DRAFT DECISION

SA Power Networks Distribution Determination 2020 to 2025

Attachment 11 Demand management incentive scheme and innovation allowance

October 2019

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to SA Power Networks for the 2020–2025 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

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

Attachment 9 – Capital expenditure sharing scheme

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 scheme and innovation allowance

Under clauses 6.6.3 and 6.6.3 A 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.

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.

This attachment sets out how we will apply the DMIS and DMIAM to SA Power Networks for the 2020–25 regulatory control period.

11.1 Draft decision

In accordance with our framework and approach (F&A),[3] our draft decision is to apply the new DMIS[4] and DMIAM[5] to SA Power Networks for the 2020–25 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, our distribution determination will provide that the cost multiplier (uplift) applicable to any eligible project will be the cost multiplier specified in the current version of the DMIS that is in effect 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, SA Power Networks, Regulatory control period commencing 1 July 2020*, July 2018, pp. 75-77.
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 $200000 (real 2017), plus 0.075 per cent of the annual allowed revenue for each regulatory year, as set out in our Post-Tax Revenue Model (PTRM) for SA Power Networks
- project eligibility requirements, and
- compliance reporting requirements.

In our final distribution determination, we will determine the amount of the DMIAM allowance for SA Power Networks for the 2020–25 regulatory period, based on the final PTRM for SA Power Networks.

11.2 SA Power Networks' proposal

SA Power Networks proposed to adopt the approach specified in the F&A.[9]

SA Power Networks noted that projects which it intends to fund using the new DMIS and DMIAM do not need to be set out in its regulatory proposal, as the scheme and mechanism have an annual application and approval process separate from the distribution determination.[10] However, SA Power Networks identified a number of potential projects that may be suitable for DMIS and DMIAM.

SA Power Networks stated that, in general it intends to make use of the allowance for targeted innovation and research projects to further its understanding of how to manage the changing nature of demand in its network, and the ongoing transition to decentralised generation.

Potential projects that have been identified as or may become DMIAM projects include:

- shifting hot water loads to daytime to match solar PV production
- controlling substation voltage to increase network hosting capacity for solar PV
- integrating with future distribution market platforms, and
- managing the potential impact of electric vehicle charging.[11]

SA Power Networks also stated it has identified about $28 million of future augmentation works, and smaller non-network alternatives under $5 million,[12] that it could possibly apply for as DMIS projects.[13]

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

9 SA Power Networks, *2020-25 Regulatory Proposal - Attachment 11 - Demand Management Incentives and Allowances*, 31 January 2019, p. 6.

10 SA Power Networks, *2020-25 Regulatory Proposal - Attachment 11 - Demand Management Incentives and Allowances*, 31 January 2019.

11 SA Power Networks, *2020-25 Regulatory Proposal - Attachment 11 - Demand Management Incentives and Allowances*, 31 January 2019, pp. 7-8.

11.3 Assessment approach

We are required to make a decision on how the DMIS and DMIAM are to apply to SA Power Networks.[14] We outlined our proposed approach to, and reasons for, the application of the DMIS and DMIAM in our F&A for SA Power Networks.

Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by SA Power Networks and by stakeholders.

11.3.1 Interrelationships

The DMIS will encourage demand management initiatives that 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 deferring or removing the need for network augmentation or replacement expenditure due to 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 our other incentive schemes – the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), and the service target performance incentive scheme (STPIS) – and vice versa.

We currently operate the CESS and the EBSS as incentive schemes designed to encourage efficient decision making by distributors. These schemes operate symmetrically to better balance incentives between capex and opex, by sharing the savings and risks of each kind of expenditure between distributors and consumers.

As explained in our final decision for the new DMIS*,* we consider that the symmetrical operation of incentives under the CESS and EBSS should balance out any negative impacts that distributors may experience under any one of these schemes. For instance, as distributors spend more on opex, they may exceed their targets under the EBSS and receive a smaller incentive or higher penalty as a result. However, since the DMIS only incentivises efficient demand management projects, we would expect that reductions in capex gained from project deferral or avoidance would exceed any increase in opex under the demand management project. In this scenario, benefits under the CESS would outweigh any detriment provided under the EBSS.[15] Hence, we expect the DMIS will encourage distributors to undertake more demand management activities where it is efficient to do so.

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[12] Proposed individual projects over this value have to pass through a Regulatory Investment Test for Distribution (RIT-T) process.

[13] SA Power Networks, *2020-25 Regulatory Proposal - Attachment 11 - Demand Management Incentives and Allowances*, 31 January 2019, p. 8.

[14] NER, cll. 6.3.2(a)(3) and 6.12.1(9).

[15] AER, *Explanatory statement, demand management incentive scheme, Electricity distribution network service providers*, December 2017, p. 60.

We will not exempt DMIS projects from the STPIS as we consider this would negatively affect consumers in two ways. First, exempting demand management solutions from the STPIS would transfer the risk of failure onto consumers, who have little opportunity to mitigate that risk. Second, 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 support the objective of the DMIS scheme, which is to promote efficient investment in non-network demand management options.[16]

11.4 Submissions

We received one submission from a stakeholder group regarding SA Power Networks' use of the demand management innovation allowance.

The group noted that SA Power Networks is one of the few network businesses to fully utilise the allowance during its current regulatory control period. For this, the group commends the efforts of SA Power Networks, as it is in keeping with the distributor's stated commitment to new energy futures.[17]

11.5 Reasons for draft decision

The new DMIS is designed to provide more incentives for electricity 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, we 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.

We note SA Power Networks identified a number of firm or potential projects it may undertake under the new DMIS and DMIAM.[18]

SA Power Networks will be required each year to provide supporting documents as required under the new DMIS and DMIAM to prove that its expenditures meet the minimum requirements. We will determine the eligibility and specific incentive payments for each project according to the criteria specified in the new DMIS and DMIAM.

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[16] NER, cl. 6.6.3(b).

[17] Partnership of SA Financial Counsellors Association, The Energy Project, and Uniting Communities, *Submission: Issues Paper - SA Power Networks revenue determination 2020-2025*, 22 May 2019, p. 22.

[18] SA Power Networks, *2020-25 Regulatory Proposal - Attachment 11 - Demand Management Incentives and Allowances*, 31 January 2019.