



# **Explanatory statement**

## **Draft Customer Service Incentive Scheme**

December 2019

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# 1 Executive Summary

We, the Australian Energy Regulator (AER), regulate electricity distribution network service providers (distributors) to deliver the long-term interests of consumers in terms of price, quality, safety, reliability and security of supply. In accordance with our powers under clause 6.6.4 of the National Electricity Rules (NER) we have published a draft Customer Service Incentive Scheme (CSIS).

The draft CSIS would allow us to set targets for distributor customer service performance and require distributors to report on performance against those targets. Under the CSIS distributors may be financially penalised or rewarded depending on how they perform against their customer service targets.

Currently, the Service Target Performance Incentive Scheme (STPIS) penalises or rewards distributors based on the proportion of fault line telephone calls they answer within 30 seconds.<sup>1</sup> AusNet's engagement with its Customer Forum identified that this incentive may not reflect customer preferences.<sup>2</sup> We received similar feedback when reviewing the STPIS in 2018.<sup>3</sup>

In July 2019, we released an issues paper seeking feedback on whether we should broaden this incentive. Stakeholders largely supported such a reform<sup>4</sup> but wanted to maintain the current overall level of the incentive at 0.5% of a distributor's annual revenue.<sup>5</sup>

Stakeholder submissions have also made clear that customer preferences may vary, based on demographics, geography, or how the network has historically operated. New technology is also changing the way customers interact with distributors.

In response to these submissions, we have developed the draft CSIS as a platform for distributors to engage with their customers, understand their needs, and select parameters that reflect those needs. This flexibility will enable the CSIS to respond to the evolution customer engagement and the introduction of new technologies.

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<sup>1</sup> AER, *Service Target Performance Incentive Scheme*, Version 2 cl. 5.2(b).

<sup>2</sup> Customer Forum, *Customer Forum Interim Engagement Report*, 6 February 2019, p. 27.

<sup>3</sup> AER, *Explanatory Statement: Final Decision Amendment to the Service Target performance incentive scheme*, November 2018, p. 37.

<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>

<sup>5</sup> For example see: *Red & Lumo, Submission to AER Customer Service Incentive Scheme Issues Paper*, 3 September 2019, p. 3.

## 2 Call for submissions

Please address submissions to Sarah Proudfoot via [regulatoryinnovation@aer.gov.au](mailto:regulatoryinnovation@ aer.gov.au). Submissions are due by COB **14 February 2020**. If you have any questions please contact us via the above email address.

In developing any scheme under clause 6.6.4 of the NER we must adhere to the distribution consultation procedures. These are set out at rule 6.16 of the National Electricity Rules (NER). They require us to publish any scheme and its accompanying explanatory statement and invite submissions before making a decision. We must allow at least 30 business days for stakeholders to provide submissions on a draft scheme. Once we publish the draft documents, we must publish the final scheme and our reasons within 80 business days.

**Table 1 Indicative Timeframes**

Small Scale Incentive Scheme	
Stage	Date
Submissions due on draft scheme	14 February 2020
Stakeholder workshops (subject to interest)	February/March 2020
Publish final scheme	April 2020

We may update our timeframes and will advise stakeholders if we do.

### 3 Why are we proposing a CSIS?

We are proposing a CSIS to incentivise electricity distributors to provide customer service in accordance with the preferences of their customers.

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 are 'natural' monopolies, which means that they 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 prefer. The NER seeks to address this issue by providing financial incentives to deliver the outcomes expected in a competitive market. Ultimately, the framework seeks to incentivise distributors to deliver quality network performance at least cost.

#### 3.1 Current incentives

This framework links revenues to efficient costs. It also provides incentives for distributors to reduce costs over time. The primary mechanisms that encourage cost reductions are the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), and economic benchmarking.<sup>7</sup>

In isolation, cost reduction incentives may encourage distributors to reduce costs at the expense of service quality. Our STPIS attempts to counter-balance this by providing distributors with incentives for maintaining and improving network performance, to the extent that consumers are willing to pay for such improvements. State and Territory energy regulators also apply guaranteed service level (GSL) schemes that penalise distributors for not meeting certain service levels.

#### Explanatory Box 1: Current Customer Focussed Incentive Schemes

##### The STPIS

Our STPIS incentivises a distributor to maintain or improve the quality of its services. 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.

When we apply our STPIS we usually limit its penalties or rewards to 5% 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. Typically under this scheme,  $\pm 0.5\%$  of a distributor's annual revenue is linked to one aspect of customer

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

<sup>7</sup> For information

service. If distributors answer a sufficient portion of fault line telephone calls within 30 seconds they are eligible for a reward.<sup>8</sup>

The STPIS does allow the application of other parameters. They are responses to written queries, streetlight repair, new connections, and notification of planned interruptions. We generally do not apply these parameters, as they are addressed by jurisdictional GSL schemes.

In 2018 we reviewed certain aspects of the STPIS. Some submissions called for reform of the customer service component. We considered that these changes would require additional consultation.<sup>9</sup> We consider that this draft decision will continue that consultation.

### GSL schemes

State and territory governments have developed GSL schemes. These schemes require distributors to pay compensation to customers who experience sustained, or frequent, unplanned outages.<sup>10</sup> Schemes vary in the parameters they address. They may 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>

## 3.2 Submissions on current customer service incentives

In submissions on our issues paper, stakeholders generally agreed that the current call answering parameter provided a narrow incentive for maintaining and improving customer service performance. This was generally acknowledged as not responding to customer preferences. Ausgrid submitted that its Customer Consultative Committee said that the telephone answering parameter was not a ‘meaningful... measure for customer service’.<sup>14</sup>

CCP17 submitted that the current telephone answering parameter did not provide an incentive for businesses to deliver customer service as desired by their customers and that a new incentive should recognise changes in technology that have altered the nature of customer service.<sup>15</sup> CitiPower, Powercor, and United Energy submitted that the current incentive was too narrow and might lead to underinvestment in customer service.<sup>16</sup>

Essential Energy pointed to a study by McKinsey & Company which suggested that reducing queue times did not have the most significant impact on customer satisfaction.<sup>17</sup> The Public

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<sup>8</sup> AER, *Service Target Performance Incentive Scheme Version 2*, December 2018, p. 16.

<sup>9</sup> AER, *Explanatory Statement: Final Decision Amendment to the Service Target performance incentive scheme*, November 2018, p. 37.

<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> Ausgrid, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, p. 7.

<sup>15</sup> CCP17, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 29 August 2019, p. 8.

<sup>16</sup> CitiPower, Powercor, and United Energy, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 29 August 2019, p. 8.

<sup>17</sup> Essential Energy, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, p. 3.



Interest Advocacy Centre (PIAC) submitted that the telephone answering parameter lacked a mechanism for testing whether its outcomes reflected customer preferences and priorities.<sup>18</sup>

Stakeholders such as John Herbst submitted that paying more than the prudent and efficient level for customer service was a negative outcome for customers.<sup>19</sup> Stakeholders at our workshop discussions generally supported not expanding the total revenue available for customer service performance.<sup>20</sup> Energy Queensland submitted that any incentive should consider existing incentives, alongside industry initiatives and critically assess the need for a new incentive.<sup>21</sup> CCP17 also submitted that the key driver for network businesses should be maintaining their social license to operate.<sup>22</sup>

### 3.3 Rule Framework

Our draft decision is to make a CSIS under clause 6.6.4.

These rules allow the AER to trial new incentives. Through these trials, we can incentivise distributors to provide their standard control services in a way that improves value for customers, without going through a full rule change process.<sup>23</sup>

The rule framework directs us to consider certain things when making a small scale incentive scheme. Box 1 set out these requirements.

#### 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

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<sup>18</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>19</sup> John Herbst, Submission to AER Customer Service Incentive Scheme Issues Paper, 22 July 2019, p. 1.

<sup>20</sup> For example see: Red & Lumo, Submission to AER Customer Service Incentive Scheme Issues Paper, 3 September 2019, p. 3.

<sup>21</sup> EQL, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 7.

<sup>22</sup> CCP17, Submission to AER Customer Service Incentive Scheme Issues Paper, 29 August 2019, p. 8.

<sup>23</sup> Australian Energy Market Commission (AEMC) 2012, Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Rule Determination, 29 November 2012, Sydney, p. 197.

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
- 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 apply 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 cease to provide rewards or impose penalties within two regulatory control periods.

### 3.4 Draft Decision

Our draft decision is to develop the CSIS under the small scale incentive scheme framework. We consider that an incentive which aligns the interests of distributors with the preferences of their customers will contribute to achieving the NEO.

We consider that an effectively designed CSIS will meet the requirements of clause 6.6.4. The CSIS will penalise or reward distributors for improving, or degrading, the value of the customer experience they provide to customers. In order to do this efficiently, the service improvements observed would need to be valuable to customers, and delivered at a cost which is less than or equal to that value. Accordingly, the draft CSIS objectives are that it:

1. Is consistent with the national electricity objective in section 7 of the National Electricity Law,
2. Is consistent with clause 6.6.4 of the NER,
3. Accomplishes objectives 1 and 2 by aligning the incentives of distributors with the customer service preferences of their customers, and
4. Promotes transparency and understanding throughout the NEM regarding a distributor's customer service initiatives.

We consider that this is achievable if the CSIS identifies areas of value to consumers, ensures those areas are effectively targeted and limits the amount of revenue at risk. We have designed the CSIS elements, discussed in Chapter 5, to address these factors.

In our view this approach is likely to improve the efficacy of customer service incentives and result in improved customer outcomes.

## 4 What is the structure of the CSIS?

This section explains why our draft decision is to make a principles-based CSIS that allows distributors to propose 'incentive designs'. Incentive designs consist of performance parameters, measurement methodologies, assessment approaches, and financial components. This section also explains why customers must agree with the incentive design, and why incentive designs can provide penalties and rewards.

### 4.1 Why have we decided to make a principles based CSIS?

A prescriptive scheme (like the STPIS) specifies precisely what is incentivised as well as how penalties and rewards are calculated. An alternative option is to have a principles based CSIS, which would allow distributors to propose bespoke performance parameters, measurement methodologies, assessment approaches, and penalties or rewards.

#### What is a prescriptive approach?

Typically, we have made prescriptive schemes that specify the components that can apply to a distributor, and the method of calculating penalties and rewards. The STPIS takes this approach.

This is simple to implement and provides certainty to stakeholders. However, it does not provide much flexibility. As a result, we consider that this approach is appropriate where the same measures are likely to deliver benefits to customers of all distributors and are likely to remain relevant over a long period.

#### What is a principles based approach?

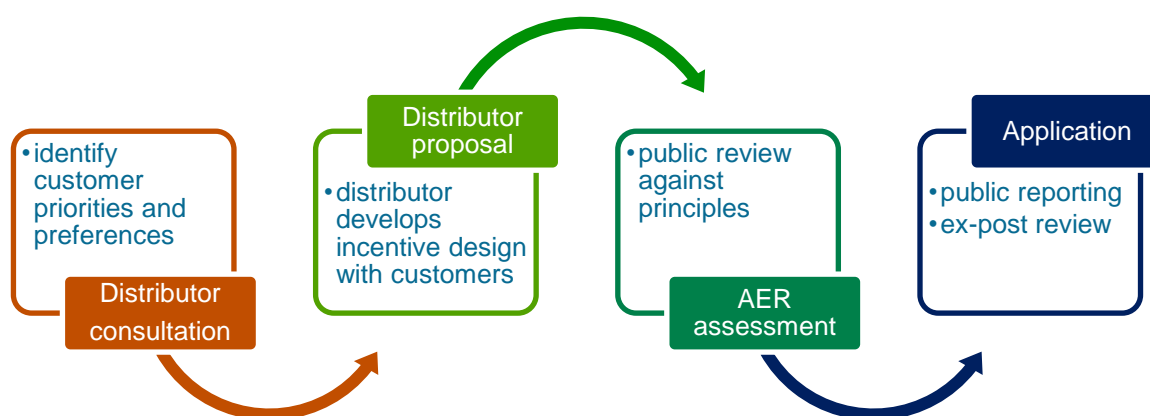
Under a principles based approach the CSIS would outline criteria. Distributors could then identify, in consultation with their customers, parameters that would meet those criteria. This allows us to apply different parameters to different distributors.

We consider that this approach is preferable where it is likely that customer preferences will differ across distributors, and may change over time.

Figure 1 illustrates how a principles-based scheme could work in practice. Distributors could take the lead in engaging with customers. The distributor could then develop an 'incentive

design' based on that engagement and we will consider it. We would assess the distributor's proposed incentive design against the principles in the scheme.

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



## What did submissions say?

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>24</sup>
- PIAC submitted that the scheme should respond to the needs and priorities of different networks' customers.<sup>25</sup>
- Ausgrid submitted that it supported a trial process, where each distributor prototypes its own scheme that best suits their customers' needs.<sup>26</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 distributors.<sup>27</sup>
- Essential Energy favoured a flexible approach to ensure that each distributor has meaningful and achievable targets which reflect their individual circumstances.<sup>28</sup>

<sup>24</sup> Energy Networks Australia, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, p. 9.

<sup>25</sup> PIAC, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 28 August 2019, p. 3.

<sup>26</sup> Ausgrid, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, p. 10.

<sup>27</sup> Evoenergy, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, pp. 2-3.

<sup>28</sup> Essential Energy, *Essential Energy's response to AER issues paper Small Scale Incentive Scheme for Customer Service*,

- Jemena submitted that the scheme should be adaptive, with measures defined by the business using ex-ante targets.<sup>29</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>30</sup>
- The Energy Project submitted that the incentive should apply in respect of connections for all distributors due to the lower level of service in this area.<sup>31</sup>
- John Herbst submitted that distributors should be required to meet minimum customer service levels, and be penalised if they failed to meet those standards.<sup>32</sup>
- Energy Queensland considered 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 distributors' circumstances and customers' preferences and to allow for the customer survey contracts that distributors currently have in place and the differing data capture capabilities of each distributor.<sup>33</sup>

## What is our decision?

Our draft decision is to make a principles based CSIS. We consider this approach is likely to deliver the best value for customers, by adapting to their needs and selecting the most relevant available parameters. This will better achieve the Scheme objectives.

Information gathered from stakeholders supports adapting to the unique preferences of distributor customers, rather than pursuing the one-size fits all approach currently adopted under the STPIS. Additionally, customer preferences are likely to continue changing over time. We consider an approach that responds to this change is likely to deliver greater customer benefits. Therefore, a principles based approach is more likely to achieve the CSIS objectives.

## 4.2 Why do customers have to agree with the incentive design?

Clause 3.1(1)(d) of the CSIS requires distributors to provide evidence that customers agree that the incentive design satisfies the relevant principles. Put another way, distributors must demonstrate overall customer support for the incentive design. To do this efficiently, we have decided to allow distributors to leverage existing engagement processes.

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August 2019, p. 5.

<sup>29</sup> Jemena, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 19 August 2019, p. 1.

<sup>30</sup> PIAC, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 28 August 2019, p. 3.

<sup>31</sup> The Energy Project, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 16 August 2019, p. 4.

<sup>32</sup> John Herbst, *Submission to AER Customer Service Incentive Scheme Issues Paper*, 22 July 2019, p. 1.

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

## What did stakeholders say?

Stakeholders had diverse views on the best way to identify whether customers support an incentive design.

Discussion in the workshops focused on what would constitute customer support for incentives proposed by distributors. Participants considered that at this stage of development, specifying a particular method of customer engagement may be counterproductive. However, it was suggested that distributors should undertake a two stage process:

- engage with their customers to identify areas of potential improvement, and
- return to their customers via a different mechanism seeking support for their proposed incentive design.

SA Power Networks emphasised that customer preferences would continue evolving, and that consultation should focus on responding to those evolutions.<sup>34</sup> Jemena submitted that an evolution was taking place in consumer engagement, driven by a change in customer preferences.<sup>35</sup>

A number of submissions stated that customer consultation is central to demonstrating customer support. Energy Networks Australia suggested that statistically representative customer support, whether demonstrated via stakeholder consultation or a customer advisory would be sufficient.<sup>36</sup> Ausgrid's submission suggested that the first stage of developing any incentive should be to engage with the relevant stakeholders.<sup>37</sup> TasNetworks submitted that extensive consultation to understand the measurable aspects of customer service would be required.<sup>38</sup> AusNet Services submitted that its consultation with its Customer Forum and the AER's consideration of the regulatory framework demonstrated sufficient customer support.<sup>39</sup>

Other submissions suggested alternative approaches to conceptualising customer support. Uniting Kildonan submitted that customer needs was enough of a justification for adjusting the incentive, as the transition in the energy sector necessitated distributors altering the way they provide customer service.<sup>40</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>41</sup> Endeavour Energy submitted that that the Energy Charter 'may be a valuable input' to the process of

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

<sup>35</sup> Jemena, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>36</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 8.

<sup>37</sup> Ausgrid, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 6.

<sup>38</sup> TasNetworks, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, 3.

<sup>39</sup> AusNet Services, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 1.

<sup>40</sup> Uniting Kildonan, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>41</sup> The Energy Project, Submission to AER Customer Service Incentive Scheme Issues Paper, 16 August 2019, p. 4.

determining what the incentive should target.<sup>42</sup> Essential Energy suggested a paper trial would be helpful in engaging with customers' service preferences.<sup>43</sup>

## What is our decision?

Our draft decision is to require that customers agree that an incentive design achieves the CSIS objectives by satisfying the principles (discussed in Chapter 5).

The draft CSIS allows for a variety of approaches to gather customer views on incentive designs, rather than specifying the mode of engagement. Our expectation is that distributors will gather the evidence of customer support as part of the consultation on their regulatory proposal. The AER Consumer Engagement Guideline provides guidance to distributors on managing this process.

Distributors have pursued a number of different approaches in this area. We consider that many different approaches could validly obtain customer perspectives. We consider that the CSIS should contribute to, and benefit from, the ongoing efforts of distributors, advocates and regulators in this area. Therefore, we do not propose to specify an engagement approach in the draft CSIS.

Speaking broadly, proposals should be subject to levels of challenge, with customers offered an opportunity to shape and hone the incentive design. Box 2 outlines some recent efforts in the NEM to introduce customer perspectives into the regulatory determination.

### Box 2 Recent Approaches to Customer Engagement

Organisation	Engagement Model
New Reg Trial <sup>44</sup>	The AER, ECA and ENA have been trialling a form of consumer engagement based on negotiations with customers. Under this process the most significant departure from traditional practice is that a Customer Forum negotiates aspects of the regulatory proposal in advance of lodgement with the AER. The Customer Forum does not represent the perspectives of particular interests, instead it must conduct research and customer engagement to ensure it can effectively represent the perspectives of all the network businesses' customers.
Jemena People's Panel <sup>45</sup>	Jemena convened representatives of local communities into a 'people's panel' that met regularly to discuss a range of key energy issues including pricing, reliability, and future technological change. The Panel was the recipient of the ENA and ECA Consumer Engagement Award for 2019.
SA Power Networks 2020-25 Consultation <sup>46</sup>	SA Power Networks' 'Talking Power' initiative sought to obtain customer feedback on its Regulatory Proposal for the 2020–25 regulatory control period. It consisted of four stages: Strategic Research & Early Engagement,

<sup>42</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

<sup>43</sup> Essential Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

<sup>44</sup> For more information please see: <https://www.aer.gov.au/networks-pipelines/new-reg>

<sup>45</sup> For more information please see: <https://jemena.com.au/about/newsroom/article/2018/people-s-panel-highlights>



In-Depth Engagement, Draft Plan Development & Consultation, and the Regulatory Proposal. The initiative's objectives were to equip customers to participate in the process, engage customers on the issues that matter to them, ensure there were no surprises, consider the concerns of customers when establishing costs, and meet engagement principles. This included dedicated web forums, in person consultation and informational videos. The program was nominated for the 2019 ECA Consumer Engagement Award.

ECA Stakeholder engagement stocktake	On 11 September 2019 ECA hosted a Consumer Engagement Stocktake in Melbourne. The workshop included participants from industry, consumer representatives and regulators. The discussion found that pre-lodgement engagement was developing well, but that standardisation of terms and an increase in 'business-as-usual' engagement would be useful. There was also support expressed for revisiting the AER Stakeholder Engagement Guideline and improving financial incentives for consumer engagement.
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As part of their incentive design proposals distributors will need to outline the consultation procedures they have undertaken to demonstrate customer value. We consider this will contribute to the improvement of customer engagement across the NEM, as distributors techniques will be detailed to enable comparisons of different approaches.

We acknowledge the suggestion of alternative justifications for applying an incentive design. For example, the value of services on the presence of customer needs. However, we consider that a thorough consultation process will augment the evidence for these justifications, while contributing the development of the incentive design.

### 4.3 Why is there a default maximum amount of revenue at risk?

The NER allows the AER to apply a maximum revenue at risk of 0.5%, or 1% where the distributor consents. Many submissions stated that that the revenue at risk under the CSIS should be capped at 0.5%.<sup>47</sup><sup>48</sup><sup>49</sup> The ENA submitted that 0.5% was the appropriate default rate, but that a stronger incentive of up to 1% should be allowed where support from customers can be demonstrated.<sup>50</sup> The Energy Project submitted that the revenue at risk should be proportionate to the value of the services being considered.<sup>51</sup> Workshop participants generally agreed that the current customer incentive level was meaningful. And that the focus of the CSIS should be on enhancing the value extracted from that revenue at risk. Our draft position is to cap the level of revenue at risk at 0.5% in line with the default maximum allowed under the NER. This places the same revenue at risk as the telephone answering parameter.

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<sup>46</sup> For more information please see: [www.talkingpower.com.au](http://www.talkingpower.com.au)

<sup>47</sup> Red and Lumo, Submission to AER Customer Service Incentive Scheme Issues Paper, 3 September 2019, p. 1.

<sup>48</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues paper, 28 August 2019, p. 2.

<sup>49</sup> AusNet Services, Submission to AER Customer Service Incentive Scheme Issues paper, 19 August 2019, p. 2.

<sup>50</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues paper, 19 August 2019 p. 9.

<sup>51</sup> The Energy Project, Submission to AER Customer Service Incentive Scheme Issues paper, 16 August 2019, p. 5.



Our draft position is to set a default maximum revenue at risk of 0.5%, but allow for 1% where distributors can demonstrate that their customers would prefer more revenue to be placed at risk. This is consistent with the many submissions stating that 0.5% is the appropriate level of revenue to put at risk, but recognises that development in this area may necessitate stronger incentives in the future.

We will consider the total rewards available to a distributor when we apply a CSIS. Under the STPIS, we may decide not to apply a parameter. We may adjust the revenue at risk to reflect this. When we apply a CSIS, we will more than likely not apply the telephone answering parameter and remove the associated revenue at risk from the STPIS. As such, a CSIS placing 0.5% of revenue at risk will not place additional revenue at risk for customer service performance.

#### **4.4 Why provide both penalties and rewards?**

Our draft decision is to allow incentive designs to provide both penalties and rewards. Stakeholder submissions and some participants at workshops suggested that the CSIS should set a standard for customer service performance, and penalise distributors who fall beneath that standard.

Both rewards and penalties may be needed to incentivise distributors to align service levels with customer preferences. Rewards provide an incentive for distributors to improve their current performance where it is below the level that customer would prefer.

We consider that a CSIS that both penalises and rewards will promote efficient outcomes. As AusNet submits, customer service is an output and so an improvement in the quality of customer service represents an increase in outputs and *ceteris paribus* an increase in efficiency. A CSIS that rewards as well as penalises creates an incentive to increase expenditure on customer service when the additional inputs are less than the value of the increased output.<sup>52</sup> Thus under a CSIS that provides rewards, where a distributor's actual cost of improving customer service is less than the reward provided through the CSIS the distributor has an incentive to carry out the works. Further, a scheme that rewards as well as penalises can act as a cost-recovery mechanism for service performance improvements, where these improvements are over and above those being funded through the revenue allowed in a distribution determination.

A penalty-only CSIS may incentivise the delivery of efficient customer service by setting the target level of customer service at the efficient level. However, identifying the efficient level of customer service may not be possible. Further, customer service is evolving, particularly in the energy space, as consumers take greater control of their energy consumption and usage. Technology is changing the ways that distributors are communicating with their customers and the information that distributors are able to share. Thus the efficient level of customer service is likely to change over time. A scheme that both penalises and rewards creates incentives for ongoing efficiency improvements such that distributors provide efficient customer service.

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<sup>52</sup> AusNet Services, Proposal for a Small Scale Incentive Scheme - customer satisfaction, March, 2019, p. 6.

We will only apply an incentive design where distributors demonstrate customer support. If, as some stakeholders suggest, a particular distributor's customers will only support an incentive design that penalises their distributor, then that is the only incentive design we would apply. However, we consider that the scheme should reward distributors for improving their customer service if this is what customers want.

## 5 What principles will we assess incentive design proposals against?

In section 4 we outlined our rationale for developing a principles based CSIS. In this section we set out the principles in the draft CSIS and our reasons for selecting them.

In our workshops we proposed preliminary principles.<sup>53</sup> There was broad support in the workshops for the principles. The principles in the draft CSIS largely reflect the principles discussed at our workshops - with some amendments to respond to issues raised by stakeholders.

Figure 2 summarises these principles. The draft CSIS divides the principles into four elements:

1. Performance parameters: the areas of performance that will be subject to the incentive (e.g. customer satisfaction in relation to new connections),
2. Measurement methodology: how to measure performance in relation to each performance parameter (e.g. a customer satisfaction survey for customers who recently received a new connection),
3. Assessment approach: how the incentive design will set targets and rate distributor performance against the parameters, and
4. Financial component: how the incentive design translates distributor performance into a penalty or reward.

**Figure 2 Draft CSIS principles**

Performance Parameters	Measurement	Assessment	Financial
<ul style="list-style-type: none"> <li>• Target aspects of service that customers particularly value</li> <li>• Substantially within control of distributor</li> <li>• Not already covered by another incentive</li> </ul>	<ul style="list-style-type: none"> <li>• Accurately measure the correct aspect of the relevant performance parameter</li> <li>• Independently, Objectively, and Reliably conducted</li> <li>• Produces results that could be audited by a third party</li> </ul>	<ul style="list-style-type: none"> <li>• Establish a baseline or neutral performance level</li> <li>• Incentivise genuine improvement</li> <li>• Create a simple relationship between performance and rewards or penalties</li> <li>• Establishes single value</li> </ul>	<ul style="list-style-type: none"> <li>• Rewards or penalties increase relative to performance</li> <li>• Rate of rewards or penalties uses an estimate customer value that is developed through a robust process</li> <li>• Reward/penalty do not exceed the value that customers place on the service levels observed</li> <li>• Overall incentives for customer service do not exceed the value that customers place on service</li> </ul>

<sup>53</sup> Workshop note, AER workshop on customer service incentives, November 2019 ([available here](#)).

## 5.1 Selecting performance parameters

The performance parameter principles are the requirements that potential metrics must satisfy.

### 5.1.1 Draft Decision

Our draft decision is to require each performance parameter to be an aspect of the customer experience component of the distributor's provision of standard control services:

- 1) **Which is particularly valued by the customers of the distributor,**
- 2) **Is substantially within the control of the distributor, and**
- 3) **For which the distributor does not already have another incentive.**

### 5.1.2 Explanation

The purpose of the first principle is to ensure that the incentive design will address services that customers' value. We have decided not to prescribe how customer value might be demonstrated. We consider that distributors will demonstrate this through the consultation process outlined in section 4.2.

The second principle directs incentive designs to target services that are substantially in the control of a distributor. This will ensure that the incentive design does not reward or penalise distributors for outcomes that are outside their control. In submissions and workshops, stakeholders suggested that other avenues of service may be appropriate targets for the incentive. Some stakeholders considered that, given most customers interact with their distributor via their retailer, that improving interactions with retailers could be a relevant measure.<sup>54</sup> Similarly, stakeholders suggested the NSW Accredited Service Provider (ASP) framework as a service channel that relied on timely service from the distributor.

These services often directly impact customer outcomes. Though the final service may not be in the control of a distributor, we consider this proposal has the potential to deliver customer benefits. We consider that that the draft design will permit such metrics where customer value demonstrated.

The third principle ensures that the incentive design will not duplicate existing incentives.<sup>55</sup> Duplication may over-incentivise a distributor to pursue certain outcomes. To avoid this, we consider performance parameters should not duplicate incentives that distributors may already have under state or territory GSL schemes.

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<sup>54</sup> AER Customer Service Incentive Scheme: Sydney Workshop Note Available here: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/customer-service-incentive-scheme>.

<sup>55</sup> Further, cl. 6.6.4(b)(4) requires that we consider the interaction of the scheme with other incentives that distributors may have under the Rules.

## Which customers are relevant?

The CSIS needs to provide benefits for customers as whole. Targeting particular pain points for certain customers may be the best way to deliver on this objective. Overseas, some regulators have operated incentives based on a satisfaction survey of a sample of all customers, while others have targeted specific groups (such as those that had a complaint or experienced an outage).<sup>56</sup>

We consider that both alternatives remain open under the draft decision. Where evidence exists of value for customers, and customers support a given measure, we will consider applying the parameter. However, defining any targeted customer group, and how this target delivers benefits to customers overall will be vital to demonstrating the value of incentive designs.

## 5.2 Selecting the measurement methodology

Once the distributor has identified performance parameters that their customers' value, the next step is to consider how to measure performance.

### 5.2.1 Draft decision

Our draft decision is to require measurement approaches to:

- 1) accurately measure the aspect of the performance addressed by the relevant performance parameter**
- 2) be sufficiently independent,**
- 3) be compiled in an objective and reliable manner, and**
- 4) produce results that could be audited by an independent third party.**

### 5.2.2 Explanation

Our draft decision is to allow a range of measurement methodologies. We consider that any measurement methodology that is accurate, independent and properly reviewed will capture value for customers. In the draft decision we have sought to address comments from stakeholders by implementing a targeted set of principles to guarantee the robustness of measurement methodologies. The principles contain three mechanisms, which identify value for customers and examine the veracity of the methodology.

The first is requiring the methodology to accurately measure the aspect of performance that is of value to customers. For instance, if distributors have identified customer satisfaction in relation to complaints as a performance parameter, then a suitable measurement methodology may be to survey customers regarding their satisfaction after filing a complaint.

Second, the mechanics of the measurement approach must be robust. This requires that the measurement be sufficiently independent, in that it is either; administered by an independent

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<sup>56</sup> Please see Appendix C.

third party or based on an independently developed methodology. If we take the example above, the distributor may need to use a third-party survey provider under an agreement that maintains the independence of the survey administration. This will provide confidence to stakeholders that the measurement will reflect performance.

Third, the methodology must gather data in a way that can be independently reviewed, including by a third party auditor. Submissions and workshop discussions made clear that robust assurance is a vital part of the incentive. However, the balance between the benefits of assurance and compliance costs is also an important consideration. In workshops, stakeholders indicated that aligning these processes with the Regulatory Information Notice annual reporting would reduce burden while providing robust assurance. While this is appealing, this approach may not be appropriate depending on the measurement methodology selected. Accordingly, we have not specified the level or type of assurance. Incentive designs will specify this.

We consider that these principles, taken together, will ensure that measurement methodologies capture value for customers. Specific discussion of the requirements for the use of surveys of customer satisfaction are discussed at Appendix A.

## 5.3 The approach to setting targets and assessing performance

An assessment approach evaluates the measured performance, and translates that performance into an expression of improvement or deterioration which we can use to determine a reward or penalty.

### 5.3.1 Draft Decision

Our draft decision is to require that proposed assessment approaches meet the following principles:

- 1) **Establish a baseline or neutral level of performance, which in normal circumstances should be at least equal to the historical performance of the distributor,**
- 2) **Set a performance target for each performance parameter that;**
  - a) **incentivises genuine improvement,**
  - b) **is based on the neutral or baseline level of performance,**
- 3) **Express the result of the assessment of measured performance against each performance target as a single value, and**
- 4) **Create a clear relationship between;**
  - a) **outperformance of the performance target resulting in a reward under the incentive design, and**
  - b) **underperformance of the performance target and receiving a penalty under the incentive design.**

## 5.3.2 Explanation

### Set targets using a baseline or neutral level of performance

We have determined that performance targets should take account of the distributor's baseline or neutral level of performance against the relevant performance parameters.

We consider that, as a default, the historical performance of the distributor should be set as the performance target. This mirrors the approach taken in the STPIS. The alternative default approach, would be to utilise benchmarking, penalising or rewarding distributors based how they perform when compared to each other.

Stakeholders had a range of views on how to best set targets. PIAC submitted that performance targets should not be 'a gimmie'.<sup>57</sup> Energy Networks Australia submitted that targets should be 'achievable'.<sup>58</sup> Endeavour Energy suggested that we measure performance against industry averages.<sup>59</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>60</sup> Essential Energy submitted benchmarking only functions correctly if the available data are truly comparable.<sup>61</sup> AGL submitted that, to the extent any incentive beyond the revenue cap is required, that incentive should rely on benchmarking against other firms, in order to ensure cost neutrality for consumers.<sup>62</sup>

In workshops, stakeholders discussed the role of historical performance in setting the baseline or neutral level of distributor performance. Participants stated that the views of customers of individual distributors should be the primary consideration when setting performance targets. Some attendees were of the view that the baseline level should be the basic level expected by customers, and that customers should not be required to pay where distributors' performance has been unacceptable in the past. Others considered that historical performance was the appropriate means of incentivising future improvements.

Overall, workshop participants supported a historical performance approach at this stage. Some participants stated that a current lack of sufficiently comparable data would likely make a benchmarking approach inappropriate, but that benchmarking could be used once data sets were established. Stakeholders also noted that benchmarking approaches may create a disincentive for distributors to collaborate to improve customer service. Stakeholders also noted that benchmark performance across networks may be above or below what some customers would prefer.

On balance we consider that a historical performance approach best addresses the current situation. The current state of customer service data, and visibility of distributor performance,

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<sup>57</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>58</sup> Energy Networks Australia, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 9.

<sup>59</sup> Endeavour Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 4.

<sup>60</sup> John Herbst, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 1.

<sup>61</sup> Essential Energy, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 5.

<sup>62</sup> AGL, Submission to AER Customer Service Incentive Scheme Issues Paper, 22 August 2019, p. 7.

does not lend itself to making comparisons between distributors. Additionally, as discussed in relation to performance parameters, we consider that customers will benefit if distributors adapt metrics to their customers' preferences. This makes comparing distributor performance more difficult. We acknowledge the potential benefits of a benchmarking approach if data improves, and we identify relevant comparable metrics. Accordingly, the draft CSIS requires incentive designs contribute to customer service performance. This ensures that public reporting will be central to incentive designs, which may facilitate the development of benchmarks.

To resolve the issue of unacceptable historical performance, we have retained flexibility to adjust the target. Where consultation with customers reveal historical performance to be unsuitable for use as a performance target, incentive designs could utilise 'deadbands' (ranges above historical performance for which the distributor does not receive an incentive) to account for the difference. For instance, AusNet Services and its Customer Forum negotiated a deadband for complaints.<sup>63</sup> We will also consider the robustness of the historical data set proposed by the distributor, and whether customer consultation has mitigated the risk of 'cherry-picking' certain data sets in our assessment of the suitability assessment approaches.

### **Create a simple relationship between performance and the reward or penalty**

When performance against the target is assessed, the result should be a single value. In most cases this will consist of a positive number where a distributor will receive rewards and a negative number where the distributor will receive a penalty. This increases the transparency of incentive designs for customers. Additionally, simplicity increases the ability of the AER to apply and rigorously examine rewards and penalties provided under the incentive.

Attendees at workshops stated that an additive approach was not always sufficient to produce accurate results. It was suggested that a geometric average (which would reward consistent performance across a number of metrics) might be more appropriate.

We have decided that as a default, incentive designs must utilise formulas based on those in the STPIS for weighting the different parameters. This is an additive approach where the total penalty or reward is the sum of individual penalties or rewards for each parameter. We consider that transparency and consistency with the STPIS is likely to better achieve the CSIS objectives in the majority of cases. The draft CSIS allows for the application of an alternative approach where this may better achieve the CSIS objectives.

## **5.4 Financial Component**

The financial component covers how an incentive design delivers penalties or rewards for a given level of performance. Our objective is that penalties and rewards under the CSIS are commensurate with customer benefits and do not provide an incentive for distributors to over-invest in customer service.

Our draft decision is to require that rewards or penalties provided under an incentive design:

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<sup>63</sup> AusNet Services, Proposal for a Small Scale Incentive Scheme - customer satisfaction, March, 2019, p. 6.



- 1) Will increase relative to the degree of outperformance or underperformance, commensurate with the identified value of the service improvement to customers of the distributor,
- 2) Are commensurate with the service improvements or degradations observed in respect of the distributor's distribution system,
- 3) Are not likely to exceed the value that customers attribute to the level of service improvement or degradation observed,
- 4) are not likely to, when considered in aggregate with all incentives applied to the DNSP for customer service, (including incentives external to the incentive design), result in the incentives available to the DNSP relating to customer service exceeding the value customers attribute to that component of service, and
- 5) In satisfying the requirements of (2) and (3), establishes the rate of the incentive using a reasonable process that identifies the value that customers attribute to the level of service improvement or degradation observed, in that the process is:
  - a) transparent, and
  - b) involves genuine consultation with the distributor's customers.

#### 5.4.1 Explanation

The financial component of the CSIS has two elements, the overall revenue at risk and the incentive rate.

The overall revenue at risk sets the maximum amount of revenue that a distributor can gain or lose under the incentive design. The incentive rate determines the degree to which we will adjust a distributor's revenue based on a given level of performance.

Both components are required to be in line with the value that customers attribute to the level of service improvement or degradation observed. To augment this, we will consider other incentives available to distributors, and the views of customers on the appropriate incentive rate.

#### Overall revenue is capped and considers all customer service incentives

As discussed in section 4.3 we have made the decision to set a cap on the overall revenue at risk. As a default, the cap is 0.5% of the relevant distributor's annual revenue. However, if distributors can provide strong evidence that 1% of annual revenue will provide an incentive in line with customer preferences, we may consider approving such an incentive design.

In submissions, some stakeholders, such as John Herbst, submitted that paying more than the prudent and efficient level for customer service was a negative outcome for customers.<sup>64</sup> Stakeholders at our workshop discussions generally supported not expanding the total revenue available for customer service performance.<sup>65</sup> Energy Queensland submitted that

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<sup>64</sup> John Herbst, Submission to AER Customer Service Incentive Scheme Issues Paper, 22 July 2019, p. 1.

<sup>65</sup> For example see: Red & Lumo, Submission to AER Customer Service Incentive Scheme Issues Paper, 3 September 2019, p. 3.

any incentive should consider existing incentives, alongside industry initiatives and critically assess the need for a new incentive.<sup>66</sup>

Clauses 3.3(4)(c) and (d) of the draft CSIS require that the incentive, both in isolation and in tandem with overall incentives, not exceed the value customers attribute to customer service. We consider that this, along with the overall cap on revenue at risk and requirement for customer support for the incentive designs application, will deliver incentives that provide customer value.

### **The incentive rate is commensurate with the value customers attribute**

Our draft decision is to require the incentive rate to be set based on the value customers' attribute to observed improvements or degradations in customer service performance.

PIAC submitted that customer willingness to pay for improvements should be the most important factor in calculating the incentive rate.<sup>67</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 was submitted as key in achieving this goal.<sup>68</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>69</sup>

At the workshop stakeholders acknowledged that some form of 'willingness-to-pay' study (such as that conducted for the VCR) would likely be the gold standard. However, conducting such surveys can be time consuming, difficult to administer, and costly. While the STPIS is an established scheme with defined parameters, we are yet to determine the parameters that will apply under the CSIS.

An alternative, suggested in the workshops, is to estimate 'willingness to reward' via a less intensive method. Where distributors genuinely engage with their customers, and test the results of that engagement with representatives and the AER. This is in line with the STPIS, which permits alternative approaches to assess the value that customers attribute to the level of service.<sup>70</sup> We agree that willingness to reward might be easier to identify via customer consultation.

Workshops participants noted that the construction of the principles presented at the workshop emphasised the possibility of distributors receiving rewards, rather than the prospect of penalties. Stakeholders suggested that the scheme should be as likely to impose a penalty as provide a reward, and that the principles should reflect this. We have adjusted the principles in response to this comment.

Clauses 3.2(4)(a), and (b) of the draft CSIS require that the incentive rate is commensurate with the service improvements or degradations observed. They also tie the incentive rate to

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<sup>66</sup> EQL, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 7.

<sup>67</sup> PIAC, Submission to AER Customer Service Incentive Scheme Issues Paper, 28 August 2019, p. 3.

<sup>68</sup> Uniting Kildonan, Submission to AER Customer Service Incentive Scheme Issues Paper, 19 August 2019, p. 2.

<sup>69</sup> Energy Australia, Submission Small Scale Incentive Scheme for Customer Service – Issues Paper, August 2019, p. 4.

<sup>70</sup> AER, Service Target Performance Incentive Scheme, November 2018, cl. 5.3.2(c).

the value customers place on those improvements or degradations. This responds to the submissions outlined above, by clearly linking the incentive to value for customers.

Clause 3.2(4)(e) establishes the process by which distributors can set the values required in previous clauses. In line with the submissions above, we have required distributors to test customer views rather than engage in a study methodology, or use a pre-determined rate. We consider that this will deliver customer benefits, by adapting to their preferences. This process should not meaningfully increase the burden of the scheme, as the incentive design must achieve overall agreement from customers. However, this requirement is necessary to direct attention to the incentive rate and ensure proper testing of customer views on this issue.

Workshop attendees also discussed the desirability of making the increase in reward or penalty non-linear in order to reflect the value to customers of different service improvements. We consider that the draft CSIS permits this, if this better reflects the value that customers attribute to the performance improvements or degradations observed.

## 6 How will we apply the CSIS?

We may apply a CSIS that places revenue at risk as part of our distribution determination for a distributor. In this section we outline the consultation steps involved in the AER's assessment of an incentive design. We also outline how incentive designs will be applied.

### 6.1 Formal consultation on incentive designs

We will only apply the CSIS if the proposed incentive design meets the incentive design criteria and objectives and principles of the scheme. As outlined in chapter 4, we consider that distributors should have primary responsibility for developing incentive designs. Distributors would conduct this consultation in advance of the submission their regulatory proposal and set out the incentive design in the proposal.

The AER's formal assessment of a proposed incentive design would commence once a distributor submits that design with its regulatory proposal.

**Table 2 Steps in assessing whether to apply an incentive design**

Determination step	Distributor/AER actions
Framework and approach	In our framework and approach papers we set out our position on the application of incentive schemes. Distributors may well still be developing incentive designs at the framework and approach stage of a determination. As such, we may be not commit to applying an incentive design in our framework and approach. However, our preference would be to provide an indicative view to provide greater certainty for stakeholders. As such, we would encourage distributors to provide information in advance of the framework and approach on their incentive designs.
Regulatory proposal	Where an incentive design is proposed, we expect that distributors will provide a complete outline of this incentive design in there proposal together with an outline of how they consulted in developing the incentive design.
Issues paper	In our issues paper we may seek comment on elements of a distributor's incentive design.
Draft determination	In our draft determination we will outline our draft decision on whether or not we will apply incentive designs proposed by distributors in accordance with the principles in the CSIS and the requirements of the NER. Our draft decision will set out whether and how we will apply the CSIS.
Revised regulatory proposal	In a revised regulatory proposal a distributor and its customers may respond to comments on an incentive design raised by the AER in its draft decision.

## 6.2 Applying incentive designs

Distributors will be required to collect and report data on performance parameters. Unless otherwise agreed, distributors will be required to report this information together with their annual reporting regulatory information notices (RINs). The submission of this information to the AER with annual RINs will enable us to calculate penalties or rewards and apply them in the next regulatory year.

The draft CSIS does not prescribe assurance requirements for data gathered by distributors under incentive designs. Our draft position is that assurance should reflect the challenges presented by the particular measurement methodology.

### 6.2.1 Publication of information

To allow stakeholders to assess the outcomes of the application of the CSIS we will publish the raw data submitted to us under an incentive design. The AER intends to publish this information in our performance reporting. Incentive designs could also mandate other reporting in order to satisfy the principles, such as in annual report on the distributor's ongoing customer engagement.

### 6.2.2 Calculation of penalties or rewards

The draft CSIS sets out default formulas used to calculate penalties or rewards. These formulas align with the formulas used to calculate penalties and rewards under the AER's STPIS. These penalties or rewards take the form of an annual adjustment to a distributor's total allowable revenue.

## 6.3 Assessing incentive design performance

The overall objective of our CSIS is to provide an incentive for distributors to provide customer service in accordance with the preferences of their customers. As part of this, we will review whether incentives have in fact resulted in service that better aligns with customer preferences.

The draft CSIS sets out objectives for both assessing proposed incentive designs and also assessing the success of incentive designs. We consider that an incentive design which is found in an ex-post assessment to have met the CSIS objectives is likely to have been successful.

## Appendix A: Good practice in survey design

This section provides some guidance for using surveys to measure customer service performance, in order to meet the measurement principles of accurately, independence, reliability and objectivity.

We consider that robust survey design is necessary in order to satisfy the principles of the CSIS. We have not previously used a qualitative measurement such as a survey to measure a distributor's performance. However, the approaches taken by other regulators provides guidance on how to design surveys. Under Ofwat's Service Incentive Mechanism (SIM) and the Customer Satisfaction Survey component of Ofgem's Broad Measure of Customer Satisfaction, it is a requirement that the utilities companies appoint an independent third party, such as a market research company to undertake customer surveying on its behalf.<sup>71</sup>

The form of surveys is also of importance. Both OFGEM and OFWAT in the Customer Satisfaction Survey and Service Incentive Mechanism rely on standardised surveying questions,<sup>72</sup> which typically involve the surveyor asking a series of related questions on a topic, before they are ultimately asked a final question, which forms the relevant data for the survey.

Using standardised questions would be essential in circumstances where we employ uniform parameters across different distributors, such as if we were to apply parameters surrounding customer satisfaction with planned and unplanned outages, in accordance with the suggestion of the Victorian distributors.<sup>73</sup>

It is important that any sample is representative of the target population's preferences. A distributor conducting a survey for the purpose of identifying customer value would need their sample to be representative of this target population. This is important to ensure the robustness of survey results by accurately weighting the perspectives of different customer groups.

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<sup>71</sup> See OFGEM, Customer Service Reporting RIGs, 30 March 2012, p.14 and OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, p. 19.

<sup>72</sup> See OFGEM, Customer Service Reporting RIGs, 30 March 2012, Appendix 2 and OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015.

<sup>73</sup> CitiPower, Powercor and United Energy, Response to Preliminary Framework and Approach, 9 November 2018, p. 5; and Jemena Energy Networks (Vic) Ltd, Submission on the preliminary 2021-25 framework and approach for Victorian electricity distribution businesses: Regulatory control period commencing 1 January 2021, 9 November 2018, AusNet Services, Customer Experience: Negotiating Position for Customer Forum, 8 August 2018, Customer Experience: Revised Negotiating Position for Customer Forum, 10 October 2018, p. 15.

## Appendix B: How other economic regulators are incentivising customer service

Customer service incentive schemes are a common feature of other regulatory frameworks. Some regulators approach customer service by employing incentives, while others set standards. In most cases, the Schemes apply to all distributors over which the regulator has jurisdiction.

### Explanatory Box 2 Customer service incentives operated by other regulators

#### Ofgem

Ofgem provide an incentive to improve customer satisfaction, the Broad Measure of 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). The incentive lays out a survey call script that the independent third parties contracted by distributors to perform the survey must use.<sup>74</sup>

Ofgem also provide a financial incentive for DNOs to deliver an improved level of performance in relation to specific output measures. The relevant measures are the number and duration of interruptions, and the quality of telephone response. This scheme is similar to the STPIS.

OFGEM's surveying in relation to planned power cuts asks *"Overall, taking into account all the aspects we have just discussed, how satisfied were you with your distributor's handling of this planned power cut"*.<sup>75</sup>

#### Ofwat

Ofwat operates a SIM to incentivise improvement in a broad measure of customer satisfaction. This broad measure is composed of a weighted average of performance in a number of categories.

The SIM relies on both qualitative and quantitative parameters, but is weighted more heavily to its qualitative measure.<sup>76</sup> The qualitative component (75% of the incentive) derives from a customer experience survey involving persons who have had direct contact with their distributor. This survey asks customers how satisfied they were with how the supplier handled their billing or operational issue.<sup>77</sup> The quantitative component (25% of the incentive) is based on the number of written complaints and customer phone contacts.<sup>78</sup> OFWAT's survey focuses on high-level concerns and

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<sup>74</sup> For more information please see: <<https://www.ofgem.gov.uk/electricity/distribution-networks/network-price-controls/customer-service>>.

<sup>75</sup> OFGEM, Customer Service Reporting RIGs, 30 March 2012, Appendix 2.

<sup>76</sup> OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, pp. 2-3.

<sup>77</sup> OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, p. 3.

<sup>78</sup> Unwanted phone contacts are those contacts that are unwanted from a customer's point of view. These include a contact about an event or action that has caused the customer unnecessary aggravation. It also includes repeat or chase calls by the customer to the company. This is determined by the subject matter of the call. OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, p. 8.



asks all customers *"taking everything into account how, how satisfied are you with the handling of this matter."*<sup>79</sup>

### **Alberta**

The Alberta Utilities Commission operates a Performance Based Ratemaking framework. The commission sets the overall revenue required for the business to meet its obligations under the rules, with businesses earning returns on capital and retaining underspends. The rules impose obligations for distributors to survey customers.<sup>80</sup> The survey methodology is set out in the Rule.

In order to meet the standard at least 75% of customers who contact the distributor must 'agree' that the distributor performed effectively. Distributors are also required to measure overall satisfaction of a sample of all customers on an annual basis. Distributors must also report on the number of complaints made about their services and meet certain obligations regarding complaints handling.

### **California**

The California Public Utilities Commission also operate a performance based rate making scheme. The Commission previously operated a Performance Based Reporting Mechanism which tracked customer service performance metrics. The incentive was based on performance in an aggregate survey of customer satisfaction. However, the Commission discontinued it following data falsification and manipulation by certain electricity distribution businesses.<sup>81</sup>

### **New York State**

The New York State Public Services Commission operates a Customer Service Performance Mechanism. The Mechanism establishes threshold performance levels for designated aspects of customer service. The designated aspects are complaint performance, call answer rate, outage notification, and Satisfaction of Callers, Visitors and Emergency Contacts. The Commission also offers a customer engagement incentive, which incentivises distributors to engage customers in innovative programs.

Satisfaction is based on the average of the satisfaction index ratings on the semi-annual surveys of customers who have contacted the distributor via each avenue.

### **Massachusetts**

The Massachusetts Department of Public Utilities tracks a range of Service Quality metrics, including customer satisfaction in relation to electricity distribution businesses. Customer satisfaction is measured via surveys that determine the customer's overall feeling towards the utility after accessing various services. Customer satisfaction is measured via telephone surveys. Rather than offering reward payments, companies are penalised if they fail to increase their performance to benchmark levels.<sup>82</sup>

### **Essential Services Commission of Victoria**

In 2018, the Essential Services Commission (ESC) of Victoria applied a new approach called PREMIO (Performance, Risk, Engagement, Management and Outcomes) to regulate the prices charged by 16

<sup>79</sup> OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, p. 19.

<sup>80</sup> Alberta Utilities Commission, Rule 2: Service Quality and Reliability Performance Monitoring and Reporting for Owners of Electric Distribution Systems and for Gas Distributors, clause 4.6.

<sup>81</sup> California Public Utilities Commission, DECISION REGARDING PERFORMANCE BASED RATEMAKING (PBR), FINDING VIOLATIONS OF PBR STANDARDS, ORDERING REFUNDS, AND IMPOSING A FINE, September 2008.

<sup>82</sup> Please see: <https://www.mass.gov/service-details/service-quality>.



Victorian water businesses. In developing this approach the ESC found water businesses had limited incentives to be accountable to customers for delivering on their service commitments. There were no material consequences for water businesses that did not achieve their standards.<sup>83</sup>

The ESC developed a financial incentive related to the level of ambition shown by a water business in the delivery of services and outcomes that matter most to customers, and to deliver these as efficiently as possible.<sup>84</sup> The ESC also directed water business to report annually to their customers on their performance against the specified outputs for each outcome, along with an overall assessment of whether the business has delivered on expectations for each outcome.<sup>85</sup>

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<sup>83</sup> Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 10.

<sup>84</sup> Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 1.

<sup>85</sup> Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 11.