



# **Workshop note**

## **AER workshop on customer service incentives**

November 2019

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# 1 Introduction

We, the Australian Energy Regulator (AER), regulate electricity distribution networks to deliver good long-term outcomes for consumers in terms of price, quality, safety, reliability and security of supply. We achieve this, in part, by regulating the revenue of Distribution Network Service Providers (distributors) so that they efficiently deliver good long-term outcomes for consumers. We have been investigating new ways to ensure that customers' preferences drive energy network business proposals and regulatory outcomes.

As part of AusNet Services' (AusNet) trial of the New Reg process,<sup>1</sup> its Customer Forum have identified areas where AusNet could improve its customer service. The Customer Forum found evidence that our current customer service incentives may be prompting distributors to make narrow customer service improvements, without accounting for broader customer preferences and have proposed that the AER develop a customer service incentive scheme (CSIS).<sup>2</sup> This scheme would financially penalise distributors that do not meet customer service targets and reward distributors that outperform the targets. This scheme would replace our current incentive for distributors to answer telephone calls within 30 seconds.<sup>3</sup>

In July 2019, the AER released an Issues Paper seeking stakeholder views on the development of a CSIS. This paper considered the current incentives that distributors have to improve their customer service and whether the AER should develop a CSIS to trial new incentives for customer service. Submissions on this paper largely supported the AER developing a new scheme.<sup>4</sup> Given these views, we are proceeding with the development of a CSIS to trial new incentives.

We are hosting two workshops to gather feedback from interested parties on aspects of the CSIS. This briefing note provides background on the matters to be discussed in these workshops. In the workshops we will consider the questions that we have set out in this note. We will publish notes from the workshops but will not attribute statements to individuals.

## Workshop details

**6 November 2019** - AER Offices in Sydney, Brisbane, Canberra 1:30 pm – 4:30 pm.

**13 November 2019** - AER Offices in Melbourne, Adelaide 9:30 am – 12:30 pm.

These workshops concern the development of an incentive scheme for electricity distributors. The AER may apply incentives to gas networks without the need to first develop

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<sup>1</sup> AusNet owns the electricity distribution network that services eastern Victoria. The New Reg trial covers AusNet's regulatory proposal for the 2021-25 period.

<sup>2</sup> AusNet Services, Proposal for a Small Scale Incentive Scheme – Customer Satisfaction, March 2019, p. 1. Customer Forum, Small Scale Incentive Scheme, March 2019, p. 1-2.

<sup>3</sup> We apply this incentive through the application of our Service Target Performance Incentive Scheme (STPIS).

<sup>4</sup> We have published submissions received on our Issues Paper, here: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/customer-service-incentive-scheme/initiation>

an incentive scheme.<sup>5</sup> We consider that the development of a similar incentive scheme for electricity transmission networks would warrant a separate consultation considering the different characteristics of transmission customers.

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<sup>5</sup> The National Gas Rules provide the AER with the ability to implement bespoke incentive mechanisms in each access arrangement. Clause 98 of the National Gas Rules permits the AER to include one or more incentive mechanisms in an access arrangement. These mechanisms can provide for carrying over revenue increments for efficiency gains and decrements for less of efficiency. They must be consistent with the revenue and pricing principles.

## 2 Purpose

The purpose of this workshop note is to facilitate discussion on a customer service incentive scheme drawing on the written submissions we received in response to our 12 July issues paper. Drawing on this discussion, and accounting for the written submissions, we intend to develop a draft Customer Service Incentive Scheme and explanatory statement.

This workshop note includes AER staff's thoughts on elements of a principles based CSIS. These views are presented for discussion at the workshop and are not the views of the AER board.

### 3 Background

In competitive markets, competition incentivises firms to deliver services that meet customers' preferences in terms of price and quality. Firms that set excessive prices, or deliver service below customers' expectations lose market share to other firms. However, distributors do not face competition from other networks.<sup>6</sup> In the absence of economic regulation, distributors do not face the same incentives to deliver price and quality of service outcomes that customers want. To address this issue, regulators develop incentive schemes to align the interests of distributors with customer preferences.

International regulators operate a variety of incentive schemes targeting customer service. In the United Kingdom, the Office of Gas and Electricity Markets (Ofgem) provides an incentive to improve customer satisfaction. This measure is comprised of the length of time taken to resolve complaints, and a customer satisfaction survey designed to capture customers' satisfaction in relation to the interruption, minor connection and general inquiry services delivered by Distribution Network Operators (DNOs).<sup>7</sup> The Office of Water Services (Ofwat) derives a broad measure composed of a weighted average of performance in a number of categories. The measure relies on both qualitative and quantitative parameters, but is weighted more heavily to its qualitative measures.<sup>8</sup> The qualitative component (75% of the incentive) derives from a customer experience survey involving persons who have had direct contact with their distributor. In the United States, the Massachusetts Department of Public Utilities directs utility owners to survey their customers, and penalises them if the results fall below benchmark levels.<sup>9</sup>

State and territory governments have developed Guaranteed Service Level (GSL) schemes under which distributors must pay customers compensation when they experience sustained, or frequent, unplanned outages.<sup>10</sup> In some jurisdictions, codes require that distributors are on time for appointments,<sup>11</sup> complete new connections within a defined period of time,<sup>12</sup> or answer written queries within a certain period.<sup>13</sup>

Our Service Target Performance Incentive Scheme (STPIS) incentivises a distributor to maintain or improve the quality of its services.<sup>14</sup> The distribution STPIS provides a financial reward if distributors improve service quality, and a penalty if it deteriorates. In principle, the STPIS shifts distributors' incentives towards efficient price and non-price outcomes in

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<sup>6</sup> Productivity Commission, Electricity Network Regulatory Frameworks, inquiry report no. 62, 2013, p. 65.

<sup>7</sup> For more information please see: <<https://www.ofgem.gov.uk/electricity/distribution-networks/network-pricecontrols/customer-service>>

<sup>8</sup> OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, pp2-3.

<sup>9</sup> Please see: <https://www.mass.gov/service-details/service-quality>.

<sup>10</sup> For example please see: Minister for Industry Resources and Energy, Distributor's Licence Under the Electricity Supply Act 1995 (NSW) Granted to Ausgrid Operator Partnership, June 2015, p. 5.

<sup>11</sup> For example: <<https://www.energex.com.au/about-us/our-commitment/to-our-customers/guaranteed-service-levels>>

<sup>12</sup> For example: Essential Services Commission of Victoria, Electricity Distribution Code: Version 9A, August 2018, p. 19.

<sup>13</sup> For example: Essential Services Commission of South Australia, Electricity Distribution Code, EDC/12, July 2015, p. 6.

<sup>14</sup> For more information on the STPIS see: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/service-target-performance-incentive-scheme-2018-amendment>

accordance with the long term interests of consumers. When we apply our STPIS, we usually limit its penalties or rewards to 5 per cent of total revenue. The bulk of this is devoted to providing financial rewards or penalties for distributors to reduce the frequency and duration of interruptions to electricity supply rather than customer service. Under the STPIS,  $\pm 0.5$  per cent of a distributor's annual revenue is linked to one aspect of customer service. Rewards are provided if distributors answer a sufficient portion of fault line telephone calls within 30 seconds.<sup>15</sup>

In submissions, stakeholders generally agreed that the current call answering incentive was too narrow and supported this consultation to reform the incentive.<sup>16</sup> However, stakeholders also generally supported not expanding the total revenue available for customer service performance.<sup>17</sup> Ausgrid did note that providing a larger incentive could be appropriate if customer value was demonstrated.<sup>18</sup>

### 3.1 The rule framework

The National Electricity Rules (NER) govern how and when the AER may apply financial incentives to electricity distributors. If we are to develop a CSIS we must do so in accordance with the Small Scale Incentive Scheme rules (NER cl. 6.6.4).

#### Explanatory Box 1: Clause 6.6.4 of the National Electricity Rules

- (a) Clause 6.6.4 permits the AER to develop and publish schemes that provide distributors with incentives to provide their standard control services in a manner that contributes to the National Electricity Objective.
- (b) In developing and applying a small scale incentive scheme, the AER must have regard to the following matters:
  - 1) distributors should be rewarded or penalised for efficiency gains or losses in respect of their distribution systems;
  - 2) the rewards and penalties should be commensurate with the efficiency gains or efficiency losses in respect of a distribution system, but a reward for efficiency gains need not correspond in amount to a penalty for efficiency losses;
  - 3) the benefits to electricity consumers that are likely to result from efficiency gains in respect of a distribution system should warrant the rewards provided under the scheme, and the detriments to electricity consumers that are likely to result from efficiency losses in respect of a distribution system should warrant the penalties provided under the scheme;
  - 4) the interaction of the scheme with other incentives that distributors may have under the Rules; and

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<sup>15</sup> AER, Service Target Performance Incentive Scheme Version 2, December 2018, p. 16.

<sup>16</sup> For example see: Uniting Kildonan, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>17</sup> For example see: Red & Lumo, Submission to AER Customer Service Incentive Scheme Issues Paper, 3 September 2019, p. 3.

<sup>18</sup> Ausgrid, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 7



5) the capital expenditure objectives and the operating expenditure objectives.

We are allowed to amend or replace Schemes according to the distribution consultation procedures.

When we do provide a Scheme the aggregate rewards or penalties under that Scheme may not exceed 0.5% of the distributor's annual revenue requirement. If the distributor agrees, we may extend this to 1%. We are also able to have distributors participate in 'paper trials' where no revenue is placed at risk. Schemes must expire within two regulatory control periods.

We generally decide whether we will apply our incentive schemes to a distributor in our distribution determinations.<sup>19</sup> This means that the earliest we may apply a CSIS that adjusts a distributor's revenue will be at the time of our next distribution determination for that distributor.

The rules allow us to apply an incentive to a distributor with zero revenue at risk. This is known as a paper trial. A paper trial may help the AER and a distributor to understand how an incentive would function prior to commencement. This may help us monitor distributor performance and understand unintended consequences without placing customer revenue at risk. We note that, distributor will have a limited incentive to respond to new incentives without a financial reward.

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<sup>19</sup> NER cl. 6.12.1(9).

## 4 A flexible, principles-based scheme to trial incentives

The objective of the CSIS could be to trial incentives for distributors to provide customer services in accordance with their customers' preferences.

In light of the different approaches to incentivising customer service adopted by other regulators, it is not as yet clear the particular incentive that would be effective in the Australian context, and trialling different approaches could have merit.

We are proposing to develop a flexible scheme that would allow for the trial of different incentives so long as they meet certain principles. This 'principles based' scheme could allow incentives to be tailored to the specific circumstances of a distributor and its customers. This would permit the AER to trial incentives that meet the particular needs of customers, by establishing bespoke parameters for individual distributors. A principles based scheme would be more flexible than our Service Target Performance Incentive Scheme (STPIS).<sup>20</sup>

Submissions were generally in favour of a flexible approach:

- ENA submitted that various customer service measures should be trialled before deciding which parts of a scheme should be consistent and which parts should be flexible.<sup>21</sup>
- PIAC submitted that the scheme should be flexible to the needs and priorities of different networks' customers.<sup>22</sup>
- Ausgrid submitted that it supported a trial process, where each distributor prototypes its own scheme that best suits their customer's needs.<sup>23</sup>
- Evoenergy submitted that the implementation of CSIS across distributors should be flexible so that there is scope for different approaches to be adopted by different distribution firms.<sup>24</sup>
- Energy Queensland considers that the application of a CSIS should be generally consistent across all distributors. However, flexibility within the scheme would be important to enable customer service indicators to be tailored to each networks circumstances and customers' preferences and to allow for the customer survey

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<sup>20</sup> The STPIS is available on our website, here: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/service-target-performance-incentive-scheme-2018-amendment>. The STPIS has set performance parameters, approach for setting performance targets, performance measurement approach, and means of assessing performance and converting that into penalties/rewards.

<sup>21</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 9.

<sup>22</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>23</sup> Ausgrid, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 10.

<sup>24</sup> Evoenergy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, pp. 2-3

contracts that distributors currently have in place and the differing data capture capabilities of each distributor.<sup>25</sup>

- Essential Energy favoured a flexible approach to ensure that each distributor has meaningful and achievable targets which reflect their individual circumstances,<sup>26</sup>
- Jemena submitted that the scheme should be adaptive, with measures defined by the business using ex-ante targets.<sup>27</sup>

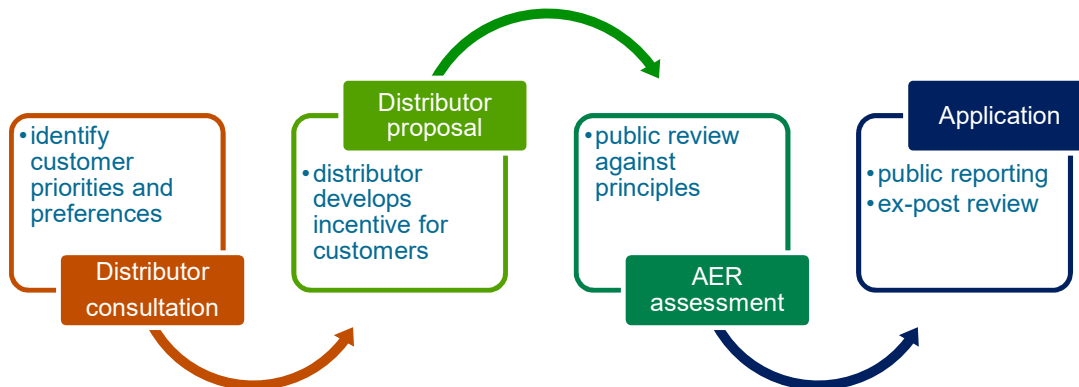
Some stakeholders submitted that there is value in a consistent approach across distributors

- PIAC submitted that comparability, particularly in regards to the amount of revenue at risk and the benchmark standard would be beneficial.<sup>28</sup>
- The Energy Project submitted that the incentive should apply in respect of connections for all distributors as in its experience with most of the NEM distributors, the level of customer service during the connection process is materially lower than would be experienced in other parts of the energy supply chain.<sup>29</sup>

## 4.1 How could a principles-based scheme work?

Figure 1 illustrates how a principles-based scheme could work in practice. The first step would be for a distributor to consult with their customers to identify their customer service preferences. The distributor would then develop incentives to deliver customer service in accordance with their customers' preferences. The AER would then assess the distributors proposed incentives against the principles in the scheme. If the incentives met the principles the AER would trial the incentives.

**Figure 1 Steps in the application of a principles based scheme**



<sup>25</sup> Energy Queensland, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>26</sup> Essential Energy, Essential Energy's response to AER issues paper Small Scale Incentive Scheme for Customer Service, August 2019, p. 5.

<sup>27</sup> Jemena, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>28</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>29</sup> The Energy Project, Submission to AER Customer Service Incentive Scheme Issues Paper, 16 August 2019, p. 4.

We could publish data on a distributors' performance under the scheme to facilitate review and evaluation of the incentive scheme.

## 4.2 What are the possible principles for the CSIS?

In order to trial incentives for distributors to provide customer services in accordance with their customers' preferences the scheme could have four components which:

1. Incentivise performance that customers want (**Performance parameters**)
2. Accurately and transparently measure performance (**Measurement**)
3. Assess performance against robust targets (Assessing performance)
4. Reward/penalise in accordance with benefits/costs to customers (**Financial**)

Figure 2 sets out four proposed components of the scheme. In the following sections we separately consider each of the components, with regard to how these components could work and the appropriate principles for each component.

**Figure 2 Possible principles for a new CSIS**

Performance Parameters	Measurement	Assessment	Financial
<ul style="list-style-type: none"> <li>• Service customers value</li> <li>• Genuine engagement and support</li> <li>• Not already be covered by another incentive</li> <li>• Can estimate willingness to pay</li> <li>• Within control of distributor</li> </ul>	<ul style="list-style-type: none"> <li>• Reliable</li> <li>• Independent</li> <li>• Objective</li> <li>• Repeatable</li> <li>• Verifiable</li> <li>• Measure the correct aspect</li> </ul>	<ul style="list-style-type: none"> <li>• Baseline or neutral performance level</li> <li>• incentivise genuine improvement</li> <li>• Create a simple relationship between outperformance and receiving the reward</li> <li>• Establishes a single value</li> </ul>	<ul style="list-style-type: none"> <li>• Increase relative to the degree of performance</li> <li>• Utilise a proxy for willingness to pay that is reasonable</li> <li>• Not exceed the customer's willingness to pay</li> </ul>

## 5 Performance parameters

Performance parameters are the metrics that a CSIS would measure. We consider that, for a CSIS to align a distributor's interests with those of its customers, the following principles may be relevant:

- **Service customers value** - the performance parameters would need to measure a service that customers value. This would ensure that improving the service would not divert attention away other desirable aspects of performance (e.g. focussing on quantity at the expense of quality or vice versa)
- **Genuine engagement and support** - draw on genuine engagement with customers to identify areas of value to customers
- **Not already be covered by another incentive** - are not already covered by other incentives schemes applying to the distributor to avoid the risk of providing overlapping incentives
- **Can provide a proxy for customer willingness to pay** - are something for which you could establish an estimate of customer willingness-to pay for improvement in performance, so that the financial rewards to the distributor can be made broadly commensurate with customers' willingness-to-pay
- **Within control of the distributor** - are within the control of the distributor so that distributors are not rewarded or penalised for outcomes that are outside their control

We consider that, in order for a financial incentive scheme to deliver tangible benefits to customers it would need to target areas that customers value. This could be demonstrated through genuine engagement with customers, showing that they support the use of the chosen parameters. In order to demonstrate that the parameters reflect what customers value, we consider that distributors should engage with their customers in the development of any proposed incentives. Customer support could be a precondition for the application of the incentive. We are interested in stakeholder perspectives on what might constitute appropriate customer support and how this might be demonstrated. Stakeholder views are outlined in section 5.1 below.

Additionally the method of calculating revenue adjustments could consider customers willingness to pay for customer service improvements. Given that assessing willingness to pay in a trial situation may be difficult, distributors could identify parameters for which a proxy for this value is identifiable. This is discussed further in relation to the Financial Component below. These views were largely supported by submissions received.

Some submissions received from parties other than distributors advocated for the application of certain incentives.<sup>30</sup> Under the principles-based approach, a distributor could provide a proposal to the AER with proposed parameters. Other stakeholders would then be afforded opportunities to comment on the proposed parameters and potentially propose their own

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<sup>30</sup> The Energy Project, Submission to AER Customer Service Incentive Scheme Issues Paper, 16 August 2019, p. 4. Energy Australia, Submission Small Scale Incentive Scheme for Customer Service – Issues Paper, August 2019, p. 4.

parameters. This approach has the benefit of placing an onus on distributors to engage with their customers in the development of incentives. However, it may afford other stakeholders sufficient opportunity to develop their own proposed incentives.

## 5.1 How could distributors demonstrate the incentive targets areas important to customers?

In response to our issues paper, stakeholders provided a range of views regarding how customers could be consulted on their views regarding the incentive. These submissions demonstrated the variety of possible means to approach customer engagement in this space.

Energy Networks Australia suggested that statistically representative customer support, whether demonstrated via stakeholder consultation or a customer advisory would be sufficient.<sup>31</sup> Ausgrid's submission suggested that the first stage of developing any scheme design should be to engage and align with the relevant stakeholders.<sup>32</sup> Jemena noted the evolution that was taking place in consumer engagement, and how this was driven by a change in customer preferences.<sup>33</sup> SA Power Networks emphasised that customer preferences would continue evolving, and that consultation should focus on responding to those evolutions.<sup>34</sup> TasNetworks submitted that extensive consultation to understand the measurable aspects of customer service would be required.<sup>35</sup>

Uniting Kildonan submitted that customer need should be explored as a justification for the incentive, as the transition in the energy sector necessitated distributors altering the way they provide customer service.<sup>36</sup> Energy AusNet Services submitted that its consultation with its Customer Forum and the AER's consideration of the regulatory framework demonstrated sufficient customer support.<sup>37</sup> Australian Gas Infrastructure Group suggested that AER consultation would be sufficient to demonstrate customer support for reform.<sup>38</sup>

Energy Networks Australia suggested that particular parameters (e.g connections) could have their importance demonstrated by the value of the service and number of complaints received by jurisdictional Ombudsmen.<sup>39</sup> Endeavour Energy submitted that that the Energy Charter 'may be a valuable input' to the process of determining what the incentive should target.<sup>40</sup> Essential Energy suggested a paper trial would be helpful in engaging with customer service.<sup>41</sup>

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<sup>31</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 8.

<sup>32</sup> Ausgrid, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 6.

<sup>33</sup> Jemena, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>34</sup> SA Power Networks, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>35</sup> TasNetworks, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, 3.

<sup>36</sup> Uniting Kildonan, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>37</sup> AusNet Services, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>38</sup> Australia Gas Infrastructure Group, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>39</sup> The Energy Project, Submission to AER Customer Service Incentive Scheme Issues Paper, 16 August 2019, p. 4.

<sup>40</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

<sup>41</sup> Essential Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

### Questions for discussion

1. What might constitute “customer support” and is this an appropriate pre-condition for the trial of incentives?
2. Should distributors have primary responsibility for developing the proposed parameters?
3. Have we identified the relevant principles?

## 6 Measurement

Once the distributor has identified performance parameters that customers value, the next step is to consider how they can be measured. Stakeholder submissions, and other international regulators, often use customer satisfaction surveys as an input into customer service schemes.

Principles for measurement could:

- **be reliable, independent, objective and repeatable**
- **be verifiable** - in other words, be able to be confirmed through audit or some other the measurement techniques must be verifiable (by audit or other appropriate mechanism)
- **measure the correct aspect** - of the service that customers value

### 6.1 Submissions

AusNet Services submitted that customer satisfaction is preferable to traditional measures, as it captures the whole experience of the customer.<sup>42</sup>

Essential Energy submitted that an independent survey company should carry out any surveys, as this could mitigate the risk of data manipulation or untrained staff.<sup>43</sup> Energy Queensland submitted that a CSIS should be a broad measure of customer satisfaction and include both qualitative and quantitative measures.<sup>44</sup> TasNetworks submitted that customer surveys alone were not a good basis for incentive schemes and noted that survey results may be impacted by issues outside of their control.<sup>45</sup> Endeavour Energy submitted that we could specify questions to overcome some inherent weaknesses of surveys.<sup>46</sup> Endeavour energy also suggested the use of broad based customer satisfaction surveys to avoid incentivising customer services that are only provided to a subset of customers.<sup>47</sup>

PIAC highlighted that cognitive bias is a feature of surveys, and suggested that they be combined with objective metrics to ensure robustness.<sup>48</sup> CCP17 highlighted that they have seen examples of poor customer surveys, but they can be controlled by combining with objective measures.<sup>49</sup> SAPN submitted that measurement approaches need to be approached cautiously and must be robust to ensure they are meaningful.<sup>50</sup>

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<sup>42</sup> AusNet Services, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>43</sup> Essential Energy, Essential Energy's response to AER issues paper Small Scale Incentive Scheme for Customer Service, August 2019, p. 5.

<sup>44</sup> Energy Queensland Limited, Submission on the Small Scale Incentive Scheme for Customer Service Issues Paper, 22 August 2019, p. 11.

<sup>45</sup> TasNetworks, Small Scale Incentive Scheme for Customer Service, 19 August 2019, p. 4.

<sup>46</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 6.

<sup>47</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p.4.

<sup>48</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>49</sup> CCP17, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p.

<sup>50</sup> SA Power Networks, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.



## 6.2 Discussion

Measurement approaches may be objective or subjective. Historically we have applied objective performance parameters. These have the advantage of being measurable and easy to interpret. However, a disadvantage of objective measures, such as our incentive to answer telephone calls within 30 seconds, is that they only measure a specific aspect of customer service.

To date, the AER has not applied a scheme that bases rewards and penalties on a customer survey. However, we have deployed surveys as an input to the financial component of the STPIS. That Scheme uses a 'Value of Customer' Reliability survey to set the incentive reward rate.

Surveys provide a broader measure of the customer experience than objective metrics. Typically, an objective metric is able to measure one dimension of the customer experience, such as how quickly the distributor answered the phone. There is no indication whether a particular customer values that particular aspect of service. In contrast, a survey can capture many dimensions, and necessarily will capture whether a customer valued the service they received.

Surveys also present challenges. They may be more prone to bias than objective metrics, as they rely on a sampling methodology and are based on subjective responses to questions. While the AER considers that any survey would need to be conducted by a reputable third party provider, these providers would be funded by distributors and therefore the potential for undue influence may arise. This could affect the robustness of data collection and sampling methodologies.

## 6.3 Assurance

Assurance requirements provide stakeholders with confidence that networks provide accurate information and apply our schemes appropriately. When the AER collects information from networks it typically requires that the networks provide assurance that the information meets the AER's requirements. Rigorous assurance could also provide customers with confidence that the CSIS is being applied correctly and penalties/rewards are warranted. However, assurance also increases costs involved in participating in the scheme. The assurance options include audits of the information provided and director's certification.

As the AER has not previously operated an incentive based on customer satisfaction surveys we are interested in what would constitute appropriate assurance on this data. In our issues paper we stated that surveys will need to be conducted by a third-party surveyor using appropriate data sampling and collection methods. The results must also be robust and capable of independent verification and audit. We are interested in stakeholder views on this topic.

In its submission, ENA did not support a requirement for networks to have their surveys audited on a regular basis.<sup>51</sup> ENA submitted that the surveys could be costly relative to the amount of revenue at risk. Instead, ENA suggests that it would be far more cost-effective for any such audits to be undertaken by the AER on an ad-hoc basis.

### **Questions for discussion**

4. What principles should be applied to manage the subjective nature of surveys?
5. What assurance requirements are appropriate for a trial incentive?
6. Have we identified the relevant principles?

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<sup>51</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p.7.

## 7 Assessing performance

An assessment methodology evaluates the measured performance, and determines how that performance can be translated into a measure of improvement (or deterioration) which can be used to determine a reward or penalty.

Principles for the assessment methodology could:

- **Set Baseline or neutral performance level** - establish a “baseline” or “neutral” level of customer service performance, which may be used as a performance target
- **Incentivise genuine improvement** - establish this baseline or neutral performance at least at the level of historical performance in normal circumstances, so that exceeding the baseline constitutes an improvement in service
- **create a simple relationship between out-performance of the neutral or baseline level and the financial reward or penalty**, and
- **establish a single value** - where there is more than one metric, a mechanism for combining parameters into a single value (weighting performance in accordance with their importance to customers) must be able to be established in advance in a reasonably non-controversial manner.

Principles will need to deliver an assessment of the distributors measured performance against a target that can be used to reward/penalise distributors in accordance with customer service improvements/detriments. The ‘simple relationship’ mentioned in the third principle above would likely be in the form of a ‘performance score’ which compares actual measured performance against the ‘neutral or baseline’ performance identified.

### 7.1 Submissions

PIAC submitted that performance targets should not be ‘a gimmie’.<sup>52</sup> Essential Energy submitted that performance assessments should take account of events outside of the control of the distributor.<sup>53</sup> Energy Networks Australia submitted that targets should be ‘achievable’.<sup>54</sup>

Endeavour Energy suggested that we measure performance against industry averages.<sup>55</sup> John Herbst submitted that we should establish the prudent and efficient level of customer service and penalise distributors that fall short of this level.<sup>56</sup> Essential Energy submitted benchmarking should only be used if the available sources are truly comparable.<sup>57</sup>

### 7.2 Discussion

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<sup>52</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>53</sup> Essential Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 5.

<sup>54</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 9.

<sup>55</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

<sup>56</sup> John Herbst, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 1.

<sup>57</sup> Essential Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 5.

Incentive schemes need provide rewards and penalties that are commensurate with the benefits or detriments to customers. Rewards would be inappropriate if they outweigh the benefit to customers from improved performance. Similarly, penalties would be inappropriate if they were unavoidable, or caused by unrealistic goals. Setting appropriate targets partially controls the risk of inappropriate rewards and penalties.

We consider that the outlined principles will deliver an appropriate assessment of the distributor's measured performance, providing a basis for calculating the financial component. We consider that implementing a benchmarking assessment approach at this stage is premature, given the developing nature of our understanding of customer measurement. The 'simple relationship' created in principle three above would likely call for distributors who outperform their 'baseline' level of performance receiving a positive score. This is the approach used under the STPIS.

Customers should not be required to provide a further incentive for distributors to invest in customer service that they should undertake as part of the current framework. For this reason, we will expect that the baseline level of performance may be adjusted in response to the expenditure allowance of the distributor. For example, if the opex allowance of the distributor is increased to fund an overhaul of the distributor's customer-relations IT infrastructure, the distributor should not also expect to receive compensation through the CSIS. Additionally, distributors may exhibit historical performance that is below a minimum level acceptable to customers. If this occurs we may consider 'deadbands'<sup>58</sup> where appropriate, to ensure that customers are not required to provide an incentive for distributors to improve their service to a minimum expected level.

An alternative option for setting targets could be to benchmark distributor performance. Under such an approach (like the one applied by Ofgem) a distributor could be rewarded for outperforming other distributors. Some submissions supported a benchmarking approach.<sup>59</sup> In order to benchmark the performance of distributors they would need to be required to collect and report the same information in the future (though they would not necessarily require a historical data set).

## Questions for discussion

7. In what circumstances should historical performance be used to set performance targets?
8. In what circumstances should industry benchmarks be used to set performance targets?
9. Have we identified the relevant principles?

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<sup>58</sup> When a deadband is set a distributor does not receive a reward for performance below that deadband. For example, AusNet' has proposed to apply a deadband to complaints such that it does not receive a reward for performance until it exceeds a score of 5 out of 10. Ref: AusNet, Proposal for a Small Scale Incentive Scheme - customer satisfaction, 27 March 2019, p. 6.

<sup>59</sup> AGL, Small Scale Incentive Scheme for Customer Service: Issues Paper, 10 September 2019, p2. Uniting Vic.Tas, ISSUES PAPER: Small Scale Incentive Scheme for Customer Service, August 2019, p. 3. Energy Australia, Submission Small Scale Incentive Scheme for Customer Service – Issues Paper, August 2019, p. 5.

## 8 Financial Component

The financial component of the CSIS would describe how the reward or penalty the distributor receives is related to the out-turn performance. An incentive rate is used to determine penalties and rewards. The incentive rate determines the degree to which we will adjust a distributor's revenue based on a given level of performance. The Issues Paper discussed design challenges in setting the incentive rate, and a selection of stakeholder responses are outline below.

Principles for the financial component could:

- **Reward increases with improvement** - rewards should increase in line with customer service improvements and likewise penalties should increase in line with customer service deterioration.
- **Not exceed the customers' willingness-to-pay** for that level of improvement,
- **Utilise a proxy for willingness to pay that is reasonable** - utilise an approximation for customer willingness to pay for improvements in such a way that it will not result in unreasonable rewards or penalties.

### 8.1 Submissions

PIAC submitted that Customer willingness to pay for improvements should be the most important factor in calculating the incentive rate.<sup>60</sup>

Uniting Kildonan submitted that the AER should be cautious in establishing the new incentive, to reduce the impact of any unintended consequences. Caution in establishing the incentive rate will be key in achieving this goal.<sup>61</sup>

Energy Australia submitted that we should draw on the VCR methodology, using a watered down version with smaller sample sizes a higher tolerance for statistical significance measures.<sup>62</sup> Essential Energy submitted that benchmarking should only be used if it can make a genuine comparison.<sup>63</sup>

### 8.2 Estimating willingness to pay

An estimate of customer willingness to pay for improved customer service could be the basis for the incentive rate to ensure that rewards/penalties align with benefits/costs to consumers. As submissions indicated, customers' willingness to pay is the most important consideration when developing the financial component. However, the customer willingness to pay could be difficult to estimate.

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<sup>60</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>61</sup> Uniting Kildonan, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>62</sup> Energy Australia, Submission Small Scale Incentive Scheme for Customer Service – Issues Paper, August 2019, p. 4

<sup>63</sup> Essential Energy, Essential Energy's response to AER issues paper Small Scale Incentive Scheme for Customer Service, August 2019, p. 5.

In the STPIS, customer willingness to pay is, in part, based on a Value of Customer Reliability (VCR) survey undertaken by the AER. The methodology underpinning this survey has been rigorously developed over a significant period. However, determining the VCR is a costly exercise and relies on a very large survey. We consider that requiring such a survey could deter distributors from trialling incentives. We therefore propose that distributors approximate customer willingness to pay.

Distributors could utilise an approximation for customer willingness to pay for improvements that it will not result in unreasonable rewards or penalties. This could be done in consultation with customers, in a forum that allows customers or their representative to provide an informed view of the outcome.

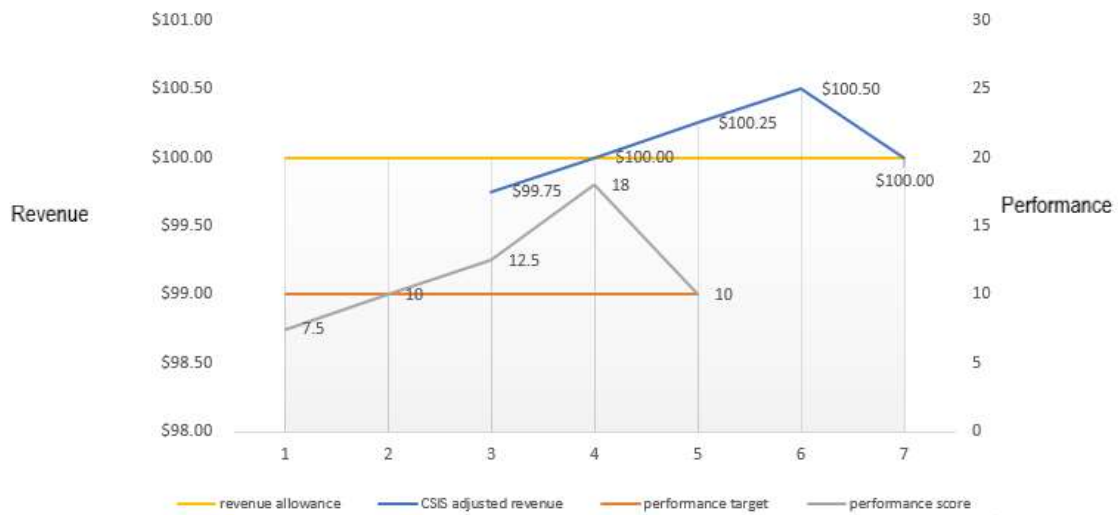
### 8.3 Calculation methodology

AusNet has proposed that the formulas in our STPIS be applied to calculate adjustments to a distributor's revenue for penalties and rewards under the scheme. We consider that this approach may have merit. The STPIS formulas are tried and tested and include a mechanism for capping total revenues and rewards as is required under the NER.

A downside of the STPIS formulas is that there is a two year lag between performance and the penalty or reward. However, a lag is inevitable when penalties or rewards are accrued through total revenues.

Figure 3 provides a simplified worked example of how this adjustment may affect revenues (in constant dollar terms). In the example a distributor has a revenue of \$100 per annum. It has a customer service target of "10" in each year of a five year regulatory control period. In *year 1* it achieves a performance score of 7.5, in *year 2* it achieves a score of 10 and in the final three years it scores 12.5, 18 and 10 respectively. As the distributor does not meet the target of 10 in *year 1* its revenue is reduced two years later in *year 3*. As the distributor meets the performance target of 10 in *year 2* it is neither penalised nor rewarded in *year 4*. In *year 3*, the distributor beats the customer service target of 10 and hence is rewarded in *year 5*. In *year 4* the distributor scores 18 which leads to the maximum reward under the scheme (of 0.5 per cent of revenue) two years later. As the distributor meets the performance target in *year 5* the distributor is neither penalised nor rewarded in *year 7*.

**Figure 3 Example revenue adjustment calculation**



**Questions for discussion**

- 10. How do you gather customer perspectives on whether the identified proxy for willingness to pay is reasonable?
- 11. Are the STPIS revenue adjustment formulas appropriate for the CSIS?
- 12. Have we identified the relevant principles?