

Report to Energy Consumers Australia

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A review of Jemena Electricity Network  
Draft Plan (2021-2025)

Spencer & Co  
Business advisory services

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April 2019

# Background - general

## Changes to the framework

The Regulatory Framework has changed in recent years to provide for formal customer representation in regulatory processes via the Customer Challenge Panel and greater support for local customer advocates via the nationally funded body, Energy Consumers Australia.

The removal of rights to appeal the merit of regulatory decisions has led business to look to customers and their advocates to provide assurance to the Australian Energy Regulator (AER) that regulatory proposals are in customers' interests.

Businesses are now engaging with customers directly and taking on feedback with the goal that with sufficient support and endorsement from customers and advocates, proposals can be accepted by the AER (subject to AER's robust assessment).

## The benefits

The process is front-loaded with large amounts of public discussion occurring *before* the formal start of the regulatory process. As a result:

- Customers are more informed at the beginning of the regulatory process and have more time to contribute to proposals

- Simpler, more accessible (i.e. less technical) information is being provided to customers. Documents now focus on customer issues and are beginning to tie costs of service to tangible benefits customers can expect to receive.
- Controversial issues such as Weighted Average Cost of Capital (WACC) are settled via a separate decision and do not form part of the current process. This reduces the level of complexity in the consultation material.
- Businesses now provide summarised data in customer friendly formats to demonstrate trends and seek assurance from customers and their representatives.
- Businesses also conduct 'deep dives' for advocates and stakeholders who are interested in understanding the detail underlying the plans.

## The cost

- Providing customers with sufficient background information to enable meaningful participation in discussions is time consuming and can be costly. It requires commitment to a long 12-18 month process of engagement prior to formal lodgement of a regulatory proposal to be effective.

- The high level nature of the documents provided in this early phase of the regulatory process has limitations. It is hard for customers to understand how a business is performing over the longer term, or how it is performing compared to peers.
- Detailed data is typically not provided in Draft Plans and is only available for past years via AER Regulatory Information Notices - a collection of more than 70 separate spreadsheets of data that is largely impenetrable to customers and most advocates.
- Detailed data for the forthcoming period is not available and will only be submitted with the formal proposals.
- Deep dive sessions are only accessible to well-resourced advocates who have time and resources to attend sessions in person.

## The role of these comments

Given the limitations above, the comments within this report should be considered as those of a 'coach' rather than those of a 'critic'. There is insufficient data to make definitive statements but in most cases, there *is* sufficient information to highlight areas where more information will be required, or where issues raise concerns or are confusing.

# Customer engagement in Victoria

The Victoria Distributors have made significant efforts to engage with customers using a variety of techniques from online and telephone surveys, to focus groups, People's Panels, deliberative forums, in-depth interviews and deep dive sessions with stakeholders. The time and effort and expertise involved in the process is impressive. Most importantly, there is clear evidence that the views and preferences of customers have influenced distributors plans.

	Jemena	AusNet services	Citipower	Powercor	United Energy
Customers surveyed	319 online	1600 online 350+ telephone	1650 online (including 400 SMEs)	1609 online (including 404 SMEs)	1609 online (including 405 SMEs)
Focus groups & Deliberative forums	6 People's Panel sessions 13 focus groups	10 focus groups	4 forums	4 forums	3 forums
Customers involved in focus groups	43 residential participants	76 participants	145 participants	174 participants	161 participants
Time line	Began Nov 2017	Began January 2018	Began March 2017		
Network tours	3 tours	-	-	-	-
Management / Board involvement	Executive and Board	Executive	Executive		Executive
Stakeholder interviews	Yes	70 interviews	10 interviews 5 mini discussion groups	15 interviews 9 mini discussion groups	14 interviews 7 mini discussion groups
Deep Dive sessions	1 all-day session	3 sessions	3 sessions		

# Engagement - Jemena

## Jemena's commitment and investment in customer engagement makes it a leader in engagement within the National Electricity Market (NEM)

Jemena has demonstrated a long-term commitment to understanding customers interests, and most importantly, has demonstrated a preparedness to act on the issues raised by customers - be they related to core business, or issues that Jemena's customers want the company to advocate on their behalf.

Jemena has thought strategically about engagement and systematically examined how best to engage customers? who to engage? and on what issues to engage?

Jemena have used the International Association for Public Participation (IAP2) framework and have strived to engage at the 'Collaborate' level in the framework. In so doing, Jemena have made a promise to the public to seek advice in forming solutions and incorporate that advice in decision making.

**How?** Jemena asked its key customer / stakeholder groups how they would like to be engaged and designed different mechanisms and opportunities for engagement based on this feedback. Jemena started early which allowed customers to become truly informed on issues they were being asked to engage on.

**Who?** Jemena reviewed its customer base and created a People's Panel that accurately reflected its customer demographic. On the business side, Jemena encouraged its senior managers and Executive to participate to hear directly from customers. Even members of the Jemena Board and the board of its parent company participated. This demonstrates the commitment of the governing and management teams to understanding customers. It also demonstrates a serious investment in both time and money to this process.

**What?** Jemena asked customers what they wanted to talk about. The topics were not narrowed up front or limited by what Jemena thought customers would consider important. This approach was more risky than controlling the topics up front, but generated trust between customers and Jemena.

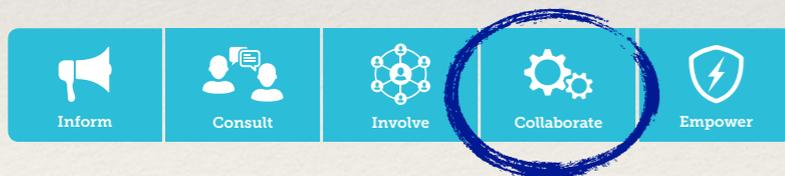
Jemena also asked other stakeholders to present to the People's Panel to ensure customers had a balanced view of issues.

**So what?** Jemena received 25 recommendations from the People's Panel and has adopted all the recommendations and used them to shape its Draft Plan. The Draft Plan does a good job in linking the recommendations made by customers to the content of the plan and demonstrates how the recommendations have influenced the business.

Jemena learned from its customers about their priorities, and were surprised by the degree to which its customers are community-minded.

Jemena should be commended for their approach to engagement.

## IAP2 engagement framework



# Draft Plan - what is its role?

Following formal changes to the framework, many distributors now choose to release a Draft Plan to provide an early picture of their proposal and its price outcomes. Draft Plans are typically pitched at customers who are not overly familiar with energy regulation and the documents explain many of the central concepts.

## Detail (or lack thereof)

There is a range of detail presented in Draft Plans. The documents to date have ranged from 30 page slide packs to 80-100 page reports. Some include charts with no numbers and other businesses include tables of numbers in appendices to support their story.

The level of detail provided (or not provided) indicates the type of information and feedback that businesses expect or want to receive from readers.

- A high level of detail assumes that those reading the document will have detailed and informed feedback.
- A low level of detail assumes readers will respond with high level feedback that supports or questions the general direction the proposal will take.

For some businesses, the Draft Plan has started to fulfil the role of the initial Proposal despite having no formal status under the Rules. However, unlike the initial Proposal, there is insufficient supporting detail or data to justify investment decisions or explain investment criteria and methodology. With less information included, how do we respond?

Other questions that are also raised by this process are as follows:

- Do plans / proposals really change between the Draft Plan and the initial proposal in practical terms?
- Does the Draft Plan simply show customers who have been engaged in the development of the plan that their feedback has been incorporated in the plans?
- For those that have not been involved, do we get comfort from the fact that others have?

The Draft Plan is one part of the early consultation process taking place. 'Deep Dives' on specific subjects are often held to provide interested parties with more detail about forecasts and investments. The Deep Dive sessions are very useful in explaining the underlying data behind the story and they allow advocates to test assumptions.

So what is the right level of detail for the Draft Plan? To the extent that distributors are seeking endorsement of Draft Plans, they need to provide sufficient information for those reading to make specific comments and definitive statements about forecasts. Where distributors seek high level feedback about trends, issues and directions, less detail is appropriate.

## What does best practice look like?

- **Open discussion** allows customers and stakeholders to direct the conversation. Some companies have set topics to discuss and others provide loose guides for discussion. Customer engagement that is narrowed up front produces narrow feedback in response. Engagement that is more expansive tends to have a broader influence and has the potential to change operations and culture outside of the regulatory process, or prompt businesses to collaborate with other stakeholders to improve outcomes for customers that are not within the regulated business's purview.
- The **timescale** over which engagement occurs determines how influential community/customer attitudes are likely to be on the business. Allowing sufficient time for feedback shows a strategic intent by the company and demonstrates how much it wants customers to influence business strategy. It also shows how important it believes feedback will be.
- **Representing the customer base** is important. Some businesses have gone out of their way to represent their customer base in forums to ensure key characteristics of age, linguistic background, gender, disability, home ownership and technology use are represented. Others have failed to adequately represent some groups within their franchise and have therefore missed rich insights garnered from a diversity of opinion and experience.

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# Energy industry transformation

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## Megatrends

Jemena has undertaken a thorough consideration of global trends and thought carefully about the impacts of these trends on its business.

Consideration of mega trends is important as it shows that the business has examined a range of different futures that it may face and acknowledges that the solutions required to address future challenges will be different to those that have been available in the past.

Discussion of these issues demonstrates skill in communicating complex ideas to customers and skill in being able to link these concepts to business needs today.

## Government policy

The Victorian Government's renewable energy targets of 25% by 2020 and 40% by 2025 is driving an increase in connections of large scale wind and solar generators to the network and provides incentives for households to install PV on their roofs.

The impact on the distribution network is being identified by increasing voltage complaints from customers in areas of high solar penetration. While this impact is being seen in pockets of the network to date, distributors predict that voltage issues will be felt across the network as solar penetration increases.

There is much talk of customers' solar systems being 'constrained off' to prevent export at times of peak network load. What we have not yet seen is analysis about whether this constraint is likely to occur a lot of the time or at only short intervals.

We would expect the distributors to apply the same level of analysis that is applied to risk when building and replacing network assets to also be applied to this issue. We would expect better underlying analysis of the problem to occur before a wide-spread roll out of programs to enable control of DER takes place.

## The benefits of flexible grids

The programs put forward by distributors are designed to gain better 'behind-the-meter' asset information. There is little discussion in the proposals about why this information is not already available through smart meters given that import and export data is recorded on separate channels within the meter, and already available to the distributor. Furthermore, retailers have information about customer assets which, could be shared with distributors in future.

Businesses are starting to make use of metering data already available to identify issues on the network. It is reasonable to expect that further data analysis will identify other benefits to the networks that will lower costs in future.

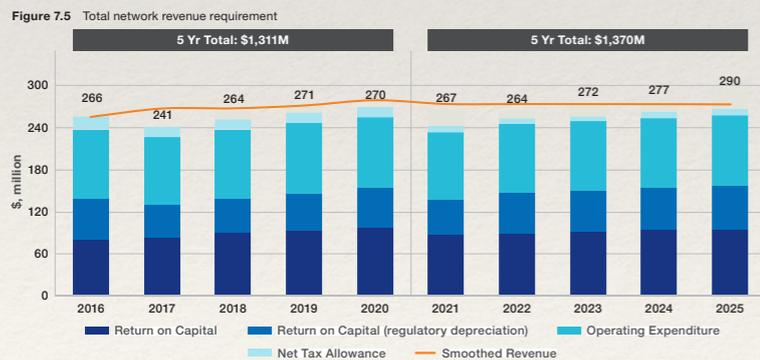
The pursuit of greater information must be paid for by benefits to customers. It is not sufficient that customers pay for more information to be collected and stored without a benefits case clearly articulated.

# Jemena revenue

Jemena predicts flat revenues in real terms for the forthcoming period 2021-25.

The relatively flat revenue forecast masks the impact of a lower WACC which we would expect to drive reductions in revenues and prices. However, Jemena has calculated that the fall in WACC only contributes \$10m reduction in revenue (3-4%). So what else is driving costs up?

Jemena's forecast capex is lower in the forthcoming period than it is in the current period. Customer growth appears to be a significant driver of capex through increased connection expenditure. Replacement capex is rising also, but this is offset by lower augmentation expenditure and lower property costs.



Jemena's Regulatory Asset Base (RAB) is forecast to rise by \$100m over the period but is stabilising on a per customer basis. This is important for future affordability.

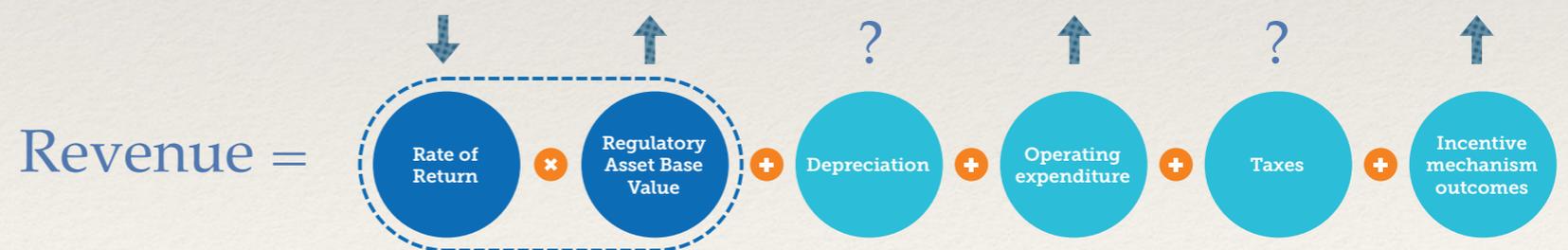
So again, what is putting upward pressure on revenues?

Operating costs are rising. This is largely due to a change in the capitalisation of corporate overheads which is responsible for \$12m (or 10% increase in opex).

Jemena expects base year costs to rise by 2% per annum to take account of forecast labour and materials cost increases over the period. However, Jemena has applied a 1% productivity escalator to operating costs which partly offsets real cost escalation.

There is little information about depreciation or tax revenues within the Draft Plan. These issues are technical but it is appropriate that Jemena explain how these components of the revenue forecast contribute to higher / lower revenues and what is driving the changes. Without this, it is difficult to see what is driving the revenues outcome. Providing detailed breakdown of revenue building blocks in a table form would be useful.

The forecast revenues in Jemena's Draft Plan show a 0.5% reduction in prices (before inflation) equivalent to a \$90 reduction in costs over 5 years. This is relatively modest in the context of a lower WACC. Subsequent analysis by Jemena shows that when growth in customer numbers is taken into account, cost reductions for average residential customers are \$138 over five years. This is better news for customers.



# Jemena capex

## Lack of project detail leads us to comment on trends.

Jemena's underlying **replacement capex** is increasing by 7%.

Replacement must be driven by thorough asset condition assessment with an overarching consideration of future network use and sustainable levels of investment. There is insufficient detail in the Draft Plan to assess whether this is the case.

We would expect Jemena to demonstrate how its proposed levels of replacement compares with the AER's repex model and how it has considered the needs of the network of the future.

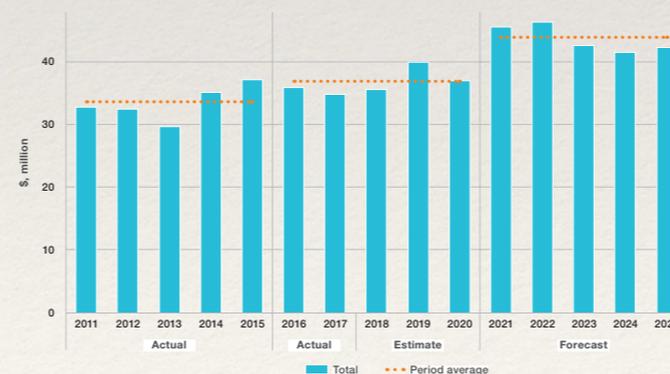
Further we would expect Jemena to make use of new technology to better assess condition and better time asset replacement. For some distributors, new technology has led to significant deferrals and lower costs, particularly in populations of wood poles.

**Customer connections** are forecast to grow by 1.6% per annum. It is recommended that this forecast growth be presented in the context of historic growth to show that this is consistent with recent trends.

Customer connection capex is forecast to increase by 19% compared to the previous period. This is a significant step up in expenditure in the largest capex category - one worth over \$40m per annum.

The lack of detail makes it difficult to ascertain whether the step up in connections between periods is consistent with a step up in growth rates, and whether the forecast step change is reasonable.

We would expect Jemena to outline its underlying assumptions, including data sources, in its proposal so the veracity of the average costs of connection used and the relationship between costs and growth can be understood.



It is unclear how much of the expenditure is linked to organic growth and funded by the network versus major connections which are largely funded by customers themselves. Jemena should consider showing the net cost to customers in its charts to make it clear what the average customer will be paying for.

Showing the contribution of major customer connections would make the underlying growth patterns more clear. However, we expect the AER to focus on Jemena's customer connections program due to the program's size and significance.

Jemena's \$100m **augmentation capex** program is forecast to fall by 5.2%.

Modest peak demand in future, and the benefit of previous augmentation projects have largely addressed major capacity shortfalls. It would be useful to understand whether expenditure on augmentation capex in previous periods is now being captured by connections capex, particularly in the major connections area.

Future Grid expenditure is a significant new program in the augmentation category and in IT.

# Jemena - non-system capex

Jemena's **non-system capex** program is declining in terms of recurrent expenditure. However, overall costs are higher. 16% of the total capex program is IT related.

IT capex has a shorter life and attracts higher depreciation than network assets, and consequently has a relatively larger impact on revenues and prices. It is a challenge for businesses to invest in IT and keep prices low. On the other hand, IT investment has the potential to drive productivity and efficiency.

Additional detail was provided about the IT asset management and investment philosophies behind Jemena's IT investment decisions through deep dive sessions. Decisions to consider alternate vendors in future, particularly in the context of cloud sourcing is appropriate and consistent with driving IT efficiencies. Jemena also reflected that its move to more cloud based facilities did not produce a higher opex due to offsetting annual upgrade costs that will no longer be required.

Jemena has cost advantages over some NEM peers by being able to share corporate systems between its various businesses.

Benchmarking provided by Jemena based on RIN data also suggests Jemena is relatively efficient in IT expenditure. That said, there are a few areas of concern.

**5-minute settlement (\$23m)** - This compliance program is significant and requires close examination. It contributes 21% to the overall IT program. It is expected that as further detailed planning takes place, costs will be better understood.

AEMC acknowledged the likelihood of higher IT and metering system costs when making the rule. However, expert submissions to AEMC's review suggested some metering and data transmission costs provided by distributors were inflated. Furthermore, we understand that cost estimates are likely to change as AEMO's implementation plans become more clear. Jemena should respond to claims of inflated cost forecasts in its submission and provide a break down of costs for this project and its level of confidence in the costings based on up to date information from AEMO.

**Future Grid (\$12m)** - Investment in Jemena's Future Grid program is also significant and requires further testing to ensure investment is in fact, in the long term interests of customers.

There is considerable uncertainty about how increasing solar penetration and the effect of Government subsidies will affect networks and the timing of these effects.

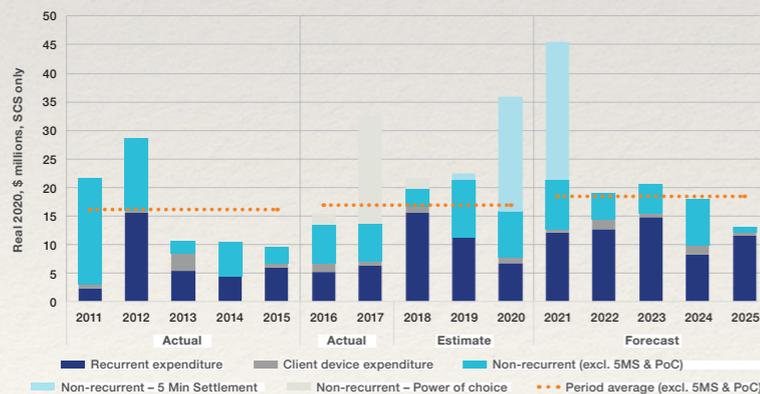
Jemena has done some good analysis to determine the lowest cost investment program over time. However, the lack of certainty makes it difficult to ascertain whether the assumptions underlying the analysis are correct.

Jemena could examine some risk sharing options such as staging the program, or returning funds to customers in the event that implementation of a solution is cheaper than forecast. A panel of customers / experts could be involved in future decision making.

**Customer experience program (\$5m)** - This program will no doubt provide improved outcomes for customers. What is less clear is whether customers will pay twice for outcomes from this program if a Customer Service Incentive Scheme were introduced in this period. Thought should be given about how to ensure this is not the case.

Jemena's attitude to IT appears to be appropriately measured. By way of example, Jemena mentioned its customer focus would require an improvement to systems, but not the introduction of a full Customer Relationship Management (CRM) system. We support investment in IT where it delivers real benefits to customers, and are pleased to hear examples from businesses where investment is well considered and forecasts designed to minimise the cost to customers as much as possible.

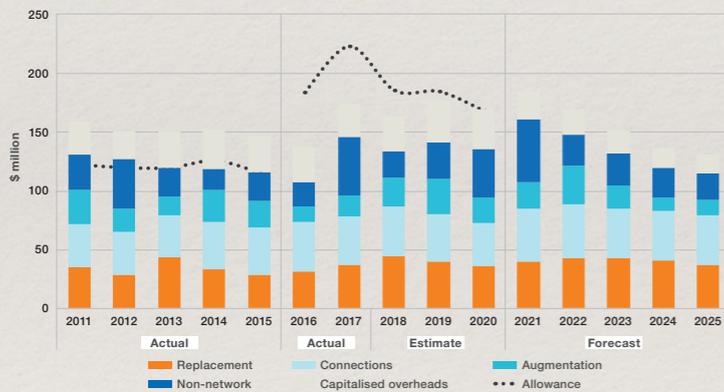
Figure 5.14 Non-network IT capital expenditure - excludes metering



# Jemena - total capex

**Total capex** forecast by Jemena shows a significant underspend during the current period. This prompts concern about the accuracy of Jemena's forecast for 2021-25 particularly in the context of the Capital Efficiency Sharing Scheme (CESS).

As context to the forecast for the 2021-25 period forecast, it would be beneficial to understand just how much of the reduction in capex in the current period is due to external factors outside Jemena's control (changing demand or fewer customer connections than was forecast) and how much can be attributed to Jemena's innovative risk management and/or efficient delivery.



Declining capex will put downward pressure on RAB growth which reduces the burden for future generations. We support Jemena's efforts to achieve a consistent level of capex that better reflects ongoing needs rather than boom / bust cycles of the past.

## Customers have received improved reliability

We note the improvements in reliability in Jemena's network that have occurred in the past decade. A significant part of the improvement is likely to relate to improvement in asset management techniques which better predict asset health and likelihood and timing of failure leading to proactive maintenance and replacement while keeping costs low.

Undoubtedly, the Service Target Performance Incentive Scheme (STPIS) scheme has influenced the focus on reliability and the improved outcomes for customers.

Jemena has received a total of \$52.8m from STPIS since 2010. We would hope that targets for the STPIS in 2021-25 reflect this improved performance and that customers see the benefit of good asset management and well-targeted investment into the future.



Figure 5.4 Reliability over time-unplanned SAIDI (measures the frequency of outages)

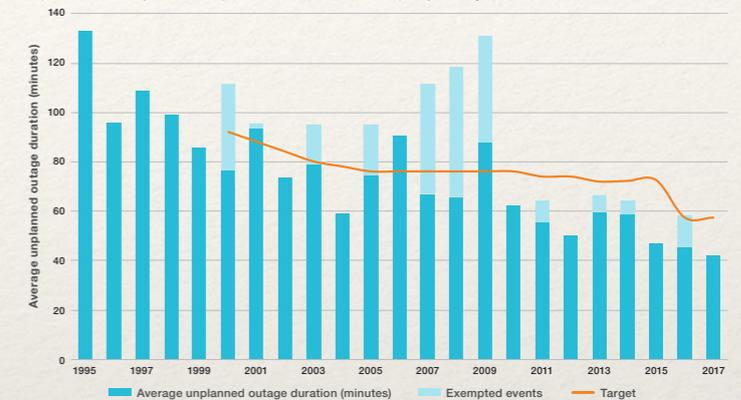


Figure 5.5 Reliability over time-unplanned SAIFI (measures the frequency of outages)



# Jemena opex

## Base year - is it efficient?

Jemena has undertaken a transformation program that has reduced underlying opex at a cost to the business of \$20m.

The reductions in opex are expected to generate \$46m worth of benefit to customers (\$9m/year over 5 years). Jemena has forecast ~\$60m worth of Efficiency Benefit Sharing Scheme (EBSS) benefits to accrue in the 2021-25 period that will more than compensate the business for its cost reduction efforts. The largest savings are coming from optimisation of staff levels and field forces as well as procurement.

Jemena explains that it has set its base year on the forecast of savings which have not yet been realised. On the other hand, customers do not know whether those savings are in fact part of a larger planned program of savings, and whether in fact more opex reductions are planned for the future that could be passed to customers immediately through a lower, more efficient base year.

In 2016-2021 Jemena initially sought operating costs that were 5% higher than the forecast put forward in its revised proposal, which was itself 4% higher than the allowance granted by the AER. Despite the lower allowance, Jemena was able to outperform the allowance and generate ~\$60m of EBSS rewards to be paid in the forthcoming period.

In 2016-21, Jemena sought \$60m (\$2015) and was granted \$17.1m (\$2015) in step changes to address one-off changes in costs at the start of current period.

The AER's methodology allows for positive step changes, but where positive step changes are overestimated EBSS rewards become easier to deliver. It would be useful to understand whether the step changes in costs foreshadowed by Jemena in the current period did eventuate and whether Jemena was over-compensated at that time. Some detail on this matter could increase the credibility of the transformation savings as being the result of sustained management effort rather than prior over-forecasting. That in turn would provide some comfort that Jemena's base year does represent an efficient starting point.

Jemena's efficiency performance as measured by the AER's econometric analysis is declining as the efficient frontier changes. Comparing a business with itself over time is reasonable. Growth in customer numbers is likely to improve benchmarking outcomes somewhat but the analysis does raise issues about the efficiency of the base year.

## Step changes - are they justified?

The change to expense corporate overheads rather than capitalise them is the most significant change to operating costs. It will drive up opex costs by \$12m per year.

The timing is good for Jemena to make this change. A lower WACC allows Jemena to align its regulatory tax treatment with its statutory accounts without a significant price impact to customers. Aligning tax treatment with other distributors is reasonable.

Jemena notes that capitalised overheads fall as capex declines. It is important that this is shown not only in the base year but reflected in the underlying costs throughout the period. We would expect the \$12m wedge that Jemena has added to base year opex to get smaller over time to reflect declining capex.

Jemena have not sought a step change in opex to cover forecast cost increases. In discussions with Jemena, this does not mean that cost increases are not forecast, but rather that the business intends to accommodate higher future costs through efficiencies elsewhere. This is a commendable strategy but one that gives further support to the possibility that Jemena has a further transformation program waiting in the wings that will more than compensate for these forecast costs through the operation of the EBSS. The question is, should customers wait 6+ years to receive 70% of the benefits of lower costs rather than receive 100% of benefits now.

## Trend - is it reasonable?

Jemena intends to use the AER's methodology to establish trends of forecast cost escalation. We anticipate that the AER will update its forecasts closer to the time of the determination and that this update will reflect changes in economic factors such as recent softening in inflation expectations and labour costs.

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# Jemena Productivity

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## The AER says...

In its draft decision the AER recommended that a 1% productivity escalator be applied to distribution businesses. This means that businesses allowances would reduce by 1% per annum (on average).

In its final decision, the AER reduced the escalator to 0.5% which reduces the expected cost improvement over the period. The AER said that "an estimate of 0.5 per cent per annum is the best available estimate of the productivity growth factor, while providing scope for individual distributors to propose some "catch up" to efficient operations within their revenue proposals."<sup>1</sup>

## Jemena says...

Jemena has said that it will apply the AER's decision in relation to productivity to its opex forecast.

Jemena incorporated the AER's draft decision to apply 1% productivity escalator to its opex forecast providing it with a further challenge to drive costs down.

## What is best for consumers?

The best outcome for consumers is lower costs over the longer term. It is in the interests of customers that businesses are provided with strong incentives to reduce costs, but that customers receive a fair share. The significant EBSS benefits being paid to Victorian distributors by customers suggest that it may be time to review the benefit sharing ratio between distributors and customers. The AER says in its decision that the productivity escalator is not intended to rebalance the sharing mechanism of the efficiency schemes. However, applying a productivity factor will have a similar effect.

The step change in technology used to deliver services for customers (automation of solar applications as just one example) is expected to drive improvements in productivity of which customers should see the benefits in the short term rather than having to wait a further 6+ years for benefits to flow.

10-year bond rates are at lowest levels since 2016 signalling expectations of further Reserve Bank rate cuts and lower inflation. In this context, wage and cost inflation could be expected to soften and consequently, productivity to improve.

Despite the AER having reduced its productivity escalator to 0.5%, there is a case to be made as to why Jemena would not continue to apply the higher productivity measure to its forecast. To do so would certainly be in the interests of customers.

If Jemena thought it could achieve those savings in the future, why not deliver those benefits to customers immediately through a higher productivity factor applied to its forecast?

Passing cost benefits on immediately would provide comfort that if there were a further cost transformation program waiting to be implemented, a portion of benefits would flow immediately to customers. This position would align with Jemena's commitment to improve energy affordability for customers. In addition, it could allay concerns about potential over-compensation of previous step changes and Jemena's declining opex benchmarking performance.

<sup>1</sup> AER final decision paper, "Forecasting productivity growth for electricity distributors, March 2019, p17.

# Incentives

## An incentive regime with added incentives.

The simple building block model has been amended over time to close gaps that, left unchecked, could lead to perverse business behaviour.

- \* The EBSS ensures businesses have consistent incentives to reduce operating costs throughout the regulatory period. Without this mechanism, businesses have an incentive to inflate operating costs on which the future period opex will be set.
- \* The CESS ensures businesses have consistent incentives to reduce both operating and capital costs. Without the CESS, businesses would receive a financial benefit from reducing opex in favour of capex with no incentive or sanction for spending capex above the allowance.
- \* The STPIS ensures businesses do not reduce opex and capex at the expense of reliability and customer service outcomes. Businesses are penalised for reductions in service and rewarded for improvements above pre-set reliability and service targets.
- \* The Demand Management Incentive Scheme (DMIS) was originally designed to ensure that business did not face a dis-incentive to invest in demand management under a price cap.
- \* The Demand Management Incentive Allowance DMIA provides businesses with a positive incentive to pursue demand management solutions over traditional network solutions in response to capacity constraints.

- \* The F-factor applies in Victoria and incentivises businesses to reduce the number of fire starts caused by network assets.

## A decade, 5 schemes and more than \$2 billion later, have customer outcomes improved?

The number of schemes in place demonstrates the complexity of the current regulatory framework. The EBSS was first introduced in 2006 and over the last 9 years, other schemes have been introduced. For Victoria, the EBSS will be applied to a fourth regulatory period in 2021-25.

By the end of 2020, the incentive schemes in total will have generated business entitlements for more than **\$2 billion** of additional revenue for distributors in the NEM. Over **\$500m** of revenue has been awarded to date. This revenue is over and above the regulated return on assets awarded by the AER via the WACC.

In NSW, the AER has awarded **\$400m+** in incentive payments in its recent draft determination.

The Queensland businesses have calculated entitlements of **\$570m+** of benefits from the schemes based on costs savings over the last regulatory period. We note that Energy Queensland has said it does not intend to recover the revenue from customers in the forthcoming period.

The Victorian distributors intend to claim around **\$605m** of incentive benefits from the current period through prices in the forthcoming period (2021-25).

## Is the additional revenue received by businesses commensurate with benefits received by customers?

The EBSS and CESS schemes are designed to share rewards and penalties between businesses and customers. They provide 30% of ongoing benefits to businesses and 70% to customers over the long term. If \$2B of benefit has been earned by businesses, this suggests \$4.8B worth of benefit has (or will) flow to customers. This is increased further to over \$5.0B+ based on the Queensland decision to return the benefit to customers by not recovering scheme entitlements through prices in the forthcoming period.

Customer feedback received by all businesses is that many customers are struggling with energy affordability. Others consider current services to be expensive. Most do not want to pay less for poorer reliability, but do not want to pay any more for improvements to services.

Within this context of significant extra revenues being earned by businesses, a lack of appetite from customers to pay more, and heightened expectations of better customer service, should yet another scheme be introduced? Do businesses require an incentive mechanism to operate to improve customer service outcomes? Are the recent changes to the framework that encourage greater focus on customers and stakeholder feedback sufficient to improve customer outcomes? Or do businesses respond better / quicker (or only respond) to explicit financial rewards?

# Customer incentive scheme

## What gap is the CSIS filling?

Two of the five Victorian distributors have put forward a Customer Service Incentive Scheme (CSIS) to be applied in 2021-25 period. The schemes put forward differ in their design, but are based on the following design principles:

- ❖ The STPIS focus on telephone answering is antiquated as customers predominantly use other digital channels to access information.
- ❖ A new Customer Service Incentive Scheme (CSIS) should be designed to improve customer service (not reliability) outcomes.
- ❖ The revenue allocated to telephone answering within STPIS should be applied to the new scheme.
- ❖ Benefits and penalties should be applied symmetrically within a cap and collar mechanism.
- ❖ Targets should be set on historic data sources (source differs between distributors).

Those businesses that propose a Customer Service Incentive Scheme claim that it will help internalise customer focus in the business and drive improvement programs, particularly as many could be self-funding.

Neither business is proposing a paper trial which was used when STPIS was first introduced.

## What is being proposed?

**Jemena** suggests that the scheme be based on improvements to a range of different parameters the existing 0.05% revenue being applied as follows:

- ❖ Complaints (33%) - Reliability of supply, Admin/customer service, connection or augmentation
- ❖ Customer satisfaction - Customer connections (33%), Call Centre performance (33%)

**AusNet Services** suggests that the scheme be based on improvements to the following parameters:

- ❖ \$1m to planned outages (28.5%)
- ❖ \$1m to unplanned outages (28.5%)
- ❖ \$1m to connections (28.5%)
- ❖ \$0.5m to complaints (14.5%)

The targets will be based on most recent Customer Satisfaction surveys. The surveys have been in place since early 2018 only.

**Citipower, Powercor and United Energy** have not outlined plans for a Customer Service Incentive Scheme in their draft plans.

It would be in customers' interest if a single scheme was negotiated between businesses and put forward jointly. This would avoid a 'battle of the schemes' and demonstrate collaboration in the interests of customers.

## The devil is in the detail.

Issues to consider is designing an incentive scheme:

- ❖ **Sufficiency and consistency of data** across Distributors is likely to be problematic. Are there consistent definitions of what constitutes a complaint? What element of the connection process will be measured? Data cleansing may also be required.
- ❖ **Target poorest performance.** Issues of process improvement are easier to fix for all customers than issues such as complaints which are specific to an individual customer and inherently subjective. Targets should be set to improve poorest performance rather than set to encourage marginal improvements for the bulk of customers.
- ❖ **Potential to pay twice when customers don't want to pay extra at all.** A step change in improved customer service outcomes is expected in the next period based on committed projects within Draft Plans and ongoing pressure from customers for better service. Is this the right time to be applying incentives for improvement? Customers could end up paying for the cost of IT systems and pay again when outcomes improve above target levels. To avoid this, targets need to be forward looking and reflect a new baseline of improved customer service.
- ❖ **A paper trial** could be used to iron out data issues for both Jemena and AusNet Services, and introduced more widely following a successful trial.

# Metering & public lighting

The rollout of AMI meters in Victoria was completed in 2015. The expected life of AMI meters is approximately 15 years, and as a result, Jemena does not expect to replace large numbers of meters within this period.

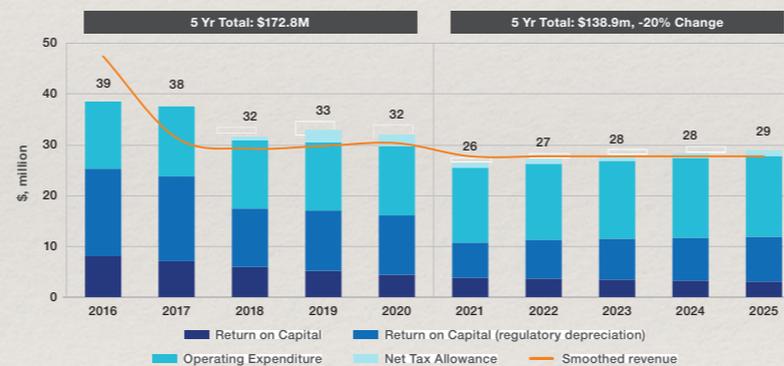
Jemena have described metering revenues in the 2012-25 period to be 20% lower overall compared to the current period. However, the fall in revenue appears to be driven by falls in WACC and lower depreciation.

The chart provided by Jemena shows that operating costs are rising. Surprisingly, the Draft Plan does not contain any information about metering operating costs or what is driving them up. We would expect Jemena to rectify this in its proposal and provide evidence to justify any cost increases.

The Draft Plan is also silent on the issue of 5-minute settlement in relation to metering revenue, and how the IT and metering cost changes foreshadowed impact Jemena's AMI services business. Furthermore, it is important to ensure that tax treatment is consistent with the AER's latest tax decision. We would expect that Jemena would update its forecast to take account of these recent decisions.

The Victorian meter fleet was installed within 2-3 years and would therefore be expected to reach end of life in the next regulatory period. It would be useful to understand whether Jemena has thought about the future of its meter fleet and its plans to cope with meter replacement should Victorian distributors maintain control over small customer metering.

Figure 7.7 Total building block revenue for AMI services for next regulatory period



# Other issues of interest

## AER Tax decision

Jemena is yet to address the change in the AER's tax treatment in its proposal. We expect Jemena to update its proposal to incorporate this change which we anticipate will lead to a lower tax allowance, and lower revenue forecast.

It would be interesting to know what impact this change has on other decisions within the proposal, if any.

## 5-minute settlement

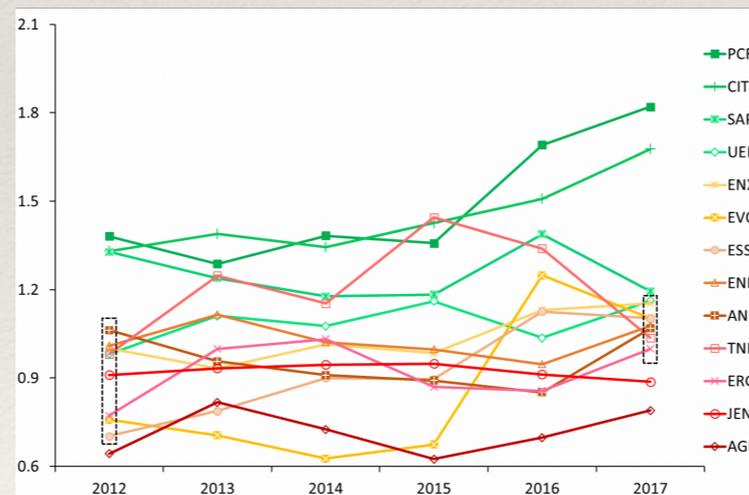
There is little doubt that changes to NEM settlement would create one-off costs, but there was significant discrepancy in submissions to AEMC about the cost of the change for networks and the market more generally. For networks, we understand costs will be driven by changes to a relatively small number of meters (boundary metering) as most AMI meters have sufficient data capacity to cope with changes (supported by meter manufacturers). Data storage will need to be increased and some system changes will be required, but we hope that any changes will be aligned to IT upgrades where possible. Data transfer costs are said to be non-linear and as a result, we expect estimates to be +70% for data costs rather than the 500% increase some distributors suggested in submissions to AEMC.

Jemena should make its case for the large IT investment for 5-minute settlement carefully to ensure that customers are not bearing more cost than is necessary to be compliant with the new Rules.

## Benchmarking

Jemena's benchmarking performance for capex is solid, but Jemena has performed less well when opex is compared to peer networks. This is somewhat surprising given that Jemena is in the fortunate position to share many of its corporate costs with its gas business and thereby achieve efficiencies not accessible to other networks.

Jemena made significant claims for opex step-changes at the beginning of the 2016-20 period, which aligns to the decline in productivity as measured by AER (see below). The transformation of costs underway at Jemena at present will go part way to addressing this trend, but larger efficiencies will be required before Jemena performs well in the AER's analysis.<sup>2</sup>



Opex multilateral partial factor productivity, 2012-17, Annual Benchmarking Report, 2018 p VI

## Depreciation

Jemena have provided very little information in the Draft Plan in relation to depreciation other than to say that it intends to apply depreciation in a manner consistent with the AER's straight-line depreciation methodologies.

The increase in IT spend across the NEM places upward pressure on prices because the costs of the investment are returned to businesses via depreciation over a shorter asset life than other network assets.

Jemena has not raised concerns of asset stranding within its network which is in contrast to its gas network. Electricity network assets that could have been stranded as a result of heavy industry closures are now being used to supply residents in these growing urban areas. The capacity available from these assets is helping to keep network augmentation costs relatively low despite steady customer growth in these areas.

# Questions put by Jemena

## *What do you think about the approach we developed to hear from our customers?*

Jemena has conducted a thorough and strategic approach to engagement and is leading the way within the industry. Jemena should be commended for its strategic approach, the timeframe over which engagement has occurred, the diversity of engagement channels used, recognition of customer diversity and reflection of that diversity in engagement, openness of communication, investment in learning, willingness to explore issues that customers have identified, willingness to go outside the typical scope for consultation, and finally, the participation of Executive and Board members which demonstrates a unique level of company commitment to understanding customer needs and delivering what customers want.

Jemena has gone out of its way to help customers provide feedback - from online feedback forms, to deep dive sessions on weekends and in the evenings to allow busy customers to attend. Jemena has tailored its engagement to the needs of customers and engaged differently with different groups based on their preferences and needs. No topics have been 'off limits' which has resulted in a broad scope of information being received including information outside of normal scope for networks.

## *Have we captured all of the customer groups?*

Jemena has focused on the future customer with diversity of motivations (from lifestyle to environment, affordability and convenience) to help it understand how customers will respond to new products such as DM opportunities, new pricing structures, and affordability issue.

The Draft Plan does not canvass the future possibility that customers will choose to go off grid. It would be worth noting the possibility of that future and the short term likelihood and location of where that might occur.

## *Are there any gaps that we haven't identified and should we go back to our customers to close them?*

The presentation of customer growth trends should show the underlying trends (i.e. remove major customer impact) and explain why customer growth is lagging in small business category (i.e. due to many new small business connections being child NMI connections within a larger parent connection such as a shopping mall).

## *Have we identified all of the key trends that could shape the energy market and impact the services we provide?*

Jemena have systematically reviewed the future landscape to identify mega trends and have tried to link them to customer issues and actions that the business should take. The trends identified appear comprehensive.

## *Are we responding the right way to the expected changes in the electricity market and have we got the timing right?*

The changes to the Grid are starting to occur and the long term impact is uncertain. Jemena should be commended for its analysis of investment options to address network constraints due to voltage issues. However, this information is not included in the Draft Plan.

We would also like to see sensitivity analysis of the forecast of solar uptake and therefore the sensitivity around the timing of network investment, and whether there is a likelihood for significant expenditure to be deferred to the following period. Thought should be given to mechanisms that could be used to address uncertainty that balance the risk of business investment and customer outcomes.

## *Are there any aspects of our expenditure program that need further explanation?*

- Flexible Grid: Jemena explained during consultation sessions that their focus is in bridging the data gap that exists because customers are not linked to specific feeders or phases in Jemena's asset systems. The question is therefore, how much data, or how accurate does the data need to be to ensure the

network can cope with solar take-up? Is there a more staged approach to target areas of solar take up first?

While Jemena's modelling shows that the smart grid option is lowest cost over long term, concerns about affordability and uncertainty about benefits lead to question whether this project should be staged over two periods, or implemented as need arises via a pass-through or some sort of look-back scheme.

- Deferrals in the context of CESS: The CESS provides benefits to businesses for efficient capex deferral. It is unclear how much/ how little of the capex deferral that has occurred has been the result of good luck or good management.

## *Are there any expected changes in expenditure trends that we have not identified?*

10 year bond rates are at lowest level since 2016 and indicate forecasts for lower inflation and a softening in the economy. This could impact on escalation factors such as forecasts of labour costs as well as forecasts for customer growth. We would hope to see this updated data reflected in Jemena's expert reports where possible, as well as in the AER's decision making when the time comes.

## *Do you have any feedback on our network pricing structures for residential and business customers?*

Energy Consumers Australia is participating in the Victorian Tariff Roundtable discussions.

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# Contact us

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