



**FINAL DECISION**  
**United Energy distribution**  
**determination**  
**2016 to 2020**

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

May 2016

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## Note

This attachment forms part of the AER's final decision on United Energy's distribution determination for 2016–20. It should be read with all other parts of the final decision.

The final 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 mechanisms

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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

Shortened form	Extended form
repex	replacement expenditure
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 United Energy's distribution determination for the 2011–15 regulatory control period.

The current DMIS for United Energy 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 United Energy during the 2011–15 regulatory control period. However, Part B will no longer be applicable to United Energy 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, where claimed, 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 Investment 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 Final decision

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

The current innovation allowance amount of \$0.4 million (\$2015) per annum will continue in the 2016–20 regulatory control period.

## 12.2 United Energy's revised proposal

United Energy accepted our preliminary decision to apply Part A of the DMIA but rejected our allowance of \$2.0 million (\$2015) in DMIA for the 2016–2020 regulatory control period. United Energy maintained its position that \$6.6 million (\$2015) is necessary to investigate and explore efficient non-network alternatives.<sup>7</sup>

## 12.3 Assessment approach

The NER require us to have regard to several factors in developing and implementing a DMIS for United Energy.<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 the 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 the DMIS and other incentive schemes.

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<sup>6</sup> AER, *Preliminary decision United Energy distribution determination 2016 to 2020, Attachment 12 – Demand management incentive scheme*, October 2015, p. 12–7.

<sup>7</sup> United Energy, *Revised Regulatory Proposal 2016-2020*, 6 January 2016, p. 68.

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



We had regard to these factors in considering the proposed approach to the DMIS for United Energy as set out in our Framework and Approach (F&A)<sup>9</sup> and preliminary decision<sup>10</sup>. We have again taken these factors into account in making our final decision.

## 12.4 Reasons for final decision

We have determined that the current DMIA amount of \$0.4 million (\$2015) per annum (or \$2 million over the period) will continue in the 2016–20 regulatory control period.

On 20 August 2015, the AEMC released the final rule change determination for the development of a new demand management incentive scheme and allowance.<sup>11</sup> We are required to develop and publish these by 1 December 2016.<sup>12</sup>

United Energy stated that many of its stakeholders have expressed strong views that our preliminary decision is not sufficient to drive the necessary change in the delivery of electricity services.<sup>13</sup> We received one submission on the preliminary decision to this effect from the Eastern Alliance for Greenhouse Action (Eastern Alliance).<sup>14</sup>

The Eastern Alliance submitted that there is a lack of support for demand management initiatives in our preliminary decision and the scale of the allowances provided to network businesses for research and development is insignificant when compared with other industrialised businesses.<sup>15</sup>

The Consumer Challenge Panel (CCP3) in its submission to the preliminary decision expressed a different view. They supported the continuation of the program using the same allowances that were included in the last regulatory control period, consistent with the AER preliminary decisions.<sup>16</sup>

It is important to recognise that the DMIA is one avenue for incentivising distributors to consider alternatives to building more network. The regulatory regime also provides incentives for businesses to achieve the most efficient investment options, which includes non-network solutions, such as demand management. This should occur under the NER regardless of the DMIA.

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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, *Preliminary decision United Energy distribution determination 2016 to 2020, Attachment 12 – Demand management incentive scheme*, October 2015, p. 12–8.

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

<sup>12</sup> NER, clause 11.82.2.

<sup>13</sup> United Energy, *Revised Regulatory Proposal 2016-2020*, 6 January 2016, p. 68.

<sup>14</sup> Eastern Alliance for Greenhouse Action, *Submission on AER preliminary decision VIC EDPR 2016-2020*, 6 January 2016.

<sup>15</sup> Eastern Alliance for Greenhouse Action, *Submission on AER preliminary decision VIC EDPR 2016-2020*, 6 January 2016, p. 2.

<sup>16</sup> Consumer Challenge Panel CCP3, *Victorian DNSPs revenue reset, comments on AER Preliminary Decisions*, 25 February 2016, p. 74.

The Eastern Alliance also considered that transitional arrangements should be established to avoid stalling the implementation of the DMIS rule change until 2020.<sup>17</sup> United Energy shared this view, stating that a delay in applying the new DMIS guidelines until 2021 will lead to a lost opportunity to ensure they are appropriately compensated to explore innovation opportunities.<sup>18</sup>

The AEMC in its final determination considered whether transitional arrangements should apply; however, it did not consider it appropriate to provide for the application of the new DMIS or DMIA midway through a regulatory control period.<sup>19</sup> We supported this approach.<sup>20</sup>

Considering the submissions received and consistent with our preliminary decision, we do not approve an increase in United Energy's allowance. Whilst United Energy has shown its 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.

We recognise the importance of appropriate demand management incentives in order to defer network augmentation. However, 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)<sup>21</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 DMIS and DMIA.

United Energy also submitted that we should review the RIIO regulatory framework in the UK which provides significant financial incentives to DNSPs for pursuing non-network alternatives.<sup>22</sup> However, consistent with our preliminary decision, 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 requires us to develop a demand management incentive scheme and allowance by 1 December 2016.<sup>23</sup> We will consider alternative demand management incentive structures, including that applied by Ofgem in the UK, in developing the new DMIS and DMIA.

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<sup>17</sup> Eastern Alliance for Greenhouse Action, *Submission on AER preliminary decision VIC EDPR 2016-2020*, 6 January 2016, p. 2.

<sup>18</sup> United Energy, *Revised Regulatory Proposal 2016-2020*, 6 January 2016, p. 68.

<sup>19</sup> AEMC, Rule Determination, *National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, 20 August 2015 pp. 78-79.

<sup>20</sup> AER, *Submission on demand management incentive scheme rule changes*, dated 9 July 2015.

<sup>21</sup> AER, *Demand management incentive scheme – Jemena, CitiPower, Powercor, SP AusNet and United Energy: 2011–15*, April 2009.

<sup>22</sup> United Energy, *Revised Regulatory Proposal 2016-2020*, 6 January 2016, p. 68.

<sup>23</sup> AEMC, Rule Determination, *National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, 20 August 2015.

For the above reasons, we are not making any changes to the DMIS and we have adopted the position proposed in our preliminary decision and approved DMIA allowances consistent with their current scale.