

# DMIS Directions Forum

Demand Management (DM)

*Incentive Scheme  
&*

*Innovation Allowance Mechanism*

29 June 2017



# The DM Incentive Scheme in four parts

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- Operation
  - Project eligibility
  - Calculating the incentive
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- Adjusting the incentive and early application

# Introduction

## Outline

The scheme aims to provide *Distribution Network Service Providers* (distributors) with an incentive to undertake efficient expenditure on relevant *non-network options* relating to DM

We have sought to achieve this objective by creating a simple, transparent scheme composed of:

- A percentage uplift on the costs of DM projects;
- Two constraints targeted to deliver value for consumers;
- Robust compliance reporting; and
- Capacity to adjust the incentive

# Introduction

## The Benefits

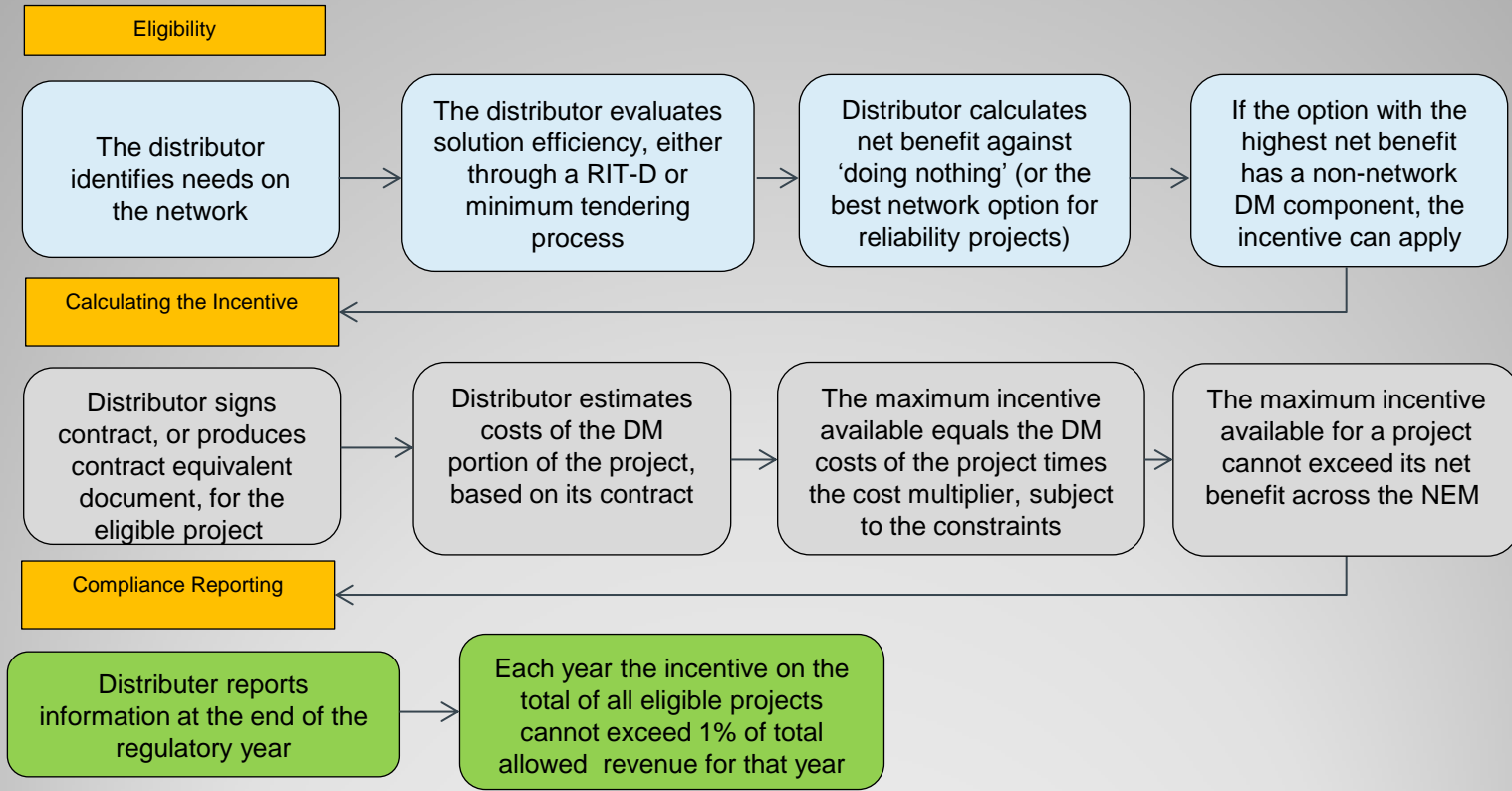
- The scheme and allowance mechanism aim to serve as a bridge between the current regulatory framework and a framework more focussed on efficient pricing of network services
- Together, the measures strengthen incentives for distributors to pursue DM, while building-in robust compliance mechanisms to deliver value for consumers

# Introduction

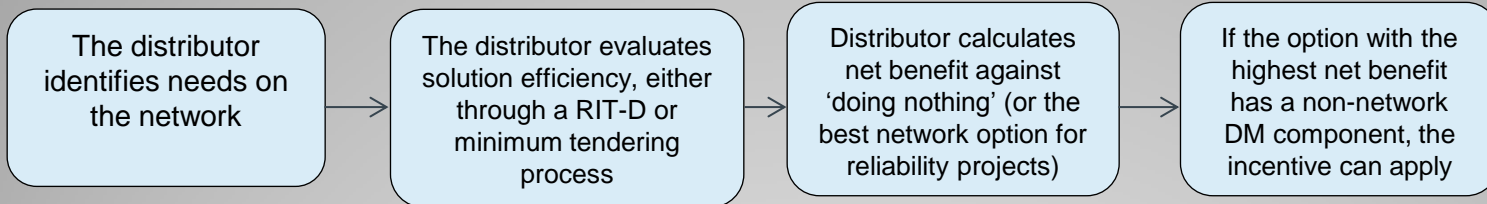
## The Cost Multiplier

- A multiplier applied to the DM costs of a project that:
  - Has been assessed as efficient;
  - Has been subjected to third party testing; and
  - Is a non-network preferred option
- Allows the distributor to receive a profit on DM, recovered from consumers via network charges
- We currently intend to set the multiplier at 50%
  - Simple
  - Positive incentive to encourage efficient DM

# Operation



# Operation – Eligibility



- A project is eligible for a cost uplift if it:
  - Addresses an identified need on the network – either augmentation or replacement;
  - Relates to DM;
  - Is evaluated as efficient; and
  - Is a non-network option
- Incentive should not be claimed on costs that are otherwise recoverable from another source

# Operation - Eligibility

## Relates to DM

- DM is the act of modifying the drivers of network usage to remove a network constraint at peak
- Eligible projects may be fully DM, or contain a DM component
- But, the incentive is only available for the portion of the project that is DM



# Operation - Eligibility

## Evaluating a Project as Efficient

- The incentive is only available for projects which are the preferred option. This means that a project must:
  - Be a credible option;
  - Address the network constraint; and
  - Have the highest net benefit of all assessed projects
- Projects must also have positive net present value when compared to the appropriate base case
  - For projects without a reliability corrective action component, the base case is a 'do nothing option'
  - For projects with a reliability corrective action component, the base case is the next best network option
- This evaluation will take place under a RIT-D or (if the RIT-D threshold is not met) by following the minimum tendering requirements set out in the scheme

# Operation - Eligibility

## Minimum Tendering Requirements

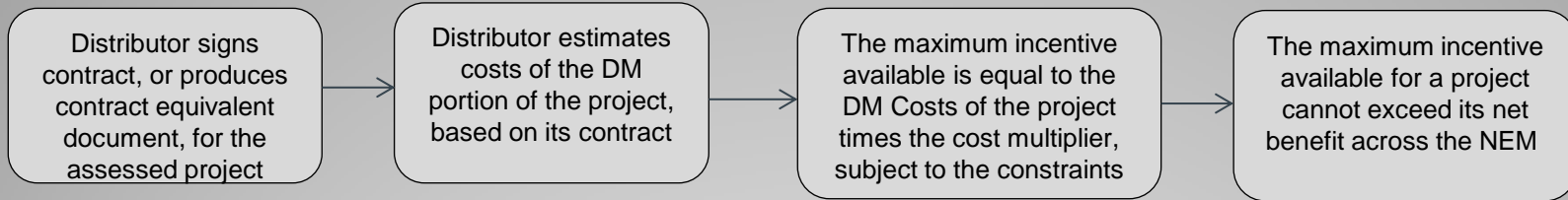
- Issue a request for quote (RFQ) to:
  - Demand side engagement register; and
  - Other parties that could deliver the DM project
- RFQ contains details on:
  - Distributor's credible options; and
  - Information to assist parties present alternative options in addressing the RFQ
- Produce a document that evaluates options and presents the analysis used to make the investment decision

# Operation - Eligibility

## Outcome

- The scheme will incentivise DM **only** where it is the most efficient option
- The process of project selection will be competitive and transparent
- This process acts as an in-built compliance check and promotes value for consumers

# Operation – Calculating the Incentive



## Project Committal

- Once a project is identified as being eligible, the distributor will make a project commitment
- The AER will require written documentation of this commitment
- For third party projects the contract must specify the amount of peak demand reduction (\$ per  $kVA_{peak}$ )
  - This creates an accountability measure for distributors and DM providers and will form a component of the Scheme Compliance Reporting
- If an in-house option is identified as the preferred option, distributors must produce a document with information equivalent to the 3rd party contract
  - This document must receive clearance from an appropriate company officer, verifying that there is a reasonable basis for concluding that the proposed costs will be incurred
  - Note that the Ring Fencing guideline will apply to these projects where relevant

# Operation – Calculating the Incentive

## Constraint

- The maximum incentive available is equal to the DM costs of the project times the cost multiplier, subject to the constraints
- However, the maximum incentive available for a project cannot exceed its net benefit across the NEM against a 'base case':
  - 'Do nothing' option; or
  - For reliability projects, the preferred network option
- Where a project would exceed this level, the incentive will be capped to the net benefits
- This constraint means that all projects must make a positive contribution for consumers

# Operation – Calculating the Incentive

## Outcome

- Delivering a more efficient network for consumers is consistent with the Scheme Objective
- The cost uplift attempts to reflect the benefits of DM, providing an incentive for distributors to undertake efficient projects
- The cost of any project's incentive payment will be capped so that all projects under the scheme deliver savings to consumers

# Compliance Reporting

## Contents

- Each regulatory year, distributors submit a DM compliance report.
- The report must include publishable project specific data relating to:
  - DM contracted, DM delivered, DM benefits, Total financial incentive proposed to be recovered, Projects identified as eligible in the regulatory year.

## Purpose

- Approving financial incentive to be recovered.
  - The total incentive for a distributor in a regulatory year cannot exceed 1% of its total allowed revenue that year
    - Prevents excessive use of the incentive
    - Responds to stakeholder feedback on this issue
  - This is not an ex-post assessment.
- Allow the AER to produce a report comparing distributor performance.
  - Assess factors such as; level of DM engaged, efficiency of DM, compliance
- Assess the merit of adjusting the incentive in future iterations of the scheme.

## Summary

- Simple
- Fixed percentage creates certainty for businesses
- Cap constraints targeted to deliver value for consumers



# Adjusting the Scheme and Early Application

## Adjusting the Scheme

- The distribution determination will apply the scheme via the inclusion of a *dt* factor
- This will be defined as the cost multiplier included in the version of the scheme operating in that regulatory year
- If the AER proposes to change the scheme we will:
  - Follow the distribution consultation guidelines; and
  - Allow for a time lag before any changes become operational
- Once the uplift is applied to a project, that percentage of uplift is available throughout the project's life
  - Any changes to the multiplier will not be applied retrospectively

# Adjusting the Scheme and Early Application

## Rationale

- The AER has received strong stakeholder feedback indicating that there should be scope for adjusting the incentive as changes occur in the market and more information is gathered about its use
- The use of the *dt* factor allows updates to the scheme to be applied to all distributors simultaneously, without reopening distribution determinations or undergoing a rule change process, reducing regulatory burden
- This design utilises the flexibility intentionally inserted into the rules and is fair and transparent
- This will assist the AER in refining the scheme over the long term

# Adjusting the Scheme and Early Application

## Early Application

- The AER is considering submitting a rule change to allow for immediate application of the scheme and allowance mechanism to all distributors
- This will prevent long delays for some jurisdictions
- Allow distributors to make investment decisions with certainty
- Allow consumers to capture the benefits sooner

# Questions

- 1) Does the proposed scheme framework achieve the Scheme Objective?
  - The objective of the *DM incentive scheme* is to provide *distributors* with an incentive to undertake efficient expenditure on relevant *non-network options* relating to DM
- 2) Should we seek a rule change for early adoption?

# **Innovation Allowance Mechanism**

## Outline

The allowance mechanism – an improved 'DMIA'

- Small improvements to increase certainty, enhance industry knowledge, and promote innovation
- A modest increase to the size of the incentive, to create greater parity amongst businesses

## How it works

- We are proposing to calculate the allowance as  $\$200,000 + 0.075\%$  of Maximum Allowable Revenue per year
  - This is a modest increase to the value of the allowance to make it more equitable for smaller distributors
- AER will set allowance cap in distribution determination
- Distributor identifies eligible project/s
  - May seek indicative confirmation
- Distributor reports data
- AER approves expenditure and determines adjustment
- AER calculates carryover amount from underspending the allowance

# Eligibility

- Projects must:
  - be DM projects;
  - have the potential to reduce long term network costs;
  - be innovative – that is, be:
    - Based on new or original concepts;
      - Such as projects that have not previously been funded under the DMIA or other funding mechanisms
    - Involving techniques not yet implemented; or
      - E.g Proof of concept projects
    - Focused on customers in a market segment, with characteristics that may materially affect demand, on which the technology has not previously been tested



# Requirements

- Distributors must fulfil the compliance reporting requirements
- Project impact must be measured
- Expenses for the project must not be:
  - Recoverable under any jurisdictional incentive scheme;
  - Recoverable under any government scheme; or
  - Included in approved forecast capex/opex

# Compliance Reporting

- Each year distributors must submit an annual report to the AER
- The report must contain:
  - Total allowance spent;
  - Project specific reports for each project claimed under the allowance mechanism; and
  - Justification for each project claimed under the allowance mechanism

# Project Specific Reports

- Must be capable of being published separately
- Must contain information about the project's:
  - Nature and scope
  - Aims and expectations
  - Implementation approach
  - Outcome measurement and evaluation approach
  - Implementation costs
  - Developments over the previous regulatory year
  - Final measurement results, analysis, and implications
  - Any other information required to allow an informed observer to potentially replicate the project

## Summary

- Reduced ambiguity in project criteria
- Stronger requirements for project reporting
- A more effective allowance mechanism

## Questions

3) Will the proposed allowance mechanism achieve its objective?

- The objective of the *DM innovation allowance mechanism* is to provide *distributors* with funding for research and development in DM projects that have the potential to reduce long term *network* costs.