

# New Reg: Towards Consumer-Centric Energy Network Regulation

## AusNet trial - AER staff guidance note 9

### AusNet Services draft proposal and the Customer Forum's Interim Engagement Report

On 12 February 2019, AusNet Services (AusNet) released its [draft regulatory proposal](#) and the Customer Forum released its [Interim Engagement report](#). AusNet is currently seeking submissions on its draft regulatory proposal.

Under the section 7 of the [Early Engagement Plan](#) and section 6.3 of [Memorandum of Understanding](#) (MOU) between AusNet, AER, and Customer Forum, the AER agreed to make AER staff available to assist the process.

The purpose of this guidance note is for AER staff to assist the New Reg process. AER staff are not providing determinative views in response to the draft regulatory proposal. When AusNet submits the regulatory proposal, the Australian Energy Regulator (AER) will assess the regulatory proposal in accordance with the National Electricity Law (NEL) and the National Electricity Rules (NER).

In preparing this guidance note, AER staff have not been able to conduct the review that AER staff would normally undertake of a proposal because AusNet and the Customer Forum are in the process of developing the proposal. AER staff have not been able to review all the evidence or supporting material to test the claims, nor apply the regulatory tools that it has available during the regulatory determination process. As a result, AER staff are not able to form a view on whether the matters in AusNet's draft proposal meet the requirements of the NEL and NER. Further, as set out under the MOU<sup>1</sup> this submission does not reflect the views of the AER. AER decisions are made by the AER Board. The AER must still undertake its formal assessment of AusNet's proposal as normal, in accordance with the NER.

On that basis, in this guidance note, AER staff:

- provide their views on the draft negotiating positions with respect to the regulatory framework and the AER's assessment approaches; and
- identify areas where the draft negotiating position may benefit from further evidence or clarification, including evidence of wider consumer support (through broader engagement or research) for that position.

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<sup>1</sup> MoU, June 2018, cl. 2.4a, cl. 6.3 d, cl. 1xiv, cl. 1xiii.

# 1 Overview of New Reg process

AusNet is trialling a new form of customer engagement in the development of its regulatory proposal. This is the 'New Reg' process under which it negotiates aspects of its proposal with a Customer Forum. New Reg is a joint initiative by the AER, Energy Networks Australia (ENA) and Energy Consumers Australia (ECA) launched to explore ways to improve sector engagement, and identify opportunities for regulatory innovation. The goal of this initiative is to ensure that customers' preferences drive energy network businesses proposals and regulatory outcomes. In March 2018, the agencies jointly released a draft New Reg process to enable consumer perspectives to be better reflected in regulatory proposals in advance of lodging those proposals for the AER's assessment.

The New Reg process empowers the Customer Forum to negotiate and agree aspects of the NSP's revenue proposal, in advance of the NSP submitting the proposal to the AER. The Customer Forum researches consumer preferences and seeks to bring that research to bear, along with direct engagement with consumers, in forming a view about aspects of the regulatory revenue proposal.

Under this process the most significant departure from traditional practice is that a Customer Forum negotiates aspects of the regulatory proposal in advance of lodgement with the AER. The Customer Forum does not represent the perspectives of particular interests, instead it conducts research and customer engagement to ensure it can effectively represent the perspectives of all the network businesses' customers. The Customer Forum's representatives are selected to credibly represent perspectives of all end users, be they residential, small business or commercial and industrial. These persons are also required to have relevant skills and experience to ensure they function as an effective and robust counterparty to the network business.

The AER must still undertake its formal assessment of matters that have been negotiated between AusNet and the Customer Forum as normal, in accordance with the NER. If the New Reg process works as intended in assessing AusNet's proposal, the AER will be able to have regard to the extent of the Customer Forum's agreement with AusNet on certain matters in the proposal, and the extent to which that agreement is based on sound evidence of consumer perspectives and preferences.<sup>2</sup> The AER can then take into account the matters that have been agreed and, conversely, those that have not been agreed, in its consideration of AusNet's proposal.

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<sup>2</sup> In accordance with the MoU, in its engagement report, where AusNet and the Customer forum agree on a matter the Customer Forum must explain how the matter is consistent with or best reflects the perspectives and preferences of AusNet Services' customers, including by reference to customer research or consultation undertaken. MoU, June 2018, cl. 5(d)(ii)(2).

## 2 Scope

The matters in the scope agreed by the AER and the reasons for this are set out in Guidance Note 2 - Scope of Negotiation. The following topics are in the scope agreed by AusNet, the Customer Forum and the AER:

- Operating expenditure
- Major augmentation capex projects
- Revenue path profile
- Customer experience
- Customer hardship arrangements

AER staff provided the Customer Forum with notes that set out the boundaries of the National Electricity Rules (NER) and the AER's guidelines for the topics in scope of the negotiation.<sup>3</sup>

AusNet and the Forum can and have decided to negotiate matters that AER staff have not agreed to be in scope including: major asset replacement projects, solar integration, innovation expenditure, smart meters and the overall 'reasonableness' of AusNet's proposal.

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<sup>3</sup> These notes are published on the AER's website: <https://www.aer.gov.au/networks-pipelines/new-reg/ausnet-services-trial>

## 3 Review of in-scope matters

In this section AER staff:

- provide their views on the draft negotiating positions with respect to the regulatory framework and the AER's assessment approaches; and
- identify areas where the draft negotiating position may benefit from further evidence or clarification, including evidence of wider consumer support (through broader engagement or research) for that position.

### 3.1 Opex

Operating expenditure (opex) is the operating, maintenance and other non-capital expenses incurred in the provision of network services. AusNet forecasts that required opex will be \$1,229 million (\$2020) in 2021-25. This forecast amount is 5% or \$59 million (\$2020) below AusNet's opex allowance in 2016-20.<sup>4</sup> This makes up 37% of AusNet's total standard control revenue forecast.<sup>5</sup>

AusNet is negotiating to include innovation expenditure in its opex with the customer forum. However, AER staff have not agreed for innovation expenditure to be in scope.<sup>6</sup> We consider the out of scope innovation expenditure further in section 4.1.

#### 3.1.1 Draft agreed outcomes

The Customer Forum and AusNet have agreed on a number of aspects of AusNet's opex forecast, including:

- The use of 2018 as the base year opex, subject to the AER confirming 2018 is an efficient year using its benchmarking methodologies.<sup>7</sup>
- The reallocation of costs associated with shared data and communication infrastructure from metering expenditure to distribution expenditure.<sup>8</sup>
- A step change for REFCL bushfire mitigation expenditure, subject to the AER being satisfied the expenditure was required for the mandated works and was not already embedded in base year expenditure.<sup>9</sup>
- A step change for five-minute metering, subject to the AER being satisfied the revenue sought fairly covered the cost of the mandatory change.<sup>10</sup>

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<sup>4</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 51.

<sup>5</sup> In nominal terms. Ref: AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 88.

<sup>6</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 2: Scope of Negotiation, July 2018, p. 2.

<sup>7</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 19.

<sup>8</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 19.

<sup>9</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 19.

<sup>10</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 19.

- The use of the AER's approach to accounting for the impact of output growth<sup>11</sup> and labour price growth during the 2021-25 period. However the customer forum noted that labour costs and customer growth numbers will be subject to AER scrutiny once AusNet lodges its formal submission.<sup>12</sup>

### 3.1.2 Draft areas of disagreement and further work

- The Customer Forum considers that, at a minimum, AusNet should apply an annual 1.5% productivity change adjustment to its opex.<sup>13</sup> However, AusNet services has agreed to accept the productivity change that is set by the AER and has not factored a productivity adjustment into its forecast of opex.<sup>14</sup>
- The Customer Forum has provided in principle support for \$2.54 million of a proposed \$7.85 million step change for cloud-based IT systems.
- The Customer Forum accepted AusNet proposed \$8.5 million for REFCL bushfire mitigation expenditure, subject to the AER being satisfied this level of expenditure was required for the mandated works and was not already embedded in base year expenditure.
- AusNet has included a \$1 million (\$2020) IT security step change in its draft proposal that it is yet to negotiate with the Customer Forum.<sup>15</sup> The Customer Forum does not comment on this step change in its report.

### 3.1.3 AER staff view

#### Productivity growth

The Customer Forum contends customers, many of whose lives are affected by productivity pressures elsewhere, quite reasonably expect their electricity distributor to respond to that same pressure. All businesses seek year-on-year productivity gains, and AusNet should be doing the same.<sup>16</sup> In support of its position that AusNet should apply a 1.5% opex productivity growth forecast the Customer Forum noted:

- the concern of some advocates that AusNet had for several years been noticeably less efficient than other distribution businesses and
- that AusNet is increasing the proportion of its network which is underground and the AER's benchmarking that indicates that a 1% growth in the proportion of undergrounding results in a 0.16% opex reduction.<sup>17</sup>

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<sup>11</sup> The AER uses an econometric benchmarking model to forecast the effect of output growth on opex. The outputs in these models include maximum demand, customer numbers, energy delivered and line length.

<sup>12</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 22.

<sup>13</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 22.

<sup>14</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 53.

<sup>15</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 89.

<sup>16</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 21.

<sup>17</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 22.

Subsequent to AusNet publishing its draft regulatory proposal, the AER has completed a review of different approaches to forecasting productivity growth. The AER's final decision is to use an opex productivity growth factor of 0.5 % in its next regulatory determination for each electricity distributor.<sup>18</sup>

The productivity growth factor is the change in productivity from one year to the next that a fully efficient firm might be expected to achieve. In addition, there may be scope for a firm that is not fully efficient to make additional productivity gains to catch up to the frontier.

While AusNet and the Customer Forum have not been able to agree on a productivity growth forecast, AusNet has committed to adopt the productivity growth factor determined by the AER in its productivity growth review.<sup>19</sup> There is scope for AusNet and the Consumer Forum to negotiate and agree on an alternative productivity growth forecast. However, AusNet's commitment means that the AER will not need to revisit the productivity growth factor when assessing AusNet's regulatory proposal.

### 3.1.3.1 Step changes

AER staff set out the AER's approach to assessing step changes in opex guidance note 4 - opex, and AER staff expect that this approach will be applied in assessing AusNet's step changes when the AusNet lodges its regulatory proposal with the AER.

#### REFCLs

AER staff have previously advised<sup>20</sup> AusNet and the Customer Forum that a consideration in the assessment of this step change would be whether these costs are already reflected in base year operating expenditure. The Customer Forum has agreed to the need for the REFCL step change subject to the AER being satisfied this level of expenditure was required for the mandated works and was not already embedded in base year expenditure.<sup>21</sup>

For Tranche 1 the AER provided AusNet with \$0.9 (\$2020, million) additional opex in 2020.<sup>22</sup> AusNet was also provided an additional \$0.8 (\$2020, million) opex in tranche 2.<sup>23</sup> AusNet's proposal is a further \$1.71 (\$2020, million) annually for tranche 3 of the REFCL rollout.<sup>24</sup>

We consider that it might be helpful for AusNet to explain why opex for tranche 3 appears high relative to the annual opex of tranches 1 and 2 combined despite tranche 3 covering fewer locations than the first two tranches. Figure 1 shows the REFCL rollout schedule which indicates that most REFCL locations were already included in the first two tranches of the rollout.

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<sup>18</sup> AER, Final decision paper, Forecasting productivity growth for electricity distributors, March 2019, p. 9.

<sup>19</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 53.

<sup>20</sup> AER staff, Note for the Customer Forum on AusNet Services negotiating position notes, August 2018, p. 12.

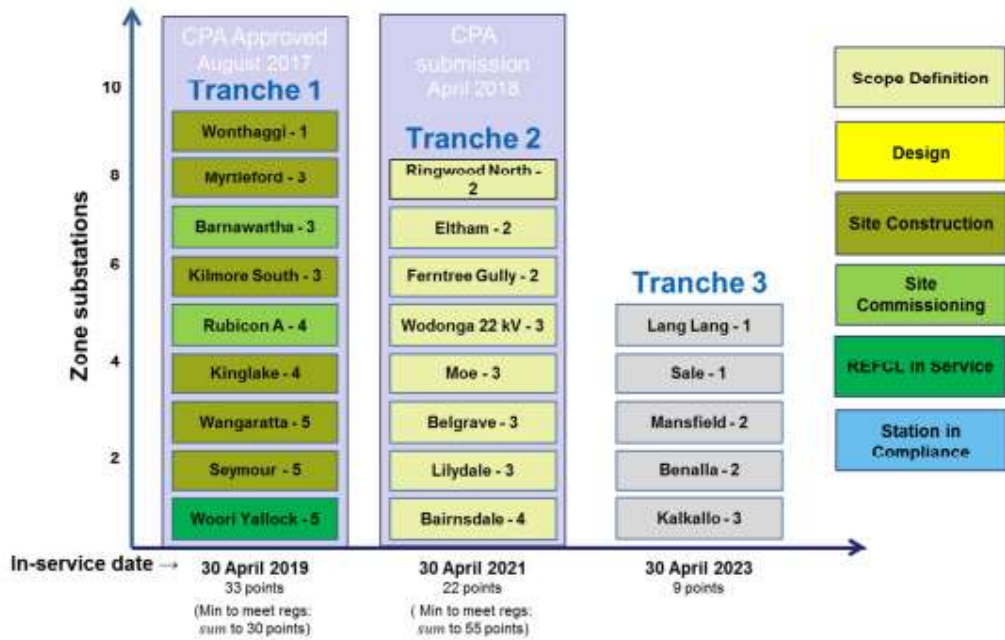
<sup>21</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 20.

<sup>22</sup> AER, *FINAL Decision AusNet Services Contingent Project Installation of Rapid Earth Fault Current Limiters (REFCLs) – tranche 1*, August 2017, p. 67.

<sup>23</sup> AER, *FINAL Decision AusNet Services Contingent Project Installation of Rapid Earth Fault Current Limiters (REFCLs) – tranche two*, 31 August 2018, p. 45.

<sup>24</sup> AusNet, *Operating expenditure, Negotiating position for the Customer Forum*, August 2018, p.4.

**Figure 1 REFCL Delivery Schedule**



Reference: AusNet, AusNet Electricity Services Pty Ltd Contingent Project Application – Tranche 2 Bushfire Mitigation PUBLIC VERSION, April 2018, p. 22.

To justify the step change AusNet could explain why the higher opex requirement is necessary to meet the Victorian state regulatory requirements<sup>25</sup> and why it does not duplicate opex in the first two tranches.

AusNet has, in accordance with our expenditure forecast assessment guideline, included opex for the first two tranches in its opex forecast.<sup>26</sup> AER staff consider that it would be helpful for AusNet to explain why this opex is required on an ongoing basis.

### Transition to cloud based software

AusNet is proposing a step change to move IT software to the cloud. The cloud based software is expected to result in lower capital expenditure either immediately or over the medium term (depending on the system in question).<sup>27</sup> Estimates of the resulting cost savings were not available at the time of the publication of AusNet's draft proposal.<sup>28</sup>

AER staff consider that AusNet could provide further evidence to support this step change. In particular, having regard to previous AER staff advice,<sup>29</sup> AusNet could set out how the step change would be offset by a reduction in ongoing capex.

<sup>25</sup> Electricity Safety (Bushfire Mitigation) Amendment Regulations 2016, S.R. No. 32/2016, Electricity Safety Act 1998, 2016.  
<sup>26</sup> AER, Better Regulation Expenditure Forecast Assessment Guideline for Electricity Distribution, November 2013, p.23.  
<sup>27</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 53.  
<sup>28</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 53.  
<sup>29</sup> AER staff, Note for the Customer Forum on AusNet Services negotiating position notes, August 2018, p. 12.

AER staff note that the Customer Forum supports, in principle, components of this step change on the basis that they will benefit customers.<sup>30</sup> These are investments for Customer Relationship Management (CRM) and Outage Management systems (OMS).

AER staff note that under the proposed customer experience incentive scheme AusNet may be rewarded for investing in the CRM and OMS. Thus if this scheme is developed, it may be another avenue of funding for the step change to transition to cloud based software.

AusNet's draft proposal does not identify the customer benefit that the CRM and outage management systems will deliver and why AusNet's proposed investment is the most efficient way of delivering these benefits. AER staff think that to justify the step change AusNet could outline the additional customer benefits will be delivered by the system upgrades, why these cannot be delivered by AusNet's existing systems, and why the proposed system upgrades are the lowest cost option for delivering these benefits. Evidence, showing that customers value the additional benefits provided by these investments would also support the step change. AER staff's opex guidance note outlines the evidence that would justify a step change on the basis that it improves service and customers are willing to pay for it.<sup>31</sup>

### Five minute metering

The five minute metering rule change will commence on 1 July 2021.<sup>32</sup> AusNet's proposal seeks to cover the ongoing operating costs of meeting the requirements of this rule change coming to \$2.6 million (\$2020) in total, with the bulk of this expenditure occurring after 2021.<sup>33</sup>

The AER will undertake its assessment of this step change in accordance with its ordinary approach. This approach is outlined in our opex guidance note.<sup>34</sup>

### IT security

AusNet has included \$1 million (\$2020) for an 'IT security' step change in its draft proposal. However, AusNet notes that it has not yet negotiated this step change with its Customer Forum. Further, AusNet has not provided much explanation for the need for the step change in its draft proposal.<sup>35</sup>

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<sup>30</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, pp. 20-21.

<sup>31</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 4: Opex, 29 August 2018, pp. 2-3.

<sup>32</sup> Australian Energy Market Commission, National Electricity Amendment (Five Minute Settlement) Rule 2017 No. 15, November 2017.

<sup>33</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 89.

<sup>34</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 4: Opex, 29 August 2018, pp. 2-3.

<sup>35</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 89.



The AER will undertake its assessment of this step change in accordance with its ordinary approach. This approach is outlined in our opex guidance note.<sup>36</sup>

### 3.1.3.2 Base year

The AER will review the efficiency of AusNet's expenditure as part of our determination.

By the time AusNet submits its regulatory proposal, the AER would have received AusNet's regulatory accounts, and will be in a position to prepare its annual benchmarking report, and undertake its assessment of the efficiency of AusNet's base opex. The AER publishes its annual benchmarking report in November.

## 3.2 Customer experience and hardship arrangements

Customer experience covers how AusNet delivers its services to its customers (including how it interacts with its customers, such as customer service).

Hardship arrangements concern the extent to which it, as a distribution business, could assist hardship customers.<sup>37</sup> AER staff treated customer experience and customer hardship arrangements as separate topics when determining scope. However, AusNet and the Customer Forum are considering these topics together. AER staff are comfortable with this as long as AusNet and the Customer Forum observe the separate boundaries of negotiation. For simplicity of reference, we will refer to these two topics collectively as customer experience.

There are two parts to AusNet and the Customer Forum's negotiations on this topic: customer service outcomes that are delivered in advance of the next regulatory period and the development of a customer satisfaction incentive scheme.

### 3.2.1 Customer Service outcomes delivered in advance of the next regulatory period

Negotiations between the Customer Forum and AusNet on customer experience have focused on AusNet's customer service and how it can be improved to better meet AusNet's customer's expectations. The Customer Forum stressed new and improved customer focussed services should be developed at the earliest opportunity and not have to wait until 2021.<sup>38</sup>

AusNet and the Customer Forum have negotiated a number of customer service initiatives that AusNet is implementing in advance of the 2021-25 regulatory period.<sup>39</sup> These initiatives are listed in AusNet's regulatory proposal.<sup>40</sup>

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<sup>36</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 4: Opex, 29 August 2018, pp. 2-3.

<sup>37</sup> New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 7: Customer Hardship – 29 August 2019, p. 1.

<sup>38</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 27.

<sup>39</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, pp. 27-30.  
AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January

**Table 1 AusNet's actions to improve customer service**

Action	Description	Effective
Establishing a clearer accountability for customer	<p>Implement a major restructure that will:</p> <ul style="list-style-type: none"> <li>• Bring together our field services staff responsible for customer-facing interactions (e.g. new connections, planned outages) with our customer contact centre.</li> <li>• Create a centralised, senior point of accountability within the company for customer experience outcomes, supported by considerable resources.</li> <li>• Involve regular meetings between senior management and regional customers.</li> <li>• Include three dedicated staff to manage relationships with our largest business customers, community renewable groups, and large generators seeking to connect to our network.</li> </ul>	Feb 2019
Aligning our incentives with customer outcomes	Subject to Board approval and development of appropriate metrics, link employee performance and bonus outcomes with customer satisfaction outcomes.	May 2019
Building our understanding of our customers' needs and expectations	Commence an ongoing research program, including annual surveys and targeted research, to ensure we have continuous insight into our customers' needs and expectations, and ensure the insights derived in the research are used by the business to deliver ongoing customer experience improvements. In designing the research program, ensure balanced research focus that will improve our understanding of the differing needs of urban and rural customers, and residential and business customers.	2019
Fixing customer pain points and improving the customer experience	Work with customers to identify and implement operational and communication changes that address customer 'pain points' associated with solar connections, new connections and outages and result in tangible improvements to customer experience. Ensure these improvements are communicated clearly to our customers.	Delivered from 2018-2019
Collaborating with the community	<p>Work closely with customer representatives to:</p> <ul style="list-style-type: none"> <li>• Identify and prioritise ways we can improve customer experience, including through better use of smart meter data.</li> <li>• Improve our understanding of vulnerable customer needs.</li> <li>• Help equip community service organisations to assist vulnerable customers</li> </ul>	Complete

2021 to 31 December 2025, February 2019, p. 83.  
 40 AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 39.

Action	Description	Effective
Making our organisation easier to deal with	Ensure our customer contact centre staff are selected, trained and monitored to ensure they provide empathetic customer service to all customers, and proactively identify and assist hardship customers.	Complete
Taking care of our most vulnerable customers	<p>Implement changes to:</p> <ul style="list-style-type: none"> <li>• Improve restoration times for life support customers, using smart meter data.</li> <li>• Provide better communications to life support customers in advance of planned outages (e.g. SMS, social media, and community messaging channels).</li> </ul> <p>Proactively engage with customer representatives regarding the best approach to advocating for the needs of life support customers, including the potential establishment of a peak advocacy body.</p>	<p>Complete</p> <p>Ongoing</p>
Making our claims process easier for all customers	<ul style="list-style-type: none"> <li>• Significantly reduce claim assessment timeframes and customer discomfort by partnering with contractors that can assist customers on-site with emergency repairs and provide a report to support their compensation claim.</li> <li>• Provide a voucher for financially vulnerable customers to allow them to purchase a temporary replacement appliance (e.g. a small heater).</li> <li>• Be available for 24/7 phone assistance to help customers complete their claim form.</li> <li>• Provide more flexible and timely compensation amounts by paying the higher of market value or second-hand item, rounding up to the nearest \$100 and transferring funds via EFT instead of cheque.</li> </ul>	Completer
Holding ourselves to account	Publish an annual Customer Interactions Report. This report will track the progress of the initiatives identified above, present results under the Customer Satisfaction Incentive Scheme, and include other measures that are important to our customers.	Dec 2009

### 3.2.2 Proposed small scale incentive scheme for customer experience

The AER's incentive schemes, and incentives imposed by the Victorian Government,<sup>41</sup> provide incentives for electricity distributors to maintain and improve certain elements of their customer experience, particularly in relation to service reliability.<sup>42</sup> However, there are other

<sup>41</sup> These are the guaranteed service level payments mandated by the Essential Services Commission (Victoria).

<sup>42</sup> The full list of incentives is provided in the AER staff's guidance note no customer experience: New Reg: Towards

aspects of AusNet's customer experience that currently aren't incentivised. This includes measures of customer sentiment such as satisfaction with AusNet's communications, call centre performance<sup>43</sup> and management of requested works (such as connections).

AusNet and the Customer Forum are yet to agree on the nature of the scheme. Table 2 shows aspects of customer service that could be measured set out in AusNet's draft proposal.

**Table 2 AusNet's potential customer satisfaction incentive measures<sup>44</sup>**

Customer satisfaction with	Incentive to improve customer satisfaction
Unplanned outages	Incentive to improve the management of unplanned outages for customers including customer notifications and interactions
Planned outages	Incentive to improve the management of planned outages for customers including customer notifications and interactions
New connections	Incentive to improve the customers' connection process
Complaints management	Incentive to improve complaint management process for customers

### 3.2.2.1 Draft agreed outcomes

AusNet and the customer Forum have agreed to the development of a customer satisfaction incentive scheme.<sup>45</sup> Accordingly, AusNet is proposing a scheme that provides incentives to improve some of the customer satisfaction measures described above.

As part of its negotiation with AusNet, the Customer Forum sought two commitments related to the enhanced customer satisfaction incentive scheme. First, the Customer Forum sought agreement from AusNet that survey data provided to the AER each year as part of an approved incentive scheme would be published. Second, the Customer Forum asked AusNet to initiate an annual Customer Interaction Report.<sup>46</sup> AusNet agreed to both requests.<sup>47</sup>

Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 3: Customer experience, August 2018, pp. 6-8.

<sup>43</sup> Under our STPIS we have a call answering parameter that provides an incentive for AusNet to answer calls to its call centre within 30 seconds. However, this measure does not capture how AusNet manages calls to its call centre.

<sup>44</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 41.

<sup>45</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 83. Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, pp. 27-30.

<sup>46</sup> The report would ensure that, beyond the enhanced customer services satisfaction scheme, no other areas of customer dissatisfaction were emerging. This report will track the progress of the initiatives identified above, present results under the Customer Satisfaction Incentive Scheme, and include other measures that are important for our customers. Ref: Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, pp. 28 & 63.

<sup>47</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 28.

### **3.2.2.2 Draft areas of disagreement and further work**

Though AusNet and the Customer Forum have agreed on a customer satisfaction incentive scheme, they are yet to agree on the specifics of such a scheme. AusNet and the Customer forum are working to refine the customer satisfaction incentive scheme to ensure that identified weaknesses in AusNet's Customer Services are targeted.<sup>48</sup> The Customer Forum's intention is that the modified scheme will place on AusNet substantially greater customer service obligations. Any failure by AusNet Service to meet any of the yet to be determined targets will result in a loss of revenue.<sup>49</sup>

### **3.2.3 AER staff view**

#### **3.2.3.1 Customer service outcomes delivered in advance of the next regulatory period**

As AusNet is proposing to implement its negotiated customer service outcomes in advance of the 2021-25 regulatory period, AusNet is not asking for a step-change for these customer service outcomes. Consequently, AER staff do not have any comments on the implications of these outcomes for AusNet's forecast expenditure in the 2021-25 period.

#### **3.2.3.2 Small scale incentive scheme for customer experience**

AER staff consider that the appropriate mechanism under the NER for developing a customer satisfaction incentive scheme would be a small scale incentive scheme.<sup>50</sup> The small scale incentive scheme rules were designed to provide for incentives not already covered by the existing incentive schemes under the NER and to test innovative approaches to incentives.<sup>51</sup> For example, the small scale incentive scheme can provide rewards for NSPs which engage more effectively with consumers.<sup>52</sup>

In order to implement such a scheme for the upcoming regulatory period, the AER is required to undertake a national consultation on the scheme, including publishing a draft scheme and explanatory statement pursuant to rule 6.16 of the NER.<sup>53</sup> The NER requires the AER to publish a proposed scheme, and explanatory statement and to allow 30 business days for submissions. Developing a proposed scheme, consultation on the proposed scheme and preparing a final scheme is not an insignificant undertaking. AER staff will look to initiate consultation in the development of the scheme shortly after AusNet and the Customer Forum have finalised their proposed scheme.

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<sup>48</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 28.

<sup>49</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 28.

<sup>50</sup> NATIONAL ELECTRICITY RULES VERSION 119, February 2019, (NER, #119, 2019), cl. 6.6.4.

<sup>51</sup> AEMC, Rule Determination, National Electricity Amendment (Economic Regulation of Network Service Providers) rule 2012, National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012, November 2012, pp. 13, 212.

<sup>52</sup> AEMC, Rule Determination, National Electricity Amendment (Economic Regulation of Network Service Providers) rule 2012, National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012, November 2012, p. 212

<sup>53</sup> NER, #119, 2019, cl. 6.16.

AusNet will submit a proposed customer satisfaction incentive to the AER in the near future. AER staff consider that it would be prudent to consult on AusNet's proposed scheme prior to any potential formal consultation on the AER's AER's draft scheme. This would allow the AER to take feedback on AusNet's proposed scheme into account prior to developing its draft scheme.

### 3.3 Augex

Augex (augmentation expenditure) is capex that is typically triggered by a need to build or upgrade network assets to address changes in demand for distribution services, or to provide quality, reliability and security of supply, and the safety of the distribution system, in accordance with legislated requirements.<sup>54</sup>

AusNet proposed two augmentation projects, one at Clyde North in Melbourne's outer south east and the other at Doreen, in Melbourne's outer north. Both projects aim to meet anticipated growth in electricity demand in high growth corridors.<sup>55</sup> The cost of the two projects (in \$2020 including overheads) are:

- Clyde North: A third and final 66/22 kV power transformer is proposed to increase capacity and address the reliability risk to customers. Total cost is \$7.7 million, with \$0.4 million in 2020 and \$7.4 million in 2021 to 2025
- Doreen: A third 20/33 MVA transformer is proposed at the Doreen zone substation at a total cost of \$5.1 million with \$4.7 million in 2021 to 2025 and \$0.4 million in 2026<sup>56</sup>

#### 3.3.1 Draft agreed outcomes

The Customer Forum supported the proposed installation of new transformers at both Clyde North and Doreen zone substations, as proposed by AusNet, subject to confirmation the following peak load mitigation options would not significantly reduce forecast load:

- The accelerating rate of residential solar and battery uptake
- Commercial and industrial customer demand management
- Network reconfiguration<sup>57</sup>

To date, the Customer Forum has only satisfied itself the accelerating rate of residential solar generation will not moderate peak demand due to peak demand occurring later in the day, when solar power is no longer contributing energy to the grid.<sup>58</sup>

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<sup>54</sup> AER, Expenditure Forecast Assessment Guideline for Electricity Distribution, November 2013, p 18.

<sup>55</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 56.

<sup>56</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 56.

<sup>57</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 26.

<sup>58</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 26.

### 3.3.2 Draft areas of disagreement and further work

The Customer Forum sought the agreement of AusNet to undertake a detailed assessment of the cost effectiveness and viability of the three other peak load mitigation options mentioned above. The Customer Forum requested this assessment be independently reviewed. AusNet agreed and terms of reference are being developed.<sup>59</sup>

### 3.3.3 AER staff view

AER staff consider that it would be helpful to set out the information and factors that we would consider in assessing AusNet's augex projects. The independent reviewer can then take this into account when assessing AusNet's proposed augex projects. The information that AER staff would consider is:

- data on forecast load supporting the customer growth forecasts and the demand per customer. This would include the After Diversity Maximum Demand (ADMD) applied for the upcoming regulatory period and the basis for the ADMD including any forecast changes to ADMD including from current levels.
- Present Value calculations that AusNet has come up with to test alternative options for investment. This should include the assumptions have been applied on factors such as outage probability, duration and the value of customer reliability (VCR), and what firm and thermal capacities of the existing transformers/feeders have been applied in coming to a conclusion that augmentation is required.
- Information on the potential to transfer loads, allowing the existing two transformers at each substation to handle the increase in load, potentially delaying the need for the third transformers.

In determining the need for and appropriate timing of the augex projects, AER staff would consider:

1. Whether the demand forecasts are reasonable, which would cover whether AusNet has:
  - aligned the land release and development timings appropriately
  - applied an appropriate Average Diversified Maximum Demand (the average demand for each residence) for the developments in question
  - appropriately taken the impact of Solar PV into account
  - applied appropriate assumptions (such as the uptake of residential batteries given the Victorian Government rebate) in developing its demand forecasts
2. Whether the constraints necessitating the augmentation expenditure are appropriate.

This would cover:

- the risk, timing and probability of a outage resulting from the constraint

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<sup>59</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 26. AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 57.

- the volume of load that is potentially at risk each year
  - the likely duration of any outage
  - whether rotational load shedding had been considered
  - how cyclic and thermal load considerations had been factored in
  - whether the right VCR has been used
3. Whether all reasonable options have been considered including non-network and other deferral options, which covers whether:
- the base case<sup>60</sup> is reasonable
  - the use of probabilistic risk analysis is appropriate and consistent
  - the time value of deferral options is appropriately considered
  - the costs for demand management and non-network options are reasonable and appropriately considered
  - the sensitivity analysis that has been undertaken is reasonable and appropriate.

### 3.4 Revenue path profile

Once the AER decides on the level of allowed revenues that is appropriate to cover AusNet's efficient costs for each year of the five year regulatory period, there is some flexibility over the profile with which that revenue is recovered (the revenue path profile). A different profile of annual revenues during the regulatory period will be one of a number of factors affecting the annual price changes that AusNet's customers will face.

It should be noted that while this topic is referred to as the "price path" in AusNet and the Customer Forum's report, this is about smoothing network revenues over the 2021-25 regulatory period rather than prices. While the path of network revenues will have an impact on electricity prices, there are a number of other factors that will influence the final electricity prices paid by customers beyond network charges, including, among other things, changes in the costs of generation and retailing.

#### 3.4.1 Draft agreed outcomes

The Customer Forum and AusNet have agreed on a revenue path profile that will maximise the network bill reductions in 2021, followed by flat revenues, in real terms.<sup>61</sup>

#### 3.4.2 Draft areas of disagreement and further work

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<sup>60</sup> AER, Industry practice application note Asset replacement planning, January 2019, p. 84.

<sup>61</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 83. Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, pp. 41-42.



Though there are no differences of opinion between AusNet and the Customer Forum, it should be noted that the revenue profile will be subject to change. A number of factors will affect the revenue profile, including adjustments to:

- Give effect to changes flowing from the AER's regulatory tax approach review<sup>62</sup>
- Incorporate up-to-date financial data used to calculate AusNet's rate of return
- Incorporate further changes that AusNet may make to its proposal subsequent to consultation on its draft proposal.

### 3.4.3 AER staff view

AusNet and the Customer Forum have undertaken research into customer needs and expectations in regards to the revenue path. This is positive and provides support for AusNet's draft revenue path profile.

AER staff would like to direct AusNet and the Customer Forum's attention to the boundaries of negotiation, as set out in the guidance note on the revenue path profile.<sup>63</sup> The NER requires that the 'smoothed' profile of the revenue path over the regulatory period—i.e., the change in revenue from one year to the next—must be set to minimise, as far as reasonably possible, the difference between the expected revenue for the final year of the regulatory period, and the annual revenue requirement for that final year.<sup>64</sup> The reason for this rule is to try to mitigate the risk of a significant step change in revenues (and prices) from one regulatory period to the next. This minimises price shocks. The AER has exercised its judgement in applying this rule. In practice, the AER has generally implemented this rule by ensuring that the difference between the expected revenue and the annual revenue requirement in the final year is no greater than +/- 3%. Currently, AusNet's proposed smoothing approach means its revenue requirement in the final year (\$744.1 million) is currently 4.5% lower than AusNet's expected revenue (\$777.9 million).<sup>65</sup> AusNet and the Customer Forum may wish to consider further whether this is appropriate in the light of the NER requirement.

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<sup>62</sup> The estimate of expected tax payments is one component we consider when we set revenue allowances for regulated electricity and gas networks. We released a final report on 17 December 2018. The final report presents analysis of the tax management practices of the regulated networks, and the AER's recommendations on changes to its regulatory tax approach. For more information please see: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/regulatory-tax-approach-review-2018>.

<sup>63</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 6: Revenue Path Profile, August 2018.

<sup>64</sup> NER, clause 6.5.9(b)(2).

<sup>65</sup> \$nominal. Ref: AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 92.

## 4 Out of scope matters

AusNet and the Customer Forum have agreed to broaden the topics discussed, negotiated and agreed beyond those agreed to be in scope to include Innovation, DER (distributed energy resources), Metering and Repex.

The focus of AER staff's involvement is to better prepare the Customer Forum to negotiate issues that are in scope. Despite this, AER staff have, in good faith, decided to provide guidance on the out of scope topics similar to the guidance on in scope topics but note again that these views do not reflect the views of the AER Board. AER staff also note the limitations of their views. In particular, AER staff have not been able to review evidence or supporting material to test claims that have been made nor apply the regulatory tools that it has available during a typical review.

### 4.1 Innovation

AusNet is proposing to undertake a number of strategic innovation projects aimed supporting the future transformation of its network to improve customer outcomes, particularly lower bills and improved choice and services and which, in AusNet's view, require regulatory funding. The majority of the innovation program relates to testing new technologies and approaches that will take the distribution network from a statically managed, centralised network to a dynamically managed, decentralised network. It is expected that trialling a range of technologies will improve customer outcomes in the long term.<sup>66</sup>

#### 4.1.1 Draft agreed outcomes

Innovation is still subject to negotiations between the Customer Forum and AusNet.

#### 4.1.2 Draft areas of disagreement and further work

In its negotiating position AusNet proposed a list of 15 projects valued at \$11.4 million (\$2020).<sup>67</sup> The Customer Forum was not convinced the rationale for the expenditure was sufficiently connected to tangible customer benefits, notwithstanding innovation expenditure cannot guarantee design and testing of new technology and processes will always deliver the anticipated outcome. To this point the Customer Forum noted only seven of the 15 project descriptions mentioned customers.<sup>68</sup>

AusNet and the Customer Forum are still to agree on the level of funding for innovation projects aimed at meeting changes in technology and customer needs and expectations.<sup>69</sup>

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<sup>66</sup> AusNet, Innovation expenditure Negotiating position for the Customer Forum, 2018, p. 5.

<sup>67</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 65.

<sup>68</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34.

<sup>69</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34. AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 57.

However, the Customer Forum has requested that AusNet refine its proposed list of projects based on the principles listed below.

AusNet states that, in agreeing to innovation funding, the Customer Forum recognised that support for innovation by electricity networks was supported by our customer research.<sup>70</sup> However, it is not clear that this is the case. Firstly, any potential agreement appears contingent on the below criteria being met. Also, the Customer Forum note the June 2018 Newgate Research qualitative research which briefly explored the extent customers believe AusNet Services should be investing in innovation.<sup>71</sup> This research found that although a few customers support innovation expenditure, it was a low priority.<sup>72</sup>

The Customer Forum has requested a refined list of innovation projects based on the following principles:

- Innovation projects/outcomes should directly benefit and result in improved service to customers
- Innovation needs to be driven by customer needs and expectations which should be identified through customer research. Customers will support innovation if they see the benefits
- The language surrounding innovation must be easy for customers to understand and offer a compelling potential benefit
- Innovation needs to be strategic and should include an evaluation
- All initiatives to be published on AusNet website and shared with industry
- Projects must show evidence of collaboration with retailers and other distribution businesses and/or retailers<sup>73</sup>

It would be helpful if the Customer Forum and AusNet undertook further work clarifying their positions on innovation. The Customer Forum advised AusNet the proposed innovation expenditure should only proceed where AusNet could link the potential customer benefits to customer and stakeholder expectations.<sup>74</sup> AusNet is yet to do this. The Customer Forum would prefer AusNet Services to construct an innovation budget of \$7.5 million (\$2020) but does not link this level of funding to customer preferences.<sup>75</sup> The customer forum and AusNet do not appear to have agreed on any specific innovation projects.<sup>76</sup> AusNet does not clearly state its proposed innovation expenditure in its draft proposal.<sup>77</sup>

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<sup>70</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 66.

<sup>71</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 33.

<sup>72</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 33.

<sup>73</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34.

<sup>74</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34.

<sup>75</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34.

<sup>76</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, pp. 65–67.

Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 33–35.

<sup>77</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, pp. 65–67.

### 4.1.3 AER staff view

Given the divergence of opinion between the Customer Forum and AusNet on innovation expenditure, AER staff consider that it is prudent to note the following matters to inform future negotiations.

#### Can the AER provide a general opex allowance for innovation?

AER staff do not consider that the AER's approved opex forecast can include a general allowance for innovation unlinked to specific projects. It is unclear how an allowance, which is not linked to a specific activity or objective, could be demonstrated to be prudent and efficient. The AER could, however, approve step changes for innovation projects and programs. AER staff previously set out the AER's approach to assessing step changes in guidance note 4 - opex.<sup>78</sup>

#### Is there evidence that customers value and are willing to pay for the proposed innovations?

AER staff have previously provided guidance to the Customer Forum on evidence to support step changes to deliver improved outcomes for customers on pages 2 and 3 of guidance note 4 - opex. The following quote from this guidance note is relevant:

However, what consumers want and are prepared to pay for, whether in terms of reliability or some other element, may assist in showing proposed expenditure is consistent with the NEO's overall efficiency objective. The Australian Energy Market Commission (AEMC) has observed that the more confident the AER can be that consumer concerns have been taken into account, the more likely the AER can be satisfied that a proposal reflects efficient costs.<sup>79</sup>

If there is robust evidence demonstrating that consumers value a more expensive option for achieving the expenditure objectives, and are prepared to pay for that, it might be that a prudent and efficient operator would choose that option.<sup>80</sup> In determining what weight to give to evidence obtained through a DNSP's consumer engagement, such as a consumer willingness to pay study, the AER would likely consider:

- how that evidence was collected,
- how relevant and up-to-date it is,
- and whether it is likely to reliably reflect the views of the DNSP's customer base over the long term.

If a higher cost option to meet the expenditure objectives is robustly supported by the evidence the Forum has assessed, then the AER would still seek to confirm that the associated forecast expenditure reflects the lowest sustainable cost to consumers for that preferred option.<sup>81</sup>

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<sup>78</sup> AER staff, New Reg: Towards Consumer Centric Energy Network Regulation, AusNet Trial - AER Staff Guidance Note 4: Opex, 29 August 2018.

<sup>79</sup> For example: AEMC, [Rule Determination, National Electricity Amendment \(Economic Regulation of Network Service Providers\) Rule 2012](#), 29 November 2012, p 101.

<sup>80</sup> For example: AEMC, [Rule Determination, National Electricity Amendment \(Economic Regulation of Network Service Providers\) Rule 2012](#), 29 November 2012, p 115.

<sup>81</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 4:

AusNet states that, in agreeing to innovation funding, the Customer Forum recognised that support for innovation by electricity networks was supported by our customer research.<sup>82</sup> However, there appears to be a diversity of views on this. Firstly, the Customer Forum's agreement appears contingent on a number of criteria being met. Further, the Customer Forum's report indicates that innovation is a low priority for customers<sup>83</sup>, and when the Customer Forum tested its initial response with customer groups and found some resistance to customer funding of innovation expenditure.<sup>84</sup> In its draft proposal AusNet also notes that customer research demonstrated customers did not want to fund innovation related to the needs of a very small number of customers expected to adopt electric vehicles over the 2021-25 period.<sup>85</sup> Despite this, AusNet Services remains of the view the case for investing in innovation for electric vehicles is strong, given the very significant impacts that even small numbers of vehicles could have on the network and on other customers without electric vehicles.<sup>86</sup>

### **Are the innovation projects already funded under the existing incentive schemes?**

Another consideration is that AusNet's proposed step change for innovation might be recovered through other means, and if so, there would be no need to provide for these projects in the opex forecast. AER staff touched on this issue in guidance note 4 - opex.<sup>87</sup>

There are a number of mechanisms that already fund innovation under AusNet's regulatory regime. AER incentive schemes reward networks for innovating in ways that deliver better outcomes for customers. These include:

- The Service Target Performance Incentive Scheme (STPIS) which rewards AusNet for improving reliability
- The Demand Management Innovation Allowance (DMIA) which provides funding for Demand Management Solutions
- The Capital Expenditure Sharing Scheme (CESS) and opex Efficiency Benefit Sharing Scheme (EBSS) that provide a continuous incentive for AusNet to pursue capex and opex efficiency improvements and share those improvements with its customers.
- The F-Factor scheme that provides incentives to reduce the risk of fire starts due to electricity infrastructure, and to reduce the risk of loss or damage caused by fire starts.

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Opex - 29 August 2018, pp. 2-3.

<sup>82</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 66.

<sup>83</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 33.

<sup>84</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 34.

<sup>85</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 66.

<sup>86</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 66.

<sup>87</sup> AER staff, New Reg: Towards Consumer-Centric Energy Network Regulation AusNet Trial – AER Staff Guidance Note 4: Opex, 29 August 2018, p.3.

This list will also include AusNet's proposed customer satisfaction incentive scheme should it be developed.

AusNet is also subject to the Victorian Government's GSL scheme. The GSL scheme provides incentives for AusNet to limit the duration and frequency of outages, be on time for appointments, and make new connections and repair streetlights within certain timeframes.

To fund innovation, AusNet may apply for grants for innovation projects from agencies such as the Australian Renewable Energy Agency which funds innovation and shares knowledge accelerating Australia's shift to affordable and reliable renewable energy.<sup>88</sup>

## 4.2 Smart Metering

The Customer Forum found that, in general, customers do not identify any value in having a smart meter and that customer research indicates customers believe smart meters have been installed primarily for the benefit of energy distributors.<sup>89</sup> AusNet have proposed options to deliver further benefits and services to customers from smart meters.<sup>90</sup>

### 4.2.1 Draft agreed outcomes

In negotiations the Customer Forum noted that AusNet's research indicated that customers are sensitive to metering charges given the contentious rollout in Victoria.<sup>91</sup> The Customer Forum considered most customers believed they had paid significantly for their smart meters and would resist paying more in the absence of understanding smart meter benefits.<sup>92</sup>

AusNet is proposing an average metering charge of \$78 per customer over the 2021 to 2025 period (after inflation), which is a 13% reduction from an average charge of \$89 per customer in the 2016 to 2020 period.<sup>93</sup>

AusNet and the Customer Forum considered options for innovative smart metering services. Table 3 sets out initiatives to maximise the benefits to customers from the significant investment in smart meters in AusNet's draft proposal. It is unclear what the costs of these initiatives are and whether they are adding to AusNet's expenditure forecasts in the 2021–25 period.

Given its view the annual average metering charge is decreasing and customer benefits are increasing, the Customer Forum believes AusNet's proposal represents value for money and will be enhanced through improved communication of metering benefits to customers.<sup>94</sup>

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<sup>88</sup> <https://arena.gov.au/>

<sup>89</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 38.

<sup>90</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 43.

<sup>91</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 38.

<sup>92</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 38.

<sup>93</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 79.

<sup>94</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 37.

**Table 3 Benefits and services delivered by smart meters**

Benefit type	Initiative	Description	Timing
Keeping you and your community safe	Prioritising life support customers in an outage	In the event of an unexpected outage, we will specifically detect when life-support customers are off supply so that we can prioritise restoring supply to their property and provide advice to follow their emergency plan in the event of any delays.	Operational by 2021
	Identifying and fixing potential faults before they become safety issues	In addition to regular maintenance and inspection programs, we will be able to detect if certain areas in the network are at a higher risk of safety issues such as fires. This allows us to pro-actively investigate and fix potential safety issues before they occur.	Operational by 2021
	Keeping critical customers on supply in an outage	In periods where there is high demand on the network, we will keep critical community infrastructure and customers (e.g. life support customers, traffic lights, police stations, nursing homes) on supply by selectively reducing energy to non-critical infrastructure.	Operational during 2021–25
Keeping your energy prices down	Notifying you when your energy use is unusual	Customers will receive a notification when their usage is significantly higher than normal, so that they are aware that their usage has changed and will likely impact their bill. This gives customers an opportunity to manage their consumption and potentially avoid bill-shock.	Operational during 2021–25
Ensure you are kept informed in the event of an electricity outage	Enabling our call centre staff to better answer customer queries	When customers call we are able to check in real time if a customer’s meter is on supply and therefore if the supply issue is caused by an AusNet network outage, or caused within the home or business. This means our call centre staff can provide timely, accurate information to customers about whether we are able to fix their supply issue or whether the customer needs to contact an electrician. This will provide better information to customers in real time and also reduce the likelihood of wasted truck visits that are paid for by customers.	Operational by 2021
Detailed view of customers experiencing outages	This allows us to detect which individual customers are off supply.	This can be used after a planned outage to ensure all our customers’ supply has been restored and, if not, who needs assistance.	Operational by 2021
Reducing the interruption	Accurate and quick response to	We are able to detect real-time when and where a wire has hit the ground on our network. This allows us to give specific location information to our trucks	Operational by 2021



Benefit type	Initiative	Description	Timing
to your day by reducing the length of an electricity outage	wire faults	on where the fault has occurred, rather than waiting for customers to call, thereby improving restoration times.	
Providing a faster response to your solar or battery application	More accurate information for customers on how much they can export into the network	This capability will expand our existing solar approval process to provide customers the ability to obtain a real-time assessment of the amount of solar and battery storage that can be approved at their property. This will be integrated with our online connection approval process for all customers.	Operational by 2021

#### 4.2.2 Draft areas of disagreement and further work

AusNet sought \$10 million to facilitate the planned Telstra transition from 3G to 4G, which will permit continuous smart meter functionality, from 2021. The Customer Forum questioned the timing of the expenditure given the uncertainty of Telstra’s changeover timing and the possibility of delay. The Customer Forum believes AusNet customers deserve a more robust interrogation of Telstra and to forecast a changeover date before agreeing to the timing of the funding.<sup>95</sup>

#### 4.2.3 AER staff view

AusNet forecasts that it will incur a higher level of capex in the early years of the 2021 to 2025 period as a result of the requirement to transition the meter communication systems from 3G to 4G.<sup>96</sup> It is not clear, to AER staff, what the proposed costs to transition from 3G to 4G are forecast to be and we consider that it would be helpful for AusNet to outline this.

AusNet submits that its proposal does not include the recovery of remediation costs, which are legacy costs associated with the original design of the communications systems. The only items of additional expenditure are due to external drivers, such as the need to transition to 4G when the 3G network is switched off.<sup>97</sup> AER staff consider that DNSPs should bear the costs of any inefficiency or imprudent actions. To do otherwise, would mean customers would fund some costs of a service provider's inefficiency or imprudent actions.

AER staff consider that for AusNet to show its proposal to transition from 3G to 4G is efficient it would be helpful for AusNet to demonstrate the overall forecast expenditure will

<sup>95</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 39.

<sup>96</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 80.

<sup>97</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 80.



result in the lowest sustainable cost (in present value terms) to meet its legal obligations.<sup>98</sup> We will assess whether forecast expenditure is expected to be the lowest cost option relative to other options in net present value terms.<sup>99</sup> To justify its proposal we consider that AusNet might want to demonstrate that transitioning to 4G is the lowest cost option, over other options that may be available.

AER staff note the initiatives that AusNet is undertaking to provide further benefits of having smart meters to its customers. AER staff consider that the Victorian Auditor-General's report "Realising the Benefits of Smart Meters" may be a useful reference in regards to the benefits that Smart Meters can deliver.<sup>100</sup>

## 4.3 Major asset replacement

The Customer Forum was presented with nine major asset replacement projects. The projects are for the replacement of deteriorated equipment within zone substations. The deterioration of the equipment over time raises the risk of a failure and of possible unplanned interruptions to customer's supply.<sup>101</sup>

### 4.3.1 Draft agreed outcomes

The Customer Forum and AusNet have not yet negotiated any major asset replacement capex (repex) projects. The Customer Forum considered that, as affordability is currently the primary concern for most customers, it would be consistent with customer preferences to explore deferrals to the timing of projects where the increase in reliability risk was relatively small.<sup>102</sup> Consequently AusNet is consulting on the impact on cost and reliability of deferring some major replacement projects.<sup>103</sup>

In considering the repex proposal the Customer Forum was unclear how AusNet had ranked the projects. AusNet acknowledged the absence of criteria and project rankings was a fault of not just the presentation but its Distribution Annual Planning Reports, which are a primary reference source. AusNet has agreed to incorporate criteria and rankings into future publications.<sup>104</sup>

### 4.3.2 Draft areas of disagreement and further work

AusNet is seeking feedback from its customers on their preference for deferring zone substation works.<sup>105</sup> AusNet and the Customer Forum will resume negotiations on the major

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<sup>98</sup> AER, Better Regulation Expenditure Forecast Assessment Guideline for Electricity Distribution, November 2013, p. 17.

<sup>99</sup> AER, Better Regulation Expenditure Forecast Assessment Guideline for Electricity Distribution, November 2013, p. 14.

<sup>100</sup> Victorian Auditor General, Realising the Benefits of Smart Meters, September 2015.

<sup>101</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 58.

<sup>102</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 58.

<sup>103</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 32.

<sup>104</sup> Customer Forum, AusNet Services EDPR Customer Forum – Interim Engagement Report, February 2019, p. 32.

<sup>105</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 58.

asset replacement projects once sufficient feedback has been garnered from AusNet's customers.<sup>106</sup>

### 4.3.3 AER staff view

AER staff consider that how costs and benefits of deferral are shared between AusNet's customers may affect feedback on the major asset replacement projects. The outages that may result from deferral would only affect customers connected to the zone substation in question. However, any cost reduction from the deferral is shared across all AusNet's customers. This can make the choice for those customers quite stark. For example, customers connected to AusNet's Thomastown zone substation have a choice between a cost-per-customer reduction of 10 cents per annum or an additional 41 minutes-off-supply in the forecast period.<sup>107</sup> AER staff consider that it would be informative to see what customer preferences would be if the cost reduction was only shared between customers that may experience a degradation in reliability.

Given the sharing of major asset replacement costs, AER staff suggest that the outcomes of consultation on deferral should be considered together with a cost/benefit analysis for each of the projects. The AER will consider AusNet's cost/benefit analysis when undertaking its review once AusNet has submitted its proposal. AER staff consider that Values of Customer Reliability (VCRs) are an important input into the cost/benefit analysis. VCR is a critical input into identifying efficient levels of network expenditure.<sup>108</sup> VCRs seek to reflect the values that different types of customers place on reliable electricity supply under different conditions and are usually expressed in dollars per kilowatt hour (kWh).<sup>109</sup>

The AER is currently conducting a review to determine the VCR's that should be used when considering network planning and development. It may well be the case that the AER's VCR might not be representative of customers in a specific area. In this instance, applying an alternative VCR in the cost/benefit analysis for a replex project might be appropriate. However, AER staff recommend that rigorous, unbiased and statistically robust research be provided to justify an alternative VCR. This could usefully consider specific customer cohorts including vulnerable and Life Support customers.

AusNet's presentation of the deferral option might also cause confusion. AusNet's does not present the expected cost reductions and reliability impacts of deferrals on the same basis. AusNet presents the cost reduction on an annual basis but presents the reliability impact over the whole 2021 to 2025 period.<sup>110</sup>

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<sup>106</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 59.

<sup>107</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 60.

<sup>108</sup> AER, Values of Customer Reliability Consultation Paper, October 2018, p. 3.

<sup>109</sup> AER, Values of Customer Reliability Consultation Paper, October 2018, p. 3.

<sup>110</sup> Reliability is measured as total expected outage duration, expressed as the number of minutes each connected customer could expect to be off supply, during 2021 to 2025. Cost per customer is the revenue associated with the projects (i.e. opex and return on and return of capital, rather than the total capital cost of delivering the project, which will be recovered over a long period of time) and is an annual average over 2021 to 2025, expressed in nominal dollars. There is no change to the reliability outcome for Newmerella as the reliability improvement under the original agreed cases occurs after 2025.

AusNet considers that, if the major asset replacement projects proceed, its STPIS targets for the 2021-25 period should be adjusted.<sup>111</sup> AER staff note that under the STPIS, AusNet's performance targets are based on average performance over the past five regulatory years.<sup>112</sup> To justify adjusting the targets AusNet should demonstrate that the deferrals constitute a material deviation its asset replacement approach in the period over which its performance targets are determined.

The AER has recently published a note on asset replacement planning which AER staff consider AusNet and the Customer Forum will benefit from having regard to when considering asset replacement projects.<sup>113</sup>

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Ref: AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 60.

<sup>111</sup> AusNet Services, Delivering Better Outcomes For Customers, Draft Electricity Distribution Regulatory Proposal, 1 January 2021 to 31 December 2025, February 2019, p. 60.

<sup>112</sup> AER, Electricity Distribution Network Service Providers Service Target Performance Incentive Scheme Version 2.0, November 2018, p. 10.

<sup>113</sup> AER, Industry practice application note Asset replacement planning, January 2019. This note is available at: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/industry-practice-application-note-for-asset-replacement-planning>

## 5 Engagement Report

AER staff request that the Customer Forum's final engagement report, but also AusNet documents, better give effect to section 5 of the MOU.

Section 5 of the MoU sets out what the Engagement Report must include. In summary, the Engagement Report:<sup>114</sup>

- (i) identify the matters in the Regulatory Proposal that are within the Scope of Negotiation and were considered by the Customer Forum;
- (ii) to the extent there is agreement between the Customer Forum and AusNet Services as to how one or more of the matters identified in paragraph 5(d)(i) are addressed in the Regulatory Proposal:
  - (1) confirm the nature and scope of the agreement; and
  - (2) explain how the matter is consistent with or best reflects the perspectives and preferences of AusNet Services' customers, including by reference to customer research or consultation undertaken;
- (iii) to the extent there remain areas of disagreement between the Customer Forum and AusNet Services about one or more matters within the Scope of Negotiation;
  - (1) identify the areas of agreement and areas of disagreement;
  - (2) for the areas of agreement, provide the information required in clause 5(d)(ii);
  - (3) summarise the process followed by the Customer Forum and AusNet Services in seeking to reach agreement on the areas of disagreement; and
  - (4) summarise the reasons of each of the Customer Forum and AusNet Services in support of their respective positions on which there remains disagreement.

The interim engagement report does not clearly set out which elements of the in scope matters are agreed. For those issues that are not agreed, it does not explain why the Customer Forum was unable to reach agreement with AusNet on those issues. For areas in which AusNet and the Customer Forum disagree, AER staff would also like to understand the respective positions of AusNet and the Customer Forum on those issues.

The Customer Forum's interim engagement report outlines the customer research on the perspectives and preferences of AusNet's customers. It then uses this research to establish the Customer Forum's position. AER staff consider more clarity is required on what agreement was reached with AusNet on in scope matters and how this agreement (as opposed to the Forum's negotiating position) is consistent with, or best reflects, the perspectives and preferences of AusNet Services' customers. For example, the Customer Forum has agreed to elements of an opex step change on the basis that it will lead to improved customer service. However, the Customer Forum have not outlined what they understand these customer service improvements to be.

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<sup>114</sup> Memorandum of Understanding between AusNet Services and the AER and Tony Robinson Chair of the Customer Forum on behalf of the Customer Forum, June 2018, pp, 4-5.