



ISSUES PAPER

Small Scale Incentive Scheme for Customer Service

July 2019

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Glossary

Term	Definition
AER	Australian Energy Regulator
AGN	Australian Gas Networks
AusNet	AusNet Services
CSIS	Customer Service Incentive Scheme
Customer Satisfaction	The rating that customers place on their experience by customers following contact with the distributor as recorded by a third party survey operator
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
Incentive Deadband	The minimum score a distributor must achieve before receiving a financial reward under the proposed Customer Service Incentive Scheme.
Incentive Rate	The rate at which a distributor is rewarded for performance improvements under the proposed Customer Service Incentive Scheme
NEL	National Electricity Law
NEO	National Electricity Objective in section 7 of the NEL: The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to— (a) price, quality, safety, reliability and security of supply of electricity; and (b) the reliability, safety and security of the national electricity system.
NER	National Electricity Rules

1 Introduction

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

As part of AusNet Services' (AusNet) trial of the New Reg process,¹ its Customer Forum have identified areas where AusNet could improve its customer service. AusNet and the Customer Forum submit that our current customer service incentives may be prompting distributors to make narrow customer service improvements, without accounting for broader customer preferences.² AusNet and its Customer Forum have proposed that the AER develop a customer service incentive scheme (CSIS). This would replace our current incentive for distributors to answer telephone calls within 30 seconds.³ The proposed replacement scheme places the same revenue at risk as the call answering incentive (0.5 per cent of total annual revenue).

We are considering whether there is merit in using the small scale incentive scheme framework in National Electricity Rules (NER) to trial a CSIS. Other economic regulators, such as Ofgem and Ofwat in the UK, the Alberta Utilities Commission, and a number of US state regulators, have developed schemes that seek to drive improved customer service by taking account of customer survey responses.

In light of this, we are commencing consultation on the effectiveness of the current framework in delivering the level of customer service that customers want and the merit of better incentivising improvements in customer service. Figure 1 sets out objective of this consultation. The small scale incentive scheme provisions allow us to trial new incentives in way that limits their risk. As envisaged by the AEMC, trials of incentive schemes should inform rule change proposals for the design of future permanent incentive schemes.

AusNet and its Customer Forum have proposed one possible incentive design. The parties agreed on the design as part of a package of measures aimed at improving customer service. These include improving specific areas of customer service, (such as training for call centre staff), public reporting of customer service outcomes in an annual customer interactions report, and proposing a CSIS.⁴ AusNet and the Customer Forum's agreed CSIS

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

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

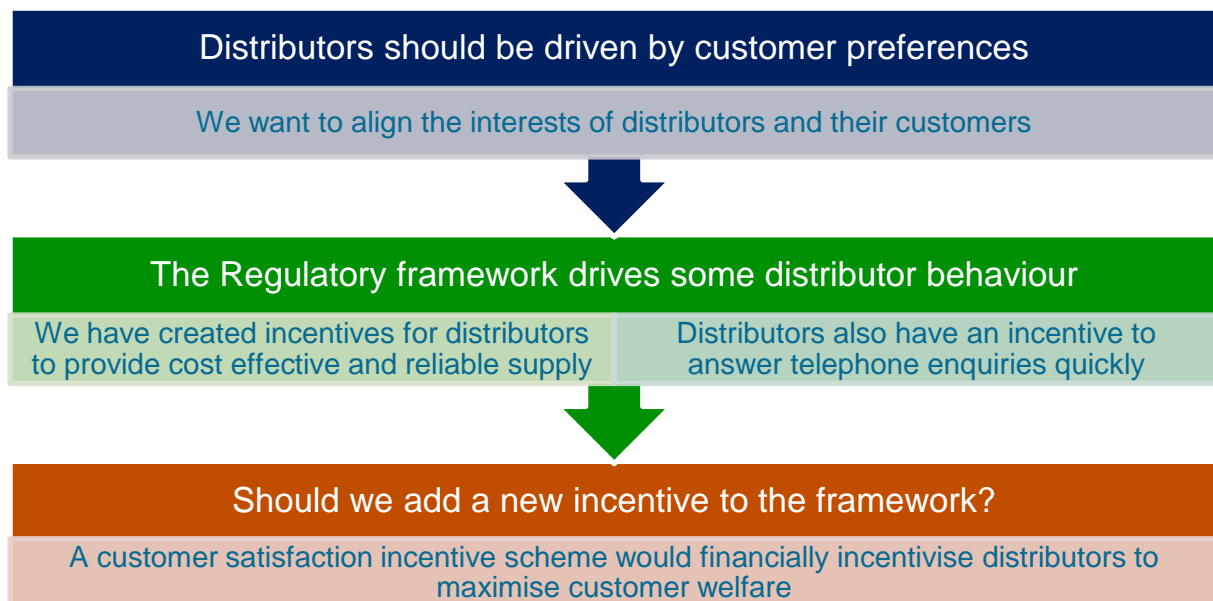
³ We apply this incentive through the application of our Service Target Performance Incentive Scheme (STPIS).

⁴ AusNet Services, Draft Electricity Distribution Regulatory Proposal 1 January 2021 to 31 December 2025, February 2019, p. 38-39. Customer Forum, Small Scale Incentive Scheme, March 2019, p. 1-2.

provides an incentive based on distributor performance in regular surveys of customer satisfaction on planned and unplanned outages, connections and complaint handling.

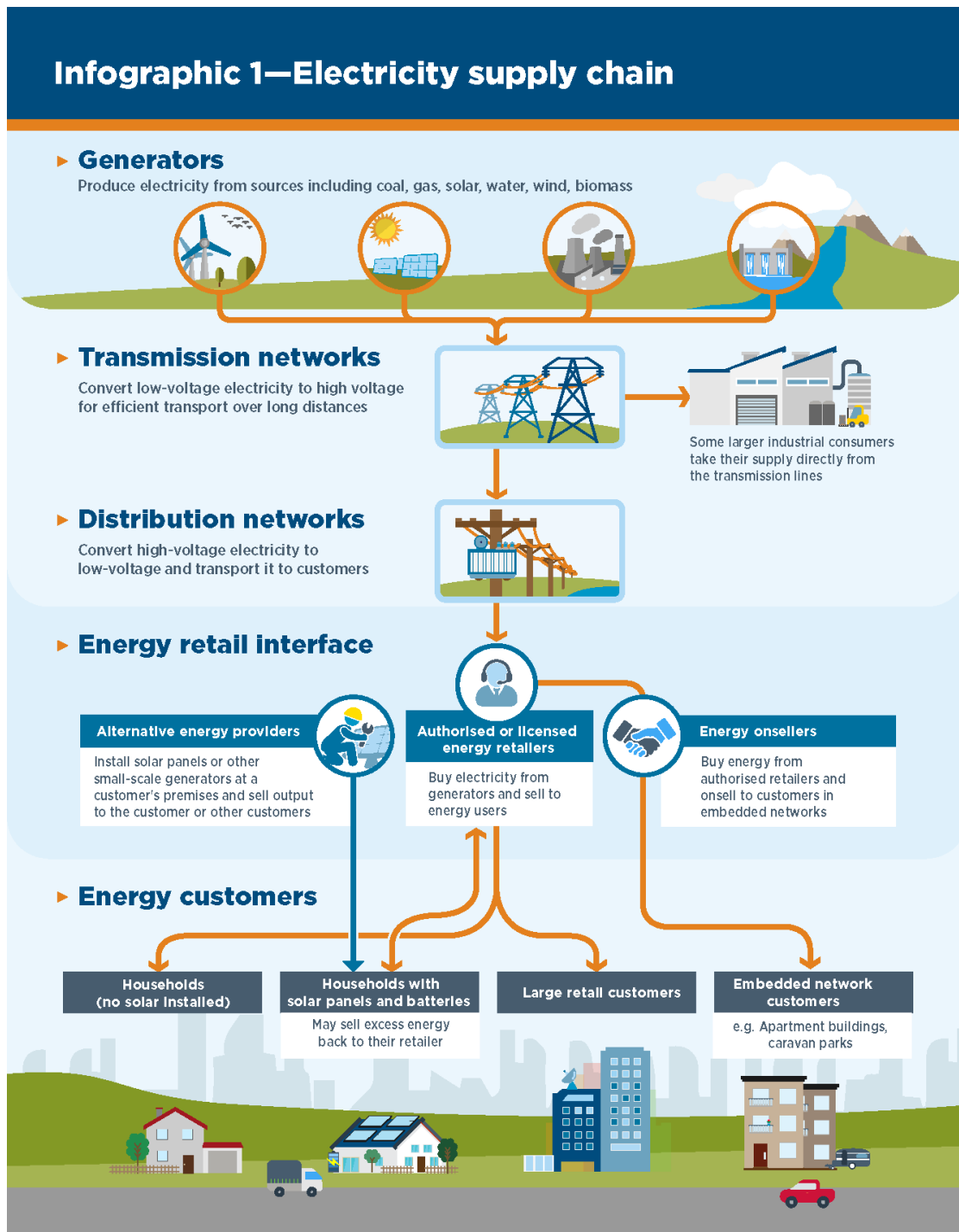
This issues paper seeks stakeholder views on the adequacy of the existing incentive framework for customer service. It also explores threshold questions regarding how we may design a broadly applicable CSIS. Depending on the response to this issues paper, the AER could develop a draft CSIS for further consultation. It also discusses the AusNet proposed scheme, and proposed scheme implementation. These aspects will be subject to further consultation, both in the development of any draft CSIS and as part of AusNet's distribution determination.

Figure 1 The objective of this consultation



In this paper we are considering the incentives for customer service on electricity distributors. Electricity distributors are one element of the electricity supply chain. They distribute electricity from the transmission grid to residential homes and commercial premises for use by energy customers. Distribution networks consist of poles and wires, substations, transformers, switching equipment, and monitoring and signalling equipment. While electricity distributors transport electricity to customers, they do not sell it. Instead, retailers purchase electricity from the wholesale market and network services from network owners, and sell them as a package to customers.

Figure 2 Electricity supply chain



2 Process and consultation timelines

Please address submissions to Chris Pattas via [regulatoryinnovation@aer.gov.au](mailto:regulatoryinnovation@ aer.gov.au). Submissions are due by 15 August 2019. If you wish to be contacted regarding consultation on a CSIS, please let us know via the above email address. If we develop a draft CSIS, we will publish it for consultation. Victorian distributors are due to submit their Regulatory proposals in January 2020. If we develop a CSIS, we would publish the final scheme in February 2019.

In developing any small scale incentive scheme we must adhere to the distribution consultation procedures. These are set out at Rule 6.16 of the National Electricity Rules. 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 days.

Table 1 Indicative Timeframes

Small Scale Incentive Scheme	
Stage	Date
Submissions on this issues paper due	19 August
Workshop (subject to stakeholder feedback)	September/October 2019
Draft Scheme Published	November 2019
Submissions on Draft Due	December 2019
Final Scheme Published	February 2020

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

This issues paper seeks stakeholder views on the adequacy of the existing incentive framework for customer service, and on some threshold questions about how we could design a CSIS which would have broad applicability. Depending on the response to this issues paper, the AER could develop a draft CSIS for further consultation. We are seeking feedback on the questions in Table 2.

Table 2 Questions for consultation

Number	Question
1	Do the AER's incentive schemes provide sufficient incentives for distributors to provide customer services as desired by customers?
2	What would be necessary preconditions for applying the trial CSIS? Is broad customer support a necessary prerequisite, and how could broad customer support be demonstrated?
3	How should we determine the revenue at risk if applying a trial CSIS?
4	Are financial incentives alone sufficient to improve customer service outcomes? Should any CSIS also involve public reporting of customer service performance?
5	Are customer surveys a good basis for an incentive? If so, what processes should be in place to ensure the robustness of the data used to calculate rewards/penalties under the incentive scheme?
6	How could the AER decide what parts of a scheme should be consistent across all distributors and what parts of a scheme should be flexible?

3 Incentives to provide customer service

In order to assess whether a new incentive is required, we are considering:

- what incentives the current application of the NER provides for distributors to deliver customer service, and
- whether distributors are currently providing a level of customer service that meets customers' expectations.

3.1 Current incentives

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.⁵ In the absence of economic regulation, distributors do not face the same incentives to deliver price and quality of service outcomes that customers want.

The NER seeks to address this issue by attaching financial incentives to the delivery of outcomes expected in a competitive market.

This framework links revenues to efficient costs, and provides incentives for distributors to reduce costs over time (through the efficiency benefit sharing scheme (EBSS) and the capital expenditure sharing scheme (CESS) and our use of economic benchmarking).

There is a risk that these incentives may encourage distributors to pursue cost reductions at the expense of service quality. Our Service Target Performance Incentive Scheme (STPIS) provides distributors with incentives for maintaining and improving network performance, to the extent that consumers are willing to pay for such improvements.

National electricity objective

The objective of the National Electricity and Gas Laws is to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to:

(a) price, quality, safety, reliability and security of supply of energy; and

(b) the reliability, safety and security of the national energy systems.

3.2 What are the current financial incentives applying to customer service?

The primary incentive for distributors to improve customer service is the STPIS. There are also other factors, external to our responsibility, such as Guaranteed Service Level (GSL) schemes which may provide incentives on customer service.

⁵ Productivity Commission, Electricity Network Regulatory Frameworks, inquiry report no. 62, 2013, p. 65.

3.2.1 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 with the long term interests of consumers.

When we apply our STPIS we usually limit its penalties or rewards to 5 per cent of total revenue. The bulk of this is devoted to providing financial rewards or penalties for distributors to reduce the frequency and duration of interruptions to electricity supply rather than customer service. Under the STPIS, ± 0.5 per cent of a distributor's annual revenue is linked to one aspect of customer service. Rewards are provided if distributors answer a sufficient portion of fault line telephone calls within 30 seconds.⁶

3.2.2 GSL schemes

State and territory governments have developed GSL schemes under which distributors must pay customers compensation when they experience sustained, or frequent, unplanned outages.⁷ In some jurisdictions, codes require that distributors are on time for appointments,⁸ complete new connections within a defined period of time,⁹ or answer written queries within a certain period.¹⁰

3.3 How other economic regulators are incentivising Customer Service

Broad 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 1 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.¹¹

⁶ AER, Service Target Performance Incentive Scheme Version 2, December 2018, p. 16.

⁷ 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.

⁸ For example: <<https://www.energex.com.au/about-us/our-commitment/to-our-customers/guaranteed-service-levels>>

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

¹⁰ For example: Essential Services Commission of South Australia, Electricity Distribution Code, EDC/12, July 2015, p. 6.

¹¹ For more information please see: <<https://www.ofgem.gov.uk/electricity/distribution-networks/network-price-controls/customer-service>>.

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.

Ofwat

Ofwat operates a Service Incentive Mechanism (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.¹² 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.¹³ The quantitative component (25% of the incentive) is based on the number of written complaints and customer phone contacts.¹⁴

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.¹⁵ 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.¹⁶

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

¹² OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, pp2-3.

¹³ OFWAT, Service Incentive Mechanism - Guidance for Collating Customer Service Information for Calculating the SIM Score, March 2015, p.3.

¹⁴ 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

¹⁵ 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.

¹⁶ California Public Utilities Commission, DECISION REGARDING PERFORMANCE BASED RATEMAKING (PBR), FINDING VIOLATIONS OF PBR STANDARDS, ORDERING REFUNDS, AND IMPOSING A FINE, September 2008.

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.¹⁷

Essential Services Commission of Victoria

In 2018, the Essential Services Commission (ESC) of Victoria applied a new approach called PREMO (Performance, Risk, Engagement, Management and Outcomes) to regulate the prices charged by 16 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.¹⁸

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.¹⁹ 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.²⁰

3.4 Are distributors delivering a level of customer service that meets customers' expectations?

We have drawn evidence regarding distributors' success in meeting customer service preferences from the work of AusNet's Customer Forum as set out in its interim engagement report. The Customer Forum identified a number of areas where AusNet Services' customer service can be improved and that while AusNet has significant electrical engineering expertise and a commitment to customers, its customer service was 'under-resourced' resulting in a largely reactive approach to addressing customer problems. It drew on research which concluded that customers had mixed views regarding the value of distributor customer service, but particularly valued service when there was an outage, a need for a new connection, or they wanted to lodge a complaint. The Customer Forum also found that service was valued more when the customer incurred greater costs.

The Customer Forum found that, although AusNet has previously undertaken customer research, it had not sufficiently 'applied the knowledge' gained from that research. AusNet informed the Forum that its customer interaction storage systems had a limited ability to

¹⁷ Please see: <https://www.mass.gov/service-details/service-quality>.

¹⁸ Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 10.

¹⁹ Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 1.

²⁰ Farrierswier, Victoria's water sector: The PREMO model for economic regulation, 28 March 2019, p. 11.

store consolidated records, impeding the resolution of customer complaints. The Customer Forum found persistent complaints regarding customer service, for instance, the provision of an overpriced and inaccurate quote and a lack of clear processes for progressing new connections. The Forum found AusNet to have an inadequate appreciation of the way that customers rely upon electricity, a perceived bias towards city based customers, and lacked a pro-active service presence. This indicates that there are opportunities to improve customer service.

The Customer Forum concluded that the service provided by electricity distributors and retailers generally falls short of customer expectations. Further, the Forum considered that the lack of an explicit mention of customer service in the National Electricity Objective had led to businesses and regulators focussing on inappropriate measures of customer service. The Forum found that while customers expected continuous improvement on the part of the distributor, the distributor did not learn lessons with sufficient speed. Ultimately, the distributor had developed the capability to meet the averages required under the framework, without building a service infrastructure that took account of the difficulties faced by customers in their unique circumstances.²¹

The Customer Forum also drew on case studies to understand AusNet's approach to customer service. For instance, when a high voltage injection into the low voltage network resulted in the failure of a local supply transformer, a number of residents of Healesville lost power and suffered damage to their property. Another example cited was new home connections. The Forum found that these were subject to a convoluted process, resulting in lengthy delays for some customers.

Additionally, opportunities for AusNet to improve customer satisfaction based on specific geographic features were identified. The reliance of the town of Heyfield on a local timber processor, meant that those customers are likely to have their opinion of AusNet defined by AusNet's treatment of the processor. The Forum cited this as an example of the diverse needs of customers and the need to serve users according to their circumstances. Consultation with Dairy farmers in Gippsland revealed similar concerns.

In response to the Customer Forum's interim engagement report, the AER's Consumer Challenge Panel supported the concept of a CSIS, on the basis that it would provide a 'useful mechanism to encourage innovation'.²² Innovation in this case, refers to distributors undertaking new activities to respond to their customer's service preferences. For instance, new methods of contact, or investment in new complaint handlings and tracking processes. The Energy Users Association of Australia submitted that, in principle, a Scheme would achieve the goal of providing customers with better value.²³

²¹ Customer Forum, Interim Engagement Report, AusNet Services 2021-2025 Electricity Distribution Price Review, 6 February 2019, p. 12

²² CCP17, AusNet Interim Engagement Report Response, 1 May 2019, p. 13.

²³ EUAA, Submission on AusNet Draft Plan, April 2019, 18 April 2019, p. 11.

3.5 The effectiveness of the current incentive framework

The STPIS measurement of customer service provides an incentive for distributors to answer fault line telephone calls within 30 seconds.

These incentives are homogenous, as they rely on a single performance benchmark. This provides a narrow incentive to produce the outcomes measured by the single benchmark. While we consider that this measure provides a useful, objective, metric for tracking distributor performance it may not fully take account of the range of customer preferences. For instance, customers may prefer to wait for a slightly longer period before the phone is answered, if they will receive a more complete resolution during their phone call.

The Customer Forum considered that the STPIS telephone answering parameter rewarded AusNet for a narrow set of customer service achievements, without recognising the broader needs of customers.²⁴ In particular, the current measure did not prompt AusNet to provide tailored responses to customers which were clear, accurate, fulfilled within the advised time frames, and did not lead to further issues.²⁵ The Forum also identified evidence that, while customers receive compensation under the state licensing regimes, this did not necessarily result in customers receiving a service that met their needs.²⁶ The Forum found that customers still value courteous, efficient and timely service from their distributor, which the current set of incentives do not directly address.

We therefore seek stakeholder views on the performance of the framework, and whether a further incentive is required for customer service in response to Question 1.

Question 1

Do the AER's incentive schemes provide sufficient incentives for distributors to provide customer services as desired by customers?

²⁴ Customer Forum, Interim Engagement Report, AusNet Services 2021-2025 Electricity Distribution Price Review, 6 February 2019, p. 27.

²⁵ Customer Forum, Small Scale Incentive Scheme, Briefing for AER, 12 May 2019, p. 1.

²⁶ Customer Forum, Interim Engagement Report, AusNet Services 2021-2025 Electricity Distribution Price Review, 6 February 2019, p. 29.

4 The Small Scale Incentive Scheme framework

The Small Scale Incentive Scheme framework allows the AER to trial new incentive schemes. The AEMC designed the framework to allow the AER to explore new ways to incentivise distributors to provide their standard control services in a way that provides value for customers, without going through a full rule change process.²⁷

The AEMC noted that trialling schemes would be good regulatory practice because it would reveal any unexpected and possibly unwelcome impacts of incentive schemes prior to establishing them as an incentive scheme under the NER.²⁸ The Small Scale Incentive Scheme framework limits the scope of trial incentive schemes in terms of the revenue at risk under the scheme (a maximum of ± 1 per cent), and the duration (a maximum of two regulatory periods).

Rather than amending the STPIS, we consider that the Small Scale Incentive Scheme framework is the best means of implementing new incentive schemes for customer service. It is possible to specify a CSIS at a general level which would allow for different incentive schemes to be trialled, and would enable comparisons of outcomes to be made in considering a rule change process for a scheme under the NER in the future.

²⁷ 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.

²⁸ 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.

Explanatory Box 2 Clause 6.6.4 of the National Electricity Rules

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

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

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

Schemes must expire within two regulatory control periods.

5 How could we design a CSIS?

In order to apply a CSIS to a distributor, we must make three separate decisions:

- whether to establish a CSIS as a Small Scale Incentive Scheme under clause 6.6.4 of the NER,
- whether to apply the CSIS to a distributor at its distribution determination, and
- how to apply the CSIS to a distributor.

This section discusses the factors that are relevant to the first of those decisions. However, we do consider the implications of different methods of establishing a CSIS for the later decisions.

Common elements of incentive schemes are:

- revenue at risk, the total amount that a distributor can gain or lose under the incentive,
- performance parameters, the areas of a distributor's service that are targeted for improvement,
- performance targets, the level of performance a distributor must exceed to earn a reward, and under which they receive a penalty, and
- the incentive rate, which determines how much of a reward or penalty the distributor receives for particular performance.

We will consider how all of these features interact and contribute to making an incentive scheme that maximises customer welfare.

5.1 Applying the scheme

As set out in section 4, one factor we must consider when deciding if to apply a small scale incentive scheme is whether the benefits/detriments to customers from applying the scheme warrant the rewards/penalties.²⁹ We are interested in stakeholder views on what preconditions should apply in order to meet this requirement.

Our preliminary position is that, in order to ensure that any scheme appropriately penalises and rewards distributors we would want to be satisfied that we can set appropriate performance targets. This may require that a distributor have sufficient, robust data to use to set targets. We would also want to be satisfied customers would want the scheme to be applied. This may necessitate that a distributor demonstrates that there is broad customer support for the scheme.

²⁹ NER, cl. 6.6.4(b)(4).

Question 2

What would be necessary preconditions for applying the trial CSIS? Is broad customer support a necessary prerequisite, and how could broad customer support be demonstrated?

5.2 Revenue at risk

The rewards or penalties allowed for in a Small Scale Incentive Scheme for a regulatory year must not exceed 0.5% of the annual revenue requirement for the distributor. A distributor may consent to placing 1% of its annual revenue requirement at risk.³⁰ The AER may also require a distributor to participate in a trial under which the distributor is not required to bear any penalty and is not entitled to earn any reward.³¹

AusNet has submitted that it wishes to engage in a live trial, meaning that some revenue will be at risk. It has proposed setting the level at $\pm 0.5\%$ of the distributor's annual revenue requirement. The Customer Forum has agreed that a live trial is likely to deliver a beneficial outcome. AusNet submitted that, based on their current revenue the total at risk under the CSIS would be \$3.5 million (\$2020).

Without proper design, this approach may expose customers to risk that they are required to pay more than they are willing for customer service improvements. Therefore, it is important to properly design the scheme, including setting incentive rates in accordance with customers' willingness to pay for improving service.

One factor that we must consider in determining the revenue at risk is the interaction of the scheme with other incentives that distributors may have under the Rules.³² In doing so, we would consider whether to apply the telephone answering parameter in the STPIS which places $\pm 0.5\%$ of the annual revenue requirement at risk. When applying the STPIS we determine which parameters will apply and the revenue at risk for each parameter.³³ If we apply a CSIS we may choose not to apply the telephone answering parameter under the STPIS.

It is important to note that AusNet is planning not to request application of the telephone answering parameter available under the STPIS if we decide to apply a CSIS at its next determination.³⁴ Hence the CSIS will assume the $\pm 0.5\%$ of the annual revenue requirement at risk under the telephone answering parameter. Given this, there will be minimal revenue impact from applying the proposed Scheme to AusNet. We expect that other distributors would be required to demonstrate similar revenue impacts in order for us to apply a CSIS.

³⁰ National Energy Rules, Clause 6.6.4(d)(1).

³¹ National Energy Rules, Clause 6.6.4(e).

³² NER, cl. 6.6.4(b)(4)

³³ AER, STPIS, 2018, p. 8.

³⁴ AusNet Services, Customer Satisfaction Incentive Scheme Supporting Submission, April 2019, p. 10.

Question 3

How should we determine the revenue at risk if applying a CSIS?

5.3 Measuring customer service

We have observed two approaches to measuring customer experience. These are objective measures and survey based measures. Objective metrics, such as the parameter in the STPIS which measures the percentage of fault-line telephone calls answered within 30 seconds, may address on one facet of customer service at the expense of other elements.

AusNet's Proposed Measurement Approach

AusNet has proposed using an ongoing monthly survey conducted by a third party provider will gauge the opinion of customers who have contacted the distributor.

As outlined in Explanatory Box 1, other economic regulators employ customer service incentives that draw on both objective measures, such as reliability and security of supply, with an additional element or incentive based on customer surveys.

Academic literature indicates that improvements in customer satisfaction (as measured by surveys) can result in increases in customer welfare.³⁵ It has been suggested that satisfaction should be part of any useful definition of consumer welfare. For example, research identifies customer satisfaction metrics as potentially appropriate measures of market efficiency that bring together concepts of consumer surplus and efficient resource allocation.³⁶ Tying incentives to customer surveys may prompt distributors to update their approach to respond to survey results, thereby responding tangibly to the preferences of customers. This market feedback and awareness is a potential advantage of CSIS.

However, incentives based on customer surveys also have potential weaknesses. The experience in California (outlined in Explanatory Box 1) demonstrates that robust data oversight is a vital component of an incentive scheme based on customer surveys. It is important to ensure that the distributor does not have the power to influence the sample taken or the responses received. The data that underpins a survey based incentive will ultimately determine what improvements a distributor needs to make to receive a reward or penalty. Any proposed survey approach must be capable of independent verification and auditing. It would be preferable to measure service using a Publicly available and standardised data set.

Question 4

Are customer surveys a good basis for an incentive? If so, what processes should be in place to ensure the robustness of the data used to calculate rewards/penalties under the incentive scheme?

³⁵ Eugene Anderson (1996), 'Customer Satisfaction and Price Tolerance', *Marketing Letters*, 7(3), p. 265-274.

³⁶ Lopo Rego (1998), 'The Relationship Market Structure–Market Efficiency from a Customer Satisfaction Perspective', *Advances in Consumer Research*, 25, p. 132-138.

5.4 Public reporting and transparency

One key advantage of a broader customer satisfaction measure is that it provides an incentive for distributors to make a greater degree of customer experience information publicly available. Public reporting of the survey results would enable the AER and other stakeholders to monitor the performance of the scheme over time.

The Customer Forum negotiated with AusNet, and agreed to the proposal on the basis that AusNet would produce an annual customer interaction report.³⁷ This report will track the progress of customer service initiatives, present the results under a potential CSIS and other customer survey data. In addition, the AER can require businesses seeking to apply a CSIS to provide data

It is also relevant to consider whether customers should be made aware that the survey responses they provide may result in variations in revenue received by distributors and thus payable by the customers. Customers bear the costs of any rewards provided under a CSIS. Businesses, both regulated and throughout society, ask customers to undertake a large number of surveys. Informing customers that this particular survey may influence a distributor's revenue could be a valuable element of transparency.

Question 5

Are financial incentives alone sufficient to improve customer service outcomes? Should any CSIS also involve public reporting of customer service performance?

5.5 What should be prescribed in any potential CSIS?

We have some flexibility regarding when we fix our approach in respect of these elements of a potential CSIS. For example, when applying the STPIS we determine the revenue at risk and the performance parameters that will apply at the distribution determination. However, many elements of our schemes are fixed. For instance, the STPIS specifies the formula used to calculate penalties and rewards. One question we will have to consider in developing a CSIS is the extent to which it can be flexibly applied.

A flexible approach has benefits. Customers of different distributors may value different aspects of customer service. For instance, a distributor that serves predominantly rural customers might need to meet different preferences to a distributor with a largely city-based network. Alternative parameters may better address differing customer concerns. The proposed CSIS design allows distributors to make proposals based on their needs of their customers. Additionally, distributors may not all gather or retain the same information on customer experience. Allowing distributors to propose their own parameters, based on a sufficiently robust

AusNet's Proposed Survey measures

AusNet proposes to have a third party survey its customers who have had contact with the distributor in relation to:

- Planned Outages
- Unplanned Outages
- New Connections
- Complaints

³⁷ Customer Forum, Small Scale Incentive Scheme, March 2019, pp. 1-2.

dataset, would potentially allow more distributors to apply a CSIS and more customers to benefit.

A downside to this approach is that it defers significant decisions on the application of the CSIS to our determinations. This would make applying the scheme much more complex. It may also result in a lack of clarity for stakeholders, as the CSIS document itself will not provide information regarding the performance parameters. Specifying performance parameters in the scheme would provide increased certainty and transparency for stakeholders. It would also allow for the comparison of performance across distributors.

Additionally, distributors may also seek to vary their parameters in different regulatory control periods, which may cause difficulties in evaluating the scheme performance.

Question 6

How could the AER decide what parts of a scheme should be consistent across all distributors and what parts of a scheme should be flexible?

5.6 Determining the incentive rate

A key question in designing the CSIS, is how to calculate financial rewards/penalties for performance improvement/deterioration. In order to satisfy the rule requirements, any CSIS we make must offer efficiencies to the distribution system, and ensure that distributors receive proportional awards or penalties.³⁸ Further, the benefits to electricity consumers must warrant the rewards and the detriments must warrant the penalties.³⁹

AusNet's Proposed Incentive Rate

AusNet has proposed setting linear rewards for distributors 'closing the gap' between their historical performance and the Industry Leading Level. The distributor receives the maximum incentive if they achieve the Industry leading level. Penalties are calculated according to the same rate.

Developing a perfect incentive is difficult under this framework, as we are not likely to have whole of industry participation. Other regulators operating survey based customer service incentives generally have whole of industry participation, construct the incentive rate methodology on that basis. Therefore, any CSIS made under this framework will focus not necessarily on developing a perfect incentive, but on improving on the current framework where possible, while gathering information that could inform an eventual rule change to develop a permanent CSIS.

In principle, the reward for improvements to customer service should align with the benefit that customers receive from that improvement. It may be possible to commission a survey that evaluates customers' willingness to pay directly to obtain more exact targets. This could be similar to the methodology the AER is considering using to determine the value of customer reliability, which, amongst other things, is used to set the incentive rate for the reliability of supply parameters in the STPIS.⁴⁰ However, this is a complicated exercise that comes with its own challenges. While the scale and long-standing nature of the STPIS and

³⁸ NER, cl. 6.6.4(b)(1)-(2)

³⁹ NER, cl. 6.6.4(b)(3)

⁴⁰ AER, Value of Customer Reliability - Consultation Update Paper, 18 April 2019.

the other applications of VCR merit the resources needed to address these challenges, a CSIS may not justify such resources at an early stage.

OfGem and OfWat do not calculate customer service incentive rates based on customers willingness to pay. Performance relative to peers determines the level of the utilities reward.⁴¹ Those that outperform the average receive increased revenues, while those that underperform have their revenues reduced. This determines the amount of revenue a distributor receives under the scheme. The regulators selected these methods to drive continuous improvement by utilities, and to bring regulated businesses in line with the service standards expected in other sectors.⁴² We are not able to pursue a similar model at this stage, given that we do are not likely to have all of industry participation in any CSIS.

It may be that, at this trial stage, it is preferable to implement solutions which are adapted and proportional to a distributor's individual circumstances. This will enable the AER to study the efficacy of different solutions, while maintaining the flexibility to reject solutions that do not adequately constrain the incentive. An alternative to setting the method for calculating the incentive rate in the scheme would be to set out criteria for determining the incentive rate.

⁴¹ OfWat, PR19 Customer Measure of Experience (C-MeX): Policy decisions for the C-MeX shadow year 2019-20, March 2012, 24 & OfGem, Electricity Distribution Price Control Review Final Proposals - Incentives and Obligations, December 2009, p. 72.

⁴² OfWat, PR19 Customer Measure of Experience (C-MeX): Policy decisions for the C-MeX shadow year 2019-20, March 2012, p. 28.