ACIL ALLEN CONSULTING

REPORT TO
ESSENTIAL SERVICES COMMISSION

8 MAY 2017

NEW FRAMEWORK FOR CUSTOMERS FACING PAYMENT DIFFICULTIES

PRELIMINARY ASSESSMENT OF THE RETAILERS' COSTS

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ABBREVIATIONS

ACIL Allen	ACIL Allen Consulting
AER	Australian Energy Regulator
Commission	Essential Services Commission of Victoria
framework	Payment difficulties framework
FTE	Full Time Equivalent
Hardship Inquiry	An inquiry undertaken by the Commission to examine the best practice of energy retailers' management of financial hardship, and identify options for improving how retailers assist customers
IT	Information Technology
NPV	Net Present Value
TBS	TBS Consulting Group

GLOSSARY OF TERMS

Avoided costs	The costs avoided by the retailer by discontinuing current practices for managing customers facing payment difficulties with the commencement of the new payment difficulties framework
Customer weighted average cost per customer	Cost per customer estimated by weighting each of the retailer's costs per customer by the number of customers for that retailer
Default assistance	An entitlement to give assistance to residential customers who are in arrears and not receiving tailored assistance, to repay their arrears over a fixed period
Minimum cost per customer	Lowest cost per customer estimated for each of the nine retailers reviewed as part of the Hardship Inquiry
Maximum cost per customer	Highest cost per customer estimated for each of the nine retailers reviewed as part of the Hardship Inquiry
Standard assistance	An entitlement to minimum standard forms of assistance for all residential customers, to help them avoid getting into arrears with their retailer
System change	A change that is required to the retailers' IT systems for the introduction of the new payment difficulties framework
Tailored assistance	An entitlement to minimum standards of flexible and practicable assistance to all residential customers who are in arrears, to make it easier for them to repay their arrears and lower their energy costs

EXECUTIVE SUMMARY

ACIL Allen Consulting (ACIL Allen) has been engaged by the Essential Services Commission (the Commission) to undertake a preliminary assessment of the impacts of a proposed new payment difficulties framework (framework) on the Victorian energy retailers, to inform its draft decision.

A detailed Information Request accompanies this report to collect information to enable a more detailed assessment of the impacts, to be undertaken to inform the Commission's final decision.

The proposed new payment difficulties framework provides three types of assistance to which residential energy customers that are anticipating or facing payment difficulties are entitled, so that disconnection is a measure of last resort. These are referred to as standard assistance, tailored assistance and default assistance. There are also miscellaneous and consequential changes proposed to the Energy Retail Code.

A preliminary assessment of the impacts of the proposed new framework has been undertaken by considering:

— the obligations that are placed on the retailers under the proposed framework
— for each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulties were reviewed as part of the Commission's Hardship Inquiry[1], which of those obligations are currently provided by the retailer and which are new
— for each of the obligations, the system changes, upfront process changes and training, and ongoing process changes that are required to meet that obligation
— an estimate of the costs associated with the system changes, upfront process changes and training, and ongoing process changes identified
— an estimate of the costs that would be avoided by implementing the proposed framework (the avoided costs)
— the costs that are estimated to be incurred by each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulties were reviewed
— by extension, the costs that are estimated to be incurred by all Victorian energy retailers.

The preliminary assessment is based on retailers meeting the proposed minimum standards for the payment difficulties framework. It is assumed that the retailers will exceed the minimum standards where there is a net benefit for them to do so.

The analysis of the system changes, upfront process changes and ongoing process changes assumes that the rate of disconnection and the average debt per customer remain unchanged. Given the uncertainty associated with these assumptions, sensitivity analysis has also been undertaken to vary the rate of disconnections and the average debt per customer. We have also analysed the impact

[1] Essential Services Commission, *Supporting Customers, Avoiding Labels. Energy Hardship Inquiry, Final Report*, February 2016

on the retailers' total debt based on our assumption that some customers will transition from tailored assistance to standard assistance two years after commencement of the new framework.

Costs estimated to be incurred by the nine retailers reviewed as part of the Hardship Inquiry

The costs per customer associated with the proposed payment difficulties framework, for each of the nine retailers whose policies, procedures and practices for managing customers facing payment difficulties were reviewed as part of the Hardship Inquiry, are summarised in Table ES 1 and are illustrated, by size of retailer, in Figure ES 1. The cost per customer includes the estimated costs avoided by moving to the new framework.

As the accuracy with which the system costs have been estimated is better for the three large retailers (AGL, Energy Australia and Origin Energy) than for the smaller retailers, and to protect the anonymity of the retailers, the three large retailers are identified as "Large retailer 1", "Large retailer 2" and "Large retailer 3", with the smaller retailers identified as "Other retailers".

TABLE ES 1 ESTIMATED COST OF PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, BY RETAILER

Retailer	Upfront cost per customer			Net ongoing operating cost per customer (per annum)	
	System	Process	Total	First 2 years	Thereafter
Large retailer 1	$11.04	$1.29	$12.32	–$0.92	–$2.33
Large retailer 2	$10.24	$1.45	$11.69	$1.19	–$0.21
Large retailer 3	$8.35	$1.18	$9.53	–$2.71	–$4.12
Other retailer 1	$2.65	$2.35	$5.00	$3.94	$2.53
Other retailer 2	$14.99	$11.67	$26.67	–$0.79	–$2.20
Other retailer 3	$3.91	$3.33	$7.24	–$1.24	–$2.65
Other retailer 4	$13.34	$10.86	$24.21	$4.40	$2.99
Other retailer 5	$3.97	$3.31	$7.28	$1.60	$0.20
Other retailer 6	$10.09	$8.09	$18.19	$2.95	$1.54
Customer weighted average	**$8.35**	**$2.44**	**$10.79**	**$0.02**	**–$1.39**

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

FIGURE ES 1 ESTIMATED COST PER CUSTOMER OF PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, BY SIZE OF RETAILER

Note: Ongoing operating costs include the estimated avoided costs

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

The additional ongoing operating costs on a per customer basis vary across the nine retailers. From a practical perspective, these costs are unlikely to vary as much as indicated in Table ES 1.

The variation in additional ongoing operating costs across the retailers is largely because of the variation in the proportion of customers that are currently in the retailer's hardship program.

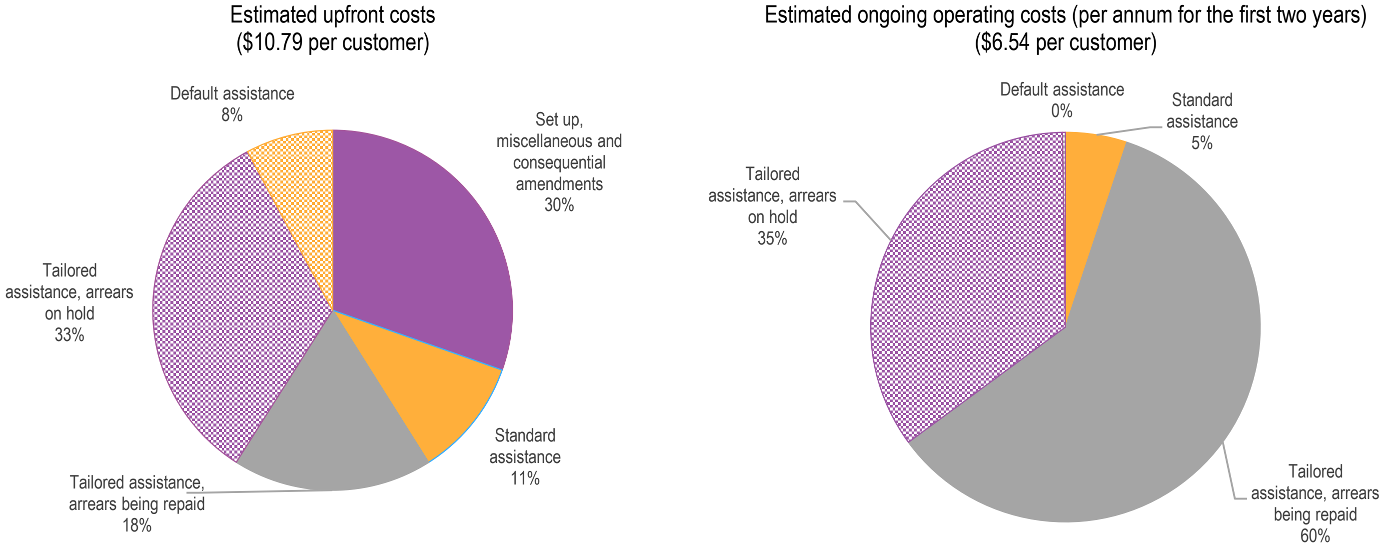
The proportion of customers receiving each type of assistance under the new framework is assumed to be the same for each retailer, while the proportion of customers receiving assistance under the retailers' existing programs varies from retailer to retailer. Those retailers that currently have a relatively high proportion of customers in their hardship program will have relatively high avoided costs compared to those retailers with a relatively low proportion of customers in their hardship program.

The upfront costs, on a weighted per customer basis, are higher for larger retailers than for smaller retailers. This is because the system costs assumed for the smaller retailers are around 15 per cent of the system costs assumed for the larger retailers, but the larger of the smaller retailers have only around half the number of customers as the larger retailers.

The smaller retailers generally use outsourced services. The outsourced service providers' systems would be used by a number of the smaller retailers. Accordingly, any costs incurred by the outsourced service providers would be recovered across a number of retailers, and hence the cost per retailer is lower.

A breakdown of the estimated upfront costs and the annual ongoing operating costs in the first two years (excluding the avoided costs and financing costs associated with debt) associated with the proposed payment difficulties framework, by type of assistance, on a cost per customer basis, is illustrated in Figure ES 2.

FIGURE ES 2 BREAKDOWN OF ESTIMATED UPFRONT COSTS AND ONGOING OPERATING COSTS, BY TYPE OF ASSISTANCE, ON A COST PER CUSTOMER BASIS



Note: The ongoing operating costs do not include the avoided costs or the financing costs associated with debt

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

Tailored assistance for customers with arrears on hold is estimated to have the highest upfront costs, largely due to the substantial system changes required to provide practical assistance that is based on the customer's pattern of energy use, and the retailer's knowledge of the circumstances of where the customer lives.

Tailored assistance for customers repaying arrears is estimated to have the highest ongoing costs, as the proportion of customers that have been assumed to access that type of assistance is higher than for the other types of assistance.

Costs estimated to be incurred across all Victorian energy retailers

In a competitive market, the operating cost per customer is expected to be similar across all Victorian energy retailers. We have therefore assumed that the efficient costs associated with implementing and operating the proposed payment difficulties framework will be of a similar order of magnitude across all retailers, on a cost per customer basis.

To obtain the costs associated with the payment difficulties framework across all retailers, we multiplied the customer weighted average costs per customer, as set out in Table ES 1, by the total number of residential customers in 2015-16, indexed by the expected Victorian population growth to 2017-18 (1.8 per cent per year[2]).

The customer weighted average costs per customer and the total costs across all retailers are set out in Table ES 2 and Table ES 3, respectively.

[2] Victorian Government Budget Papers 2016-17, Overview, page 5

TABLE ES 2 ESTIMATED COST PER CUSTOMER ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Type of assistance	Weighted average cost per customer		
	Upfront	Annual ongoing operating cost (first 2 years)	Annual ongoing operating cost (thereafter)
Set up, miscellaneous and consequential amendments	$3.28	$0.00	$0.00
Standard assistance	$1.15	$0.33	$0.70
Tailored assistance, arrears being repaid	$1.94	$3.91	$2.14
Tailored assistance, arrears on hold	$3.58	$2.28	$2.28
Default assistance	$0.85	$0.02	$0.02
Sub total	$10.79	$6.54	$5.13
Less avoided costs	$0.00	–$6.52	–$6.52
Total	**$10.79**	**$0.02**	**–$1.39**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

TABLE ES 3 ESTIMATED TOTAL COSTS ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Type of assistance	Costs incurred by all retailers		
	Upfront	Annual ongoing operating cost (first 2 years)	Annual ongoing operating cost (thereafter)
Set up, miscellaneous and consequential amendments	$8,215,308	$0	$0
Standard assistance	$2,880,362	$835,991	$1,745,936
Tailored assistance, arrears being repaid	$4,852,948	$9,802,646	$5,371,098
Tailored assistance, arrears on hold	$8,965,643	$5,706,756	$5,706,756
Default assistance	$2,118,224	$39,987	$39,987
Sub total	$27,032,484	$16,385,380	$12,863,777
Less avoided costs		–$16,344,933	–$16,344,933
Total	**$27,032,484**	**$40,447**	**–$3,481,156**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

The total upfront cost per customer associated with introducing the proposed payment difficulties framework is estimated to be $10.79, with the net ongoing operating cost estimated to be $0.02 per customer per year over the first two years and a reduction in net operating costs estimated to be $1.39 per customer per year thereafter. The total upfront cost across all Victorian energy retailers is estimated to be $27.0 million and the net annual operating cost is estimated to be around $40,000 per year over the first two years with a net annual saving estimated to be $3.5 million per year thereafter.

Table ES 4 presents the upfront and ongoing operating costs in a comparable way by depreciating the upfront costs over a ten year period.

TABLE ES 4 ESTIMATED ANNUAL ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Cost category	Annual cost (first 2 years)	Annual cost (thereafter)
Upfront costs (depreciated over 10 years)	$1.08	$1.08
Operating costs	$0.02	–$1.39
Total costs per customer	**$1.10**	**–$0.31**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

When the upfront costs are depreciated over a ten year period, the annual cost to customers is $1.10 in each of the first two years and a benefit of $0.31 in each of the subsequent eight years.

Sensitivity analysis – disconnections, bad debts and arrears

The analysis assumes that the rate of disconnections remains unchanged with the introduction of the new framework. As the impact of the new framework on the rate of disconnections is highly uncertain, sensitivity analysis has been undertaken on the impact of the rate of disconnections on the retailers' operating costs and the level of bad debts. The results from the sensitivity analysis are set out in Table ES 5.

TABLE ES 5 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' OPERATING COSTS AND BAD DEBTS WRITTEN OFF BY THE RETAILERS

Scenario	Incremental cost per customer (per annum)	Incremental cost across all retailers (per annum)	Incremental bad debt per customer (per annum)	Incremental bad debt across all retailers (per annum)
Base case (current rate of disconnection)	$0.00	$0	$0.00	$0
80% of current rate of disconnection	–$0.03	–$76,166	–$0.55	–$1,370,992
60% of current rate of disconnection	–$0.06	–$152,332	–$1.09	–$2,741,985

SOURCE: ACIL ALLEN

As the proportion of customers facing payment difficulties that are assumed to be disconnected is small, the impact of a change in the rate of disconnections on the retailers' costs is relatively immaterial. As would be expected, as the rate of disconnection decreases, the bad debts that are written off by the retailers decreases.

The impact of the new framework on the average debt for customers facing payment difficulties is unclear. The results from the sensitivity analysis on the impact of a change in the average debt for customers facing payment difficulties on the level of total debt, at a particular point in time, are set out in Table ES 6. Table ES 6 assumes no change in the number of customers. As the number of customers increases, so too will the debt across all retailers.

TABLE ES 6 ESTIMATED IMPACT AT A POINT IN TIME OF A CHANGE IN THE AVERAGE DEBT FOR CUSTOMERS FACING PAYMENT DIFFICULTIES

	Base case	Average debt reduced by 5%	Average debt reduced by 15%	Average debt reduced by 25%
At commencement of new framework				
Incremental debt per customer [a]	$0.00	–$1.19	–$3.57	–$5.94
Incremental debt across all retailers	$0	–$2,978,376	–$8,935,127	–$14,891,879
Incremental financing cost [b]	$0	–$148,919	–$446,756	–$744,594

	Base case	Average debt reduced by 5%	Average debt reduced by 15%	Average debt reduced by 25%
Two years after commencement of the new framework				
Incremental debt per customer [a]	–$6.37	–$7.24	–$8.98	–$10.72
Incremental debt across all retailers	–$15,953,571	–$18,134,268	–$22,495,663	–$26,857,057
Incremental financing cost [b]	–$797,679	–$906,713	–$1,124,783	–$1,342,853

[a] Incremental debt across all residential electricity customers

[b] Financing cost assumes an interest rate of 5%

Note: Estimated impact relative to the base case at commencement of new framework. Assumes no change in the number of customers.

SOURCE: ACIL ALLEN

Table ES 6 indicates that the total debt for customers facing payment difficulties varies significantly as the average debt for customers facing payment difficulties varies. However, the retailers' financing costs associated with this change in debt level do not change materially.

As it is assumed that a proportion of customers on tailored assistance will transition to standard assistance two years after commencement of the new framework, the total debt for customers facing payment difficulties is estimated to reduce significantly.

Total impact on the retailers

The net present value (NPV) of the total impact of the new payment difficulties framework on the Victorian energy retailers has been calculated over a ten year period using a discount rate of 4 per cent per annum, consistent with the Government's guidance for regulatory proposals.[3]

The total impact comprises the upfront costs and the net ongoing operating costs, and the reduction in financing costs associated with the reduction in arrears, as customers transition from tailored assistance to standard assistance. The rate of disconnections and therefore bad debt, is assumed to remain unchanged.

The upfront costs are assumed to be incurred in 2017, the ongoing operating costs are assumed to be incurred from 2018 to 2027, and the benefits associated with reduced financing costs are assumed to accrue from 2020, two years after the commencement of the new framework.

The costs and benefits presented in the preceding sections are based on the estimated customer numbers in 2017-18. Customer numbers are assumed to continue to grow by 1.8 per cent per annum over the ten year period.

The NPV of the total impact of the payment difficulties framework on all retailers, is summarised in **Table ES 7.** The NPV over ten years is a benefit of $2.5 million (2017 dollars), with a payback period of less than ten years.

[3] Department of Treasury and Finance, Victorian Guide to Regulation, Toolkit 2: Cost-benefit analysis, Updated July 2014, page 11

TABLE ES 7 NPV OF THE TOTAL IMPACT OF THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK ON ALL VICTORIAN ENERGY RETAILERS

Type of cost / benefit	NPV ($2017)
Set up, miscellaneous and consequential amendments	–$8.2 million
Standard assistance	–$16.6 million
Tailored assistance, arrears being repaid	–$60.8 million
Tailored assistance, arrears on hold	–$59.3 million
Default assistance	–$2.5 million
Avoided costs	$144.3 million
Reduced financing costs	$5.5 million
Total	**$2.5 million**

Note: 4 per cent discount rate

SOURCE: ACIL ALLEN BASED ON SYSTEM CHANGE COSTS PROVIDED BY TBS CONSULTING GROUP

1 INTRODUCTION

In February 2015, the Commission received terms of reference from the Minister for Finance, in consultation with the Minister for Energy and Resources, to conduct an inquiry and report on best practice hardship programs of energy retailers (the Hardship Inquiry).

The Commission released its final report on the inquiry's findings, *Supporting Customers, Avoiding Labels*. *Energy Hardship Inquiry, Final Report*, in February 2016. The Commission found that the current regulatory framework is ineffective in helping many customers avoid debt and disconnection. The framework has also led to a lack of consistency, transparency and clarity in retailer practices, which can reduce consumer confidence in the protection and assistance that retailers provide.

The Commission identified the following practices that can deliver better outcomes for customers:

— identifying and providing early assistance to customers facing payment difficulties
— applying payment plans that have a duration that is proportionate to the level of debt and type of payment difficulties of the customer (to improve the likelihood that debt will be repaid)
— providing customers with practical in-home assistance for energy management, noting that customers on payment plans and in hardship programs use, on average, more than twice as much electricity as other customers in their postcode
— establishing partnerships with government and the welfare sector to address the underlying causes of the payment difficulties
— having unambiguous conditions that limit the use of disconnection as a last resort measure, and clear disconnection procedures that can be strictly enforced.

The Commission subsequently consulted informally with industry and other stakeholders on the design of a new payment difficulties framework. As a result of that consultation, the proposed framework was simplified relative to the framework foreshadowed in the Final Report for the inquiry having regard to:

— the cost of new IT and business systems, system change and systems integration
— the need to align incentives and avoid perverse incentives for retailers and customers
— the enforceability of obligations to provide certainty that assistance is provided and that disconnection for non-payment of a bill is a measure of last resort.[4]

On 21 October 2016, the Commission released its Draft Decision on a new payment difficulties framework (framework), including a draft of amendments to the Energy Retail Code to give effect to the framework. Overall submissions were not supportive of the proposed framework.

[4] Essential Services Commission of Victoria, *Safety Net for Victorian Energy Consumers Facing Payment Difficulties- Customer Advice Manual – Amendments to the Energy Retail Code: Draft Decision*, October 2016, page 2

Concerns broadly fell into two categories:

i. Continued concerns with the objectives and approach to assisting customers facing payment difficulty, as set out in the Final Report of the Hardship Inquiry, endorsed by the Government; and

ii. Concerns that the Commission had still not found the right balance between principle and prescription.[5]

On 31 January 2017 the Commission conducted a stakeholder forum, which was opened by the Minister, to consult further on the proposed framework. Subsequent to that forum, the Commission advised stakeholders that a new Draft Decision on the payment difficulties framework would be released.

The Commission is seeking to assess the impact of the proposed framework on retailers, customers with payment difficulties, energy customers more broadly, and the community.

ACIL Allen Consulting (ACIL Allen) has been engaged by the Commission to assist it to undertake a preliminary assessment of the impacts of the proposed payment difficulties framework on retailers, for the purposes of the Commission's revised draft decision, based on information provided to ACIL Allen as part of the Hardship Inquiry. The purpose of this report is to describe the approach and methodology for this preliminary assessment, and to provide the outcomes of the assessment.

A detailed Information Request accompanies this report as a means to collect data from the retailers. This data will enable a more detailed assessment to be undertaken to inform the Commission's Final Decision.

Structure of this report

This report is structured as follows:

— chapter 2 provides the context for the preliminary assessment of the impact of the proposed payment difficulties framework on retailers

— the methodology and assumptions used to undertake a preliminary assessment of the impact of the proposed payment difficulties framework on retailers, including the operating costs that are avoided, are provided in chapter 3

— the estimated costs associated with each type of assistance to be provided to customers in payment difficulties, and the costs avoided by implementing the new framework, are provided in chapter 4

— the net costs associated with the proposed payment difficulties framework are presented for each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulties were reviewed as part of the Hardship Inquiry, in chapter 5

— a preliminary estimate of the net costs associated with the proposed payment difficulties framework for all Victorian energy retailers is provided in chapter 6

— chapter 7 provides the results of sensitivity analysis to variations in the rate of disconnections and the average debt for customers facing payment difficulties

— the total impact of the proposed payment difficulties framework on all Victorian energy retailers is presented in chapter 8

— an overview of the detailed Information Request that will be used to collect information from the retailers to enable a more detailed assessment to be undertaken for the Commission's Final Decision, is provided as Appendix A.

[5] Essential Services Commission, *New Draft Decision on Safety Net for Victorian Energy Consumers Facing Payment Difficulties, Record of Decision,* 8 February 2017

2 CONTEXT FOR THE PRELIMINARY ASSESSMENT

This chapter provides background information as context for the preliminary assessment of the impact of the proposed payment difficulties framework on retailers. The legislative framework for the preliminary assessment is provided in section 2.1, an overview of the framework for the payment difficulties framework is provided in section 2.2, and the retailer costs and benefits associated with the payment difficulties framework are discussed at a high level in section 2.3.

2.1 Legislative framework for the preliminary assessment

The Commission's overarching objective is to:

… promote the long term interests of Victorian consumers.[6]

Specific objectives of the Commission for each of the industries it regulates are set out in the relevant industry legislation.

The *Electricity Industry Act 2000* and *Gas Industry Act 2001* were amended in 2015 to incorporate a new objective for the Commission that is relevant to this assessment. The new objective is to:

... promote protections for customers, including in relation to assisting customers who are facing payment difficulties.[7]

In seeking to achieve these objectives, the Commission must have regard to a range of factors, including:

… the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for—

(i) consumers and users of products or services (including low income and vulnerable consumers);

(ii) regulated entities

This preliminary assessment relates to the benefits and costs of the payment difficulties framework (the regulation) on retailers (the regulated entities).

2.2 Overview of the payment difficulties framework

The Commission's revised Draft Decision sets out a framework of entitlements (minimum standards of assistance) for Victorian energy residential customers anticipating or facing payment difficulties, so that disconnection of a residential customer is a measure of last resort. The draft framework provides

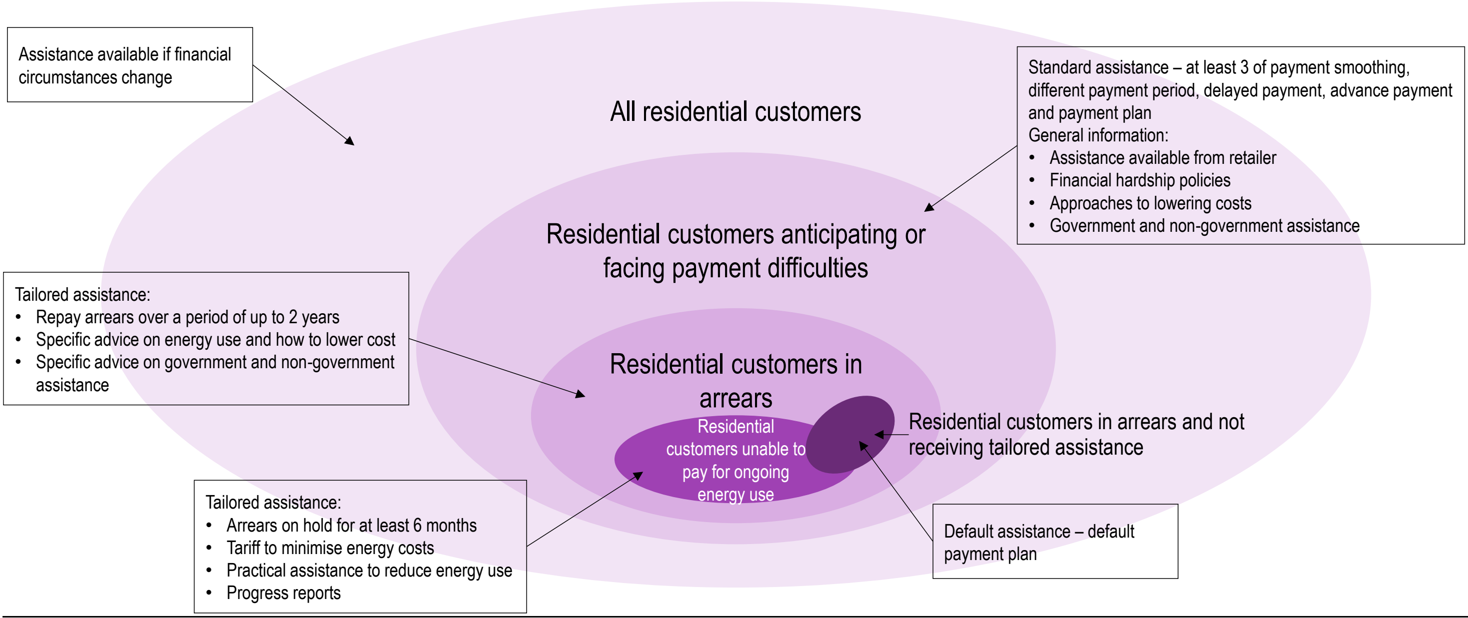
[6] Essential Services Commission Act 2001, section 8(1)
[7] Electricity Industry Act 2000, section 10(c); Gas Industry Act 2001, section 18(c)

three types of assistance for energy customers that are anticipating or facing payment difficulties. These are referred to as:

— standard assistance
— tailored assistance
— default assistance.

An overview of each of the types of assistance available is provided as Figure 2.1, with further detail provided in the following sections.

FIGURE 2.1 OVERVIEW OF ASSISTANCE AVAILABLE UNDER THE PAYMENT DIFFICULTIES FRAMEWORK



SOURCE: ACIL ALLEN

2.2.1 Standard assistance

Under the draft framework, the retailers are to make at least three of five alternative payment options available to all residential customers, as a minimum standard. These can be exercised by residential customers facing payment difficulties to help them avoid getting into arrears. The five payment options are:

— payment smoothing, which enables customers to pay an equal amount over a specified period
— different payment period, which enables customers to make payments at different intervals
— extended payment period, which enables the payment period for a bill to be extended by at least one billing cycle in any 12 month period
— paying for energy in advance, which enables customers to pay in advance rather than in arrears
— a payment plan, which enables customers to pay any *anticipated* arrears over a period that is three times the length of the customer's billing period.

ACIL Allen recently reviewed, as part of the Commission's Hardship Inquiry, the policies, procedures and practices of nine Victorian energy retailers for managing customers facing payment difficulties. At the time of the Hardship Inquiry, the nine energy retailers supplied around 96 per cent of residential electricity customers and more than 99 per cent of residential gas customers in Victoria.

The review identified that most retailers offered the four standard assistance payment options to customers that were not in their hardship program.

In addition to providing all residential customers with an alternative payment option, energy retailers must also ensure that all customers are able to access general information about:

- the types of assistance available, and how to access them
- the retailer's financial hardship policy
- approaches to lowering energy costs
- government or non-government assistance that may be available to help with meeting energy costs.

2.2.2 Tailored assistance

Residential customers that are facing payment difficulties and are in arrears can contact their retailer to seek tailored assistance. The type of assistance will depend on whether or not the customer is able to pay for on-going energy use and repay their arrears over a period of up to two years.

Tailored assistance for residential customers that are able to pay for on-going energy use and repay their arrears over a period of up to two years

Residential customers that are able to pay for on-going energy use and repay their arrears over a period of up to two years are entitled to receive the following tailored assistance, as a minimum standard:

- a payment plan with the arrears repaid over a period of up to two years, by instalments at intervals of up to one month which cover at least the cost of on-going energy use
- specific advice about lowering their energy costs
- specific advice about any government or non-government assistance that may be available to help meet their energy costs.

The assistance proposed under tailored assistance is similar to the assistance that is currently offered to customers by retailers, with a couple of significant differences:

- The payment plan must allow the arrears to be paid in full over a period of up to two years – many of the retailers currently offer payment plans over a shorter period, and others are, in effect, open ended.
- The customer proposes the payment schedule, which must be accepted by the retailer if it meets the objectives in the Energy Retail Code, taking into account the customer's circumstances. Currently most retailers set the instalments based on a customer's capacity to pay, which may not facilitate the arrears being paid in full within two years or for the payment for on-going energy use.
- The advice provided by some retailers to customers about lowering energy costs may not be specific to that customer.
- The advice provided by some retailers to customers about government or non-government assistance that may be available may not be specific to that customer.

Tailored assistance for residential customers for whom the repayment of arrears is on hold

Residential customers that are *not* able to pay for on-going energy use and have the repayment of arrears on hold are entitled to receive the following tailored assistance, as a minimum standard:

- a payment plan with the arrears repaid over a period of up to two years, by instalments at intervals of up to one month
  - an initial period of at least six months during which the repayment of arrears is put on hold and the customer pays less than the cost of on-going energy use
- specific advice about lowering their energy costs, including:
  - the tariff that is most likely to minimise the customer's energy costs
  - practical assistance to help the customer reduce their use of energy
  - information about how the customer is progressing towards lowering their energy costs
- specific advice about any government or non-government assistance that may be available to help a customer meet their energy costs.

If the customer is unable to make payments that will repay the arrears over two years, the retailer may, but is not required to, extend the period over which arrears are repaid if the retailer believes that this would assist the customer to lower their energy costs, or may cease providing tailored assistance.

2.2.3 Default assistance

Residential customers that are in arrears but have not contacted their retailer to receive tailored assistance, or those that have ceased to receive tailored assistance, are entitled to default assistance. The form of the default assistance is to be placed on a default payment plan. Under the default payment plan, the customer is required to pay their arrears by equal monthly instalments over a period that is three times longer than their current billing period, for example nine monthly instalments for a customer on a quarterly billing cycle.

This is a new type of assistance to be provided by retailers, albeit based on payment plans that are currently provided by each of the retailers.

2.3 High level retailer costs and benefits

The Commission expects that the new framework will support the following associated outcomes:

— retailers and their customers will be more incentivised to work together to find solutions that best meet the customer's circumstances
— customers will be empowered to better manage their energy use so that their energy costs are more manageable within the financial resources available to them
— customers will have improved knowledge of, and access to, government and non-government support services
— arrears will not be left unattended which, all other things being equal, will lead to lower levels of customer arrears, than they would have been in the absence of the changes.

This report focuses on the impacts on the retailers to introduce and operate the new payment difficulties framework. The Commission is separately considering the broader benefits.

3 METHODOLOGY AND ASSUMPTIONS

For the purposes of the Commission's revised Draft Decision, a preliminary assessment of the impacts on the retailers associated with the proposed payment difficulties framework has been undertaken by considering:

- the obligations that are placed on the retailers under the proposed framework
- for each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulties were reviewed, which of those obligations are currently provided by the retailer and which are new
- for each of the obligations, the system changes, upfront process changes and training, and ongoing process changes that are required to meet that obligation
- an estimate of the costs associated with the system changes, upfront process changes and training, and ongoing process changes identified
- an estimate of the costs that would be avoided by implementing the proposed framework
- the costs that are estimated to be incurred by each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulties were reviewed.

The preliminary assessment is based on retailers meeting the proposed minimum standards for the payment difficulties framework. It is assumed that the retailers will exceed the minimum standards where there is a net benefit for them to do so.

Further details on the methodology and assumptions for undertaking the preliminary assessment of the retailers' impacts are provided in the following sections.

The impact of the proposed payment difficulties framework on the rate at which customers facing payment difficulties are disconnected, on the average debt for customers facing payment difficulties, and on the bad debts written off by retailers, are also considered.

For the purposes of the Commission's Final Decision, the methodology that will be used to assess the impacts on the retailers associated with the proposed payment difficulties framework will be similar. However, the costs will be based on data that are provided by each of the Victorian energy retailers in response to a detailed Information Request. Further information on the Information Request is provided in Appendix A.

3.1 Obligations under the proposed framework

The obligations that are to be placed on the retailers under the proposed payment difficulties framework are set out in Commission's draft amendments to the Energy Retail Code. The obligations are summarised in Table 3.1.

TABLE 3.1 PROPOSED NEW OBLIGATIONS ON RETAILERS UNDER THE PAYMENT DIFFICULTIES FRAMEWORK

Obligation	Description of obligation
Standard assistance	
Payment smoothing (clause 76(2)(a))	Pay an equal amount over a specified period.
Different payment period (clause 76(2)(b))	Pay once a month or once every fortnight rather than every quarter.
Delayed payment (clause 76(2)(c))	Defer paying one bill for a specified period for at least one billing cycle over a 12 month period.
Advance payment (clause 76(2)(d)	Pay for energy use in advance, rather than in arrears.
Payment plan (clause 76(2)(e))	Pay for anticipated arrears over a period that is three times longer than the customer's billing period.
General information on assistance available (clause 88(1)(a))	Make general information readily available on the assistance available and on how to access them, by having it easily accessible on retailer's website or sending it by email or other electronic means.
General information on financial hardship policy (clause 88(1)(a))	Make general information readily available on the retailer's financial hardship policy, by having it easily accessible on retailer's website or sending it by email or other electronic means.
General information on lowering energy costs (clause 88(1)(c))	Make general information readily available on how to lower energy costs, by having it easily accessible on retailer's website or sending it by email or other electronic means.
General information on other assistance (clause 88(1)(d))	Make general information available on government or non-government assistance that may be available to help with meeting energy costs, by having it easily accessible on retailer's website or sending it by email or other electronic means.
Tailored assistance	
Payment plan – pay full cost of on-going energy use and arrears (clause 79, 80 and 81)	Customer proposes payments that will pay off arrears over a period of up to two years, at intervals of up to a month. Retailer must accept proposal if it would result in their arrears being fully repaid within two years, or a longer period if considered necessary after taking into account the customer's circumstances, and provide written schedule of payments.
Payment plan – revised proposal (clause 80 and 81)	A revised proposal for payments can be put forward by the customer at any time. Retailer must accept revised proposal if it would result in their arrears being fully repaid within two years, or a longer period if considered necessary after taking into account the customer's circumstances, and provide written schedule of payments.
Specific information on lowering energy costs (clause 79(1)(c))	Provide specific advice about the likely cost of a customer's future energy use and how this cost may be lowered.
Specific information on other assistance (clause 79(1)(d))	Provide specific advice about any government or non-government assistance that may be available to help with meeting energy costs.
Payments not made by due date – repaying arrears (clause 80(3))	If a payment towards arrears is not made by the due date, the retailer *must* use its best endeavours to contact the customer, taking into account the customer's circumstances, to discuss a revised payment proposal.
Payment plan – arrears on hold and pay less than full cost of on-going energy use (clause 79)	For an initial period of 6 months, repayment of arrears on hold and customer pays less than the full cost of their on-going energy use while working to lower that cost. The initial 6 month period may be extended.
Practical assistance to help lower energy costs (clause 79(1)(e))	For customers that cannot pay the full cost of on-going energy use, the retailer must offer: – the tariff that is most likely to minimise the customer's energy costs – practical assistance to help the customer reduce their use of energy – information about how the customer is progressing towards lowering their energy costs.

Obligation	Description of obligation
Lack of progress implementing practical assistance (clause 81(3))	If at any time a retailer forms a reasonable belief that a customer is not meeting their responsibilities to implement any practical assistance provided by the retailer, the retailer must use its best endeavours to contact the customer and work with them to identify an implementation timeframe.
Payments not made by due date – arrears on hold (clause 81(2))	If a payment towards ongoing energy use is not made by the due date, the retailer *must* use its best endeavours to contact the customer, taking into account the customer's circumstances, to discuss varying the payment amount and/or frequency.
Default assistance	
Payment of arrears by monthly instalments (clause 85)	Default payment plan – pay arrears by equal monthly instalments over a period that is 3 times the length of the billing period. Retailer must provide schedule of instalments.
Miscellaneous	
Financial hardship policies (clauses 86 and 87)	Retailer must prepare a financial hardship policy for approval, which must include the minimum entitlements to assistance under the framework.
Written communications (clause 89)	Retailer must give or send by post, at no charge, written communication unless explicit informed consent provided to another way.
Retailer obligations (clause 91)	Retailer must co-operate with any government or non-government service providing support to customer receiving assistance, comply with any guideline published by the Commission, and is not required to provide assistance to customers not anticipating or facing payment difficulties.
Provision of additional assistance (clause 92)	Retailer may provide assistance in addition to the minimum standards.
Restriction on conditions (clause 93)	Retailer must not impose any conditions on the provision of assistance that requires the customer to provide personal or financial information, or to waive any entitlement.
Debt (clause 94)	Retailer must not commence debt recovery from customers with repayment of arrears on hold. Must not sell debt while customer receiving assistance or within 10 days of disconnection.
Supply capacity control product (clause 95)	Retailer must not offer a supply capacity control product to a residential customer for any credit management purpose.
Restriction on transfer to another retailer (clause 96)	Retailer must object to transfer from another retailer if the customer's repayment of arrears is on hold.
Payment by Centrepay (clause 97)	Customer can request payments to be paid through Centrepay.
Consequential amendments	
Reminder Notices (clause 109)	Must not be issued if customer has submitted a proposal for tailored assistance in accordance with the Energy Retail Code or until retailer has used best endeavours to provide tailored assistance. Includes date notice issued, date to be paid by, information about assistance available, and who to contact in case of complaint or dispute.
Disconnection Warning Notices (clause 110)	Must state type of assistance that residential customer is receiving, explain notice and why issued, and provide clear and unambiguous advice as to what needs to be done to avoid disconnection.
De-energisation for not paying bill (clause 111)	When two consecutive payments not paid by due date.
De-energisation as a last resort (clause 111A)	Retailer may only arrange de-energisation of a residential customer facing payment difficulties if payments have been missed, the terms of the assistance have not been complied with, a reminder notice and disconnection warning notice has been issued, the retailer has use best endeavours to contact the customer, the customer has not taken reasonable action to remedy the matter, and the retailer has records to evidence this.
Restrictions on de-energisation (clause 116)	Where residential customer is receiving assistance and complying with the terms of that assistance.

Note: Unless otherwise specified, clause references are to the draft amended Energy Retail Code

SOURCE: ESSENTIAL SERVICES COMMISSION, DRAFT AMENDMENTS TO THE ENERGY RETAIL CODE, VERSION 10.1 (3 MAY 2017)

3.2 New obligations by retailer

For each of the proposed new obligations identified in Table 3.1, Table 3.2 identifies the extent to which the nine Victorian energy retailers, whose policies, procedures and practices for managing customers with payment difficulties were recently reviewed, have processes and systems currently in place to meet each of those obligations.

TABLE 3.2 EXTENT TO WHICH RETAILERS CAN CURRENTLY MEET PROPOSED NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTIES FRAMEWORK

Obligation	Extent to which retailers currently meet obligation
Standard assistance	
Payment smoothing	All but two of the retailers currently provide a payment smoothing option.
Different payment period	One retailer offers a monthly payment period by default, and two retailers offer a monthly payment period as an option.
Delayed payment	All retailers offer delayed payment, with the period of delay varying from up to 14 days to five weeks.
Advance payment	The review did not identify whether retailers do or do not offer advance payment.
Payment plan	All retailers currently offer payment plans.
General information on assistance available	While all retailers provide information on their hardship policy on their websites, the information will need to be updated to align with the new standard assistance.
General information on financial hardship policy	All retailers currently have a financial hardship policy on their website, but some are more accessible than others.
General information on lowering energy costs	All retailers include general energy saving tips on their websites.
General information on other assistance	While all retailers maintain up-to-date information on, and contact details for, assistance provided by government on their websites, most retailers do not provide information on non-government assistance on their websites.
Tailored assistance	
Payment plan – pay full cost of on-going energy use and arrears	While all retailers currently offer payment plans with various periods over which the plans are structured, there are substantial changes required to the way in which the payment plans will operate under the new framework. In many cases, the payments are set such that the arrears are not paid within a defined period. The payments are generally influenced by the customer's capacity to pay rather than an amount proposed by the customer.
Payment plan – revised proposal	While the payments are currently revised in many cases, the revised payments are generally influenced by the customer's capacity to pay rather than an amount proposed by the customer.
Specific information on lowering energy costs	While many retailers provide some form of advice on energy usage to customers, only one retailer currently has a structured approach based on a customer's "pattern of energy usage and of the circumstances of where they live" with a clear expectation that energy usage will be reduced.
Specific information on other assistance	While all retailers maintain up-to-date information on, and contact details for, assistance provided by government on their websites, most retailers do not provide information on non-government assistance on their websites.
Payment plan – arrears on hold and pay less than full cost of on-going energy use	All retailers currently offer payment plans with various periods over which the plans are structured. In many cases, the payments are set such that the arrears are not paid within a defined period. The payments are influenced by the customer's capacity to pay rather than an amount proposed by the customer.
Practical assistance to help lower energy costs	All retailers currently check the tariff applicable to a customer, although this process is now more complex with the introduction of cost reflective network tariffs. The retailers' appliance replacement programs are currently of a small scale (generally trials only) or for low cost equipment (for example, door snakes). We are not aware of any retailers providing information to customers on their progress towards lowering their energy costs.

Obligation	Extent to which retailers currently meet obligation
Lack of progress implementing practical assistance	While one retailer may contact customers when there is a lack of progress in implementing practical assistance, it is unlikely that any other retailers do so.
Payments not made by due date	Retailers will generally contact customers when payments have not been made by the due date, but the timeframe for contacting customers may be tighter for some retailers.
Default assistance	
Payment of arrears by monthly instalments	All retailers currently offer payment plans, but do not put customers on a payment plan by default
Miscellaneous	
Financial hardship policies	All retailers currently have a financial hardship policy, but they will need to be revised to reflect the new payment difficulties framework.
Written communications	Current practice.
Retailer obligations	Minor additional obligations on retailers
Provision of additional assistance	Minor additional obligations on retailers.
Debt	Minor additional obligations on retailers.
Supply capacity control product	Current practice.
Restriction on transfer to another retailer	While retailers are currently able to object to a transfer based on “bad debt”, they do not necessarily object currently.
Payment by Centrepay	All retailers allow customers to make payments through Centrepay.
Consequential amendments	
Reminder Notices	Minor change required to the Reminder Notice.
Disconnection Warning Notices	Minor changes required to Disconnection Warning Notices.
De-energisation / disconnection	Provides clear boundary on the de-energisation/disconnection of customers facing payment difficulties.

SOURCE: ACIL ALLEN, ENERGY CUSTOMERS IN HARDSHIP, COMPENDIUM OF RETAILERS' POLICIES, PROCEDURES AND PRACTICES, 20 AUGUST 2015

3.3 System changes

System changes are changes that are required to the retailers’ IT systems for the introduction of the new payment difficulties framework.

The system changes that are required by the retailers that are currently not able to meet the proposed new obligations under the new payment difficulties framework are described in Table 3.3.

As we are not experts in estimating IT costs, TBS Consulting Group (TBS) was separately engaged by the Commission to estimate the costs of the system changes required for the new framework. IN assessing the costs estimated by TBS, we have deducted operating costs that have been separately accounted for in sections 3.4 and 3.5.

The costs of system changes as estimated for AGL and Origin Energy are provided in Table 3.3.

TBS estimated that the costs for Energy Australia are 8 per cent higher than those estimated for AGL and Origin Energy, other than for the changes required for practical assistance.

The system costs for the smaller retailers, who generally use outsourced services, was estimated by TBS to be 15.1 per cent of the cost for AGL and Origin Energy. The outsourced service providers’ systems would be used by a number of the smaller retailers. Accordingly, any costs incurred by the outsourced service providers would be recovered across a number of retailers, and hence the cost per retailer is lower.

TABLE 3.3 SYSTEM CHANGES THAT MAY BE REQUIRED TO MEET THE PROPOSED NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTIES FRAMEWORK

Obligation	System changes that may be required to meet obligation	Estimated cost for AGL and Origin Energy
Set up costs for the range of payment plans	System changes may be required to: – assist in identifying the appropriate payment plan – produce written advice on the payment plan to be provided to the customer.	 $984,500 $614,495
Standard assistance		
Payment smoothing	System changes may be required to introduce a payment smoothing option that can be accessed by contacting the retailer or on line.	$300,000
Different payment period	System changes may be required to introduce a different payment option that can be accessed by contacting the retailer or on line.	$523,490
Delayed payment	System changes may be required to introduce a delayed payment option that can be accessed by contacting the retailer or on line. As all retailers currently offer this option, there are no additional costs.	$0
Advance payment	Not costed – assumed that retailers would offer payment smoothing, different payment period and delayed payment as the three payment options required under standard assistance.	N/A
Payment plan	Not costed – assumed that retailers would offer payment smoothing, different payment period and delayed payment as the three payment options required under standard assistance.	N/A
Tailored assistance		
Payment plans: – pay full cost of on-going energy use and arrears – arrears on hold and pay less than full cost of on-going energy use	System changes may be required to: – display to the customer service agent the minimum payments required under this option – allow the customer service agent to enter the payment proposed by the customer – produce the advice that is to be provided to the customer in writing (in particular, a schedule of payments).	$835,190
Specific information on lowering energy costs	Substantial system changes may be required to: – input a customer's metering data – reconcile the metering data with the customer's usage of energy – identify options for reducing energy usage – produce written advice.	$1,202,025
Practical assistance to help lower energy costs	System changes may be required to: – estimate a customer's energy costs using the customer's metering data and the retailer's range of tariffs – produce written information on the customer's progress towards lowering their energy costs.	$590,700
Default assistance		
Payment of arrears by monthly instalments	System changes may be required to place customers on a payment plan by default when the customer is in arrears and has not taken up, or has ceased to receive, tailored assistance.	$389,625
Consequential amendments		
Reminder Notices	The system may need to be configured to amend the content of reminder notices, but no system changes required.	$0

Obligation	System changes that may be required to meet obligation	Estimated cost for AGL and Origin Energy
Disconnection Warning Notices	System changes may be required to include status settings for customers to align with the range of assistance provided under the framework. The system may need to be configured to amend the content of disconnection warning notices, and to align the triggers to issue a disconnection warning notice with the new obligations. Cost of system changes not material.	$0
De-energisation	The system may need to be configured to operationalise new rules on de-energisation, but no system changes required.	$0

SOURCE: ACIL ALLEN ASSESSMENT BASED ON TBS CONSULTING GROUP, IMPLEMENTATION SYSTEM COST GUIDE, IMPLEMENTATION SYSTEM COST GUIDE, V2.2, 1 MAY 2017

3.4 Upfront process changes

Upfront process changes may be required by those retailers that are currently not able to meet the proposed new obligations under the payment difficulties framework. Upfront process changes include changes to policies and procedures, marketing collateral, changes to the website, legal advice, changes to scripts for customer service agents, and the preparation of training materials.

For the purposes of this assessment, upfront process changes have been categorised as major, moderate, or minor. The categorisation of upfront process changes that may be required, and the estimated cost that would be incurred, are set out in Table 3.4.

TABLE 3.4 UPFRONT PROCESS CHANGES THAT MAY BE REQUIRED TO MEET THE PROPOSED NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTIES FRAMEWORK

Category	Upfront process changes required	Estimated cost for each retailer for each change
Major (2)	Tailored assistance: – specific information on lowering energy use and government and non-government assistance – practical assistance, practical measures	$100,000 each
Moderate (4)	Financial hardship policy Standard assistance options: – payment smoothing Tailored assistance: – practical assistance, tariff to minimise energy cost Default assistance – payment of arrears by monthly instalments	$50,000 each

Category	Upfront process changes required	Estimated cost for each retailer for each change
Minor (14)	Standard assistance options: – different payment period – delayed payment – payment plan / paying for energy use in advance General information: – information on assistance available – general information on lowering energy use – general information on other (government and non-government) assistance Tailored assistance: – customer may revise payment proposal – information on progress towards reducing energy use – payment not made by due date (arrears being repaid) – payment not made by due date (arrears on hold) Restriction on transfer to another retailer Restriction on de-energisation / disconnection Reminder notice Disconnection warning notice	$20,000 each

SOURCE: ACIL ALLEN ASSESSMENT

The estimated cost of each process change is an average cost for that category of changes – the actual cost for a particular change may be higher or lower than the estimate for the category. While it is likely that some upfront process changes will be underestimated, others will be overestimated, and our judgement is that, in aggregate, the total cost for upfront process changes is reasonable.

Subsequent to the Commission's Hardship Inquiry, the Australian Energy Regulator (AER) released a Sustainable Payment Plans Framework. The Sustainable Payment Plans Framework consists of:

- *a set of principles that should guide retailers' capacity to pay conversations with customers, and*
- *good practice actions and considerations retailers should follow at different stages of a payment plan, including determining the customer's capacity to pay, reviewing the payment plan, helping customers in severe financial difficulty, dealing with missed payments and completing a payment plan.*[8]

Of the nine retailers whose policies, processes and practices for managing customers in payment difficulties that were reviewed as part of the Hardship Inquiry, four have adopted the Framework:

- AGL
- Energy Australia
- Origin Energy
- Simply Energy.

Where these retailers have made changes to their processes to meet the requirements of the AER's Sustainable Payment Plan Framework, the estimated costs of process changes required to meet the Commission's proposed payment difficulties framework may be lower than those set out in Table 3.4.

Training

It is assumed that all customer service agents will need to receive some training on the process changes associated with the new payment difficulties framework. The costs of the training include the

[8] https://www.aer.gov.au/consumers/my-energy-bill/experiencing-trouble-paying-your-energy-bills, accessed 18 April 2017

cost of training direct call centre staff, indirect call centre staff (managers and supervisors), and the trainers.

It has been assumed that 60 per cent of direct call centre staff will attend a one hour training course, 20 per cent will attend a two hour training course, 10 per cent will attend a four hour training course and 10 per cent will attend an eight hour training course.

All indirect call centre staff (managers and supervisors) are assumed to attend an eight hour training course.

The number of direct call centre staff has been estimated based on:

— the number of calls forwarded to an operator in 2015-16, as set out in Table 3.5, indexed by the expected Victorian population growth to 2017-18 (1.8 per cent per year[9])

— assuming that each call centre staff member works a 7.5 hour day for, on average, four days a week for 46 weeks of the year, and answers four calls per hour on average.

The cost of direct call centre staff has been assumed to be $60 per hour.

The number of indirect call centre staff has been estimated assuming that the cost of indirect call centre staff is 20 per cent of the cost of direct call centre staff and that the cost of indirect call centre staff is $80 per hour.

The cost of the trainers has been estimated assuming that each training session has up to 25 participants and the hourly cost is $100.

The estimated training costs for each of the nine retailers, whose policies, procedures and practices for managing customers in payment difficulties were reviewed, are also provided in Table 3.5.

TABLE 3.5 NUMBER OF CALLS ANSWERED BY AN OPERATOR, 2015-16

Retailer	Number of calls answered by an operator – 2015-16	Estimated training costs
AGL	1,345,500	$61,096
Alinta	239,362	$12,180
M2	306,660	$14,236
Energy Australia	592,915	$26,924
Lumo	358,961	$16,836
Momentum	157,654	$8,920
Origin Energy	1,030,903	$47,528
Red Energy	390,931	$18,268
Simply Energy	411,386	$19,016

SOURCE: ESSENTIAL SERVICES COMMISSION, VICTORIAN ENERGY MARKET REPORT 2015-16, *NOVEMBER 2016, PAGE 142*

3.5 Ongoing operating costs

With the introduction of the proposed payment difficulties framework, the retailers will incur additional operating costs on an ongoing basis, largely associated with:

— calls to the retailer's call centre, both inbound and outbound calls

— mailing written communication to the customer.

These additional costs will be offset by costs that are currently incurred by the retailers under the existing arrangements for customers facing payment difficulties, which are discussed in section 3.6.

For the purposes of estimating the ongoing operating costs, we have made a range of assumptions on:

[9] Victorian Government Budget Papers 2016-17, Overview, page 5

— the number of residential customers in 2015-16, as set out in Table 3.7, indexed by the expected Victorian population growth to 2017-18 (1.8 per cent per year[10])
— the proportion of a retailer's customers that are on the various types of assistance
— the proportion of these customers that select options on line or through the retailer's call centre
— the proportion of these customers that pay on time
— the proportion of customers facing payment difficulties that receive paper bills
— for those customers on a different payment period, the proportion that receive monthly or fortnightly bills
— the proportion of a retailer's customers that are facing payment difficulties and are subsequently disconnected
— the length of calls to the call centre – short (5 minutes), medium (15 minutes) or long (30 minutes)
— the lower utilisation of call centre staff that are handling calls from those currently in the hardship program and will handle calls from those on tailored assistance with arrears on hold (60 per cent)
— the cost of calls ($60 per hour for direct staff plus $12 per hour for indirect staff)
— the cost of sending written communication ($2).

The two key assumptions in the analysis relate to the proportion of customers that are on the various types of assistance and the number of calls that are made by or to the retailer.

3.5.1 Proportion of customers on various types of assistance

In 2015-16, approximately 3.7 per cent of residential customers were on payment plans and approximately 0.95 per cent of residential customers were on a retailer's hardship program and were on payment plans.

The review of retailers' policies, procedures and practices for managing customers facing payment difficulties indicated that around 5.0 per cent of residential customers face payment difficulties, with customers not on payment plans (1.3 per cent of residential customers) on bill smoothing arrangements or deferring payments.

The review of retailers' policies, procedures and practices indicated that approximately 70 per cent of customers in the hardship program (0.67 per cent of residential customers) were able to pay for on-going energy usage.

For the purposes of this analysis, we have assumed that those customers that face payment difficulties and are on a bill smoothing arrangement or deferred payments (1.3 per cent of residential customers) will receive standard assistance. We have assumed that the retailers will offer three of the five payment options to which customers are entitled under standard assistance. We have assumed that retailers will offer payment smoothing, different payment periods and deferred payment. In the absence of any information, we have assumed that a third of the 1.3 per cent of customers will take up each of these three options (0.43 per cent each).

We have assumed that customers currently on a payment plan will receive tailored assistance or default assistance.

We have assumed that 0.29 per cent of residential customers (30 per cent of those currently in a retailer's hardship program) will be on a tailored assistance payment plan with the repayment of arrears on hold and paying less than the full cost of their on-going energy use.

We have assumed that a further 0.29 per cent of residential customers (30 per cent of those currently in a retailer's hardship program) will not engage with the retailer and will be on a default assistance payment plan.

We have assumed that the remaining 3.13 per cent of residential customers currently on a payment plan will be on a tailored assistance payment plan, with arrears to be paid within a two year period.

[10] Victorian Government Budget Papers 2016-17, Overview, page 5

We have assumed that the proportion of residential customers receiving default assistance and tailored assistance, with the repayment of arrears on hold and paying less than the full cost of their on-going energy use, will remain constant over time at 0.29 per cent of residential customers each.

We have assumed that the proportion of residential customers on a tailored assistance payment plan, repaying arrears over a two year period and paying the full on-going cost of energy use, will decrease two years after commencement of the new framework as they pay their arrears and transition to standard assistance, such as payment smoothing, different payment period or deferred payment. We have assumed that the proportion of residential customers on a tailored assistance payment plan, repaying arrears over a two year period and paying the full cost of on-going energy use, will decrease from 3.13 per cent to 1.72 per cent (with 2.0 per cent of residential customers on tailored assistance in total).

We have assumed that the 1.41 percentage point reduction in the proportion of residential customers receiving tailored assistance will receive standard assistance. The proportion of residential customers on standard assistance is assumed to increase from 1.3 per cent to 2.71 per cent of residential customers two years after commencement of the new framework, with the proportion of residential customers taking up payment smoothing, different payment periods and deferred payment each increasing from 0.43 per cent to 0.91 per cent.

3.5.2 Calls to or by the retailer

The frequency with which calls are made to or by the retailer, and the proportion of time that the specialised customer service agents deal with customers in more severe payment difficulties, has been informed by considering:

- the number of Full Time Equivalents (FTEs) currently employed by the retailers
- the level of activity undertaken by those customer service agents.

The review of the retailers' policies, procedures and practices for managing customers in payment difficulties revealed that there were 144.5 FTEs managing 23,010 customers in the nine retailers' hardship programs, or one FTE for 159 customers in the hardship programs. The costs of these FTEs has been estimated to be in the order of $14.7 million per annum.

3.5.3 Ongoing operating cost assumptions by obligation

The assumptions that have been applied to each of the proposed new obligations are summarised in Table 3.6.

TABLE 3.6 ONGOING OPERATING COSTS ASSOCIATED WITH THE PROPOSED NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTIES FRAMEWORK

Obligation	Assumptions used to estimate ongoing operating costs	
Standard assistance		
Payment smoothing	% of customers that take up option	0.43% in the first two years, increasing to 0.91%
	% of customers that call retailer to take up option	100%
	Length of call	Medium
	Frequency of bills	Monthly (8 additional bills per annum)
	% that receive paper bills	50%
Different payment period	% of customers that select option	0.43% in the first two years, increasing to 0.91%
	% of customers that call retailer to take up option	100%
	Length of call	Short
	Frequency of bills	50% monthly (8 additional bills per annum), 50% fortnightly (22 additional bills per annum)
	% that receive paper bills	50%

Obligation	Assumptions used to estimate ongoing operating costs	
Delayed payment	% of customers that select option	0.43% in the first two years, increasing to 0.91%
	% of customers that call retailer to take up option	100%
	Number of payments delayed per annum	1
	Length of call	Short
Advance payment	% of customers that select option	0%
Payment plan	% of customers that select option	0%
Tailored assistance		
Payment plan – pay full cost of on-going energy use and arrears	% of customers put on this payment plan	3.13% in the first two years, decreasing to 1.72%
	% of customers that call retailer to take up option	100%
	Length of call to take up option	Long
	Written advice to customer	
Payment plan – pay full cost of on-going energy use and arrears – revised proposal	% of customers on tailored assistance that propose a new plan	50% per annum
	% of customers that call retailer with new proposal	100%
	Length of call to take up option	Medium
	Written advice to customer	
Specific information on lowering energy costs	Phone call – included in phone call on payment plan	
	Written advice to customer	
Specific information on other assistance	Phone call – included in phone call on payment plan	
	Written advice – included in written advice on lowering energy costs	
Payment plan – arrears on hold and pay less than full cost of on-going energy use	% of customers put on this payment plan	0.29%
	% of customers that call retailer to take up option	100%
	Length of call to take up option	Long
	Written advice to customer	
Payment plan – arrears on hold and pay less than full cost of on-going energy use – revised proposal	% of customers on tailored assistance that propose a new plan	100% per annum
	% of customers that call retailer with new proposal	100%
	Length of call to take up option	Medium
	Written advice to customer	
Practical assistance to help lower energy costs – tariff	Included under payment plans above	
Practical assistance to help lower energy costs – practical assistance	% of customers on tailored assistance with repayment of arrears on hold	0.29%
	Length of call	Long
	Cost of appliance replacement, and for arranging appliance replacement	$350
Practical assistance to help lower energy costs – information on progress	% of customers on tailored assistance with repayment of arrears on hold	0.29%
	Frequency of information to customer	Quarterly
	Written communication	
	% of these customers that call in response to information	20%
	Length of call	Medium

Obligation	Assumptions used to estimate ongoing operating costs	
Lack of progress implementing practical assistance	% of customers on tailored assistance with repayment of arrears on hold	0.29%
	% that don't implement practical assistance	20%
	Length of call	Long
Payments not made by due date	% of customers on tailored assistance	3.42% in the first two years, decreasing to 2.0%
	% that will miss two consecutive payments each fortnight	25% (650% on an annualised basis)
	Length of call	Medium – for those not paying full cost of on-going energy use Short – other
Default assistance		
Payment of arrears by monthly instalments	% of customers put on default assistance	0.29%
	% of customers that call retailer to revert to other types of assistance (the costs of which are captured under that type of assistance)	20%
	Length of call	Medium
	Written advice to customer	

SOURCE: ACIL ALLEN

3.5.4 Number of residential electricity customers and proportion on a payment plan

The number of residential electricity customers and the proportion of residential electricity customers on a payment plan in 2015-16 is set out in Table 3.7.

TABLE 3.7 NUMBER OF RESIDENTIAL ELECTRICITY CUSTOMERS AND PROPORTION ON A PAYMENT PLAN, BY RETAILER, 2015-16

Retailer	Number of residential electricity customers	Proportion of residential electricity customers on a payment plan	Proportion of residential electricity customers in the hardship program
AGL	533,231	2.0%	1.5%
Alinta Energy	74,199	3.2%	0.5%
Blue NRG	85	0.0%	0.0%
Click Energy	29,777	1.4%	0.5%
CovaU	159	1.9%	0.0%
Diamond Energy	3,975	0.5%	0.1%
Energy Australia	477,011	10.5%	0.9%
Globird Energy	1,347	0.0%	0.0%
Lumo Energy	188,517	2.3%	0.8%
M2 Energy	49,948	1.2%	1.2%
Momentum	59,409	0.6%	0.3%
Next Business	79	0.0%	0.0%
Online Power and Gas	3,910	0.4%	0.1%
Origin Energy	484,353	1.4%	0.9%
Pacific Hydro	459	1.3%	0.0%
People Energy	6,980	2.7%	0.1%
Powerdirect	34,863	0.5%	0.0%

Retailer	Number of residential electricity customers	Proportion of residential electricity customers on a payment plan	Proportion of residential electricity customers in the hardship program
Powershop	44,872	0.7%	0.3%
Qenergy	867	3.5%	1.7%
Red Energy	216,877	2.0%	0.3%
Simply Energy	202,646	4.1%	1.2%
Sumo Power	4,086	0.0%	0.0%
Sun Retail	2	0.0%	0.0%
Total	**2,417,650**	**3.7%**	**0.9%**

SOURCE: ESSENTIAL SERVICES COMMISSION, VICTORIAN ENERGY MARKET REPORT 2015-16, PAGES 80, 89-91

3.6 Avoided operating costs

The avoided operating costs are the costs avoided by the retailer by discontinuing current practices for managing customers facing payment difficulties with the commencement of the new payment difficulties framework.

The avoided operating costs have been estimated using the same methodology used to estimate the ongoing operating costs. The assumptions that have been applied to estimate the avoided operating costs are summarised in Table 3.8.

TABLE 3.8 OPERATING COSTS AVOIDED BY THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK

Obligation	Assumptions used to estimate avoided operating costs	
Current customers in hardship program and on payment plans	% of customers currently in hardship program and on a payment plan	As per Table 3.7
	% that call retailer to be put on payment plan	100%
	Length of call to place customer on payment plan	Medium
	Number of calls made by/to retailer per annum to discuss payment plan / length of calls	Four / Medium
	Number of calls to discuss energy efficiency / length of call	One / Long
	% that do not pay on time / length of call	20% per fortnight / Medium
	Number of pieces of written communication per annum	4
Current customers not in hardship program and on payment plans	% of customers currently on a payment plan and not in hardship program	As per Table 3.7
	% that call retailer to be put on payment plan	100%
	Length of call to place customer on payment plan	Medium
	Number of pieces of written communication per annum	2
Current customers facing payment difficulties but not on a payment plan	% of customers currently facing payment difficulties but not on a payment plan	1.3%
	Length of call to place customer on bill smoothing or deferred payment	Medium
	Number of pieces of written communication per annum	1

SOURCE: ACIL ALLEN

3.7 Sensitivity analysis – disconnections, bad debts and arrears

The analysis of the system changes, upfront process changes and ongoing operating costs assumes that the rate of disconnection remains unchanged and therefore there is no incremental ongoing operating costs associated with disconnecting customers.

In addition, it has been assumed that the average debt for customers facing payment difficulties remains unchanged.

Given the uncertainty associated with these assumptions, sensitivity analysis has been undertaken to consider the impact on the retailers of varying the rate of disconnections and the average debt for customers facing payment difficulties.

We have also analysed the impact on the retailers' total debt based on our assumption that customers will transition from tailored assistance to standard assistance two years after commencement of the new framework.

3.7.1 Disconnections

The rate at which customers are disconnected for non-payment depends on a whole range of factors, of which the payment difficulties framework is just one factor.

The impact of the new payment difficulties framework on the rate at which customers are disconnected for non-payment is highly uncertain.

The framework has been designed to improve the assistance that is provided to customers that are facing payment difficulties so that disconnection only occurs as a last resort. However, the extent to which the rate of disconnections may decrease is unknown.

Given the uncertainty, we have assumed a number of scenarios for the purposes of this report. As a worst case, we have assumed no change in the rate of disconnections. We have also assumed two scenarios with a decrease in the rate of disconnections.

Of the 0.29 per cent of residential electricity customers that are placed on default assistance, we have assumed that 20 per cent will contact their retailer and will be offered tailored assistance. The remaining 80 per cent are assumed to be disconnected (0.23 per cent of residential electricity customers), with 2/3 of these customers also being disconnected from gas.

While we do not know the current rate at which customers that are facing payment difficulties are disconnected, we estimate that this proportion is similar to the current rate based on data in the Commission's 2015-16 Energy Market Report[11].

Under both the current and proposed arrangements, we have assumed that the retailers would issue a reminder notice and a disconnection warning notice (two of each if the customer also has a gas account) to a customer prior to disconnection, and complete a 'disconnection checklist' to ensure the disconnection is not wrongful. We have therefore estimated that there is no incremental ongoing operating cost associated with disconnecting customers under the base case.

To test the sensitivity of this assumption, we have considered the retailers' incremental ongoing operating costs if the disconnection rate is:

— 80 per cent of the current disconnection rate
— 60 per cent of the current disconnection rate.

3.7.2 Bad debts

Under our base case, we have assumed that there is no change in the bad debts written off by retailers with the introduction of the proposed payment difficulties framework.

However, if the rate of disconnection increases, the bad debts written off by retailers will increase. Conversely, if the rate of disconnection decreases, the bad debts written off by retailers will decrease. Consistent with our sensitivity analysis of the ongoing operational costs associated with disconnection, we have estimated the impact of the proposed payment difficulties framework on a retailer's bad debts if the disconnection rate is:

— 80 per cent of the current disconnection rate
— 60 per cent of the current disconnection rate.

[11] Essential Services Commission, *Victorian Energy Market Report, 2015-16 update*, November 2016, pages 111, 113-4, 117, 120, 129

There is a wide distribution of debts for customers that are facing payment difficulties and it is unclear whether the customers that would be disconnected have a debt that is:

— close to the average debt
— less than the average debt
— more than the average debt.

For the purposes of our analysis, we have assumed that customers that are disconnected will, on average, have the average debt for customers that are currently in the hardship program, that is, $1200 (as discussed in the next section).

3.7.3 Arrears

As part of the Hardship Inquiry, we estimated the average arrears for customers in a retailer's hardship program and for customers facing payment difficulties that are on a payment plan but not in a retailer's hardship program.

The Commission's Energy Market Reports indicate that the total outstanding debt for customers in the hardship program increased from $49.3 million in 2015-16[12] to $59.0 million in July 2016 to $63.8 million in December 2016[13]. While the 2015-16 debt reported may not be directly comparable to the debts reported in 2016[14], the trend for an increase in debt is clear.

For the purposes of this analysis, we have assumed that the average debt for customers that are currently on the hardship program (either on default assistance, on tailored assistance with arrears on hold, or on tailored assistance repaying arrears) to be $1200 and for the remaining customers facing payment difficulties and on a payment plan to be $450. These estimates are based on our estimates at the time of the Hardship Inquiry, increased in line with the increase in the total debt.

Under our base case, we have assumed that the average debt per customer remains unchanged. However, two years after commencement of the new framework, as the proportion of customers on standard assistance is assumed to increase and the proportion of customers on tailored assistance is assumed to decrease, the total debt for customers facing payment difficulties will decrease.

It is uncertain whether the average debt for customers facing payment difficulties will remain unchanged. The average debt may decrease under the proposed payment difficulties framework if:

— customers facing payment difficulties receive assistance earlier than they do currently, while the level of debt is relatively low
— retailers choose to exercise their discretion to disconnect customers that are not able to meet the required repayments under the minimum standard.

To test the sensitivity of this assumption, we have considered the retailers' total debt if the average debt for customers facing payment difficulties is decreased by:

— 5 per cent
— 15 per cent
— 25 per cent.

We have also considered the impact on a retailers' costs by assuming a financing cost of 5 per cent per annum is incurred on the total debt outstanding.

[12] Ibid, page 106
[13] Essential Services Commission, *Victorian Energy Market Report, July – December 2016 update*, March 2017, page 11
[14] The dent reported in 2015-16 included only debt that had been outstanding for over 90 days.

4 COSTS ASSOCIATED WITH EACH TYPE OF ASSISTANCE

The costs associated with each type of assistance under the proposed payment difficulties framework have been estimated for each of the nine retailers whose policies, procedures and practices were reviewed for the Hardship Inquiry.

To protect the anonymity of each of the nine retailers and enable comparison, the costs are presented on a cost per customer basis. The costs are based on the number of residential electricity customers on the basis that customers generally purchase electricity and gas from the one retailer, and when they are in payment difficulties, it impacts their ability to pay for both electricity and gas.

The costs are disaggregated by:

— the upfront costs – changes that are made to the retailer's processes and systems to implement the new payment difficulties framework
— ongoing operating costs – costs that are incurred annually by the retailer for each of the first two years and each year thereafter, to manage customers facing payment difficulties under the new framework
— avoided costs – the costs avoided by the retailer by discontinuing current practices for managing customers facing payment difficulties with the commencement of the new payment difficulties framework.

The costs are presented as the minimum, maximum and customer weighted average. The minimum cost per customer is the lowest cost per customer estimated for each of the nine retailers. The maximum is the highest cost per customer estimated for each of the nine retailers. The customer weighted average is the cost per customer estimated by weighting each of the retailer's costs per customer by the number of customers for that retailer.

The estimated costs are presented in:

— section 4.1, for the set-up to implement the new framework, and for the miscellaneous and consequential amendments
— section 4.2, for standard assistance
— section 4.3, for tailored assistance
— section 4.4, for default assistance
— section 4.5, for the costs that are avoided by the retailers with the introduction of the new framework.

A summary of the costs estimated is provided in section 4.6.

As discussed in section 3.7, this chapter assumes there are no incremental ongoing operating costs associated with disconnections and does not consider the financing costs associated with debt. These issues are separately considered in chapter 7.

4.1 Set up costs, miscellaneous and consequential amendments

The retailers' set up costs include the system changes to display information to assist choosing the appropriate payment plan for a customer and to produce a written schedule of payments for customers on a payment plan, and the costs associated with training customer service agents.

The miscellaneous and consequential amendments include upfront process changes relating to:

— revising financial hardship policies
— restricting the transfer to another retailer
— making minor changes to reminder notices and disconnection warning notices
— ensuring that disconnection is a last resort measure.

The estimated range of costs for the set up, and for miscellaneous and consequential amendments, is summarised in Table 4.1.

TABLE 4.1 ESTIMATED RETAILERS' COSTS FOR SET UP, AND FOR MISCELLANEOUS AND CONSEQUENTIAL AMENDMENTS

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Upfront cost	$1.52	$7.45	$3.28

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

4.2 Standard assistance

The retailers' costs for standard assistance include:

— system changes to allow customers to choose a payment smoothing, different payment period or delayed payment option, on the basis that these are the three standard assistance payment options offered by retailers
— upfront process changes to:
  – allow customers to choose a payment smoothing, different payment period or delayed payment option, on the basis that these are the three standard assistance payment options offered by retailers
  – make general information readily available on the assistance available, approaches to lowering energy costs, and government or non-government assistance that may be available to help with meeting energy costs
— ongoing operating costs associated with calls to the retailer and an increased number of bills sent to customers (where they elect to receive paper bills).

The estimated range of retailers' costs for standard assistance is summarised in Table 4.2.

TABLE 4.2 ESTIMATED RETAILERS' COSTS FOR STANDARD ASSISTANCE

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Upfront cost	$0.14	$4.46	$1.15
Ongoing operating costs (per annum)			
First 2 years		$0.33	
Thereafter		$0.70	

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

The ongoing operating costs are estimated to increase after the first two years as those customers that receive tailored assistance during the first two years transition to standard assistance, with the repayment of arrears.

4.3 Tailored assistance

Tailored assistance for residential customers that are able to pay for on-going energy use and repay their arrears over a period of up to two years

The retailers' costs for tailored assistance for residential customers that are able to pay for on-going energy use and repay their arrears over a period of up to two years include:

- system and upfront process changes to enable retailers to meet the new obligations associated with payment plans under tailored assistance
- ongoing operating costs associated with:
  - inbound and outbound calls
  - providing written advice to the customer on the payment plan, specific advice on lowering energy costs and on government or non-government assistance that may be available to a customer to help meet their energy costs.

The estimated range of retailers' costs for tailored assistance for customers repaying their arrears is summarised in Table 4.3.

TABLE 4.3 ESTIMATED RETAILERS' COSTS FOR TAILORED ASSISTANCE, ARREARS BEING REPAID

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Upfront cost	$1.18	$5.14	$1.94
Ongoing operating costs (per annum)			
First 2 years	$3.91		
Thereafter	$2.14		

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

The ongoing operating costs are estimated to decrease after the first two years as customers on payment plans under tailored assistance are transitioned to standard assistance, with their arrears repaid.

Tailored assistance for residential customers for whom the repayment of arrears is on hold

The retailers' costs for residential customers that are not able to pay for on-going energy use and repay their arrears over a period of up to two years include:

- system and upfront process changes to:
  - enable retailers to provide practical assistance based on the customer's pattern of energy use, and the retailer's knowledge of the circumstances of where the customer lives
  - enable retailers to provide information to customers on how they are progressing towards lowering their energy costs
- ongoing operating costs associated with:
  - inbound and outbound calls
  - providing written advice to customers on the payment plan, specific advice on lowering energy costs, specific advice on government or non-government assistance to help meeting energy costs, and information for customers on their progress towards lowering their energy costs
  - practical assistance to help the customer reduce their use of energy.

The estimated range of retailers' costs for tailored assistance for customers with the repayment of arrears on hold is summarised in Table 4.4.

TABLE 4.4 ESTIMATED RETAILERS' COSTS FOR TAILORED ASSISTANCE, ARREARS ON HOLD

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Upfront cost	$0.80	$8.90	$3.58
Ongoing operating costs (per annum)		$2.28	

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

4.4 Default assistance

The retailers' costs for default assistance include:

— system changes to enable customers to be placed on a payment plan, by default

— upfront process changes associated with placing customers on a payment plan, by default

— ongoing operating costs associated with calls to the retailer and written advice to the customer.

The estimated range of retailers' costs for default assistance is summarised in Table 4.5.

TABLE 4.5 ESTIMATED RETAILERS' COSTS FOR DEFAULT ASSISTANCE

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Upfront cost	$0.48	$2.10	$0.85
Ongoing operating costs (per annum)		$0.02	

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

The ongoing operating costs associated with default assistance are not material under each of the scenarios. This is because it is assumed that a relatively small proportion of customers will be provided with default assistance and these customers will either contact the retailer to move to some other type of assistance, the costs of which are captured under that type of assistance, or will choose to continue to disengage.

4.5 Costs avoided

The retailers currently incur ongoing operating costs to manage customers facing payment difficulties that are on payment plans. The estimated range of costs that are avoided by the retailers by implementing the new payment difficulties framework is summarised in Table 4.6.

TABLE 4.6 ESTIMATED RETAILERS' COSTS THAT ARE AVOIDED UNDER THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Ongoing operating costs (per annum)	–$9.25	–$2.14	–$6.52

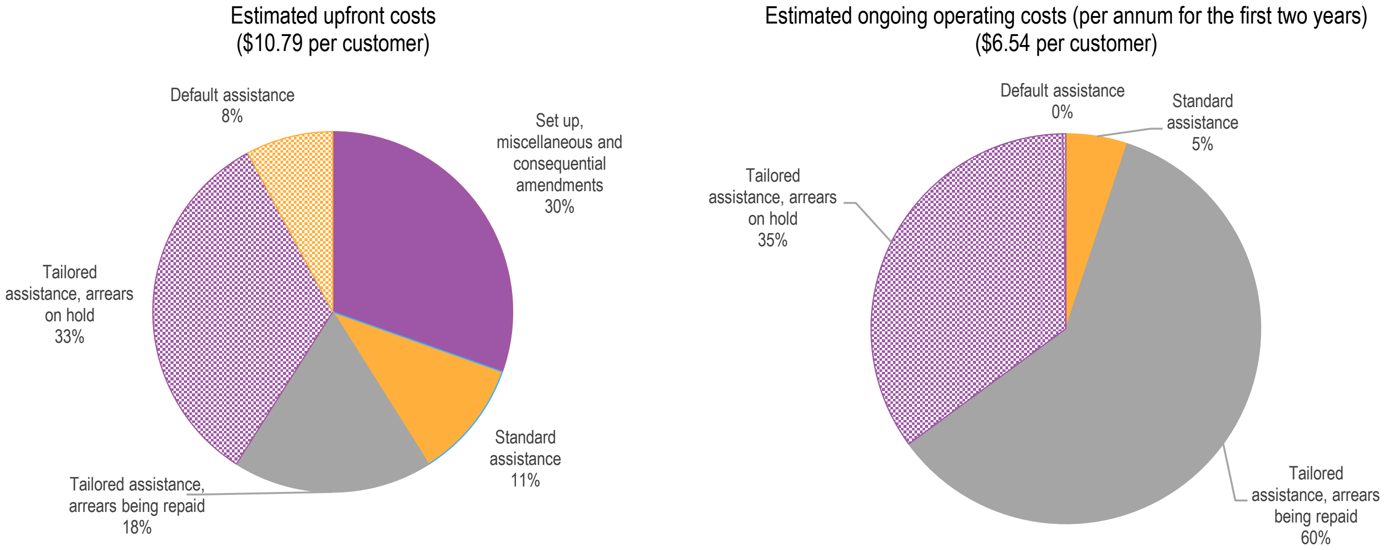
SOURCE: ACIL ALLEN

The avoided costs are a function of the proportion of a retailer's residential customers that are currently in the retailer's hardship program and on a payment plan. The range of estimated avoided costs reflects the range in the proportion of a retailer's residential customers that are currently in the retailer's hardship program, which varied from 0.3 per cent to 1.5 per cent in 2015-16, and the proportion of residential customers on a payment plan, which varied from 0.6 per cent to 10.5 per cent in 2015-16.

4.6 Summary

A breakdown of the estimated upfront costs and the annual ongoing operating costs in the first two years (excluding the avoided costs and financing costs associated with debt) associated with the proposed payment difficulties framework, by type of assistance, on a cost per customer basis, is illustrated in Figure 4.1.

FIGURE 4.1 BREAKDOWN OF ESTIMATED UPFRONT COSTS AND ONGOING OPERATING COSTS, BY TYPE OF ASSISTANCE, ON A COST PER CUSTOMER BASIS



Note: The ongoing operating costs do not include the avoided costs or the financing costs associated with debt

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

Tailored assistance for customers with arrears on hold is estimated to have the highest upfront costs, largely due to the substantial system changes required to provide practical assistance that is based on the customer's pattern of energy use, and the retailer's knowledge of the circumstances of where the customer lives.

Tailored assistance for customers repaying arrears is estimated to have the highest ongoing costs, as the proportion of customers that have been assumed to access that type of assistance is higher than for the other types of assistance.

5 COSTS ESTIMATED TO BE INCURRED BY NINE RETAILERS REVIEWED AS PART OF HARDSHIP INQUIRY

The cost per customer associated with the proposed payment difficulties framework, for each of the nine retailers whose policies, procedures and practices for managing customers facing payment difficulties were reviewed, are summarised in Table 5.1 and are illustrated, by size of retailer, in Figure 5.1. The cost per customer includes the estimated costs avoided by moving to the new framework.

To protect the anonymity of the retailers, the costs are presented as the cost per customer.

As the accuracy with which the system costs have been estimated is better for the three large retailers (AGL, Energy Australia and Origin Energy) than for the smaller retailers, and to protect the anonymity of the retailers, the three large retailers are identified as “Large retailer 1”, “Large retailer 2” and “Large retailer 3”, with the smaller retailers identified as “Other retailers”.

TABLE 5.1 ESTIMATED COST OF PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, BY RETAILER

Retailer	Upfront cost per customer			Net ongoing operating cost per customer (per annum)	
	System	Process	Total	First 2 years	Thereafter
Large retailer 1	$11.04	$1.29	$12.32	–$0.92	–$2.33
Large retailer 2	$10.24	$1.45	$11.69	$1.19	–$0.21
Large retailer 3	$8.35	$1.18	$9.53	–$2.71	–$4.12
Other retailer 1	$2.65	$2.35	$5.00	$3.94	$2.53
Other retailer 2	$14.99	$11.67	$26.67	–$0.79	–$2.20
Other retailer 3	$3.91	$3.33	$7.24	–$1.24	–$2.65
Other retailer 4	$13.34	$10.86	$24.21	$4.40	$2.99
Other retailer 5	$3.97	$3.31	$7.28	$1.60	$0.20
Other retailer 6	$10.09	$8.09	$18.19	$2.95	$1.54
Customer weighted average	**$8.35**	**$2.44**	**$10.79**	**$0.02**	**–$1.39**

Note: Ongoing operating costs include the estimated avoided costs but exclude the financing costs associated with debt

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

FIGURE 5.1 ESTIMATED COST PER CUSTOMER OF PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, BY SIZE OF RETAILER

Note: Ongoing operating costs include the estimated avoided costs but exclude the financing costs associated with debt

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP

The additional ongoing operating costs on a per customer basis vary across the nine retailers. From a practical perspective, as discussed in chapter 6, these costs are unlikely to vary as much as indicated in Table 5.1.

The variation in additional ongoing operating costs across the retailers is largely because of the variation in the proportion of customers that are currently in the retailer's hardship program.

The proportion of customers receiving each type of assistance under the new framework is assumed to be the same for each retailer, while the proportion of customers receiving assistance under the retailers' existing programs varies from retailer to retailer. Those retailers that currently have a relatively high proportion of customers in their hardship program will have relatively high avoided costs compared to those retailers with a relatively low proportion of customers in their hardship program.

For example, the net operating costs that are estimated to be incurred by large retailer 3 are negative and more negative than any other retailer. This is because it has a relatively high proportion of customers currently in its hardship program and therefore relatively high avoided costs by moving to the new framework. Our analysis assumes that all retailers will have the same proportion of customers receiving tailored assistance under the new framework. If large retailer 3 has a higher proportion of customers receiving tailored assistance than other retailers, then its costs will be higher than estimated.

If this is the case, then there will be other retailers that have a lower proportion of customers on tailored assistance than we have assumed and thus lower costs associated with the new payment difficulties framework.

The upfront costs, on a weighted per customer basis, are higher for larger retailers than for smaller retailers. This is because the system costs assumed for the smaller retailers are around 15 per cent of the system costs assumed for the larger retailers, but the larger of the smaller retailers have only around half the number of customers as the larger retailers.

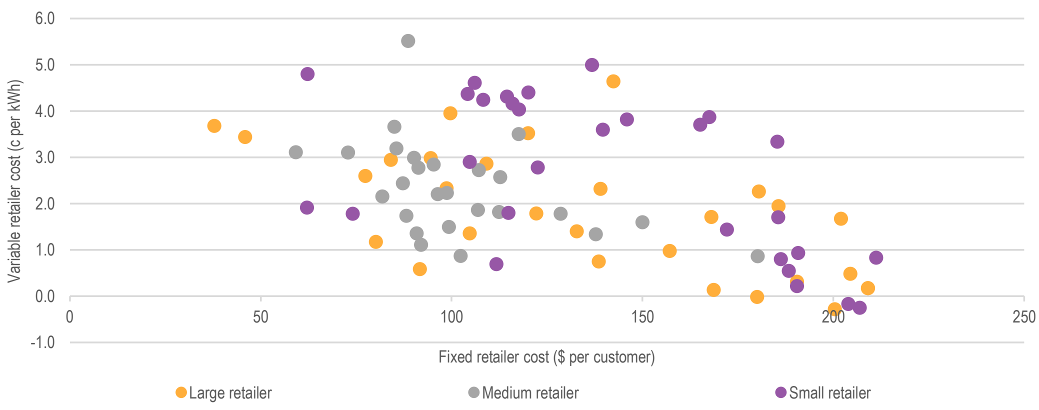
As discussed in section 3.3, the smaller retailers generally use outsourced services. The outsourced service providers' systems would be used by a number of the smaller retailers. Accordingly, any costs incurred by the outsourced service providers would be recovered across a number of retailers, and hence the cost per retailer is lower.

6

COSTS ESTIMATED TO BE INCURRED ACROSS ALL VICTORIAN RETAILERS

ACIL Allen has previously analysed the retailer costs and margins across ten retailers operating in Victoria, New South Wales, Queensland and South Australia. That analysis revealed that the retailer costs and margins do not vary significantly by retailer size, as illustrated in Figure 6.1.

FIGURE 6.1 FIXED AND VARIABLE RETAILER COSTS, BY SIZE OF RETAILER, 2015-16



SOURCE: ACIL ALLEN ANALYSIS FOR THE QUEENSLAND COMPETITION AUTHORITY (HTTP://WWW.QCA.ORG.AU/GETATTACHMENT/5591E73B-9DDA-4780-9920-A30D6435D74B/ACIL-ALLEN-REGULATED-RETAIL-PRICES-FOR-2016-17-E.ASPX)

Based on this analysis, we have assumed that the efficient costs associated with implementing and operating the proposed payment difficulties framework will be of a similar order of magnitude across all retailers, on a cost per customer basis.

The cost per customer for the nine retailers, whose policies, procedures and practices for managing customers facing payment difficulties were reviewed, weighted by the number of customers is provided, by type of assistance, in Table 4.1 to Table 4.6. We then multiplied the costs per customer by the total number of residential customers in 2015-16, indexed by the expected Victorian population growth to 2017-18 (1.8 per cent per year[15]).

The average cost per customer and the total costs across all retailers are set out in Table 6.1 **and** Table 6.2, respectively.

[15] Victorian Government Budget Papers 2016-17, Overview, page 5

TABLE 6.1 ESTIMATED COST PER CUSTOMER ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Type of assistance	Weighted average cost per customer		
	Upfront	Annual ongoing operating cost (first 2 years)	Annual ongoing operating cost (thereafter)
Set up, miscellaneous and consequential amendments	$3.28	$0.00	$0.00
Standard assistance	$1.15	$0.33	$0.70
Tailored assistance, arrears being repaid	$1.94	$3.91	$2.14
Tailored assistance, arrears on hold	$3.58	$2.28	$2.28
Default assistance	$0.85	$0.02	$0.02
Sub total	$10.79	$6.54	$5.13
Less avoided costs	$0.00	–$6.52	–$6.52
Total	**$10.79**	**$0.02**	**–$1.39**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

TABLE 6.2 ESTIMATED TOTAL COSTS ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Type of assistance	Costs incurred by all retailers		
	Upfront	Annual ongoing operating cost (first 2 years)	Annual ongoing operating cost (thereafter)
Set up, miscellaneous and consequential amendments	$8,215,308	$0	$0
Standard assistance	$2,880,362	$835,991	$1,745,936
Tailored assistance, arrears being repaid	$4,852,948	$9,802,646	$5,371,098
Tailored assistance, arrears on hold	$8,965,643	$5,706,756	$5,706,756
Default assistance	$2,118,224	$39,987	$39,987
Sub total	$27,032,484	$16,385,380	$12,863,777
Less avoided costs		–$16,344,933	–$16,344,933
Total	**$27,032,484**	**$40,447**	**–$3,481,156**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

The total upfront cost per customer associated with introducing the proposed payment difficulties framework is estimated to be $10.79, with the net ongoing operating cost estimated to be $0.02 per customer per year over the first two years and a reduction in net operating costs estimated to be $1.39 per customer per year thereafter. The total upfront cost across all Victorian energy retailers is estimated to be $27.0 million and the net annual operating cost is estimated to be around $40,000 per year over the first two years with a net annual saving estimated to be $3.5 million per year thereafter.

Table 6.3 presents the upfront and ongoing operating costs in a comparable way by depreciating the upfront costs over a ten year period.

TABLE 6.3 ESTIMATED ANNUAL ASSOCIATED WITH THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK, ALL RETAILERS

Cost category	Annual cost (first 2 years)	Annual cost (thereafter)
Upfront costs (depreciated over 10 years)	$1.08	$1.08
Operating costs	$0.02	–$1.39
Total costs per customer	**$1.10**	**–$0.31**

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP:

When the upfront costs are depreciated over a ten year period, the annual cost to customers is $1.10 in each of the first two years and a benefit of $0.31 in each of the subsequent eight years.

7 SENSITIVITY ANALYSIS – DISCONNECTIONS, BAD DEBTS AND ARREARS

The results of the sensitivity analysis that has been undertaken to consider the impact on the retailers of varying the rate of disconnections and the average debt for customers facing payment difficulties are provided in this chapter. The impact on the retailers' total debt, based on our assumption that customers will transition from tailored assistance to standard assistance two years after commencement of the new framework, is also provided.

7.1 Disconnections

It has been assumed that, under the current and proposed arrangements, the retailer will incur the costs associated with issuing a reminder notice and a disconnection warning notice prior to disconnecting a customer and will also complete a 'disconnection checklist' to ensure the disconnection is not wrongful. As the rate of disconnection increases, the costs incurred by the retailer will increase.

The results from the sensitivity analysis on the rate of disconnections are set out in Table 7.1.

TABLE 7.1 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' COSTS

Scenario	Incremental cost per customer (per annum)	Incremental cost across all retailers (per annum)
Base case (current rate of disconnection)	$0.00	$0
80% of current rate of disconnection	–$0.03	–$76,166
60% of current rate of disconnection	–$0.06	–$152,332

SOURCE: ACIL ALLEN

As the proportion of customers facing payment difficulties that are assumed to be disconnected is small, the impact of a change in the rate of disconnections on the retailers' costs is relatively immaterial.

7.2 Bad debts

The results from the sensitivity analysis on the impact of the rate of disconnections on the level of bad debts are set out in Table 7.2.

TABLE 7.2 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' COSTS

Scenario	Incremental bad debt per customer (per annum)	Incremental bad debt across all retailers (per annum)
Base case (current rate of disconnection)	$0.00	$0
80% of current rate of disconnection	–$0.55	–$1,370,992
60% of current rate of disconnection	–$1.09	–$2,741,985

SOURCE: ACIL ALLEN

As would be expected, as the rate of disconnection decreases, the bad debts that are written off by the retailers decreases.

7.3 Arrears

We have assumed that, when the new framework commences, 0.95 per cent of customers will have an average debt of $1200 and 2.75 per cent of customers will have an average debt of $450. Two years after commencement of the new framework, we have assumed that some customers will transition from tailored assistance to standard assistance, and the proportion of customers with an average debt of $450 will decrease to 1.34 per cent (a decrease of 1.41 percentage points).

Given the uncertainty as to the average level of debt for customers facing payment difficulties, we have varied the average level of debt, to estimate the impact at a point in time relative to the base case at the commencement of the new framework. The results from the sensitivity analysis, assuming no change in the number of customers, are set out in Table 7.3. As the number of customers increases over time, the debt levels across all retailers will increase accordingly.

TABLE 7.3 ESTIMATED IMPACT AT A POINT IN TIME OF A CHANGE IN THE AVERAGE DEBT FOR CUSTOMERS FACING PAYMENT DIFFICULTIES

	Base case	Average debt reduced by 5%	Average debt reduced by 15%	Average debt reduced by 25%
At commencement of new framework				
Incremental debt per customer [a]	$0.00	–$1.19	–$3.57	–$5.94
Incremental debt across all retailers	$0	–$2,978,376	–$8,935,127	–$14,891,879
Incremental financing cost [b]	$0	–$148,919	–$446,756	–$744,594
Two years after commencement of the new framework				
Incremental debt per customer [a]	–$6.37	–$7.24	–$8.98	–$10.72
Incremental debt across all retailers	–$15,953,571	–$18,134,268	–$22,495,663	–$26,857,057
Incremental financing cost [b]	–$797,679	–$906,713	–$1,124,783	–$1,342,853

[a] Incremental debt across all residential electricity customers

[b] Financing cost assumes an interest rate of 5%

Note: Estimated impact relative to the base case at commencement of new framework. Assumes no change in the number of customers.

SOURCE: ACIL ALLEN

Table 7.3 indicates that the total debt for customers facing payment difficulties varies significantly as the average debt for customers facing payment difficulties varies. However, the retailers' financing costs associated with this debt do not change materially.

As the proportion of customers transitioning from tailored assistance to standard assistance is assumed to increase, the debt for customers facing payment difficulties is expected to reduce significantly – by $16.0 million two years after commencement of the new framework, assuming no change in the average debt per customer. If the average debt reduces by 5 per cent, then the debt for customers facing payment difficulties is expected to reduce by $18.1 million two years after commencement of the new framework

8 TOTAL IMPACT ON THE RETAILERS

In this chapter, the net present value (NPV) of the total impact of the new payment difficulties framework on the Victorian energy retailers is calculated.

The total impact of the new payment difficulties framework on the Victorian energy retailers comprises the upfront costs and the net ongoing operating costs, as discussed in chapter 6, and the reduction in financing costs associated with the reduction in arrears, as customers transition from tailored assistance to standard assistance, as discussed in chapter 7. In calculating the total impact, we have assumed that the rate of disconnections and therefore bad debt, remain unchanged.

We have calculated the NPV over a ten year period using a discount rate of 4 per cent per annum, consistent with the Government's guidance for regulatory proposals.[16]

The costs and benefits presented in the preceding chapters were calculated based on the estimated customer numbers in 2017-18, which were calculated based on the published customer numbers for 2015-16 assuming a 1.8 per cent per annum population growth. In calculating the NPV of the impact on the retailers over ten years, we have assumed that population growth would continue at 1.8 per cent per annum, and have escalated the costs and benefits accordingly.

The upfront costs are assumed to be incurred in 2017, in preparation for a 1 January 2018 commencement date. The ongoing operating costs are assumed to be incurred from 2018 to 2027. The benefits associated with reduced financing costs for reduced arrears are assumed to accrue from 2020, two years after the commencement of the new framework.

The NPV of the total impact of the payment difficulties framework on all retailers, is summarised in Table 8.1. The NPV over ten years is a benefit of $2.5 million (2017 dollars), with a payback period of less than ten years.

[16] Department of Treasury and Finance, Victorian Guide to Regulation, Toolkit 2: Cost-benefit analysis, Updated July 2014, page 11

TABLE 8.1 NPV OF THE TOTAL IMPACT OF THE PROPOSED PAYMENT DIFFICULTIES FRAMEWORK ON ALL VICTORIAN ENERGY RETAILERS

Type of cost / benefit	NPV ($2017)
Set up, miscellaneous and consequential amendments	–$8.2 million
Standard assistance	–$16.6 million
Tailored assistance, arrears being repaid	–$60.8 million
Tailored assistance, arrears on hold	–$59.3 million
Default assistance	–$2.5 million
Avoided costs	$144.3 million
Reduced financing costs	$5.5 million
Total	**$2.5 million**

Note: 4 per cent discount rate

SOURCE: ACIL ALLEN BASED ON SYSTEM CHANGE COSTS PROVIDED BY TBS CONSULTING GROUP

APPENDICES

A

INFORMATION REQUEST

An Information Request has been prepared to enable retailers to submit comprehensive information so that the retailers' impacts can be more accurately assessed for the Commission's Final Decision.

The Information Request has been prepared in an Excel spreadsheet and consists of the following worksheets:

— Introduction – explains purpose of Information Request and collects contact details for the retailer
— General – collects information on the number of customers, and costs associated with the call centre, training, and written communication
— General information – collects information on what is readily available on the types of assistance, and general information on approaches to lowering energy costs, and government and non-government assistance that may help with meeting energy costs.
— Standard assistance – Payment smoothing – collects information on the retailer's current and proposed arrangements, including the number of customers, frequency of payments and billing, system changes and upfront process changes required, the number and length of phone calls, and written communication.
— Standard assistance – Payment at different intervals – collects information on the retailer's current and proposed arrangements, including the number of customers, frequency of payments and billing, system changes and upfront process changes required, the number and length of phone calls, and written communication.
— Standard assistance – Delayed payment – collects information on the retailer's current and proposed arrangements, including the number of customers, length of payment delay, system changes and upfront process changes required, and the number and length of phone calls.
— Standard assistance – Payment in advance – collects information on the retailer's current and proposed arrangements, including the number of customers, proportion of the customer's bill made in advance, system changes and upfront process changes required, the number and length of phone calls, and written communication.
— Standard assistance – Payment plan for anticipated arrears – collects information on the retailer's current and proposed arrangements, including the number of customers, arrears, frequency of payments and billing, system changes and upfront process changes required, the number and length of phone calls, and written communication.
— Tailored assistance – payment plan with arrears being repaid – collects information on the retailer's current and proposed arrangements, including the number of customers, arrears, frequency of payments and billing, system changes and upfront process changes required, the number and length of phone calls, written communication, and the specific information provided on lowering energy costs, and government or non-government assistance to help meeting energy costs.

- Tailored assistance – payment plan with arrears on hold – collects information on the retailer's current and proposed arrangements, including the number of customers, arrears, frequency of payments and billing, the length of time that customers would be paying less than the full on-going cost of energy use and have the repayment of arrears on hold, system changes and upfront process changes required, the number and length of phone calls, written communication, and the specific information provided on lowering energy costs, and government or non-government assistance to help meeting energy costs.
- Tailored assistance – other assistance for those with arrears being repaid – collects information on the retailer's current and proposed arrangements for offering an alternative tariff, providing practical assistance and providing information to customers about how they are progressing towards lowering their energy costs, including the number of customers, system changes and upfront process changes required, the number and length of phone calls, written communication, and other costs.
- Default assistance – Default payment plan – collects information on the retailer's current and proposed arrangements, including the number of customers, arrears, frequency of payments and billing, system changes and upfront process changes required, the number and length of phone calls, and written communication.
- Disconnections – collects information on the number of customers facing payment difficulties that are currently being disconnected and are expected to be disconnected under the new framework, and their associated bad debts.

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