

27 March 2019

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Dear Mr Pattas

Proposal for a Small Scale Incentive Scheme – Customer Satisfaction

AusNet Services requests that the AER begin consultation on a small scale incentive scheme under clause 6.6.4 of the NER, which will apply to AusNet Services in the 2021-25 regulatory control period.

This scheme has been developed as part of the 'New Reg' process, to enhance our incentive to place a greater focus on the meeting the needs of our customers. The existing telephone answering parameter (contained in the Service Target Performance Incentive Scheme) does not adequately address the broad needs and preferences of our customer. We consider that a more holistic incentive scheme should be applied instead.

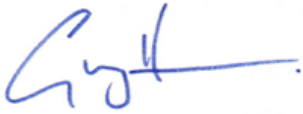
The proposed scheme has been agreed with the Customer Forum, which considers it to be a significant improvement on the existing arrangements. Nonetheless, both AusNet Services and the Customer Forum acknowledge that there is scope to improve this scheme over time and this scheme is only one element of AusNet Services commitment to improving its customer experience. In addition to proposing this scheme, AusNet Services has agreed with the Customer Forum that it will commit to:

- Improving our data collection to enable refinement of the scheme at the next regulatory period.
- Delivering a range of initiatives to improve customer experience prior to 2021, as outlined in our Draft Proposal
- The publication of an annual Customer Interactions Report, which will contain metrics of importance to customers broader than those included in the proposed scheme.

We have attached a draft of the small scale incentive scheme, which could form the basis of the AER's consultation on the development of the scheme. This draft scheme has been formulated to maintain as much consistency with the design principles underpinning the Service Target Performance Incentive Scheme (STPIS) as practicable. In this way, our proposed scheme reflects accepted regulatory practices and should be welcomed by the AER and our customers.

Should you have any further enquiries concerning this information please do not hesitate to contact Michael Larkin on (03) 9695 6346.

Sincerely,

A handwritten signature in blue ink, appearing to read 'G. Hannan', with a long horizontal stroke extending to the right.

Greg Hannan
Manager Economic Regulation
AusNet Services

Attachment 1 - Proposal for a Small Scale Incentive Scheme

This Attachment sets out our proposal for a small scale incentive scheme in accordance with clause 6.6.4 of the NER. We consider there are two separate decisions that need to be made:

- A decision on the framework for the scheme in accordance with clause 6.6.4 of the NER;
- A decision on the specific parameters, targets, deadbands and incentive rates to apply. This decision will ultimately be made by the AER in AusNet Services distribution determination (or any other DNSPs distribution determination to which the scheme is applied). We have set-out our position on these matters in this proposal.

Objective

In developing this proposal, our objective has been to design a scheme that will drive improvements in the satisfaction of AusNet Services customers across core operational services we deliver. We propose to use customers reported satisfaction with our services as the basis of the incentive scheme. This ensures that the scheme provides a broad incentive to improve customers experience and that our customers ultimately assess whether we are providing them with an experience they value.

International examples

Customer satisfaction incentive schemes have been implemented by a number of international regulators. Basing an incentive scheme on customers' reported satisfaction is new for Australian electricity DNSPs, but has previously been implemented by other international regulators. This approach has been implemented by the following regulators:

- OfGEM – Broad Measure of Customer Satisfaction (BMCS)¹
- OFWAT – Service Incentive Mechanism (SIM)²
- New York State Department of Public Service - Customer Service Performance Mechanism (CSPM)³
- California Public Utilities Commission⁴

The SIM was first implemented in 2010 and has now been operating for close to two regulatory periods. OfWat has published a review of its existing SIM, which found that:⁵

There is widespread agreement it [the SIM] has strongly contributed to significant improvements in customer service in the water sector, including a 60% reduction in written complaints.

OfWat is also considering future improvements to the SIM and the review found that:⁶

¹ RIIO-ED1 regulatory instructions and guidance: Annex H – Customer Service, 18 June 2015

² Service incentive mechanism (SIM) for 2015 onwards – conclusions, April 2014

³ RE: Case 16-E-0060 – Con Edison Electric Rates Con Edison's Customer Service Performance Mechanism Performance, 1 March 2018

⁴ PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA Document #808

⁵ <https://www.ofwat.gov.uk/wp-content/uploads/2016/11/Future-customer-service-incentive-for-water.pdf>

⁶ <https://www.ofwat.gov.uk/wp-content/uploads/2016/11/Future-customer-service-incentive-for-water.pdf>

The main focus of the new incentive mechanism should be customer satisfaction. Asking customers directly about their satisfaction is the best way to measure this.

We consider that using customers reported satisfaction as the basis of an incentive scheme is consistent with international practices for incentivising improvements in customer satisfaction.

Scheme Design

We have designed this scheme to closely mirror the Service Target Performance Incentive Scheme (STPIS), as this is an accepted approach within the Australian regulatory framework. The key features of the proposed incentive scheme are:

- There is no financial reward or penalty if our customers satisfaction levels do not change.
- Financial rewards are provided to AusNet Services if customers satisfaction improves from current levels. Conversely financial penalties are applied to AusNet Services if customers satisfaction decreases from current levels.
- The size of the reward or penalty varies with the degree of improvement or decline in satisfaction as the incentive rate scales the size of the reward for the level of improvement or decline in performance.
- There are caps on the size of the reward or penalties that can be paid under the scheme.

AusNet Services commissions a monthly telephone survey of our residential and business customers' satisfaction. The results of this ongoing survey, which are reported quarterly, will form the basis of the customer service incentive scheme. The survey captures customer satisfaction with the performance metrics in table 1 below.⁷

Table 1 Performance Metrics

Performance Metric	Description	Survey Quota (quarterly)
Customer Satisfaction – unplanned outages	The customers are asked to rate their overall satisfaction with a recent outage event they experience. This interaction excludes recloses or interruptions of less than 1 minute under the assumption that the customer affected may not have experienced the outage.	105
Customer Satisfaction – planned outages	The customers are asked to rate their overall satisfaction with a planned outage they recently experienced so would incentivise AusNet Services to handle notification and customer interactions	105

⁷ AusNet Services started collecting a data on a 5th interaction in February 2019. However, we are not proposing to include a parameter based on DER connections.

	better.	
Customer Satisfaction – New Connections (Basic and Standard)	<p>The customers are asked to rate their overall satisfaction with the connections process.</p> <p>Basic and standard connections are captured in this interaction. A basic connection includes hanging a meter and energising the premise where network changes or upgrades are not required.</p> <p>A standard connection does require a network change which might include a new pole installation, line extension or upgrade, pit construction and other technical changes like substation upgrades and making supply available to a site in accordance with customer’s load requirements. A standard connection does not include hanging a meter and site energisation.</p> <p>Negotiated or more complex connections that require some bespoke design and planning are excluded from this interaction.</p>	90
Customer Satisfaction – Complaints	The customers are asked to rate their overall satisfaction with a recent escalated complaint they made.	60

These performance metrics are key interactions or experiences that customers have with AusNet Services. Our decision to adopt these particular metrics was based on consultation undertaken to help understand the areas where customers value improved service delivery. A large number of our customers experience planned or unplanned outages each year, so improvements in these areas have widespread impact. New connections impact a smaller number of customers, but it is a particularly important interaction as delays could slow down a customer when they are seeking to occupy a premises. Similarly, complaints are only made by a small number of customers, but likely reflect a deficiency in our service delivery and so are a high priority interaction for the customers impacted.

Calculation of reward or penalty

We propose to use the average overall satisfaction score for each of these measures as the annual performance measure. This annual performance measure will be compared against performance targets and customer satisfaction levels above the target will result in a financial reward and satisfaction levels below the target will result in a financial penalty.

The calculation of rewards of penalties for each parameter will be as follows:

$$\text{Reward or Penalty} = ir_p * [\text{Tar}_p - \text{Act}_p]$$

where:

- ir_p is the incentive rate for parameter p
- Tar_p is the target set for parameter p
- Act_p is the annual performance measure for parameter p

This approach to calculating the reward or penalty is consistent with the STPIS and provides symmetrical rewards and penalties.

Targets

We propose fixed performance targets set using the average of the CSAT data. We propose to use the data available at the time of the AER's final decision (in October 2020). This means that the targets indicated below will be updated closer to the implementation of the scheme to ensure that they are set appropriately. The update to the targets will be able to incorporate customer satisfaction data from 2018, 2019 and half of 2020. At the time of this submission our average performance (the 'target') for each of these metrics was:⁸

- 7.3 out of 10 for Planned interruptions (indicative)
- 6.1 out of 10 for Unplanned interruptions (indicative)
- 5.6 out of 10 for Connections (indicative)
- 3.2 out of 10 for Complaints (indicative). Complaints will have a deadband, with no rewards until performance exceeds 5 out of 10.

We propose that the targets are fixed for each year of the 2021-25 regulatory control period.

Revenue at risk

Our proposed scheme has a default revenue at risk of 0.5%, but consistent with clause 6.6.4(d)(1) of the NER allows a DNSP to propose a cap on revenue at risk of up to 1%.

We propose that 0.5% revenue at risk be applied to AusNet Services in the 2021-25 regulatory period. This matches the revenue at risk under the existing telephone answering parameter in the STPIS and ensures that customers are not exposed to an overall greater revenue at risk than under the existing scheme. We propose a cap on each scheme parameter, as shown in the table below.

Table 2 Cap on revenue at risk

Scheme Parameter	Revenue at Risk
Planned Interruptions	0.143%
Unplanned Interruptions	0.143%
Connections	0.143%
Complaints	0.071%
Total	0.5%

Incentive Rates

Clause 5(b) of our proposed scheme allows for AusNet Services to propose a methodology for setting the incentive rate. AusNet Services proposes that the incentive rates for each parameter are derived as follows:

⁸ We note that this is based on only one year of data. We will have a longer series of data available before a decision is made in the distribution determination.

For each parameter, the cap on rewards should be received if we achieve a reported satisfaction level consistent with industry leading performance. Industry leading performance should be identified from a benchmark of firms taking a survey by the same third party provider. The calculation of incentive rates would therefore be as follows:

$$ir_p = rr_p / (Tar_p - ilp_p)$$

where:

- ir_p is the incentive rate for parameter p
- rr_p is the revenue at risk for parameter p
- ilp_p is an estimate of Industry Leading Performance for parameter p

At this time industry leading performance for each parameter is:

- 8.7 out of 10 for Planned interruptions (indicative)
- 8.7 out of 10 for Unplanned interruptions (indicative)
- 8.4 out of 10 for Connections (indicative)
- 5.8 out of 10 for Complaints (indicative)

This reflects the highest performance measured by a one of the seven Australian electricity or gas distribution business who are currently using the same third party provider. We will provide updated information on industry leading performance as part of our regulatory proposal. This means that the benchmark of industry leading performance will be updated closer to the implementation of the scheme to ensure that it is set appropriately.

Performance Deadband

AusNet Services proposes that the scheme can allow for a deadband to be set, which is an area of performance where a reward or penalty should not be received.

The Customer Forum expressed concern that we would be rewarded for improving our complaints score off a low baseline. Accordingly, we propose that a deadband is applied to the complaints parameter in the 2021-25 regulatory period. This ensures that we are not rewarded unless we achieved a minimum level of customer satisfaction with the complaints process. We propose that a deadband is set with the lower bound at the performance target and with a higher upper bound. This means that:

- AusNet Services will face a penalty if customer satisfaction declines below the target level.
- AusNet Services will only receive a reward if it achieves a material improvement in customer satisfaction above the target level. This ensures that there is no reward or penalty provided until we have achieved a minimum level of satisfaction for our customers.

We have agreed with the Customer Forum that the deadband for the complaints threshold is set at 5 out of 10. This means that AusNet Services will only receive a reward if performance exceeds a satisfaction level of 5. We note that our current performance is 3.2 out of 10 and that industry leading performance is 5.8 out of 10. As such, this represents a commitment to a significant improvement in our customers' satisfaction in our complaints handling process.

Opportunities for continuous improvement

The Customer Forum has expressed concerns with the relatively static nature of the regulatory regime and that there are limited opportunities to review the operation of the scheme or improve the scheme outside the 5 year regulatory process. We have agreed with the Customer Forum to propose the AER should review the scheme partway through the 2021-25 regulatory period, with an aim of implementing any improvements prior to the end of the regulatory period. We consider this review should occur in 2023, once two years of performance data is available and this would allow for changes to be incorporated for at least two years of the 2021-25 regulatory control period. Regardless, the scheme should be reviewed prior to the 2026-2030 regulatory period to determine whether it should continue to apply in that regulatory period and whether any alterations are necessary.

In conjunction with the Customer Forum, we have identified areas where we think the scheme could potentially be improved in the future:

- Improving our data collection to enable future refinement of the scheme at the next regulatory period:
 - Greater disaggregation of customer types or locations. This would allow more precise targeting of the incentives and could drive a normalisation of experience across the network.
 - Capture a broader range of interactions. Particularly, the Customer Forum would like larger connections capture in a satisfaction measure.
- Target Setting – Rather than using an average measure, the targets could be based on improving the experience of customers reporting low or high levels of satisfaction. Additional work to factor in the statistical variability of the data should also be undertaken.
- The publication of an annual Customer Interactions Report, which will contain metrics of importance to customers broader than those included in the proposed scheme.

Rules Requirements

Clause 6.6.4 of the NER allows the AER to develop a small scale incentive scheme and states that:

(a) The AER may, in accordance with the distribution consultation procedures, develop and publish an incentive scheme or schemes (small-scale incentive scheme) that provides Distribution Network Service Providers with incentives to provide standard control services in a manner that contributes to the achievement of the national electricity objective.

(b) In developing and applying a small-scale incentive scheme, the AER must have regard to the following matters:

(1) Distribution Network Service Providers 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 Distribution Network Service Providers may have under the Rules; and

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

We have designed this scheme to comply with the requirements of the NER and to satisfy the National Electricity Objective. The implementation of the Customer Service Incentive Scheme should occur as two interlinked processes:

- The development of the small scale incentive scheme in accordance with clause 6.6.4 of the NER.
- The AER's distribution determination for AusNet Services 2021-25 regulatory control period, where the key parameters in the scheme are finalised.

The AER's consultation on the scheme under clause 6.6.4 of the NER allows stakeholders to consult on the scheme design principles. The key inputs into the incentive scheme (i.e. the performance targets and incentive rates) should be finalised as part of our distribution determination. This is consistent with the approach taken with the STPIS and is appropriate as it allows us time to gather additional data to on which to set these important elements of the scheme.

Each of the matters the AER must have regard to and the reason we consider the proposed scheme satisfies these requirements is set out below:

- **6.6.4(b)(1) Distribution Network Service Providers should be rewarded or penalised for efficiency gains or losses in respect of their distribution systems.**

The proposed scheme is designed so that improvements in customer satisfaction are rewarded and declines in customer satisfaction are penalised. We propose that the targets are set at the historical average and so our performance relative to this historical average that is either rewarded or penalised.

Customer service is an output of our business and so an improvement in the quality of customer service represents an increase in outputs and ceteris paribus an increase in our efficiency. The incentive scheme will provide AusNet Services an incentive to increase expenditure on customer service when the additional inputs are less than the value of the increased output. This represents an overall gain in the efficiency of our network.⁹

⁹ Customer Service is not included as an output is not measure in the AER's econometric benchmarking model, so expenditure on customer service improvements would likely appear as a

- **6.6.4(b)(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.**

The rewards and penalties are scaled based on the size of the improvement or decline in customer satisfaction. A larger increase in satisfaction generates a commensurately larger reward and vice versa.

- **6.6.4(b)(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.**

A key element of the scheme is the incentive rate that is used to calculate the rewards or penalties for changes in service delivery. We propose to set the incentive rates with reference to industry leading performance as demonstrated by the performance of 7 electricity and gas distribution businesses, which use the same third party provider. We propose to set the incentive rate so that the maximum reward is generated if we manage to achieve industry leading performance. This scales the reward to drive AusNet Services towards the top of the industry in the next regulatory period. However, it does not provide an incentive to drive higher than already achieved by other businesses in the short term. This ensures that the incentive rate is not inappropriately high in the first application of the scheme.

- **6.6.4(b)(4) the interaction of the scheme with other incentives that Distribution Network Service Providers may have under the Rules**

There are limited interactions with the AER's existing STPIS, however these limited interactions are not impediments to implementing this customer satisfaction incentive scheme.

We propose that the existing telephone answering parameter should not apply to AusNet Services in the 2021-25 regulatory period and this removes any interaction with the STPIS.

The STPIS also provides rewards for reductions in the number and duration of unplanned outages. The customer satisfaction incentive scheme will measure customer's satisfaction with the unplanned outages they experience. However, this does not result in an inappropriate interaction between the two schemes because the two measures should be largely independent. The use of automatic outage restoration technology has been able to reduce the number of customers who experience a sustained outage (as we are able to use switching to restore supply to many customers in under a minute), but does not change (either increase or decrease) the length of the outage for the customers who remain affected (we still need to dispatch a truck to resolve the problem and this response is unchanged by the automatic restoration of some customers).

As such, we do not expect a strong correlation between reliability (as measured by the STPIS) and the customer satisfaction parameter. When the average reliability improves or declines, this generally reflects more or less customers experiencing an outage, but the experience of an individual who experiences an outage is largely unchanged. As such, we expect that factors like communication will be more important in driving the customer satisfaction scores.

- **6.6.4(b)(4) the capital expenditure objectives and the operating expenditure objectives.**

Clause 6.5.7(a)(3)(iii) of the NER allows that building block proposal must include the capital expenditure to maintain the quality, reliability and security of supply of standard control services. Similarly, Clause 6.5.6(a)(3)(iii) of the NER requires that the building block proposal must include the operating expenditure to maintain the quality, reliability and security of supply of standard control services.

We consider that customer satisfaction is an element of the quality of supply of standard control services. As such, AusNet Services should be funded in its distribution determination to maintain existing levels of customer satisfaction. The proposed Customer Satisfaction Incentive Scheme is then the appropriate mechanism for AusNet Services to be compensated for programs to increase customer satisfaction.