AUSTRALIAN ENERGY REGULATOR

Our Ref: 58882
Contact Officer: Pradeep Fernando
Contact Phone: (02) 6243 1264

14 December 2017

John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

By email

Dear Mr Pierce

Re: Request for Rule Change – Early Implementation of the Demand Management Incentive Scheme

Please find attached the Australian Energy Regulator's (AER) rule change proposal seeking to allow distribution network service providers (distributors) to apply to the AER for early application of the new Demand Management Incentive Scheme (Scheme) published on 14 December 2017.

The proposed rule change will amend chapter 11of the National Electricity Rules (NER) to allow a distributor to apply to the AER for application of the Scheme during its current regulatory control period. This is to be a 'one-off' and will only apply to the new Scheme published in December 2017, not any future revision of the Scheme.

The amendments proposed in the attached rule change proposal are conducive to the successful application of clause 6.6.3 of the NER. The change will allow greater certainty for distributors when committing projects and increase the timeliness of the benefits to electricity consumers. These features are in service of the National Electricity Objective.

It is the AER's view that the early implementation rule change will not require a reopening of any current distribution determination. While early implementation of the rule change will allow distributors to accrue project incentives under the Scheme during the current regulatory control period, these incentives will not be payable to distributors until the subsequent regulatory control period. This occurs due to a two year lag between when distributors accrue and are paid incentives under the Scheme. Therefore, implementing the Scheme early does not require an amendment to the control mechanism, and would not require a reopening of the determination.

This rule change proposal has been prepared in accordance with section 92 of the National Electricity Laws (NEL), and includes the text of the AER's proposed rule amendment.

As part of the development of this rule change proposal, the AER consulted openly with external stakeholders on the nature and content of the rule change proposal. This included a consultation paper released on 28 August 2017 as well as a discussion during the AER's Demand Management Directions Forum held on 29 June 2017. Both the forum and consultation paper were open to all stakeholders, and resulted in input from various stakeholders, including distributors, other industry participants and consumer groups. The feedback was supportive of the rule change proposal, with only one submission opposing.

Should you have any questions or queries regarding the attached proposal, please contact Pradeep Fernando on 02 6243 1264.

Yours sincerely

Michelle Groves

Sent by email on: 14.12.2017

National Electricity Rules

Proposal to make a rule to allow a Distribution Network Service Provider to apply the Demand Management Incentive Scheme to their current regulatory control period.

1. Name and address of person making the request

Australian Energy Regulator
23 Marcus Clarke Street
CANBERRA ACT 2601

2. Description of the proposed Rule

This rule change proposes the making of a Rule that would allow eligible Distribution Network Service Providers (**distributors**) to apply to the Australian Energy Regulator (**AER**) for approval to apply the new Demand Management Incentive Scheme (**Scheme**) mid-way through an existing regulatory control period.

The AER may, from time to time and in accordance with the distribution consultation procedures amend, or replace the Scheme[1] that is published under clause 6.6.3(d)(1) of the National Electricity Rules (**NER**). However, given that a building block determination must specify how any applicable Scheme is to apply to a distributor, the new Scheme is unable to replace the application of the older version of the Scheme to a distributor in respect to a regulatory control period that has already commenced.[2]

In particular, the AER considers that the implementation of the proposed Rule can be achieved by inserting the Rule into the savings and transitional provisions in Chapter 11 of the NER.

The AER advises it has consulted on the nature and content of the rule change proposal (discussed in more detail in section 4).

3. Background to the Scheme

In 2015, the Australian Energy Market Commission (**AEMC**) made a rule change in response to two separate rule change proposals — submitted by COAG Energy Council and the Total Environment Centre. This rule change required the AER to make a new Scheme. The rule, which became rule 6.6.3 of the NER, requires that the AER design the Scheme:

- to achieve the Scheme Objective of encouraging distributors to meet consumer demand for electricity services at the lowest total cost, by non-network or network options;
- to reward distributors for implementing non-network demand management solutions, that deliver net cost savings to consumers;
- to balance the incentives between expenditure on network options relating to demand management;
- to not impose a penalty on distributors ;
- ensuring that the level of the incentive be reasonable and not include costs that are otherwise recoverable from any other source;
- so it is not limited to the length of a single regulatory control period, where doing so would not achieve the Scheme Objective; and

1 NER 6.6.3(d)(2).

2 NER 6.3.2(a)(3).

- considering its interaction with other incentives, mechanisms and obligations to which distributors are subject.

In making this rule change, the AEMC considered that the current arrangements had created an insufficient incentive for distributors to engage in demand management.[3]

The intention of the rule change was to strengthen the pre-existing demand management rules in Chapter 6 and to provide greater clarity regarding the Scheme's aims and provide the AER the flexibility to implement an appropriate Scheme. The intention of the rule was to help the AER balance the incentives for distributors seeking to engage in demand management against network options.[4] The AEMC acknowledged in its final determination that changes in market conditions had an effect on the uptake of demand management projects, and noted other regulatory changes that aimed to redress the reward for non-network expenditure.[5] However, the AEMC considered that there was a bias against non-network solutions and that a principles-based approach would help distributors to redress this imbalance.[6]

In developing the new Scheme under the AEMC's rule, the AER has been running a rigorous stakeholder consultation process. This process has entailed:

- hosting an Issues Day stakeholder workshop on 20 September 2016 to understand stakeholder views on the key issues relating to network-based demand management;
- publishing a Consultation Paper in January 2017 to seek stakeholder views on possible models for a Scheme;
- holding an Options Day stakeholder workshop on 6 April 2017 to gather stakeholder feedback on specific questions arising from submissions on the Consultation Paper;
- holding a Directions forum on 29 June 2017 to receive stakeholder feedback on the direction of the draft Scheme;
- publishing a draft Scheme in August 2017 to seek stakeholder views on the AER's proposed drafting of the Scheme;
- holding a Feedback Forum on 8 November 2017, to show stakeholders how previous feedback has been implemented and provide another round of collaboration on further suggested changes; and
- publishing the final Scheme in December.

This development process has resulted in a Scheme designed to incentivise efficient demand management projects. Stakeholders wanted the Scheme to have a relatively low administrative burden, not contribute to uncertainty and be powerful enough to incentivise (but not over-incentivise) demand management.[7] The Scheme the AER has developed has in-built controls that aim to give effect to these stakeholder values. For instance, the Scheme design incorporates the following features:

- a cost-uplift to make the calculation of the incentive relatively simple;

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3 AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, August 2015,p. i.

4 AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, August 2015, p. 26.

5 AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, August 2015, p. 23.

6 AEMC, *Rule Determination, National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, August 2015, p. 38.

7 SA Power Networks, *Additional note on AER demand management workshop*, April 2016, p. 2; United Energy, *Demand management incentive scheme and innovation allowance mechanism*, April 2017, p. 2.

- a requirement to prevent the incentives a project can accrue from exceeding that project's expected net benefit;
- an overall cap placed on the total project incentives each distributor can accrue in any regulatory year;
- sufficient flexibility, such that there is scope to alter the Scheme incentives to levels that may better achieve consumer benefits in the future; and
- sufficient project criteria and compliance reporting obligations that should ensure projects are efficient and compliant with the Scheme.

The collaborative efforts of the industry and consumer representatives have resulted in a Scheme that reflects stakeholder values. The decisions made by the AER have their lineage in stakeholder submissions.

4. AER consultation on rule change proposal

As part of the consultation on the draft Demand Management Incentive Scheme (**draft Scheme**) (published on 28 August 2017), the AER also undertook consultation on the nature and content of the rule change proposal. A summary of the consultation, the issues raised during the consultation and the AER's response to those issues is outlined below.[8]

The AER first raised this rule change proposal at its Directions Forum videoconference on 29 June 2017 (**Directions Forum**). The proposal received general support, with some stakeholders seeking clarification on the details surrounding the legal mechanism for early implementation.[9] However, the AER's Directions Forum was not the first forum in which early implementation of the Scheme was discussed. The AER notes that the AEMC's consultation process on the 2015 rule change included discussion on early implementation of the Scheme. The AER also notes that during this consultation, the Public Interest Advocacy Centre and the Total Environment Centre commented that further delay for implementation of the Scheme would be unnecessary[10] and that a consultation process should encourage earlier implementation.[11]

On 28 August 2017, as part of the consultation on the draft Scheme, the AER published a separate document titled 'Consultation Paper: Demand management incentive scheme early implementation rule change'[12] (**rule change consultation paper**). The rule change consultation paper outlined the elements of the AER's proposed rule change, such as the nature and scope of the rule change, how it contributes to the achievement of the National Electricity Objective (**NEO**), and the costs and benefits of the proposed rule change. The rule change consultation paper also included a draft of the proposed Rule as an attachment to the paper.[13]

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8 Regulation 8(1)(f) of the National Electricity Law Regulations.

9 AER, *Summary of Demand Management Options Day*, 29 June 2017, Available at: https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism/initiation.

10 Public Interest Advocacy Centre, *Submission on the Draft National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, July 2015, p. 1.

11 Total Environment Centre, *Submission on the Draft National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015*, July 2015, p .4.

12 Available at https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism/draft-decision.

13 AER, *Consultation Paper, Demand management inventive scheme early implantation rule*, August 2017, p. 21.

The AER invited submissions on the rule change consultation paper from a range of stakeholders, including customer advocate groups, electricity retailers, local governments, distributors and representatives from industries that would be affected by the change. All submissions are available on the AER's website.[14]

Table 1 summarises submissions received on the rule change consultation paper. In these submissions, most stakeholders were supportive of the early implementation rule change, with only one opposing.[15] Overall, stakeholders saw value in the early implementation of the Scheme, with the general themes of increasing the timeliness of benefits and creating investment certainty, emerging from the consultations.

Table 1: Summary of submissions on the rule change consultation paper

Submission	Summary
Ausnet Services	The rule change would give Victorian consumers earlier access to the benefits of the Scheme.
Central Victorian Greenhouse Alliance, Eastern Alliance Greenhouse Action, Northern Alliance Greenhouse Action	Fully supports the proposal to fast track the new Scheme mid-way through the current regulatory control period. The Rule will have the effect of enabling Victorian distributors to trial and test new approaches to non-network solutions and work with stakeholders to achieve efficient energy outcomes in the current regulatory control period. The proposed rule contributes to the NEO as it is in the long-term interest of consumers for regulatory decision-making to reflect the current context of the transitioning energy market. The benefits of early implementation outweigh the costs. The energy market is undergoing rapid transformation, which requires rule changes to keep pace and be more flexible and adaptive.
Citipower, Powercor and United Energy	The group supports the intent of the proposed rule change that would enable Victorian distributors to be eligible under the Scheme before 1 January 2021
Energy Efficiency Council	Supports early implementation of revisions to the Scheme. This will provide more certainty, earlier investment in demand management, and therefore potentially a greater reduction in energy consumers' bills.
Energy Networks Australia (**ENA**)	Supports the proposed Rule and considers that it will ensure that consumers benefit from the increased use of demand management without delay as well as promoting clear efficient investment signals for demand management. ENA also highlighted that early implementation will avoid a three-year delay in the case of Victorian distributors, which is significant in terms of potential benefits that can be realised to customers through providing them to access to efficient demand management projects on an earlier timetable. Furthermore, ENA noted that the AER has designed the Scheme in a way that does not require any amendments to the distribution determinations of businesses that wish to become early adopters of the Scheme.
Energy Queensland	Supports an early rule change, subject to the areas of concern raised throughout their submission regarding the Scheme.
GreenSync	Considers that early implementation is essential to allow networks, technology companies and retailers to begin the transformation required for our energy systems. They note the emphasis from many parts of the market – especially consumers – that further delay to the new Scheme is unnecessary.
Institute for Sustainable Futures (**ISF**)	ISF strongly supports the AER's proposed rule change to allow new Scheme to be brought forward to start during the current regulatory period. There is little, if anything to lose from adopting the proposed rule change and potentially much for consumers to gain.
Red Energy and Lumo Energy	On the basis that Red and Lumo do not support the draft Scheme, they do not support the AER's proposed rule change allowing eligible distributors to request approval to apply the Scheme midway through an existing regulatory control period. They consider this a controversial Rule and will provide further views to the consultation when the rule change is lodged.
South Australian Council of Social Service	Has no objection to the AER seeking expedition of its proposed early application rule change under section 96 of the NER as it is non-controversial in nature. The proposed rule change would deliver consistency and certainty for consumers across the National Electricity Market. Early application of the Scheme will assist with driving efficient outcomes for consumers. Supports the narrow scope of the rule change (including only applying for early application of the Scheme, whilst allowing the current operation of the demand management innovation allowance to run until the distribution

[14] Available at: https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism/draft-decision.

[15] Red Energy & Lumo Energy, *Demand Management Incentive Scheme*, 12 October 2017.

	determinations are remade on the current schedule).
SA Power Networks	Supports the early rule change to hasten the application of the Scheme. They wish to confirm however that under the amended rule, distributors will not be required to include all specific details of the demand management project for which incentive payments will be sought, instead just broad descriptions of the issue.

SA Power Networks supports the AER's proposal for a rule change, but sought confirmation on whether when submitting an application under the amended rule, distributors would be required to include in their applications, all specific details of the demand project/s for which the Scheme incentive payments will be sought.[16] In response to this, the AER considers that distributors will be expected to report on each demand management project as it would be for a normal project under the Scheme. This information will be necessary when the project is committed rather than during the application for early implementation. In the application for early implementation, a distributor is only obliged to provide the information required under 1.1.3(b) of the draft rule change.

Red Energy (**Red**) and Lumo Energy (**Lumo**) do not support AER's proposed rule change. In the AER's view, their objection is based on concerns with the Scheme and its application within the ring-fencing framework, rather than its early application. Red and Lumo are concerned that the ring-fencing framework is not sufficiently strong to prevent distributors from favouring affiliates under the Scheme, and therefore the application of the Scheme in these circumstances may damage competition. As such, they submit that delaying the Scheme will delay the negative outcomes they have identified. The AER has considered Red and Lumo's submissions and accept there could be a risk to competition if the ring-fencing framework is not sufficient. However, at this point the AER does not share the concerns with the ring-fencing framework. Further, delaying the Scheme will delay the development of effective demand management action on the part of the distributors. Consequently, the AER considers it is more harmful to delay implementing the Scheme.

Red and Lumo are concerned that a Scheme which provides distributors with a 50 per cent cost uplift will provide greater financial leverage to distributors to award demand side contracts to their ring-fenced affiliates. Specifically, they contended the Scheme would increase the ability for a distributor's ring-fenced affiliate to price their demand side options lower than their competitors, knowing that this will be offset (within the distributor's corporate group as a whole) by the project incentive awarded to the distributor.[17] Given this, Red and Lumo considered that the draft Scheme would increase the potential for distributors to undermine the AER's Distribution Ring-fencing Guideline.[18]

The AER understands but does not agree with the basis of Red and Lumo's concerns. Although Red and Lumo's argument focussed on how affiliated entities would price, the projects that are eligible under the Scheme are those with the highest expected net benefits. As such, cost is just one part of the equation. Given the variety of potential solutions encompassed by the concept of demand management, the AER considers that, in most cases, cost advantages of the kind that Red and Lumo are concerned about are unlikely to be the determining factor in the assessment of particular projects under the Scheme.

There are some potential market outcomes that encompass situations where the ring-fenced affiliate prices its demand side options so they have higher expected net benefits than their competitors. These are where:

- The affiliate bid resulted in the highest expected net benefit, but the affiliate, as a standalone entity, still expects to provide the project above its own costs:

16 SA Power Networks, *AER draft decisions – demand management incentives and innovation allowance*, 12 October 2017, p. 3.

17 Red Energy and Lumo Energy, *Re: Demand management incentive scheme and proposed early application rule change consultation paper*, 12 October 2017.

18 Red Energy & Lumo Energy, *Demand Management Incentive Scheme*, 12 October 2017, p. 2.

- In this situation, the non-affiliated entities in the market could have offered a project with a higher net benefit than this, but did not do so. Where the affiliate was able to price its bid above its own costs, this outcome is result of the affiliate being able to be more competitive, rather than as a result of any advantage it may get through its affiliation with the distributor. The affiliate may be accepting a lower profit margin and/or be a more efficient operator than other market participants. This efficient market behaviour provides value to electricity consumers.
- In this situation, the non-affiliated entities in the market could not have offered a project with a higher net benefit without providing the demand management service at a loss. This indicates that the affiliate has the lowest overall costs for the value it provides and is able to price better than their competitors. The affiliate would be providing an efficient service and value to consumers.

- The affiliate bid resulted in a higher expected net benefit than what a non-affiliated company could achieve. This is because the affiliate bid below its costs as a standalone entity, with the affiliated company using the incentive scheme, and its affiliation with the distributor, to offset the loss in the manner contemplated by Red and Lumo. This would require some other form of cross-subsidisation between the distributor and its ring-fenced affiliate, which should be prevented for the reasons outlined in the second dot point below.

We do not consider the Scheme will increase the risk of the latter of the above possibilities occurring. This is because:

- Under the Scheme, distributors receive financial incentives regardless of the identity of the other party with whom they contract for demand management services. Thus, the Scheme itself does not provide any significant reason for a distributor to favour its affiliate's projects over those of third parties. Also, as noted above, the identification of a particular project as an eligible project involves consideration of a wide range of costs and benefits that will impact on whether an affiliate's project or a third party project, is identified as the eligible project for the purposes of the Scheme.
- The Ring-Fencing Guideline is designed to prevent the use of regulated income, either directly or indirectly, in contestable markets.[19] Ring-fencing compliance is designed to prevent, detect and deter cross-subsidies. Reporting on the application of cost allocation methods would also detect the existence of such cross-subsidies between distribution services and non-distribution services.

5. Nature and scope of the rule change proposal

[19] See AER, *Ring-fencing guideline: Electricity distribution*, November 2016.

The nature of the issue that is proposed to be addressed by the proposed Rule is to permit eligible distributors to apply to the AER for approval to apply the new Scheme mid-way through an existing regulatory control period. In the absence of the proposed Rule, the new Scheme would not apply until the commencement of a distributor's next regulatory control period. The AER considers that the proposed Rule will allow distributors to apply the Scheme as early as 2019 and in some cases, avoid a three-year delay.

The scope of the issue that is proposed to be addressed by the proposed Rule is narrow in that the proposed Rule is confined to permitting distributors to seek early application of the new Scheme only. The proposed Rule does not include any proposed changes to the NER provisions in relation to other incentive schemes or regulatory mechanisms. Similarly, it does not involve exemptions or amendments to any of these mechanisms, such as the efficiency benefit sharing scheme (**EBSS**), capital expenditure sharing scheme (**CESS**) and service target performance incentive scheme (**STPIS**).

The AER has designed the Scheme in a way that mitigates disruption to other elements of a distributor's revenue determination. The Scheme does not exempt or exclude projects using the new Scheme from any existing incentive scheme that applies to distributors. During the 2015 rule change process, the AER considered the potential for exempting demand management projects from other schemes to remove distributors' disincentives to undertake demand management. The AER raised the challenges associated with this approach in its submissions during the AEMC's 2015 rule change proposal.

The early implementation rule change will not require a re-opening or review of any existing distribution determination. While early implementation of the rule change will allow distributors to accrue project incentives under the Scheme during the current regulatory control period, these incentives will not be payable to distributors until the subsequent regulatory control period. This occurs because the timing of project incentives under clause 2.2(1) of the Scheme results in a two-year lag between when distributors accrue and are paid incentives under the Scheme. Therefore, implementing the Scheme early does not require an amendment to the control mechanism, and would not require a reopening or review of any existing distribution determination.

Under the new Scheme and Mechanism, the AER is not proposing to amend the manner in which the STPIS and EBSS apply, and as such, there is no need to reopen other elements of the distributor's current determination. Furthermore, there will be no need to re-examine the assumptions and decisions made in creating those elements of the distribution determination, meaning that the process of applying the new Scheme is likely to be relatively simple.

The AER explored the option of offering projects under the Scheme an exemption from the other regulatory incentive schemes or mechanisms in its January 2017 Consultation Paper—such as by providing exemptions to the STPIS or EBSS.[20] However, the AER has decided to adopt a Scheme design that does not provide regulatory exemptions. This has limited the scope of this proposed rule change as providing project exemptions would require amendments to existing distribution determinations. The impact of the chosen Scheme design on a distribution determination is elaborated on below.

Why the AER is not providing STPIS exemptions

The AER will not exempt projects from the STPIS under the Scheme, as it considers this would negatively affect consumers in two ways. Firstly, not applying the STPIS to demand

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[20] AER, *Demand Management Incentive Scheme and Innovation Allowance Consultation Paper, January 2017, Available at:* https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism>.

management solutions would transfer the risk of solution failure onto consumers, who have little opportunity to mitigate that risk. Distributors are best placed to evaluate and mitigate such risks. Therefore, subjecting demand management projects to the same targets as other projects should promote investment signals that encourage prudent and efficient decisions.

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 Scheme Objective of promoting efficient investment in demand management solutions.

Why the AER is applying the efficiency incentive package

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 capital expenditure (**capex**) and operating expenditure (**opex**), by sharing the savings and risks of each kind of expenditure between distributors and consumers.

The AER expects the Scheme will encourage distributors to undertake more demand management where it is efficient. Since demand management typically consists of opex rather than capex, the Scheme might result in distributors receiving higher penalties or lower rewards under the EBSS. The EBSS penalties would, in isolation, severely reduce the incentive for demand management projects as they have to accept 30 per cent of the opex increase.

When considered in tandem with the CESS, however, efficient demand management is further 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 would be awarded to the distributor, in addition to the Scheme cost uplift. This provides an incentive structure that flexibly rewards distributors for creating the greatest cost savings.

Therefore, the CESS and EBSS contribute to the Scheme Objective and at this point in time, it is unnecessary to amend either scheme to support the Scheme. As such, the proposed Rule is unlikely to result in any amendments to either scheme.

6. How the proposed Rule will contribute to the achievement of the National Electricity Objective

The NEO is:[21]

> …to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

The AER considers that the proposed Rule will contribute to the achievement of NEO because it promotes non-network investment when this is the most efficient option, which is in the long-term interests of consumers in terms of both price and reliability. The current demand management incentive scheme insufficiently rewards expenditure on demand management projects and therefore has had a limited ability to contribute towards the NEO,

[21] Section 7 of the NEL.

which prompted the rule change in 2015.[22] It would not be in consumers' long-term interest to continue with the current demand management incentive scheme when there is little cost to implementing the more effective new Scheme, with immediate effect across all the distributors subject to chapter 6 of the NER.

Technological innovations, such as decentralised generation and smart energy management, are influencing the broader market at an increasing speed. These innovations have increased the potential efficiency gains from deferred expenditure initiatives. Without a sufficient incentive to undertake efficient demand management, distributors may bypass these opportunities, making their chosen network capex solutions relatively more inefficient and costly to consumers.[23]Therefore, early application of the Scheme will help to create an environment that encourages efficient investments, as required by the NEO, sooner.

Without the proposed Rule, application of the new Scheme will be delayed until the start of the next regulatory control period, commencing in July 2020 for Queensland and South Australia, and in January 2021 for Victoria. This will delay the opportunity and/or create a lagged approach for electricity consumers across the different jurisdictions to benefit from efficient demand management solutions. The AER considers the removal of this delay/lag is in the long-term interest of electricity consumers across all the distributors.

The AEMC, in its 2015 final rule change determination, supported the introduction of an improved Scheme, and commented that other options such as cost reflective pricing solutions would take time to promote efficient investment, and this would delay investment in demand management solutions.[24] While the AER and AEMC both acknowledge that other factors have played a role in reducing investment in demand management, the AER's stakeholder engagement process identified that some stakeholders consider there is need for quick action in order for the Scheme to be effective.

7. Expected benefits and costs of the proposed Rule

The benefit of this Rule is that it will promote efficient investment, ultimately reducing costs to electricity consumers. The Scheme allows distributors to access a cost-uplift on efficient demand management projects that deliver a net benefit to electricity consumers. This will provide certainty for distributors in accessing net market benefits across the electricity supply industry and assist in developing the demand management services market. This certainty and market development will lead to lower costs for customers by promoting efficient investment.

As mentioned above, in its submission on the draft of the National Electricity Amendment (Demand Management Incentive Scheme) Rule 2015, the AER submitted that applying the Scheme midway through a regulatory control period may require a reopening of the relevant distribution determination, which would impose considerable costs on distributors and the AER.

The protracted period of consideration, both of the AEMC's Scheme rule change and the AER's development of the Scheme has created its own form of uncertainty. Some stakeholders have commented on the need to have a quicker Scheme development process.[25] This has caused the AER to reconsider its earlier view with regard to the costs associated with early implementation of the Scheme.

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[22] AEMC, *National Electricity Amendment (Demand management incentive scheme) Rule 2015 No. 8*, August 2015.

[23] ISF, *RE: Demand Management Incentive Scheme Supplementary Submission*, 8 May 2017, p. 4.

[24] AEMC, *Rule determination: Demand management incentive scheme*, 20 August 2015, pp. 20–21.

[25] Total Environment Centre, *Submission on the DMIS consultation paper*, February 2017; GreenSync, *Presentation for AER DM workshop*, 20 September 2016.

During the consultation process, many stakeholders agreed that investment in demand management was below an optimal level. They considered that, without the incentive, this would remain so. Early implementation of the Scheme would benefit the market, by allowing demand management investment to reach an optimal level more quickly. The Scheme aims to reward demand management projects that have the highest net benefit in meeting an identified need on the distribution network. It will also provide financial incentives that are sufficiently modest for consumers to receive a net benefit under the Scheme. In light of this, the AER is of the opinion that the benefits of having an early application of the Scheme will outweigh any associated costs.

Earlier implementation of the Scheme should not create material administrative costs. The availability of the incentive payment allows distributors to make investment decisions based on their own cost benefit analysis, mitigating the costs of early adoption. The additional administrative costs to the AER would be limited to the fact that the AER's ongoing compliance work under the Scheme (and associated costs) would commence earlier, because the Scheme will apply earlier.

Proposed drafting of Rule

1.1.1 Title of Rule

This Rule is the National Electricity Amendment (Early Implementation of Revised Demand Management Incentive Scheme) Rule 2017 No. [X]

1.1.2 Commencement

This Rule commences on [   ].

1.1.3 Savings and Transitional Amendments to the National Electricity Rules

The National Electricity Rules are amended as set out in Schedule 1.

Schedule 1

Chapter 11 Savings and Transitional Rules

Part ZZ[X] Early Implementation of Revised Demand Management Incentive Scheme

Rules consequential on the making of the National Electricity Amendment (Early Implementation of Revised Demand Management Incentive Scheme) Rule 2017.

1.1.1 Definitions

In this Rule [XX]:

Amending Rule means the National Electricity Amendment (Early Application of Revised Demand Management Incentive Scheme) Rule 2017.

commencement date means the day on which the Amending Rule commences operation.

existing demand management incentive scheme means a scheme developed and published by the *AER* under clause 6.6.3 of the *Rules* prior to 1 December 2016.

current regulatory control period means, for a *Distribution Network Service Provider*, a *regulatory control period* that commenced before the commencement date and, as at the commencement date, has not ended.

revised demand management incentive scheme means a scheme developed and published by the *AER* under clause 6.6.3 of the *Rules* on or after [1 December 2016 but before 31 December 2017.

1.1.2 Purpose

The purpose of this Rule [XX] is to allow a *Distribution Network Service Provider* to apply to the *AER* for the application of a revised demand management incentive scheme during its current regulatory control period.

1.1.3 Early application of revised Demand Management Incentive Scheme

(a) A *Distribution Network Service Provider* may seek application of the revised demand management incentive scheme notwithstanding that the current *regulatory control period* may have commenced before the revised demand management incentive scheme's commencement date.

Submission of proposal

(b) If a *Distribution Network Service Provider* wishes the revised demand management incentive scheme to apply during the current regulatory control period, the *Distribution Network Service Provider* must submit a proposal to the *AER* setting out:

(1) the proposed start date for the application of the revised demand management incentive scheme, which must not be earlier than 60 *business days* after the proposal is submitted;

(2) a description of how the proposed early application of the revised demand management incentive scheme will assist the *Distribution Network Service Provider* in undertaking efficient expenditure on relevant non-network options relating to demand management; and

(3) such other information as that the *Distribution Network Service Provider* considers relevant to its application for early application of the revised demand management incentive scheme.

Publication and consultation on proposal

(c) The *AER* must as soon as practicable, *publish*:

(1) a proposal submitted under paragraph (b); and

(2) an invitation for written submissions from any person on the proposal within a period specified by the *AER,* being a period not less than 20 *business days* from the date of publication of the invitation for submissions.

(d) Any person may make a written submission to the *AER* on the proposal, within the period specified in the invitation referred to in paragraph (c)(2).

Making of final decision

(e) The *AER* must make a final decision on whether to apply the revised demand management incentive scheme to a *Distribution Network Service Provider* during its current *regulatory control period*.

(f) The *AER*'s final decision must:

(1) include a decision on the start date; and

(2) set out reasons for the decision.

(g) The *AER* may make a decision on a start date which is different to the proposed start date.

(h) In making its final decision, the *AER* must consider the proposal submitted under paragraph (b) and any written submissions made on the proposal, and must have regard to the factors in clause 6.6.3(c).

(i) If the *AER* makes a final decision that the revised demand management incentive scheme will apply then it will apply to the relevant *Distribution Network Service Provider* from the start date set out in the final decision.

Notice of final decision

(j) The *AER* must, at least one *business day* before the start date determined under paragraph (i) *publish*:

(1) notice of the making of the final decision; and

(2) the final decision, including its reasons.

Application of existing scheme

(k) Nothing in this Part [X] affects the application of an existing demand management incentive scheme to a Distribution Network Service Provider in respect of the current regulatory control period.