department of Economic Development, Jobs, Transport and Resources (Department) and the Consumer Challenge Panel (CCP).

The Alliance submitted that we should consider the efficient costs for consumers through the application of an appropriate DMIS allowance and ensuring support for other forms of demand management expenditure where there is a compelling business case.[[12]](#footnote-12) Regarding AusNet Services, the Alliance considered there is no justification for us to curtail the modest allowance request proposed in the 2016–20 regulatory control period.[[13]](#footnote-13)

The Department submitted that we should ensure that any funding is consistent with the objectives of the DMIA and demand management initiatives are not funded through the DMIA when it is more appropriate for them to be funded through an opex or capex allowance, or through expenditure incentive schemes.[[14]](#footnote-14)

1. The CCP submitted that it is concerned at the large amounts that are included for demand management projects under the DMIA and that we should ensure that there is no duplication and that the projects will provide benefits to consumers. The CCP recommends that no changes to the incentive schemes should be allowed.[[15]](#footnote-15)

We acknowledge the need to reform the existing demand management incentive arrangements and the importance of demand management in deferring the need for network augmentation by alleviating network utilisation during peak usage periods. However, quite separately to incentive or innovation allowances, the move to a revenue cap form of control removes any disincentive for distributors to reduce the quantity of electricity sold by pursuing demand management initiatives. More robust obligations to consider non-network alternatives under RIT-D requirements also provide distributors with opportunities to improve and expand their demand management programs.

We recognise the importance of appropriate demand management incentives in order to defer network augmentation. In response to submissions, and consistent with our final F&A, we do not consider it appropriate to develop an alternative incentive structure or increase the size of the DMIA in parallel to developing a new DMIS and DMIA. The AEMC's final rule determination[[16]](#footnote-16) requires us to develop a demand management incentive scheme and allowance by 1 December 2016.

We do not approve an increase in AusNet Services' allowance. Whilst AusNet Services have shown their commitment to demand management through the projects implemented in the 2011─15 regulatory period we do not consider additional funding is appropriate at this stage. Any change to the current allowance (which was originally set by scaling the allowance to the relative size of each distributor's average annual revenue)[[17]](#footnote-17) should be considered at a whole of industry level, rather than each individual business. This will be done during the development of the new scheme. This is supported by the CCP recommendation that the incentive scheme remain unchanged.

For these reasons, we are not making any changes to the DMIS and we have adopted the position proposed in our final F&A and approved DMIA allowances consistent with their current scale.

AusNet Services' proposed a number of demand management costs as part of its total forecast operating expenditure building block. Our decision on AusNet Services’ demand management related operating expenditure building block can be found in attachment 7.

1. NER, cl. 6.6.3(a). [↑](#footnote-ref-1)
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. [↑](#footnote-ref-2)
3. AER, Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15, April 2009. [↑](#footnote-ref-3)
4. The DMIA excludes the costs of demand management initiatives approved in our determination for the 2011–15 regulatory control period. [↑](#footnote-ref-4)
5. AER, Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15, April 2009, pp. 5─6. [↑](#footnote-ref-5)
6. AER, Final Framework and Approach for the Victorian Electricity Distributors, October 2014, p. 114. [↑](#footnote-ref-6)
7. AusNet Services, Electricity Distribution Price Review 2016─20, 30 April 2015, p. 255. [↑](#footnote-ref-7)
8. NER, cl 6.6.3(b). [↑](#footnote-ref-8)
9. AER, Final Framework and Approach for the Victorian Electricity Distributors, October 2014, p. 114. [↑](#footnote-ref-9)
10. AER, Final Framework and Approach for the Victorian Electricity Distributors, October 2014, p. 114. 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 – see http://www.aemc.gov.au/Rule-Changes/Demand-Management-Embedded-Generation-Connection-I [↑](#footnote-ref-10)
11. AEMC, Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015, 20 August 2015. [↑](#footnote-ref-11)
12. Local Government, Response to the Victorian Electricity Distribution Price Review (EDPR) 2016-20, 13 July 2015, p. 26. [↑](#footnote-ref-12)
13. Local Government, Response to the Victorian Electricity Distribution Price Review (EDPR) 2016-20, 13 July 2015, p. 30. [↑](#footnote-ref-13)
14. Department of Economic Development, Jobs, Transport and Resources Submission to Victorian electricity distribution pricing review – 2016 to 2020, 13 July 2016, p. 13 [↑](#footnote-ref-14)
15. Consumer Challenge Panel Sub Panel 3, Response to proposals from Victorian electricity distribution network service providers for a revenue reset for the 2016-20 regulatory period, 10 August 2015, p. 10. [↑](#footnote-ref-15)
16. AEMC, Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015, 20 August 2015.: <http://www.aemc.gov.au/getattachment/f866b41b-753b-471c-91cf-4f558ca130b2/Final-rule-determination.aspx> [↑](#footnote-ref-16)
17. AER, Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15, April 2009. [↑](#footnote-ref-17)