



New rules for a demand management incentive scheme

Publication of final rule determination and final rule

The AEMC has made a new rule to help balance the incentives on distribution businesses to make efficient decisions in relation to network expenditure, including demand management. It follows rule change requests from the Total Environment Centre and the COAG Energy Council.

What did we decide in the final determination?

The Commission has amended the rules to provide greater clarity to the Australian Energy Regulator (AER) and stakeholders in respect of how demand management incentive mechanisms should be developed and applied. These mechanisms, if applied by the AER, have the potential to encourage more efficient expenditure decisions by distribution businesses, which may reduce costs to consumers over time.

There are two mechanisms under the new framework:

- **Demand management incentive scheme** - the objective of the incentive scheme is to provide distribution businesses with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management. The scheme will reward distribution businesses for implementing relevant non-network options that deliver net cost savings to retail customers.
- **Demand management innovation allowance** – the objective of the innovation allowance is to provide distribution businesses with funding for research and development in demand management projects that have the potential to reduce long term network costs. The allowance will be used to fund innovative projects that have the potential to deliver ongoing reductions in demand or peak demand.

The key features of the final rule are as follows:

- Creation of separate provisions in the National Electricity Rules for a demand management incentive scheme and a demand management innovation allowance mechanism.
- Introduction of an objective for the incentive scheme, and a separate objective for the innovation allowance, specifying what these must aim to achieve.
- Introduction of a set of principles for the incentive scheme, and a separate set of principles for the innovation allowance, intended to guide the AER in developing and applying these to help achieve their respective objectives.
- Requirement for the AER to develop and publish the incentive scheme and innovation allowance in accordance with the distribution consultation procedures, by 1 December 2016.

The AER is able to decide whether, and if so how, to apply the incentive scheme and innovation allowance to individual distribution businesses. This is appropriate as the AER will need to consider the applicability of the incentive scheme in the context of the broader regulatory framework for each distribution business, and whether additional incentives are necessary to encourage efficient decision making. If the AER considers that, overall, incentives are not balanced, it is able to tailor its application of the incentive scheme to suit the circumstances of individual distribution businesses.

Under the rule, the AER is required to develop and publish the incentive scheme and innovation allowance in accordance with the distribution consultation procedures, by 1 December 2016.

The new rule establishes a framework that aims to balance the incentives between investment in network and non-network options so that the least cost option is selected.

This leads to lower overall system costs which should be reflected in lower retailer prices for consumers.

The new incentive scheme and innovation allowance can be applied from the next round of regulatory determinations, preparation for which commences in early 2017. Reopening regulatory determinations to apply the incentive scheme and innovation allowance during the current regulatory control periods would be costly with unclear benefits, particularly as the broader regulatory framework already provides significant incentives for distribution businesses to explore demand management options.

What does the rule change address?

The final rule addresses issues raised by the COAG Energy Council and the Total Environment Centre in relation to the previous demand management incentive scheme (the demand management and embedded generation connection incentive scheme). The rule change proponents raised concerns that the previous scheme was not effective in providing distribution businesses with incentives to undertake efficient demand management projects.

Why has the Commission made the final rule?

The rule (a more preferable rule) is broadly in line with the intent of the changes proposed by the COAG Energy Council and the Total Environment Centre, but is less prescriptive in the approach it takes to address the issues identified by the proponents in their rule change requests.

The Commission is satisfied that the final rule will, or is likely to, better contribute to the achievement of the national electricity objective than the proposed changes.

The national electricity objective is met by providing a framework that provides clarity for stakeholders regarding the way in which the incentive scheme and innovation allowance are developed and applied. This is balanced with flexibility for the AER to consider the role of incentives to undertake demand management in the context of other components of the regulatory framework and as circumstances change.

The final rule provides a framework that, if applied, will encourage more efficient decisions by distribution businesses that may reduce costs to consumers over time.

In submissions to the draft rule determination most stakeholders were supportive of the draft rule, the proposed objectives and principles and the balance between prescription and flexibility for the AER. Several submissions raised concerns with the discretion afforded to the AER under the rule to apply the incentive scheme and innovation allowance to distribution businesses, and with not implementing the rule change midway through the regulatory control period.

Of the 16 submissions received, three were not supportive of the draft rule. These submissions considered the rule would give distribution businesses an unfair advantage in the competitive market for demand management services. The Commission has considered these submissions and responded to them in the final rule determination.

AEMC Power of Choice Reform Package

This rule change is part of a reform program identified by the 2012 AEMC Power of Choice Review. This review set out a market-wide reform program to give electricity consumers more opportunities to understand and take control their electricity use and costs.

The Power of Choice review made a number of recommendations in relation to the incentives for distribution businesses to undertake demand management projects that provide net benefits for consumers, through lower overall capital and operating expenditure. These recommendations have been implemented via the AEMC's distribution network pricing arrangements rule and this demand management incentive scheme rule.

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