FINAL

Customer Service Incentive Scheme

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AUSTRALIAN ENERGY REGULATOR

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1 Nature and authority

1.1 Authority

1) The *AER* has developed this *scheme* in accordance with clause 6.6.4 of the *National Electricity Rules (NER)*.

2) The *AER* will decide how the *small scale incentive scheme* will apply to a *Distribution Network Service Provider (DNSP)* in its *distribution determination* for that *DNSP* in accordance with clauses 6.3.2(a)(3) and 6.12.1(9) of the *NER*.

1.2 Rule requirements

1) Clause 6.6.4(a) of the *NER* allows the *AER* to make *small-scale incentive schemes*.

2) In making *small scale incentive schemes* we must have regard to the matters laid out in clause 1.4(2).

1.3 Role of this scheme

1) The role of this *scheme* is to provide incentives for *DNSPs* to provide customer service that aligns with their customers' preferences.

2) To that end, this *scheme*,

   a) Allows the *AER* to apply an *incentive design* to a *DNSP*,

   b) Defines the structure of an *incentive design*, and

   c) Establishes the circumstances in which the *AER* will decide to apply an *incentive design*.

1.4 Scheme Objectives

The *Objectives* for this *scheme* are that it:

1) Is consistent with the *national electricity objective* in section 7 of the *National Electricity Law (NEL),*

2) Is consistent with clause 6.6.4 of the *NER,* which requires that, in developing a *small-scale incentive scheme* the *AER* must have regard to the following matters;

   a) *DNSPs* should be rewarded or penalised for efficiency gains or losses in respect of their *distribution systems*,

   b) 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;

   c) 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*

d) The interaction of the *scheme* with other incentives that *DNSPs* may have under the rules, and

e) The *capital expenditure objectives* and the *operating expenditure objectives*.

3) Achieves clauses 1.4(1) and 1.4(2) by aligning the incentives of *DNSPs* with the customer service preferences of their customers.

4) Promotes transparency and understanding throughout the *National Electricity Market* (NEM) regarding a *DNSP's* customer service initiatives.

1.5 Confidentiality

The *AER's* obligations regarding confidentiality and the disclosure of information provided to it by a *DNSP* are governed by the *Competition and Consumer Act 2010 (Cth),* the *NEL* and the *NER*. For further information see the *AER's Confidentiality 3 guideline 2013*, which is available on the *AER's* website.

1.6 Definitions and Interpretation

1) In this *scheme* unless otherwise indicated:

a) The words and phrases in italics have the meaning given to them in:

i) The glossary, or

ii) If not defined in the glossary, the glossary of the *NER* or section 2 of the *NEL.*

b) A reference to:

i) a 'clause' is a reference to a clause in this *scheme* (unless otherwise specified).

ii) An appendix is a reference to an appendix in this *scheme*.

2) Explanations in this *scheme* about why certain information is required are provided for guidance only.

1.7 Processes for revision

The *AER* may amend this *scheme* according to the *distribution consultation procedures*.

1.8 Version history, effective date

A version number and an effective date of issue will identify every version of this *scheme*.

The *AER* may only apply this *scheme* to a *DNSP* for two *regulatory control periods*.

2 Application of the scheme

1) The *AER* may apply an *incentive design* as part of a distribution determination to a *DNSP* if it is satisfied that the *incentive design*:[1]

   a) will achieve the *Scheme Objectives* as defined in clause 1.4,

   b) meets the *incentive design criteria* as defined in clause 3.1, and

   c) is accompanied by a proposal that meets the *incentive design proposal requirements.*

2) The obligation of a *DNSP* to comply with this *scheme* is additional to and does not derogate from any obligation imposed upon or provided for under *jurisdictional electricity legislation* or *national electricity legislation* applying to a *DNSP*.

3) The following processes may contribute to the *AER's* consideration of how, if at all, an *incentive design* will apply to a *DNSP* for a *regulatory control period*:

   a) The *AER's framework and approach* paper may contemplate whether the *AER* will consider applying an *incentive design* to a *DNSP*,

   b) A *DNSP's regulatory proposal* may include an *incentive design proposal,* and

   c) The *AER's distribution determination* for the *DNSP* may set out how, if at all, an *incentive design* is to apply to a *DNSP* in the relevant *regulatory control period*.

4) Where a *DNSP* proposes an *incentive design*, it must meet the *incentive design proposal requirements* set out in clause 3.3.

[1] However, the AER may, outside of a distribution determination, by consent with the relevant DNSP, apply an incentive design that places no revenue at risk (a paper trial).

3 Incentive Design

3.1 Incentive Design Criteria

1) The *incentive design criteria* are:

   a) The *incentive design* must calculate any revenue adjustment using the method set out in Appendix A unless the AER is satisfied that another approach will better achieve the *scheme objectives*.

   b) The *incentive design* must set out each of the *scheme elements*, which are:

      i) *Performance Parameters*, consisting of the metrics of customer service performance subject to the *incentive design*,

      ii) *Measurement Methodology*, consisting of a description of how performance against the *performance parameters* will be measured and the assurance arrangements that will apply to the measurement,

      iii) *Assessment Approach*, consisting of a *performance target* and a method for evaluating measured performance against performance targets, and

      iv) *Financial Component*, consisting of an overall *revenue at risk*, an amount of *revenue at risk* for each *performance parameter*, and a means of setting the *incentive rate* for each *performance parameter*.

   c) Each of the *scheme elements* must satisfy the corresponding principles outlined in clause 3.2,

   d) Customers of the *DNSP* strongly support the application of the *incentive design*,

   e) The *incentive design* must not continue beyond the end of the *DNSP's* next regulatory period. For clarity, the *AER* may, at a *regulatory determination*, make a decision to apply an identical *incentive design* for a second time to a *DNSP*, and

   f) The *incentive design* must place a valid amount of revenue at risk. The revenue at risk will be valid if, by default, the maximum revenue increment or decrement (the revenue at risk) for each *performance parameter* in aggregate for each *regulatory year* within the *regulatory control period* is 0.5% of the *DNSP's annual revenue requirement* or less. That is, the sum of the H-factors associated with all *performance parameters* must lie between +0.5% (the upper limit) and –0.5% (the lower limit).

3.2 Scheme Element principles

1) The relevant principles for *performance parameters* are that each *performance parameter* must be an aspect of the customer experience component of the *DNSP's standard control services*;

2) that the customers of the *DNSP* particularly value and want improved, as evidenced by genuine engagement with, and support from, the *DNSP's* customers,

   a) that is substantially within the control of the *DNSP*, and

   b) for which the *DNSP* does not already have an incentive under another *incentive scheme* or *jurisdictional arrangement*.

3) The relevant principles for *measurement methodology* are that for each *performance parameter*, the proposed measurement;

   a) accurately measures the features of the *performance parameter* identified in clause 3.2(1)(a),

   b) is sufficiently independent, in that it is either conducted by an independent third party or based upon an independently developed methodology,

   c) is compiled in an objective and reliable manner with data retained in a secure and logically indexed database, and

   d) produces results that could be audited by an independent third party.

4) The relevant principles for *assessment approaches* are that for each *performance parameter*; the *incentive design*;

   a) Establishes a baseline or neutral level of performance, which in normal circumstances should be at least equal to the historical performance of the *DNSP*,

   b) Sets a *performance target* for each *performance parameter* that;

      i) incentivises genuine improvement in line with the value of the identified service improvement to the *DNSPs* customers, and

      ii) makes reference to the baseline or neutral level of performance established in clause 3(4)(a),

   c) Expresses the result of the assessment of measured performance against each *performance target* as a single value, and

   d) Creates a clear relationship between;

      i) outperformance of the *performance target* resulting in a reward under the *incentive design*, and

      ii) underperformance of the *performance target* and receiving a penalty under the *incentive design*.

5) The relevant principles for the *financial component* are that, the *incentive design* provides rewards or penalties that;

   a) will increase relative to the degree of outperformance or underperformance, commensurate with the identified value of the service improvement to customers of the *DNSP*,

   b) are commensurate with the service improvements or degradations observed in respect of the *DNSP's distribution system*,

   c) are not likely to exceed the value that customers attribute to the level of service improvement observed,

   d) are not likely to, when considered in aggregate with all incentives applied to the *DNSP* for customer service, (including incentives external to the *incentive design*), result in the incentives available to the DNSP relating to customer service exceeding the value customers attribute to that component of service,

e) in satisfying the requirements of clause 3.2(4)(a) and (c), the value that customers attribute to service improvements or degradations is established using a reasonable process that identifies the value that customers attribute to the level of service improvement or degradation observed, in that the process:

   i) is transparent, and

   ii) involves genuine consultation with the *DNSP's* customers; and

f) Will exclude in circumstances agreed between the distributor and its customers, giving effect to principles 4)a) to 4)e) inclusive.

3.3 Incentive design proposal requirements

1) As stated in clause 2.1(c), where a *DNSP* proposes an *incentive design*, to be applied this proposal must meet the *incentive design proposal requirements*. The *incentive design proposal requirements* are that a proposal must:

   a) Include an *incentive design* satisfying the *incentive design criteria,*

   b) Include a submission setting out;

      i) how, in the view of the *DNSP*, the *incentive design* satisfies the requirements of clause 2(1)(a) and (b),

      ii) how the *DNSP* consulted with its customers and other stakeholders, covering the perspectives of different parts of its customer base, and how it reconciled the different preferences of customers in developing the *scheme*,

      iii) definitions of *performance parameters* to be applied,

      iv) a template with which the *DNSP* will annually report on its performance in accordance with each of the performance parameters to the *AER*,

      v) a description of the *measurement methodology* and associated assurance processes,

      vi) proposed *performance targets* and the data used to calculate these proposed performance targets, and

      vii) proposed *incentive rates* and an outline of how these were calculated.

      viii) any proposed circumstances where the penalties and rewards are not applied (exclusions) in accordance with clause 3.2.4)f)

   c) Be submitted with the *DNSP's regulatory proposal*, unless the *AER* grants approval to submit at an alternative time.

4 Implementation

4.1 Information gathering

1) The *AER* may require the *DNSP* to provide information that it considers relevant to its consideration of the *incentive design*.

2) In order to consider adjustments to the *DNSP's* annual revenue, the *AER* may, in the *incentive design*, require the *DNSP* to provide information at a time and in a format specified in the *incentive design*.

4.2 Transitional arrangements

1) Transitional issues may arise from one *regulatory control period* to the next *regulatory control period* if the *scheme's* parameters or other attributes are altered or the *scheme* is discontinued.

2) The *AER* will give consideration to an arrangement proposed under this *scheme* that reduces the impact of any transitional issues.

3) The *AER* shall decide on the appropriateness of the arrangement to address a transitional issue on the basis of:

   a) Materiality of the issue,

   b) Reasonableness and fairness to the *DNSP* and customers, and

   c) Consistency with the objectives as set out in clause 1.4.

4) To avoid doubt, revenue increments or decrements calculated in relation to performance in the current *regulatory control period* are expected to be applied in the subsequent regulatory control period regardless of whether this *scheme* is discontinued in the subsequent regulatory control period.

4.3 Suspension of an incentive design

1) At any time during a *regulatory control period* in which an *incentive design* applies to a *DNSP*, the *AER* may suspend an *incentive design* or, a given *performance parameter* for either the remainder of the *regulatory control period* or a portion of a *regulatory control period.*

2) The *AER* will make a decision under clause 4.3(1) if it is satisfied that the *incentive design*, relevant *performance parameter* (or the *measurement methodology*, *assessment approach* or *financial component* applicable to the relevant *performance parameter*) are no longer compliant with the *incentive design criteria*.

3) A *DNSP* proposing that the *incentive design* or given *performance parameter* be suspended must provide in writing its reasons for proposing the suspension.

4) The *AER* will publish its reasons for making a decision under clause 4.3(1).

5) Before making a decision to suspend a *scheme*, the *AER* will consult with the relevant *DNSP* and such other persons as it considers may be affected by and/or have an interest in such a decision.

Appendix A: Formula for adjusting allowed revenue

A *DNSP's* annual revenue (through average tariffs for all customers) is increased (or decreased) based on changes in customer service from regulatory year to regulatory year. This is applied through a 'H-factor' in the revenue control mechanism for standard control services. The H-factor applies only to standard control services.

Clause 6.2.6 of the NER requires that the control mechanism for standard control services must be of the prospective CPI minus X form, or some incentive-based variant of the prospective CPI minus X form. The H-factor amount, expressed as a nominal dollar change in revenue for each regulatory year, is incorporated into the control mechanism in accordance with the NER and the *DNSP's* distribution determination.

The value of the H-factor for each regulatory year of a regulatory control period is calculated in accordance with this appendix.

Below is the formula to apply to standard control services revenues.

Figure 1 Calculation of revenue adjustment for the Customer Service Incentive Scheme

1. $TARt \geq \sum_{i=1}^{n} \sum_{j=1}^{m} p_t^{IJ} q_t^{ij}$	**i=1,…,n and j=1,…, m and t=1,2,.., 5**
2. $TAR_t = AAR_t + I_t + B_t + C_t$	t = 1, 2. . . ,5
For the first year of a regulatory control period:	
3. $AAR_t = AR_t$	t = 1
For the second and subsequent years of a regulatory control period:	
4. $AAR_t = AAR_{t-1} \times (1 + \Delta CPI_t) \times (1 - X_t)$	t = 2, … , 5

Where:

TAR_t is the total allowable revenue in year t.

p_t^{ij} is the price of component 'j' of tariff 'i' in year t.

q_t^{ij} is the forecast quantity of component 'j' of tariff 'i' in year t.

t is the regulatory year.

AR_t is the annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year t.

AAR_t is the adjusted annual smoothed revenue requirement for year t.

I_t is the sum of incentive *scheme* adjustments in year t. Likely to incorporate but not limited to revenue adjustments for the Customer Service Incentive Scheme H-factor H_t, the f-factor, Demand management innovation allowance (DMIA), Demand management innovation

allowance mechanism (DMIAM), Demand management incentive scheme (DMIS) and service target performance incentive scheme s-factor as applicable. To be decided in the distribution determination. To be decided in the distribution determination.

B_t is the sum of annual adjustment factors in year t. Likely to incorporate but not limited to adjustments for the unders and overs account. To be decided in the distribution determination.

C_t is the sum of approved cost pass through amounts (positive or negative) with respect to regulatory year t, as determined by the AER. It will also include any end-of-period adjustments in year t. To be decided in the distribution determination.

ΔCPI_t is the CPI for year t, as determined in the relevant distribution determination. For example, for 2020–21, year t–2 is the December quarter 2018 and year t–1 is the December quarter 2019.

X_t is the X-factor in year t, incorporating annual adjustments to the PTRM for the trailing cost of debt where necessary. To be decided in the distribution determination.

Figure 2 H-factor calculation formula

$$H_t = AR_{t-2}H_{t-2}^{\%} \times (CPI_{t-1}/CPI_{t-3}) \qquad t = 1,\ldots,5$$

Where:

Ht is the H-factor for regulatory year t.

AR_{t-2} For t=1 and 2, $ARt-2$ represents the annual smoothed revenue requirement in the Post Tax Revenue Model (PTRM) for year 4 and 5 of the previous regulatory control period, respectively.

$H_{t-2}^{\%}$ is the sum of the raw H-factors for all parameters for regulatory year t - 2 expressed as a percentage of revenue (or prices) calculated annually through the compliance assessment. For t = 1 and 2, $H_{t-2}^{\%}$ represents the sum of the raw H-factors for year 4 and 5 of the previous regulatory control period, respectively.

The Customer Service H-factor

The H-factor for each parameter is calculated by comparing a *DNSP's* performance against its parameters and the performance targets and incentive rates included in the *DNSP's* distribution determination for a regulatory year during the regulatory control period.

The raw H-factor is the sum of the H-factors for each parameter. Equation (X) ensures that the raw H-factor result cannot exceed the percentage of revenue at risk specified in clause 3.1(1)(f) or the relevant distribution determination.

$$H_t^{\%} = \min(\max(H_t', H-), H+)$$

where:

$H-$ is the lower limit of the revenue at risk

$H+$ is the upper limit of the revenue at risk

H_t' is the sum of the raw H-factors for all customer service parameters

The sum of the raw H-factors for all customer service parameters is calculated as follows:

$H_t' = \sum_p ir^p \times [\, Act_{t-1}^p - Tar_{t-1}^p]$

where:

H_t is the sum of the raw H-factors for all parameters

p is a performance parameter

ir^p is the incentive rate for parameter p

Act_{t-1}^p is the actual performance for parameter p in year t-1

Tar_{t-1}^p is the target performance for parameter p in year t-1

t is the regulatory year t

5 Glossary

The scheme uses the following definitions

Annual revenue requirement	Has the meaning set out in the *National Electricity Rules*
Assessment Approach	How performance against a *performance parameter* is evaluated
Distribution consultation procedures	Has the meaning set out in the *National Electricity Rules*
Financial Component	How the outcome of the *Assessment Approach* is translated into a reward or penalty for the DNSP
Incentive Design	A set of *Performance Parameters, Measurement Methodologies, Assessment Approach* and *Financial Component* that will apply to a DNSP in a regulatory control period.
Incentive Design Criteria	Has the meaning set out in section 3.1.
Incentive Design Proposal Requirements	Has the meaning set out in section 3.3.
Incentive Rate	The rate at which a revenue increment or decrement accrues due to a change in service performance
Incentive Scheme	Means the efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme, demand management innovation allowance mechanis or small-scale incentive scheme or a jurisdictional scheme.
Jurisdictional Electricity Legislation	Has the meaning given to that term in the *National Electricity Law.*
Jurisdictional Incentive	A jurisdictional incentive applied through *jurisdictional electricity legislation* including guaranteed service levels.
Measurement Methodology	The means by which performance in accordance *performance parameters* is quantified
National electricity market	Has the meaning set out in the *National Electricity Law*
NER (National Electricity Rules)	The rules made under Part 7 of the *National Electricity Law*
Performance Parameters	The metrics of customer service performance subject to incentives

Performance Targets	The level of performance, above which the distributor receives an incentive reward, and below which they receive a penalty (subject the operation of any deadband)
Scheme	The Customer Service Incentive Scheme
Scheme Elements	The *Performance Parameters, Measurement Methodology, Assessment Approach* and *Financial Component* in a given incentive design
Small-Scale Incentive Scheme	A scheme made pursuant to clause 6.6.4 of the National Electricity Rules