



# **DRAFT DECISION**

## **Power and Water Corporation Distribution Determination 2019 to 2024**

### **Attachment 11 Demand management incentive schemes**

September 2018

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## Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Power and Water Corporation for the 2019–2024 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

Attachment 12 – Classification of services

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## Shortened forms

Shortened form	Extended form
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CCP 13	Consumer Challenge Panel, sub-panel 13
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIAM	demand management innovation allowance (mechanism)
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
NT NER or the rules	National Electricity Rules As in force in the Northern Territory

Shortened form	Extended form
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
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
SCS	standard control services
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

# 11 Demand management incentive schemes

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.

This attachment sets out how we will apply the DMIS and DMIAM to Power and Water for the 2019–24 regulatory control period.

## AER's DMIS and DMIAM

On 13 December 2017, we published a new DMIS<sup>1</sup> and a new DMIAM.<sup>2</sup> These will replace the current DMIS and demand management innovation allowance (DMIA) in the forthcoming regulatory control periods for all electricity distributors.

### 11.1 Draft decision

In accordance with our framework and approach (F&A) position,<sup>3</sup> our draft decision is to apply the new DMIS<sup>4</sup> and DMIAM<sup>5</sup> to Power and Water for the 2019–24 regulatory control period, without any modification.

The DMIS contains three elements:<sup>6</sup>

- 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, the AER's distribution determination will provide that the cost multiplier (uplift) applicable to any eligible project will be the cost multiplier specified in the version of the DMIS that is in effect under clause 6.6.3 of the NER at the time the eligible project becomes a committed project.<sup>7</sup>

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<sup>1</sup> AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

<sup>2</sup> AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

<sup>3</sup> AER, *Final framework and approach for Power and Water, for the Regulatory control period commencing 1 July 2019*, July 2017, pp. 49–53.

<sup>4</sup> AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

<sup>5</sup> AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

<sup>6</sup> AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

<sup>7</sup> AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017, clause 2.1(2).

The DMIAM comprises:<sup>8</sup>

- a fixed allowance of \$200,000 (real 2017), plus 0.075 per cent of the annual allowed revenue for each regulatory year, as set out in AER's Post-Tax Revenue Model (PTRM) for Power and Water
- project eligibility requirements
- compliance reporting requirements.

## 11.2 Power and Water Corporation's proposal

Power and Water proposed to adopt the approach specified in the F&A.<sup>9</sup>

### 11.3 Assessment approach

We are required to make a decision on how the DMIS and DMIAM are to apply to Power and Water.<sup>10</sup> We outlined our proposed approach to, and reasons for, the application of the DMIS and DMIAM in our F&A for Power and Water. Our draft decision has adopted the position in the F&A. We have considered materials submitted to us by Power and Water and by stakeholders.

#### 11.3.1 Interrelationships

The DMIS will encourage demand management initiatives which 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 the deferral of, or removal of the need for, network augmentation or replacement/refurbishment expenditures, such as by more efficient use of existing infrastructure.

In applying the DMIS, we will have regard to the effect that it could have on the incentives created by the EBSS, CESS and STPIS, and vice versa.

We currently operate two incentive schemes designed to encourage efficient decision making by distributors—the CESS and the EBSS. These 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.

We expect the DMIS will encourage distributors to undertake more demand management activities where it is efficient to do so. Since demand management typically consists of opex rather than capex, the DMIS might result in distributors receiving higher penalties or lower rewards under the EBSS. The EBSS penalties

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

<sup>9</sup> Power and Water Corporation, *Power and Water Corporation Regulatory Proposal, Regulatory Control Period 1 July 2019 to 30 June 2024*, March 2018, pp. 114–118.

<sup>10</sup> NER, cl.6.3.2(a)(3) and 6.12.1(9).



would, in isolation, severely reduce the incentive for demand management projects as they have to accept 30 per cent of the opex increase.

When the EBSS is considered in tandem with the CESS, however, efficient demand management is encouraged. The CESS will allow for 30 per cent of any savings on capex to be retained by the distributor for the regulatory control period. As all eligible projects require a reduction in costs, the increase in opex should be lower than the decrease in capex. This will effectively negate the detriment of the EBSS penalty. Moreover, given the CESS, 30 per cent of the total difference in cost, or cost savings, between the network and non-network option will be awarded to the distributor, in addition to the DMIS cost uplift. This provides an incentive structure that flexibly rewards distributors for creating the greatest cost savings.

We will not exempt projects from the STPIS under the DMIS, as we consider this would negatively affect consumers in two ways. Firstly, not applying the STPIS to demand management solutions would transfer the risk of solution failure onto consumers, who have little opportunity to mitigate that risk. Secondly, 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 further the objective of the DMIS scheme, which is to promote efficient investment in non-network demand management options.<sup>11</sup>

## 11.4 Reasons for draft decision

The new DMIS is designed to provide more incentives for the 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 scheme, the AER has 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.

Jacana Energy strongly supported the implementation of a DMIS and DMIAM, noting that they are important mechanisms allowing customers to create values for themselves through increasing distributed energy resources (DER), while benefiting the power system as a whole.<sup>12</sup> No stakeholder has raised an issue on Power and Water's proposed implementation of the new DMIS and DMIAM.

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<sup>11</sup> NER, cl. 6.6.3(b).

<sup>12</sup> Jacana Energy, *Submission to Power and Water Corporation regulatory proposal*, May 2018, p. 3.