



**PRELIMINARY DECISION**  
**CitiPower distribution**  
**determination**  
**2016 to 2020**

**Attachment 12 – Demand**  
**management incentive scheme**

October 2015

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## Note

This attachment forms part of the AER's preliminary decision on CitiPower's revenue proposal 2016–20. It should be read with all other parts of the preliminary decision.

The preliminary 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 mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	advanced metering infrastructure
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.<sup>1</sup> 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)<sup>2</sup> for CitiPower's distribution determination for the 2011–15 regulatory control period.

The current DMIS for CitiPower includes the demand management innovation allowance (DMIA).<sup>3</sup>

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<sup>4</sup> in the previous year, which we then assess against specific criteria.<sup>5</sup>
- Part B compensates distributors for any foregone revenue demonstrated to have resulted from demand management initiatives approved under Part A. We applied this to CitiPower during the 2011–15 regulatory control period. However, Part B will no longer be applicable to CitiPower 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.

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<sup>1</sup> NER, cl. 6.6.3(a).

<sup>2</sup> 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.

<sup>3</sup> AER, *Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15*, April 2009.

<sup>4</sup> The DMIA excludes the costs of demand management initiatives approved in our determination for the 2011–15 regulatory control period.

<sup>5</sup> AER, *Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15*, April 2009, pp. 5–6.

## 12.1 Preliminary decision

We have determined to continue Part A of the DMIS for CitiPower in the 2016–20 regulatory control period (that is, the DMIA component). We will not apply Part B of the DMIS to CitiPower 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).<sup>6</sup>

The current innovation allowance amount of \$0.2 million (\$2015) per annum will continue in the 2016–20 regulatory control period.

## 12.2 CitiPower's proposal

CitiPower supported the proposed approach set out in our F&A to continue applying Part A (the DMIA) of the DMIS at the same scale it is currently applied.<sup>7</sup>

CitiPower proposed an amendment to the DMIS whereby they can seek additional funding under the scheme on the proviso that we pre-approve all proposed DMIS initiatives above the capped amount.

## 12.3 AER's assessment approach

The NER require us to have regard to several factors in developing and implementing a DMIS for CitiPower.<sup>8</sup> 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.

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<sup>6</sup> AER, *Final Framework and Approach for the Victorian Electricity Distributors*, October 2014, p. 114.

<sup>7</sup> CitiPower, *Regulatory Proposal*, 30 April 2015, pp. 188–189.

<sup>8</sup> NER, cl. 6.6.3(b).



We had regard to these factors in considering the proposed approach to the DMIS for CitiPower as set out in our F&A<sup>9</sup> and we have again taken these factors into account in making our preliminary decision.

## 12.4 Reasons for preliminary decision

We have determined that the current innovation allowance amount of \$0.2 million (\$2015) per annum (or \$1 million over the period) will continue in the 2016–20 regulatory control period.

Our 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.<sup>10</sup> On 20 August 2015, the AEMC released the final rule change determination.<sup>11</sup>

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. Regarding CitiPower, the Alliance considered that CitiPower need to provide further information on the types of projects they would include in their proposal to seek additional funding for pre-approved demand management projects.<sup>12</sup>

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.<sup>13</sup>

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.<sup>14</sup>

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<sup>9</sup> AER, *Final Framework and Approach for the Victorian Electricity Distributors*, October 2014, p. 114.

<sup>10</sup> 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.

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

<sup>12</sup> Local Government, *Response to the Victorian Electricity Distribution Price Review (EDPR) 2016-20*, 13 July 2015, p. 26.

<sup>13</sup> Department of Economic Development, Jobs, Transport and Resources, *Submission to Victorian electricity distribution pricing review – 2016 to 2020*, 13 July 2016, p. 13

<sup>14</sup> 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.

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 F&A, we do not consider it appropriate to implement an amendment to add a pre-approval function to the current scheme, for expenditure beyond the capped allowance, in parallel to developing a new DMIS and DMIA. The AEMC's final rule determination<sup>15</sup> requires us to develop a demand management incentive scheme and allowance by 1 December 2016.

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)<sup>16</sup> 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 F&A and approved DMIA allowances consistent with their current scale.

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

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<sup>15</sup> AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, 20 August 2015. Scheme: <http://www.aemc.gov.au/getattachment/f866b41b-753b-471c-91cf-4f558ca130b2/Final-rule-determination.aspx>.

<sup>16</sup> AER, *Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15*, April 2009.