19 August 2019

Mr Chris Pattas
General Manager, Distribution
Australian Energy Regulator (AER)
GPO Box 520
Melbourne, VIC, 3001

Dear Mr Pattas,

ISSUES PAPER: SMALL SCALE INCENTIVE SCHEME FOR CUSTOMER SERVICE

Endeavour Energy appreciates the opportunity to provide feedback to the AER on the Small Scale Incentive Scheme (SSIS) for customer service issues paper. We support the use of the AER's powers under clause 6.6.4 of the National Electricity Rules (NER or rules) to trial a Customer Service Incentive Scheme (CSIS).

In preparing our 2019-24 proposal we received feedback that the customer service component of the Service Target Performance Incentive Scheme (STPIS) required review and expansion[1]. Based on the timing of this feedback we committed to working with stakeholders over the course of the 2019-24 period to investigate and develop alternative measures for the following regulatory control period.

AusNet, and other distributors, have now received similar feedback plus broad stakeholder support for utilising the SSIS as a way of incorporating changes in time for the 2021-26 Victorian determinations given the STPIS cannot be modified, or a new incentive scheme introduced, in the time available.

We think it is important to fulfil the negotiated outcomes arising from the New Reg trial and to also trial material changes to the incentive based regulatory framework before implementing a rule change.

To better understand and test the potential design and operation of a CSIS we support a flexible approach to the SSISs applied in upcoming determinations. However, this is subject to the views of the distributors, customers and stakeholders to whom the SSIS will apply.

For any CSIS that is subsequently developed it will be important to provide greater certainty and stability so that networks make investment decisions and operational changes required to improve customer service performance on a continual and long-term basis.

Our key observations are outlined below along with responses to the questions in the issues paper.

Is a CSIS required?

As noted in the Issues Paper, the AER's role is to maximise customer welfare as enshrined by the NEO. Put differently, networks are regulated to minimise the welfare loss of monopoly with respect to price, outputs and also quality. Incentive regulation is widely accepted as the most effective way to overcome the information asymmetry that exists between the regulator and regulated firm and to induce efficient behaviour to obtain socially optimal price and quality levels.

In developing incentive schemes, or any regulation for that matter, balancing the cost-quality relationship is key to promoting the NEO. The Efficiency Benefit Sharing Scheme (EBSS), Capital Efficiency Sharing Scheme (CESS) and various expenditure assessment tools available to the AER, particularly benchmarking, means the cost efficiency aspect of regulation is relatively well established

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[1] Endeavour Energy, 'Endeavour Energy request to update Framework and Approach paper for the next regulatory control period', Attachment B: 'Tariff Structure Statement & Framework and Approach Workshop Report', September 2016, p. 15.

and mature. The recently modified Demand Management Incentive Scheme (DMIS) also acts to incentivise dynamic efficiency so that networks pursue continuous cost efficiency improvements in the long-term.

Quality regulation is commonly[2] divided into three main parts and can be regulated by a mix of minimum standards and obligations and through incentive schemes:

1. Continuity of Supply
2. Power/Voltage quality
3. Customer service quality

For each of these areas consideration needs to be given to what form of regulation would promote the optimal cost-quality relationship; rules or incentives. Stakeholders have raised concerns with the regulation of customer service quality. In particular, that the customer service component of the STPIS; telephone answering[3], is antiquated and incomprehensive. In the Issues Paper the AER also note that customer satisfaction levels are, inter alia, a potential measure of market efficiency.

We accept this stakeholder feedback and the academic literature referred to be the AER. Therefore, we think it is appropriate to make improvements to the regulation of customer service quality. We agree that these improvements would be best made via an incentive scheme rather than a rules-based approach which sets a minimum standard of service.

An incentive scheme will provide greater flexibility, which is necessary given the difficulty in determining the customer service levels that customers value, compared with the precision required for a rules-based solution. An incentive scheme also provides a more effective countervailing power against the financial rewards and penalties associated with the cost efficiency incentive schemes.

In developing a long-term solution consideration should be given to whether a stand-alone CSIS is necessary or whether any learnings from the SSISs could be used to expand and improve the customer service component of the STPIS. Our preference is the latter, but for convenience and consistency with the Issues paper, we refer primarily to the CSIS in the remainder of our response.

What should a CSIS cover?

When considering quality regulation, particularly the customer service component, there are three main challenges[4]:

1. The problem of measuring quality levels
2. The problem of lacking information on consumer demand for quality
3. The substantial lack of information on the efficient costs required to produce optimal quality

These issues are less problematic in developing SSISs where unique measures and approaches can be adopted on a per determination basis. This also provides the benefit of testing multiple scheme designs which will be necessary in order to best resolve these issues in developing a CSIS.

We consulted on a number of regulatory matters in preparation for our 2019-24 regulatory proposal in September 2016. This included a discussion around the STPIS and whether networks should be

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[2] E. Andersson, 'The Regulation of Quality in Distribution Systems – Proposing a Pan-Nordic Quality Regulation Model', Masters Thesis, Chalmers University of Technology, 2006.

[3] Defined as: *Calls to the fault line answered in 30 seconds where the time to answer a call is measured from when the call enters the telephone system of the call centre i.e. queues (including that time when it may be ringing unanswered by any response) and the caller speaks with a human operator, but excluding the time that the caller is connected to an automated interactive service that provides substantive information. This measure does not apply to; calls to payment lines and automated interactive services and calls abandoned by the customer within 30 seconds of the call being queued for response by a human operator.*

[4] V. Ajodhia, K. Petrov & G. C. Scarsi, 'Quality, Regulation and Benchmarking – An Application to Electricity Distribution Networks', *Zeitschrift für Energiewirtschaft*, 29, 2, 2004, 107.

provided with an incentive to manage customer service outcomes. Stakeholders provided the following suggestions for designing a CSIS[5]:

- Consider replacement measures [to telephone answering] for customer service e.g. access measures;

- Understand what customers require and measure against that;

- Actionable measures; and

- Needs to be auditable by a third party;

The most important aspect of developing a CSIS is understanding what customers value. For an incentive scheme to be effective it must reward (or penalise) behaviours that are valued by customers and that meaningfully contribute to efficient outcomes. However, for an incentive to be functional it should be limited to behaviours that are both measurable and actionable.

Customer service quality is, unlike other aspects of quality regulation, not related to the quality of the actual supply of electricity. Instead, it deals with human relations in transactions between an individual and a distributor. Furthermore, customers have contact with more than one party (e.g. their Retailer) which increases the possibilities for misunderstandings in roles and responsibilities. It is for these reasons that customer service quality is, by its nature, complicated to measure, value and optimise.

It will therefore be critical to consult further with stakeholders to develop an appropriate list of customer service metrics. It will also be important to engage with networks in assessing whether prospective customer service metrics can be measured and are actionable.

The Issues Paper includes a number of international case studies which provide a useful starting point for identifying potential metrics. It may be helpful to further disaggregate customer service quality by area to help target desired objectives. For example, customer service quality could be split by; pre and post connection service events, or by; customer satisfaction, complaints and stakeholder engagement, or by; quantitative and qualitative measures, or a combination of these groupings.

There may also need to be variations to account for jurisdictional differences. For instance, pre-connection service metrics would need to account for the Accredited Service Provider (ASP) scheme in NSW which means that, unlike other DNSPs, NSW DNSPs do not perform connection works.

Potential metrics could include:

- Pre-Connection:
  - Average response time to demands for low voltage supply
  - Time of connection of a new customer to the network (where jurisdictionally applicable)

- Outage notification: % of calls to the fault line answered within 30 seconds

  In our view this measure should be complemented by additional measures rather than replaced. This is consistent with feedback received from the AER's Consumer Challenge Panel (CCP) as part of the NSW Framework and Approach consultation for the 2019-24 determination[6].

- Complaints management:
  - % of total complaints outstanding after 3, 5 and 7 days
  - % of ombudsman complaints referred back to the DNSP as a Level 1 investigation

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[5] Endeavour Energy, 'Endeavour Energy request to update Framework and Approach paper for the next regulatory control period', Attachment B: 'Tariff Structure Statement & Framework and Approach Workshop Report', September 2016, p. 15.
[6] Consumer Challenge Panel 10, 'Submission on preliminary framework and approach for NSW distributors', 21 April 2017, p. 17-18.

- Customer satisfaction: surveys of customers to rate recent customer service event experience in the following categories:
  - Planned
  - Unplanned
  - General enquiries
  - Complaints
  - Network connections

This is not an exhaustive list but illustrative of the significant number of options available. We note the Energy Charter may be a valuable input in identifying and weighting customer service metrics. The Energy Charter is a whole-of-sector initiative focused on embedding customer-centric culture and conduct. Participants are currently preparing reports against the Five Principles for first year of the Energy Charter's operation. This exercise may provide valuable insights for potential measures and reporting requirements.

The measures may also require further segmentation based on the customer type, location, connection status and/or level of vulnerability. Alternatively, this issue could be addressed through a core set of measures that apply NEM-wide with the option for add-ons to target areas of customer service that are uniquely valued by the DNSPs customer base.

Our primary concern is with customer satisfaction surveys. In our view surveys restricted to recently served customers run the risk of overstating the value of customer service. To maximise social welfare, it is the service received by the average customer that matters. Hence, the reliability component of the STPIS measures performance on an averaged basis. The average customer may not require (and therefore value) pre-connection, outage notification and complaint resolution services on a frequent basis. Measuring performance, and/or setting incentive rates, on the basis of the subset of customers who do utilise these services may be distortionary (in a similar way to the current disproportionate focus on telephone answering) Therefore, when determining the list of potential measures, we suggest customer satisfaction surveys of a broad-based nature are also considered.

Another key challenge will be accounting for customer self-service channels. A criticism of the telephone answering measure is its antiquated nature that does not fully account for multiple modes of consumer engagement. In all likelihood, customers would prefer to access information quickly via a website, app or social media account rather than having to call, email or write to a distributor. This is especially the case of unplanned interruptions where customers seek updated information about the cause of outage, network response and estimated restoration time. An incentive scheme which does not recognise this will incentivise investment in solutions and behaviours that do not maximise social welfare. In addition to customer satisfaction surveys, it will be important to consider how self-service channels are accounted for in any scheme. This could include metrics around the number of visits or downloads and/or real time surveying of customers via survey, ratings and other feedback options.

To optimise efficiency, the group of measures selected should be weighted by importance/value to customers. We note that the weightings (and potentially the metrics) will vary between customer groups and networks more broadly. This will require a trade-off between accuracy and simplicity.

In our view, when implementing a SSIS it is appropriate to develop an accurate, individual set of metrics and weightings. However, for a CSIS (or amended STPIS) consistency and simplicity, subject to periodic review, is more desirable than a flexible, bespoke approach. This allows the AER (and others) to assess the impact of a CSIS over time and between DNSPs. It also provides DNSPs with the necessary certainty to invest in systems and processes to improve performance over a long-term period.

If uniformity erodes the relevance and value of a CSIS we accept that variations should be permitted. Ideally, this would be limited to the weighting of the available measures. This could operate similarly to the data transformation method when calculating MED thresholds in the STPIS; whereby the onus is on the DNSP to provide evidence that an alternative method is more accurate.

What should be the strength of a CSIS?

As aforementioned, it is difficult to determine the consumer demand for customer service quality. It is also difficult to determine the efficient costs require to produce the socially optimum level of quality. If the revenue at risk and/or incentives rates are misspecified it will result in an over or under supply of

customer service quality. We therefore recommend a cautious approach is taken in setting the revenue at risk and the incentive rates.

For instance, the revenue at risk for NSW DNSPs during the 2014-19 regulatory control period was ±0.25% for the customer service component of the STPIS. This was due to implementation issues in transitioning to a new scheme, uncertainty on trends in reliability following significant investment over 2009-14 and consumer research suggesting an unwillingness to pay for further reliability improvements[7]. With additional data and greater confidence in the potential outcomes the NSW DNSPs have increased the STPIS revenue at risk to ±5% (±0.5% for the customer service component).

If the STPIS customer service component is updated or instead replaced by a CSIS a revenue at risk of ±0.5% appears to be reasonable. This could be reviewed and potentially adjusted once the new measures have been in place for at least one full regulatory control period.

In regard to the incentive rates the AER recognise the difficulties of valuing customer service quality and note that a willingness to pay study may not be practical. Instead, a yardstick benchmarking approach could be adopted, similar to OfGem and OfWat, to incentivise continuous improvement through rewarding outperformance of the industry average performance. As noted by the AER this would require industry wide data meaning it is a longer-term solution that could not be implemented for the SSIS being considered.

A yardstick benchmark approach will certainly incentivise continuous improvement amongst networks. However, we question whether this will result in an oversupply of customer service rather than maximise social welfare. If customer preferences vary materially between networks, it would be more appropriate to reward (or penalise) a network for improvements (or declines) relative to their historical performance rather than compared to peers.

This issue (incentive rates) will require further consideration if a CSIS is developed and following further research. It is for this reason that we are supportive of the SSIS being utilised to test potential approaches. For the SSIS a bespoke approach whereby the AER, stakeholders and each relevant network can adopt a revenue at risk and incentive rate that best suits their individual circumstances is appropriate.

Our response to the questions in the consultation paper are provided in Attachment 1. If you have any queries or wish to discuss this matter further please contact Patrick Duffy, Regulatory Strategy Manager at Endeavour Energy on (02) 9853 4375 or via email at patrick.duffy@endeavourenergy.com.au.

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Manager Network Regulation

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[7] AER, 'Draft Decision Endeavour Energy distribution determination 2015-16 to 2018-19 Attachment 11: Service Target Performance Incentive Scheme', November 2014, p. 11-13.

Attachment 1: Responses to questions in the issues paper

Question 1: Do the AER's incentive schemes provide sufficient incentives for distributors to provide customer services as desired by customers?

A better understanding of consumer demand for customer service quality is required to determine whether the current incentives are deficient. In the absence of industry wide data on complaints, customer satisfaction surveys and willingness to pay studies over the last several years this will need to be assessed further.

As a proxy, consumer representative groups have been raising concerns with the current customer service component of the STPIS. We received feedback during the 2019-24 determination process encouraging the AER and networks to consider expanding the STPIS to include other service areas, particularly with an increasing number of customer interactions in written and electronic form[8]. We note that other DNSPS, particularly Ausnet through the New Reg Trial, have received similar feedback.

We consider this feedback to be reasonable and it would suggest that the incentive schemes are not adequately targeting customer service areas that are valued by customers. On that basis further research (and in this instance trials via the SSIS) should be conducted to better understand whether changes are required to the STPIS or the introduction of a CSIS is required.

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?

A SSIS should be used to trial a potential CSIS design in accordance with the considerations set out in 6.6.4(b) of the rules. Additionally, we support network and customer support as a pre-condition. It would be difficult to demonstrate broad customer support through end-use customer engagement given the time available and the technical regulatory nature of the issue. Instead, consumer support could be demonstrated through engagement with peak consumer representative groups and the AER's CCP.

Question 3: How should we determine the revenue at risk if applying a trial CSIS?

For a trial there will not be sufficient time to conduct any detailed willingness to pay study or similar research to quantify the value consumers place on customer service quality. Instead, international benchmarks and existing measures (i.e. the customer service measure in the STPIS) should be used to determine revenue at risk unless agreed otherwise with the network in question and relevant stakeholders.

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?

It depends on the materiality of the incentive scheme but generally no; satisfaction surveys are subjective and difficult to measure consistently. Incentive schemes are more well-suited to outcomes that are quantifiable and that can be measured straight-forwardly, reliably and consistently.

These shortcomings could be mitigated through specifying interview scripts and reporting and audit requirements. They may also be mitigated by baselining a distributors performance over a period in the order of 5 years (similar to the STPIS) and measuring performance against a distributor's own historical performance. A yardstick approach (i.e. where a distributor is measured against an industry average) requires a degree of comparability that customer satisfaction surveys may not be able to provide.

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[8] Consumer Challenge Panel 10, 'Submission on preliminary framework and approach for NSW distributors', 21 April 2017, p. 17-18.

In developing SSISs to trial potential solutions it would be worth engaging an independent expert to advise of potential issues with customer satisfaction surveys (like the sampling method, quality of survey data, non-response problems and interpreting results) and how these can best be managed through the design of the survey and/or incentive scheme.

Question 5: Are financial incentives alone sufficient to improve customer service outcomes? Should any CSIS also involve public reporting of customer service performance?

For transparency any incentive scheme should be accompanied by public reporting on the relevant measures. Reporting can also provide an avenue for monitoring and gathering data on potential future measures. There may also be areas of customer service that cannot be reliably measured for the purposes of an incentive scheme but are nevertheless valued by customers that should be subject to public reporting in order to foster greater accountability.

In section 5.4 the AER also raise the question of whether customers should be made aware that the survey responses they provide may result in variations in revenue received by distributers and thus payable by the customers. In our view, such a disclosure is likely to skew the survey responses and inexorably link the results to customers prevailing views on energy affordability rather than customer service quality. It could result in the survey becoming a de facto willingness to pay study rather than a survey of customer service quality contrary to the AER's position, that being to not conduct a willingness to pay study, as outlined in section 5.6.

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?

We acknowledge it will be difficult to develop a scheme that appropriately balances the desire for certainty with the need to be accurate. The delineation is likely to become clearer during more detailed research and consultation on a potential CSIS.

Our preliminary position is that there should be a consistent set of measures across all distributors with a baseline weighting of these measures. In limited circumstances a distributor could apply for a variation of these weightings at the time of a determination. For instance, if there were a measure of physical connection works an NSW distributor would re-weight this to zero. Additionally, a distributor may conduct additional analysis demonstrating that an alternate weighting would better promote the objective(s) of the CSIS.

The scheme should then be subject to periodic review to assess whether the measures and/or weightings should be adjusted to account for any potential changes in consumer demand for customer quality.

However, subject to further investigation, we accept that it may be appropriate for there to be multiple sets of baseline weightings and potentially different measures available. For instance, customers may need to be segmented by:

- Location (e.g. urban and rural);
- Type (e.g. industrial, small business and residential);
- Status (e.g. pre and post network connection);
- Vulnerability level (e.g. income, communication skills, life support)

If a high degree of segmentation and customisation is required, it would suggest to us that customer service quality is ill-suited to industry wide incentive scheme regulation.