ACIL ALLEN CONSULTING

REPORT TO
ESSENTIAL SERVICES COMMISSION

9 OCTOBER 2017

NEW FRAMEWORK FOR CUSTOMERS FACING PAYMENT DIFFICULTY

ASSESSMENT OF THE RETAILERS' COSTS

ACIL ALLEN CONSULTING PTY LTD
ABN 68 102 652 148

LEVEL FIFTEEN
127 CREEK STREET
BRISBANE QLD 4000
AUSTRALIA
T+61 7 3009 8700
F+61 7 3009 8799

LEVEL ONE
15 LONDON CIRCUIT
CANBERRA ACT 2600
AUSTRALIA
T+61 2 6103 8200
F+61 2 6103 8233

LEVEL NINE
60 COLLINS STREET
MELBOURNE VIC 3000
AUSTRALIA
T+61 3 8650 6000
F+61 3 9654 6363

LEVEL ONE
50 PITT STREET
SYDNEY NSW 2000
AUSTRALIA
T+61 2 8272 5100
F+61 2 9247 2455

LEVEL TWELVE, BGC CENTRE
28 THE ESPLANADE
PERTH WA 6000
AUSTRALIA
T+61 8 9449 9600
F+61 8 9322 3955

161 WAKEFIELD STREET
ADELAIDE SA 5000
AUSTRALIA
T +61 8 8122 4965

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C O N T E N T S

C O N T E N T S

ABBREVIATIONS

ACIL Allen	ACIL Allen Consulting
AER	Australian Energy Regulator
Commission	Essential Services Commission (of Victoria)
EWOV	Energy and Water Ombudsman, Victoria
framework	Payment difficulty 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 difficulty with the commencement of the new payment difficulty 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 relevant customers for that retailer
Default assistance	An entitlement that was proposed in the Draft Decision to give assistance to residential customers who are in arrears and not receiving tailored assistance, to repay their arrears over a fixed period. This form of assistance has subsequently been removed from the payment difficulty framework.
Minimum cost per customer	Lowest cost per customer estimated – either, for each of the nine retailers reviewed as part of the Hardship Inquiry, or for the retailers that submitted information in response to the information request
Maximum cost per customer	Highest cost per customer estimated – either, for each of the nine retailers reviewed as part of the Hardship Inquiry, or for the retailers that submitted information in response to the information request
Standard assistance	An entitlement to a minimum standard of assistance to enable a residential customer anticipating payment difficulty or possible payment difficulty with ways to avoid getting into arrears
System change	A change that is required to the retailers' IT systems for the introduction of the new payment difficulty framework
Tailored assistance	An entitlement to a minimum standard of assistance to a residential customer to pay off arrears within two years and, if unable to meet the cost of their energy usage, to obtain tailored advice on how to reduce energy costs while repayment of arrears is placed on hold for an initial period of six months. No residential customer will be disconnected while meeting the terms of a tailored assistance arrangement

EXECUTIVE SUMMARY

ACIL Allen Consulting (ACIL Allen) has been engaged by the Essential Services Commission (the Commission) to assess the impacts of a new payment difficulty framework (framework) on the Victorian energy retailers, to inform its final decision.

ACIL Allen's analysis of the impact of the payment difficulty framework on retailers occurred in two stages.

The first stage was a preliminary assessment based on assumptions developed by ACIL Allen and informed by input from an IT specialist, TBS Consulting Group. The preliminary assessment of the impacts of the proposed new framework was undertaken by considering:

— the obligations that are placed on the retailers under the three types of assistance that were proposed under the new framework in the Draft Decision – standard assistance, tailored assistance and default assistance
— for each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulty 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 new 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 difficulty were reviewed
— by extension, the costs that are estimated to be incurred by all Victorian energy retailers.

The second stage involved seeking input directly from the Victorian energy retailers.

During the second stage, ACIL Allen issued a formal detailed information request to the retailers. ACIL Allen consulted with the retailers during the information gathering process to ensure clarity regarding the information required and relevant assumptions. ACIL Allen structured its analysis and information gathering process to allow it to test the cost implications of making variations to the design of the framework.

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

Following incorporation of the information submitted by the retailers, the analysis revealed the following design elements of the framework resulted in disproportionate costs:

— default assistance
— the proposed definition of arrears
— the separation of usage and arrears in repayment arrangements.

The second stage of analysis accounts for changes to the framework design that were made by the Commission between the draft and final decisions. These included the removal or modification of each of these three elements of the framework that were identified as causing disproportionate costs.

The second stage of analysis indicated a level of uncertainty regarding the final costs of the framework, which are sensitive to a number of factors. These factors include the percentage of customers who take up each form of assistance and the impact of the framework on the average arrears for customers. Notably, retailer estimates of the level of take up for each form of assistance, both at the commencement of the framework and over time, varied significantly. ACIL Allen has performed sensitivity analyses to reflect this uncertainty.

To account for the results of the sensitivity analysis, ACIL Allen's final analysis of the likely cost impact of the framework on the retailers is stated as a range.

The assumptions underlying the low-end estimate are broadly similar to those that underpinned the first stage of analysis; the results using these assumptions are referred to in this report as the "updated preliminary assessment". The assumptions underpinning the high-end estimate are largely derived directly from the retailers' submissions; the results using these assumptions are referred to in this report as the "information submitted by the retailers".

The actual costs to retailers may, in practice, fall near either end of this range but are unlikely to be outside it.

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

Costs associated with each type of assistance

A breakdown of the estimated upfront costs and the annual ongoing operating costs (excluding the avoided costs, disconnection costs, financing costs associated with debt and bad debts) associated with the new payment difficulty framework, by type of assistance, on a cost per customer basis, is illustrated in Figure ES 1. The breakdown of costs includes default assistance.

The upfront costs and the ongoing operating costs submitted by the retailers are significantly higher than estimated using the updated assumptions from the preliminary assessment.

The estimates using the updated assumptions from the preliminary assessment indicate that tailored assistance for customers with arrears on hold has the highest upfront costs and tailored assistance for customers repaying arrears has the highest ongoing costs, as the proportion of customers assumed to access that type of assistance is higher than for the other types of assistance.

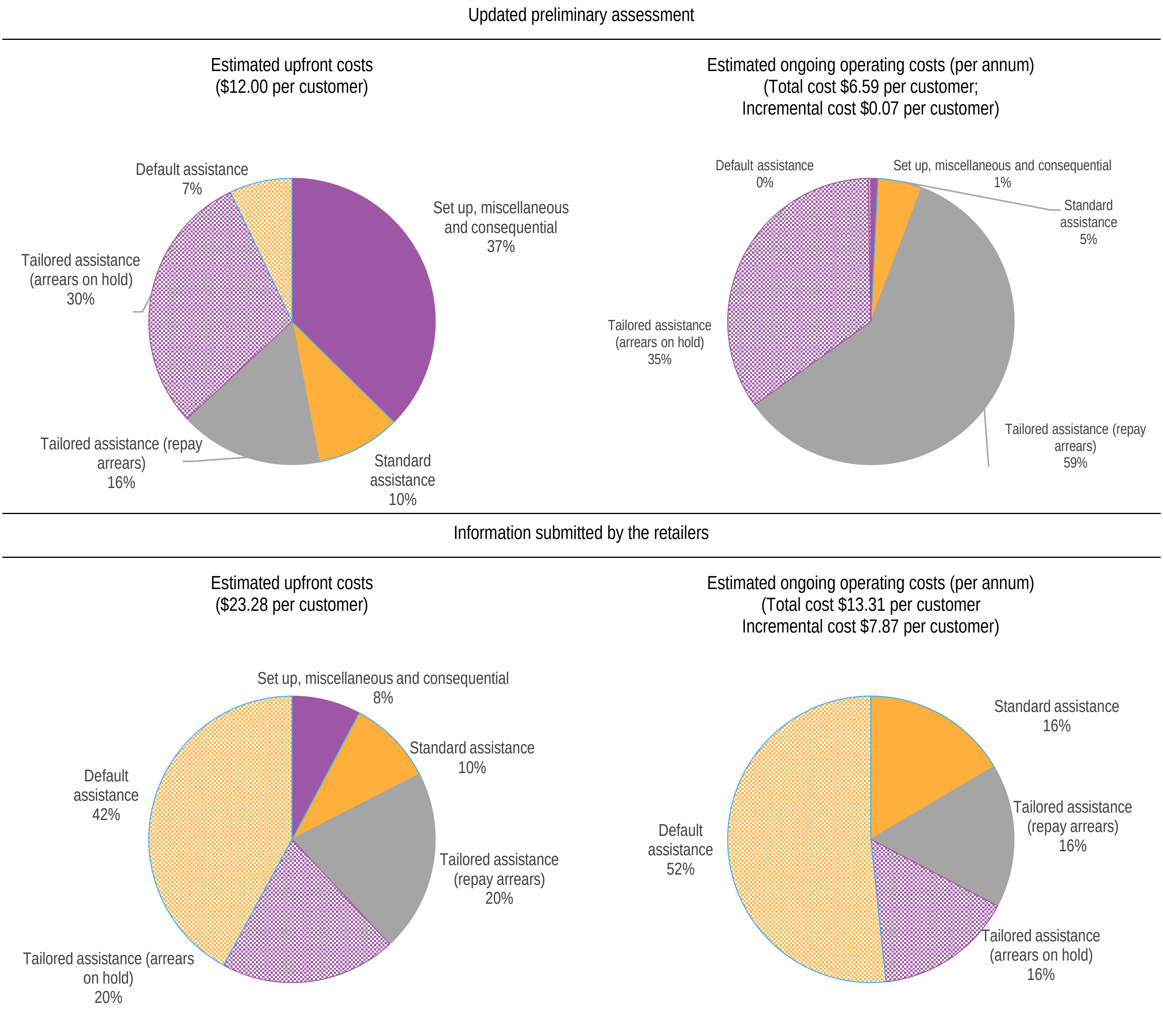
The retailers have estimated that the upfront and ongoing operating costs associated with default assistance are the highest of each of the types of assistance, and substantially higher than estimated using the assumptions updated from the preliminary assessment.

If the proportions of customers on each type of assistance are scaled to state-wide estimates[2] then, based on the information submitted by the retailers, the total ongoing operating costs decrease from $13.31 to $13.15 on a cost per customer basis, and the incremental ongoing operating costs reduce from $7.87 to $7.83 on a cost per customer basis. The costs associated with tailored assistance (with arrears being repaid) reduce from 16 per cent to 13 per cent of the ongoing operating costs, and the costs associated with tailored assistance (arrears on hold) increase from 16 per cent to 18 per cent of the ongoing operating costs.

[2] There is a variance between the proportion of customers currently on payment plans for the retailers that submitted information and for all retailers.

If default assistance is removed from the framework then, based on the information submitted by the retailers, it is estimated that the upfront costs would reduce from $23.28 to $18.38 per customer, the total ongoing operating costs would reduce from $13.31 per customer to $6.43 per customer (or from $13.15 per customer to $6.27 per customer if the proportions of customers are scaled in line with state-wide estimates) and the incremental ongoing operating costs would reduce from $7.87 per customer to $0.99 per customer (or from $7.83 per customer to $0.95 per customer if the proportions of customers are scaled in line with state-wide estimates).

FIGURE ES 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, disconnection costs, the financing costs associated with debt, or bad debts

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

Estimated costs for providing assistance 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 new payment difficulty framework will be of a similar order of magnitude across all retailers, on a cost per customer basis.

To obtain the costs associated with providing assistance under the payment difficulty framework, across all retailers, we multiplied the customer weighted average 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[3]).

The customer weighted average costs per customer and the total costs across all retailers are set out in Table ES 1 and Table ES 2, respectively.

TABLE ES 1 ESTIMATED COST PER CUSTOMER ASSOCIATED WITH PROVIDING ASSISTANCE UNDER THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS

Type of assistance	Costs incurred by all retailers			
	Updated preliminary assessment		Information submitted by the retailers	
	Upfront	Annual ongoing operating cost	Upfront	Annual ongoing operating cost
Set up, miscellaneous and consequential amendments	$4.49	$0.05	$1.81	
Standard assistance	$1.15	$0.33	$2.26	$2.20
Tailored assistance, arrears being repaid	$1.94	$3.91	$4.79	$2.15
Tailored assistance, arrears on hold	$3.58	$2.28	$4.62	$2.08
Default assistance	$0.85	$0.02	$9.80	$6.88
Sub total	$12.00	$6.59	$23.28	$13.31
Less avoided costs	$0.00	–$6.52	$0.00	–$5.44
Total	$12.00	$0.07	$23.28	$7.87
Total (if default assistance not required)	$11.58	$0.05	$18.38	$0.99

Note: Columns may not add due to rounding. It has been assumed that 50 per cent of the upfront costs and 100 per cent of the ongoing operating costs associated with default assistance will be avoided if default assistance is removed from the framework.

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

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

TABLE ES 2 ESTIMATED TOTAL COSTS ASSOCIATED WITH PROVIDING ASSISTANCE UNDER THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS

Type of assistance	Costs incurred by all retailers			
	Updated preliminary assessment		Information submitted by the retailers	
	Upfront	Annual ongoing operating cost	Upfront	Annual ongoing operating cost
Set up, miscellaneous and consequential amendments	$11,246,924	$128,000	$4,535,399	
Standard assistance	$2,880,362	$835,991	$5,656,831	$5,508,955
Tailored assistance, arrears being repaid	$4,852,948	$9,802,646	$12,010,071	$5,395,654
Tailored assistance, arrears on hold	$8,965,643	$5,706,756	$11,576,202	$5,202,941
Default assistance	$2,118,224	$39,987	$24,546,951	$17,238,206
Sub total	$30,064,101	$16,513,380	$58,325,424	$33,345,756
Less avoided costs		–$16,344,933		–$13,637,898
Total	$30,064,101	$168,447	$58,325,454	$19,707,858
Total (if default assistance not required)	$29,004,989	$128,460	$46,051,979	$2,469,652

Note: Columns may not add due to rounding. It has been assumed that 50 per cent of the upfront costs and 100 per cent of the ongoing operating costs associated with default assistance will be avoided if default assistance is removed from the framework.

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

The total upfront cost per customer associated with introducing the new payment difficulty framework, including default assistance, is estimated to be in the range of $12.00 to $23.28, with the net ongoing operating cost estimated to be in the range of $0.07 to $7.87 per customer per year. If default assistance is not required, the total upfront cost per customer is estimated to be in the range of $11.58 to $18.38, with the net ongoing operating cost estimated to be in the range of $0.05 to $0.99 per customer.

If default assistance is not required, the total upfront cost across all Victorian energy retailers is estimated to be in the range of $29.0 million to $46.1 million and the net annual operating cost is estimated to be in the range of $0.1 million to $2.5 million per year.

Sensitivity analysis – disconnections, bad debts and arrears

Disconnections

The preceding 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. The results from the sensitivity analysis are set out in Table ES 3.

TABLE ES 3 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' OPERATING COSTS

Scenario	Updated preliminary assessment		Information submitted by retailers (customer weighted mean)	
	Incremental cost per customer (per annum)	Incremental cost across all retailers (per annum)	Incremental cost per customer (per annum)	Incremental cost across all retailers (per annum)
Base case (current rate of disconnection)	$0.00	$0	$0.05	$134,546
80% of current rate of disconnection	–$0.03	–$76,166	$0.03	$71,469
60% of current rate of disconnection	–$0.06	–$152,332	$0.00	$8,392

SOURCE: ACIL ALLEN

As the proportion of customers facing payment difficulty 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 costs associated with disconnections, as estimated based on information submitted by the retailers, are higher than estimated using the assumptions updated from the preliminary assessment. The variation is driven by the estimates for the time to complete a 'disconnection checklist' under the current and new payment difficulty frameworks.

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 on an annual bad debts per customer basis in Table ES 4 and as the total annual bad debts to retailers in Table ES 5. The range of average debt considered in the sensitivity analysis is less than submitted by the retailers to reflect changes made by the Commission to the definition of arrears and to provide increased flexibility for the retailers to manage payments for arrears and energy use, subsequent to its Draft Decision.

TABLE ES 4 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS AND AVERAGE DEBT ON THE RETAILERS' BAD DEBTS, INCREMENTAL ANNUAL BAD DEBTS PER CUSTOMER

Scenario	Average level of debt				
	30% decrease	15% decrease	No change	15% increase	30% increase
Base case (current rate of disconnection)	-0.82	-0.41	0.00	0.41	0.82
80% of current rate of disconnection	-1.20	-0.88	-0.55	-0.22	0.11
60% of current rate of disconnection	-1.59	-1.34	-1.09	-0.85	-0.60

SOURCE: ACIL ALLEN

TABLE ES 5 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS AND AVERAGE DEBT ON THE RETAILERS' BAD DEBTS, TOTAL INCREMENTAL ANNUAL BAD DEBTS

Scenario	Average level of debt				
	30% decrease	15% decrease	No change	15% increase	30% increase
Base case (current rate of disconnection)	-$2,056,489	-$1,028,244	$0	$1,028,244	$2,056,489
80% of current rate of disconnection	-$3,016,183	-$2,193,588	-$1,370,992	-$548,397	$274,198
60% of current rate of disconnection	-$3,975,878	-$3,358,931	-$2,741,985	-$2,125,038	-$1,508,092

SOURCE: ACIL ALLEN

As would be expected:

- as the rate of disconnection decreases, the bad debts that are written off by the retailers decreases
- as the average debt for customers that are disconnected decreases, the bad debts that are written off by the retailers decreases.

Arrears

The results from the sensitivity analysis on the impact of a change in the average debt for customers facing payment difficulty 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 DIFFICULTY

			Average debt		
	30% decrease	15% decrease	No change	15% increase	30% increase
Updated preliminary assessment – at commencement of new framework					
Incremental debt per customer [a]	-$7.13	-$3.57	$0.00	$3.57	$7.13
Incremental debt across all retailers	-$17,870,254	-$8,935,127	$0	$8,935,127	$17,870,254
Incremental financing cost [b]	-$895,513	-$446,756	$0	$446,756	$895,513
Updated preliminary assessment – reduction in proportion of customers on tailored assistance and repaying arrears from 2.75 per cent to 1.34 per cent					
Incremental debt per customer [a]	-$11.59	-$8.98	-$6.37	-$3.76	-$1.15
Incremental debt across all retailers	-$29,037,754	-$22,495,663	-$15,953,571	-$9,411,479	-$2,869,388
Incremental financing cost [b]	-$1,451,888	-$1,124,783	-$797,679	-$470,574	-$143,469
Information submitted by retailers – at commencement of new framework					
Incremental debt per customer [a]	-$8.82	-$4.41	$0.00	$4.41	$8.82
Incremental debt across all retailers	-$22,095,387	-$11,047,693	$0	$11,047,693	$22,095,387
Incremental financing cost [b]	-$1,104,769	-$552,385	$0	$552,385	$1,104,769
Information submitted by retailers – 30 per cent reduction in proportion of customers on tailored assistance and repaying arrears					
Incremental debt per customer [a]	-$13.99	-$10.69	-$7.39	-$4.09	-$0.79
Incremental debt across all retailers	-$35,056,985	-$26,786,777	-$18,516,569	-$10,246,361	-$1,976,153
Incremental financing cost [b]	-$1,752,849	-$1,339,339	-$925,828	-$512,318	-$98,808

[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 difficulty varies significantly as the average debt for customers facing payment difficulty varies. However, the changes in the retailers' financing costs associated with this debt are less material.

As the proportion of customers on tailored assistance and repaying arrears is assumed to decrease, the debt for customers facing payment difficulty is expected to reduce significantly:

- by $16.0 million using the assumptions updated from the preliminary assessment on the proportion of customers on tailored assistance and with no change in the average debt per customer
- by $18.5 million using the retailers' assumptions on the proportion of customers on tailored assistance initially, and our assumptions of a 30 per cent reduction in the proportion of customers on tailored assistance and no change in the average debt per customer.

The retailers' total debt will increase (or decrease) as the average debt increases (or decreases). The financing costs associated with the retailers' debt will increase (or decrease) as the cost of capital increases (or decreases)

Total impact of the framework on the retailers

In calculating the total impact of the new payment difficulty framework on retailers, we have used the customer weighted average costs and have assumed that the Commission:

— removes default assistance
— changes the definition of arrears
— provides the retailers with flexibility in managing payments for arrears and energy use.

In addition, it assumes the rate of disconnections remains unchanged.[4]

The Commission has decided to increase the minimum outstanding amount for disconnection to occur in Victoria from $120 (exclusive of GST) to $300 (exclusive of GST), as applies in other jurisdictions. The potential cost savings associated with this alignment between Victorian and national arrangements has not been taken into consideration in assessing the total impact of the new payment difficulty framework.

Table ES 7 presents the upfront and ongoing operating costs in a comparable way by depreciating the upfront costs over a ten year period. The annualised costs are also presented as a proportion of the retailers' revenue, assuming that the retailers' revenue from the electricity and gas markets is in the order of $8 billion.[5]

TABLE ES 7 ESTIMATED ANNUALISED COST ASSOCIATED WITH THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS ($2017)

Cost category	Updated preliminary assessment		As submitted by the retailers	
	Cost per customer	% of retailer revenue	Cost per customer	% of retailer revenue
Upfront costs amortised over 10 years	$1.16	0.04%	$1.84	0.06%
Costs of new framework				
Operating costs	$6.57		$6.43	
Disconnection costs	$0.15		$0.13	
Bad debts	$2.74		$2.74	
Financing costs	$1.19		$1.47	
Subtotal	$10.65	0.33%	$10.76	0.34%
Costs of current framework				
Operating costs	-$6.52		-$5.44	
Disconnection costs	-$0.15		-$0.05	
Bad debts	-$2.74		-$2.74	
Financing costs	-$1.19		-$1.47	
Subtotal	-$10.60	0.33%	-$9.70	0.30%
Total annualised costs	$1.21	0.04%	$2.90	0.09%

Note: Columns may not add due to rounding

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

[4] This assumption is not a prediction or a forecast of the future rate of disconnection. As discussed above, no change in the level of disconnection is the most conservative assumption that can be adopted for the costings. Sensitivity analyses for lower rates of disconnection would result in lower costs than discussed in the remainder of the Executive Summary.

[5] Estimate of retailers' revenue calculated based on the Australian Energy Regulator's revenue determinations for the electricity and gas network businesses, and estimates of the network component as a proportion of the total retail bill.

Table ES 7 indicates that the upfront costs associated with implementing the new payment difficulty framework is between $1.16 and $1.84 per customer per year, or between 0.04% and 0.06% of the retailers' annual revenue, for ten years.

The annual costs associated with the current framework, including the costs associated with payment plans and the hardship program, disconnection, bad debts and financing costs associated with arrears are estimated to be between $9.70 and $10.60 per customer, or between 0.30% and 0.33% of the retailers' annual revenue.

With the introduction of the new framework, these annual costs are estimated to increase to between $10.65 and $10.76 per customer, or between 0.33% and 0.34% of the retailers' annual revenue. This represents an annual increase of between $1.21 and $2.90 per customer, or between 0.04% and 0.09% of the retailers' annual revenue.

If there is a modest increase in the average debt for customers on tailored assistance under the new framework[6], the annual costs are estimated to increase to between $11.24 and $11.39 per customer, or between 0.35% and 0.36%. This represents an annual increase of between $1.80 and $3.53 per customer, or between 0.06% and 0.11% of the retailers' annual revenue.

On a net present value (NPV) basis, the retailers' costs to 2028 are most likely to lie within the range of $18 million to $78 million, assuming:

— no requirement for default assistance
— a change to the definition of arrears subsequent to the Commission's new Draft Decision
— the retailers have flexibility to manage payments for arrears and energy use
— no reduction or a phased reduction in the proportion of customers on tailored assistance and repaying arrears
— no increase or a modest increase in the average debt[7].

[6] Assuming a 15 per cent increase in average debt
[7] For the purposes of the analysis, assumed up to a 15 per cent increase

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 difficulty
- applying payment plans that have a duration that is proportionate to the level of debt and type of payment difficulty 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 difficulty
- 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 difficulty 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.[8]

On 21 October 2016, the Commission released its Draft Decision on a new payment difficulty 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 and on 9 May 2017, the Commission released a new Draft Decision.[9]

[8] 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

[9] Essential Services Commission of Victoria, *Payment Difficulty Framework, New Draft Decision*, May 2017

In developing the payment difficulty framework, the Commission has assessed the impact of the framework on retailers, customers with payment difficulty, energy customers more broadly, and the community. ACIL Allen Consulting (ACIL Allen) was engaged by the Commission to assist it to assess the impacts of the new payment difficulty framework on retailers.

ACIL Allen's analysis of the cost impact on retailers occurred in two stages. The first stage was a preliminary assessment based on assumptions developed by ACIL Allen and informed by input from an IT specialist, TBS Consulting Group. The second stage involved seeking input directly from the Victorian energy retailers.

During the second stage, ACIL Allen issued a formal detailed information request to the retailers. ACIL Allen consulted with the retailers during the information gathering process to ensure clarity regarding the information required and relevant assumptions. ACIL Allen structured its analysis and information gathering process to allow it to test the cost implications of making variations to the design of the framework.

The purpose of this report is to describe the approach and methodology for the assessment, and to provide the outcomes of the assessment.

Structure of this report

This report is structured as follows:

- chapter 2 provides the context for the assessment of the impact of the new payment difficulty framework on retailers
- the methodology and assumptions used to assess the impact of the new payment difficulty 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 facing payment difficulty, and the costs avoided by implementing the new framework, are provided in chapter 4
- an estimate of the net costs associated with providing each type of assistance under the new payment difficulty framework, for all Victorian energy retailers, is provided in chapter 5
- chapter 6 provides the results of sensitivity analysis to variations in the rate of disconnections and the average debt for customers facing payment difficulty on the costs associated with disconnections, financing and bad debts written off
- the total estimated impact of the new payment difficulty framework on all Victorian energy retailers is presented in chapter 7
- an overview of the detailed Information Request that was used to collect information from the retailers to inform this assessment, is provided as Appendix A.

2 CONTEXT FOR THE ASSESSMENT

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

2.1 Legislative framework for the assessment

The Commission's overarching objective is to:

… promote the long term interests of Victorian consumers.[10]

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.[11]

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.[12]

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

2.2 Overview of the payment difficulty framework

The purpose of the payment difficulty framework is to provide customers facing payment difficulty with a set of minimum entitlements to assistance or avoid or repay arrears, and ensure that disconnection for non-payment of a bill is a measure of last resort.

[10] Essential Services Commission Act 2001, section 8(1)
[11] Electricity Industry Act 2000, section 10(c); Gas Industry Act 2001, section 18(c)
[12] Essential Services Commission Act 2001, section 8A(1)(e)

The draft framework provided three types of assistance for energy customers facing payment difficulty. These were referred to as:

— standard assistance
— tailored assistance
— default assistance.

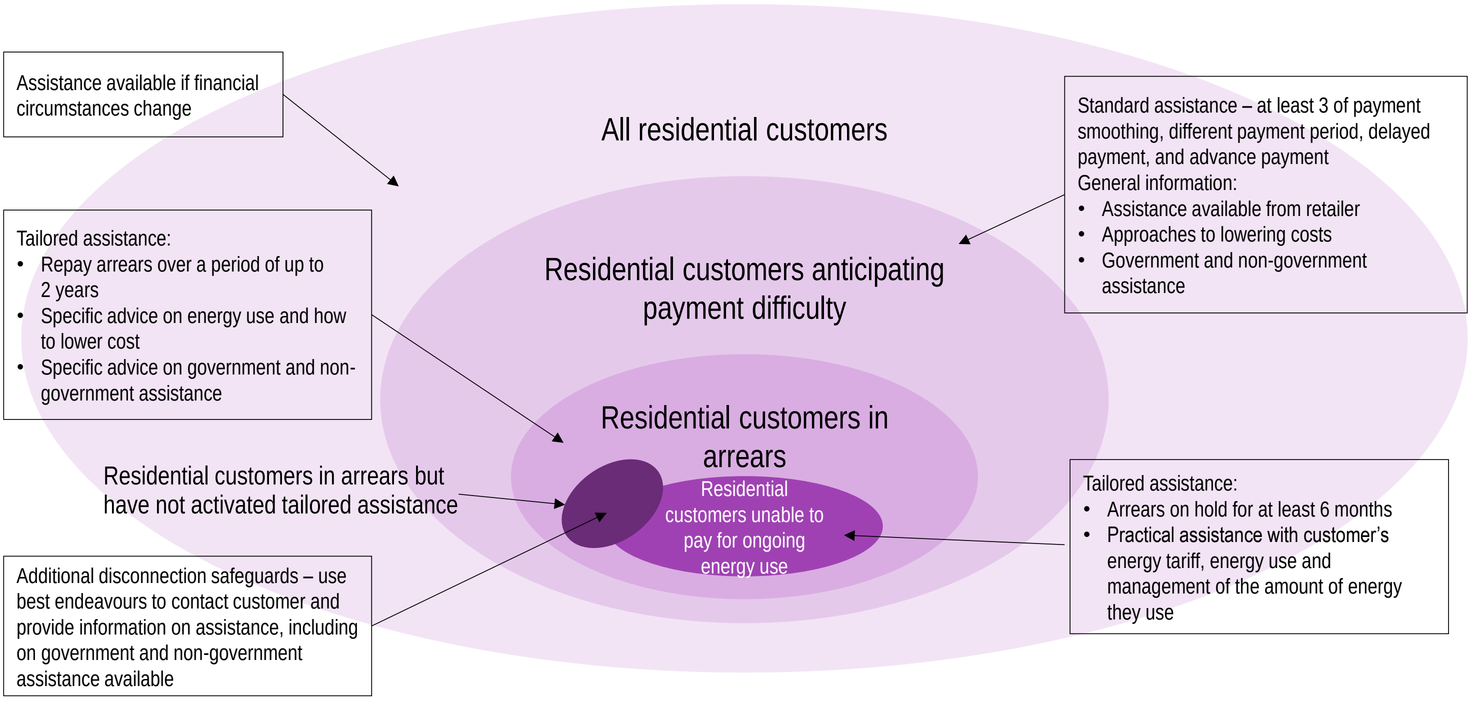
Information submitted by the retailers following the release of the draft decision indicated that default assistance resulted in disproportionate costs. Consequently, the Commission removed default assistance from the framework.

The payment difficulty framework therefore now comprises a comprehensive suite of safeguards consisting of three sets of assistance measures:

— standard assistance
— tailored assistance
— additional disconnection safeguards.

An overview of each of the types of assistance to which customers facing payment difficulty are entitled is provided as Figure 2.1, with further detail provided in the following sections on these forms of assistance, as well as on default assistance.

FIGURE 2.1 OVERVIEW OF ASSISTANCE AVAILABLE UNDER THE DRAFT PAYMENT DIFFICULTY FRAMEWORK



SOURCE: ACIL ALLEN

2.2.1 Standard assistance

The aim of standard assistance is to enable a residential customer anticipating payment difficulty to avoid getting into arrears.

Retailers must have available for residential customers at least three of the following four forms of assistance to avoid getting into arrears:

— pay an equal amount over a specified period
— pay once a month or once every fortnight rather than every quarter (in the case of electricity) or once every two months (in the case of gas)
— defer paying one bill for a specified period for at least one billing cycle over a 12 month period
— pay for energy use in advance, rather than in arrears.

A fifth form of assistance – to pay for anticipated arrears over a period that is three times longer than the customer's billing period – was removed subsequent to the new Draft Decision.

In addition to providing alternative payment options, energy retailers must make their financial hardship policies available to their residential customers and have the following information available:

— customer entitlements under standard assistance, and how to access them
— how to lower energy costs
— government and non-government assistance (including Utility Relief Grants and energy concessions) available to help them meet their energy costs.

Customers should be able to access standard assistance through self-service on-line, without requiring detailed or ongoing engagement with their retailer. However, retailers will also facilitate customers access to standard assistance by phone.

Retailers currently generally provide assistance that is similar to standard assistance.

2.2.2 Tailored assistance

The aim of tailored assistance is to enable a residential customer who is in arrears to pay for their on-going energy use and repay their arrears in a manageable way.

Tailored assistance is based on active engagement between the retailer and the customer. Once a customer gets into arrears of more than $50, the retailer is expected to assist the customer to establish payment arrangements that will enable the arrears to be repaid within two years.

Retailers have up to 21 business days after a bill is unpaid by the due date to contact the customer and provide information and advice about the assistance available. Customers have up to six business days after receiving the information and advice to propose a payment arrangement they believe they can manage.

Importantly, tailored assistance does not require retailers to automatically give every customer two years to repay their arrears. Instead, retailers will be required to provide a customer in arrears with information about their current pattern of energy use and what this is likely to cost in the future, and repayment options for the customer to consider.

Once the retailer has provided the customer with this information, and advice about any government or non-government assistance that may also be available, the customer has 6 business days to propose a payment arrangement that suits their circumstances and will result in the arrears being repaid in two years or less.

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 retailer must accept payment arrangements that involve at least monthly payments of equal amounts and will result in repayment of the customer's arrears within two year. Retailers may, after taking the customer's circumstances into account, accept payment proposals that involve payment of different amounts at different intervals. Retailers may also extend the repayment period beyond two years and accept payments for energy use separate from payments for arrears.

Because a customer's circumstances may change, tailored assistance also provides customers to vary their payment arrangement. A customer who has scheduled to repay their arrears in less than two years may reduce the amount that they pay, provided it still results in repayment within two years.

Retailers are also provided with flexibility to respond to changes in the customer's circumstances, including extending repayment periods, and the amount of time a customer has to reduce their energy costs.

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

If a customer cannot afford a payment arrangement that will cover their future energy use, the retailer must offer the customer practical assistance to reduce the cost of their energy consumption. Making use of the retailer's knowledge of the customer's pattern of energy use and payment history, three forms of practical assistance must be provided:

- the tariff that is most likely to minimise the customer's future energy costs
- assistance to help the customer reduce their energy use
- regular information about how the customer is progressing to reduce their energy costs.

Where it may assist the customer to reduce energy costs the practical assistance must include auditing energy use and appliance replacement.[13]

Because it takes time and access to specialist assistance to identify and implement ways of reducing energy consumption, the retailer must put the repayment of arrears on hold for an initial period of six months. However, during this time the customer must make regular payments towards the cost of their energy consumption.

2.2.3 Additional disconnection safeguards

The aim of additional disconnection safeguards is to ensure that customers facing payment difficulty re only disconnected as a last resort.

Where a residential customer has missed a bill payment but not contacted their retailer to activate an entitlement to a tailored assistance arrangement, a retailer has an obligation to:

- contact the customer within 21 business days of a missed bill payment, to inform them of their entitlements to tailored assistance
- within 21 business days of a missed bill payment, issue a reminder notice
- allow the customer at least six business days to respond to being informed of their entitlements, so that the customer has a reasonable period in which to contact their retailer
- having made contact with the customer, provide them with assistance to which they are entitled under the payment difficulty framework
- provide information about the assistance to which the customer is entitled under the framework during any period the customer has to respond to a disconnection warning notice

[13] Electricity Industry Act 2000(Vic) section 43C and *Gas Industry Act 2001* (Vic) equivalent.

— also include information about community support services, including the contact details of those services on any disconnection warning notice that is sent to a customer, so the customer has access to help if they are unwilling or unable to engage directly with their retailer to seek assistance.

If the customer has still not responded after the retailer has issued a disconnection warning notice, the retailer has a further obligation to use their best endeavours to:

— contact the customer
— provide the customer with clear and unambiguous information about the assistance to which the customer is entitled under the payment difficulty framework.

In addition, the Commission has decided to increase the minimum outstanding amount for disconnection to occur in Victoria from $120 (exclusive of GST) to $300 (exclusive of GST), as applies in other jurisdictions.

2.2.4 Default assistance

Under the draft framework, residential customers in arrears but had not contacted their retailer to receive tailored assistance, or those that had ceased to receive tailored assistance, were entitled to default assistance. As the information submitted by the retailers indicated that the costs associated with this form of assistance are disproportionate, the Commission has removed it from the final framework.

The form of default assistance proposed in the draft framework was for customers to be placed on a default payment plan. Under the default payment plan, the customer would have been required to pay their arrears by equal monthly instalments over a period three times longer than their current billing period, for example nine monthly instalments for a customer on a quarterly billing cycle.

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 being more incentivised to work together to find solutions that best meet the customer's circumstances
— customers facing payment difficulty being empowered to better manage their energy use so that their energy costs are more manageable
— customers facing payment difficulty having improved knowledge of, and access to, government and non-government support services
— arrears not being left unattended.[14]

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

[14] Essential Services Commission of Victoria, *Payment Difficulty Framework, New Draft Decision*, May 2017, page 139

3 METHODOLOGY AND ASSUMPTIONS

ACIL Allen's analysis of the cost impact of the new payment difficulty framework on retailers occurred in two stages.

The first stage of the analysis was a preliminary assessment based on assumptions developed by ACIL Allen and informed by input from an ICT specialist. The preliminary assessment of the impacts on the retailers associated with the new payment difficulty framework was undertaken by considering:

- the obligations placed on the retailers under the new framework
- for each of the nine retailers whose policies, procedures and practices for managing customers in payment difficulty 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 new 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 difficulty were reviewed.

The second stage of the analysis involved seeking input directly from retailers. During the second stage, ACIL Allen issued a formal detailed information request to the retailers. ACIL Allen consulted with retailers during the information gathering process to ensure clarity regarding the information required and relevant assumptions. ACIL Allen structured its analysis and information gathering process to allow it to test the cost implications of making variations to the design of the framework.

Following incorporation of the information received from the retailers, the analysis revealed the following design elements of the framework resulted in disproportionate costs:

- default assistance
- the proposed definition of arrears
- the separation of usage and arrears in repayment arrangements.

The second stage of analysis accounts for changes to the framework design that were made by the Commission between the draft and final decisions. These included the removal or modification of each of these three elements of the framework that were identified as causing disproportionate costs.

The second stage of analysis indicated a level of uncertainty regarding the final costs of the framework, which are sensitive to a number of factors. These factors include the percentage of customers who take up each form of assistance and the impact of the framework on the average arrears for customers. Notably, retailer estimates of the level of take up for each form of assistance, both at the commencement of the framework and over time, varied significantly. ACIL Allen has performed sensitivity analyses to reflect this uncertainty.

To account for the results of the sensitivity analysis, ACIL Allen's final analysis of the likely cost impact of the framework on the retailers is stated as a range.

The assumptions underlying the low-end estimate are broadly similar to those that underpinned the first stage of analysis; the results using these assumptions are referred to in this report as the "updated preliminary assessment". The assumptions underpinning the high-end estimate are largely derived directly from the retailers' submissions; the results using these assumptions are referred to in this report as the "information submitted by the retailers".

The actual costs to retailers may, in practice, fall near either end of this range but are unlikely to be outside it.

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

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

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

3.1 Information submitted by the retailers

The retailers were requested to provide detailed information on the proportion of customers that they expected would receive each type of assistance, the activities they expected to undertake to provide that assistance (most commonly, interaction through their call centres and written communication), and the costs they expected to incur upfront to enable the assistance to be provided (system and process changes).

Information was submitted by eight retailers. Of these:

- four provided most of the information required
- two had some information missing
- one provided the costs associated with system changes only
- one provided information by exception, where it significantly disagreed with our preliminary assessment.

The retailers placed significant qualifications on the information that was submitted. They questioned the robustness of the data provided as:

- they were not clear on the obligations that were to be placed on them under the new payment difficulty framework
- it was clear that some changes would be made by the Commission in finalising the framework, but it was unclear as to the exact changes that would be made
- there was insufficient time and/or resources to source high quality information from within the business to populate the information request.

For example, Origin Energy identified the following issues:

> – *the applicability of definitions such as hardship and payment difficulties. We also note that the definition of arrears in the information request may be interpreted in both the usual sense and [in] terms of the Draft Code's specific definition;*
> – *uncertainty over when a customer can be disconnected, which impacts on retailer debt;*
> – *the impact of the definition of 'arrears' on customer and retailer debt;*
> – *splitting use from arrears in a mandated payment plan and what impact this might have on debt and customer compliance;*

– *the ability of customers to vary payment plans, combined with an unclear path to disconnection, means that we do not know how long we will need to carry this debt for or how much debt the customer will have;*
– *the lack of clarity around retailer knowledge of customer circumstances and the resulting risk for retailers of being wrong in that assessment; and*
– *the confusion of what is a minimum standard at a given point in time, creating confusion about which forms of assistance must be offered and in which order.*[15]

As a result of these types of uncertainties, another retailer commented that:

… the figures are incomplete and based on very high level estimates of how we might seek to implement and how [we] believe customers will respond.[16]

The information submitted by the retailers was utilised in the analysis to the maximum extent possible. Where the data gaps were minimal, they were filled based on information submitted by the other retailers or assumptions that were made for the preliminary assessment.

3.2 Obligations under the framework proposed in the new Draft Decision

The obligations that were proposed to be placed on the retailers under the payment difficulty framework were set out in the Commission's amendments to the Energy Retail Code published with the new Draft Decision. The obligations are summarised in Table 3.1.

TABLE 3.1 PROPOSED NEW OBLIGATIONS ON RETAILERS UNDER THE PAYMENT DIFFICULTY 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.

[15] Origin Energy, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 16 June 2017, page 19
[16] Provided in confidence in response to the Information Request

Obligation	Description of obligation
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.
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 difficulty.
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.

Obligation	Description of obligation
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 difficulty 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)

3.3 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 difficulty were recently reviewed, have processes and systems currently in place to meet each of those obligations. Where the information submitted by the retailers provides information to support or refute the findings from the earlier review, this information is also included in the table.

TABLE 3.2 EXTENT TO WHICH RETAILERS CAN CURRENTLY MEET NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTY FRAMEWORK PROPOSED AS PART OF THE NEW DRAFT DECISION

Obligation	Extent to which retailers currently meet obligation
Standard assistance	
Payment smoothing	All but two of the nine retailers reviewed currently provide a payment smoothing option.
Different payment period	One of the nine retailers reviewed offers a monthly payment period by default, and two of the nine retailers offer a monthly payment period as an option.
Delayed payment	All of the nine retailers reviewed 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. Two of the retailers that submitted information indicated that they provide an advance payment option.
Payment plan	All retailers currently offer payment plans, but only one retailer that submitted information indicated they provide a payment plan for *anticipated* arrears.

Obligation	Extent to which retailers currently meet obligation
General information on assistance available	While all retailers provide information on their financial 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. Several retailers commented that the separation of the payment for energy use and the repayment of arrears is a substantial departure from current practices.
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. Retailers are concerned that there is no limit on the number of times that a customer could revise their payments and extend the timeframe over which repayments are made.
Specific information on lowering energy costs	While many retailers provide some form of advice on energy use to customers, only one retailer currently has a structured approach based on a customer's "pattern of energy use and of the circumstances of where they live" with a clear expectation that energy use 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. Several retailers commented that the separation of the payment for energy use and the repayment of arrears is a substantial departure from current practices.
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.
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 no retailers put customers on a payment plan by default. Retailers commented that default assistance is a significant departure from their current practices and is likely to capture a large proportion of customers that do not pay on time.

Obligation	Extent to which retailers currently meet obligation
Miscellaneous	
Financial hardship policies	All retailers currently have a financial hardship policy, but they will need to be revised to reflect the new payment difficulty 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 difficulty.

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

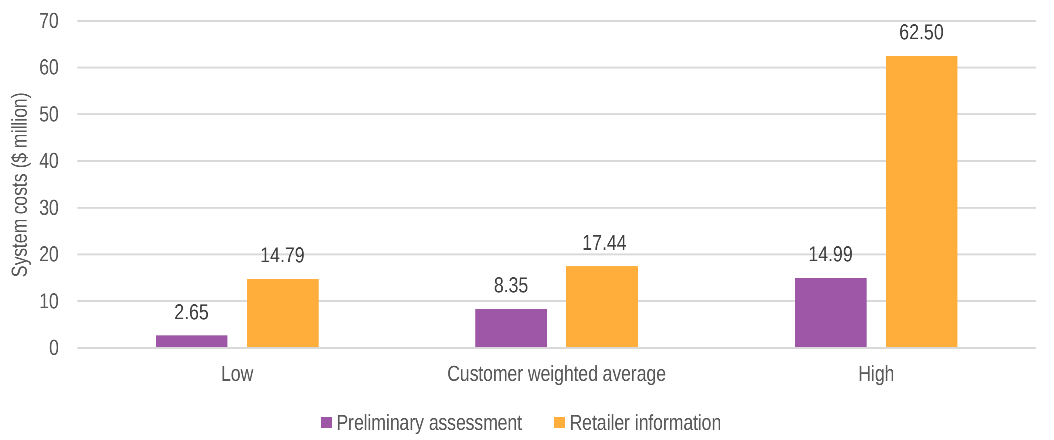
3.4 System changes

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

An IT specialist, TBS Consulting Group (TBS), was separately engaged by the Commission to estimate the costs of the system changes required for the new framework for the purposes of the preliminary assessment.

The system costs submitted by the retailers are significantly higher than those estimated by TBS, as illustrated in Figure 3.1.

FIGURE 3.1 ESTIMATED SYSTEM COSTS

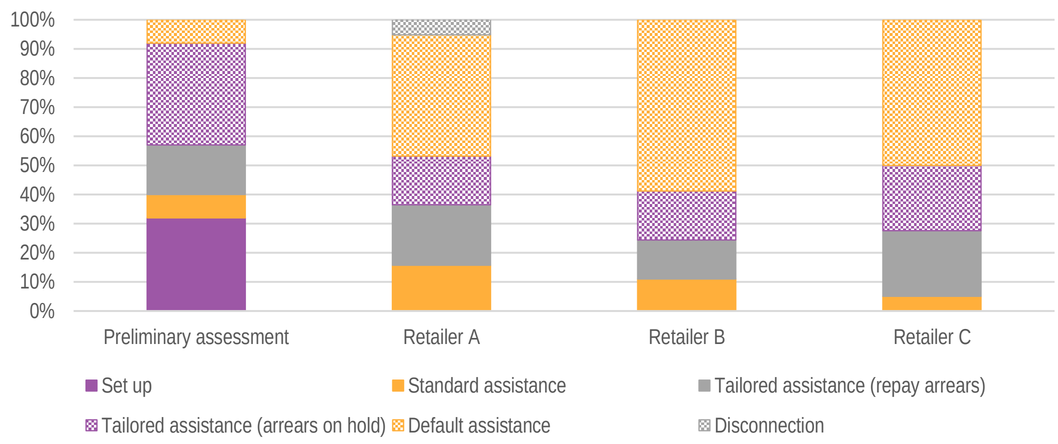


Note: One retailer provided total upfront costs which we have disaggregated for the purposes of this analysis

SOURCE: ACIL ALLEN ASSESSMENT BASED ON TBS ESTIMATES AND RETAILERS' INFORMATION REQUESTS

Retailers indicated that, from a systems perspective, one of the most significant items was default assistance. While only three retailers provided a breakdown of system costs by the type of assistance, that information confirms that a substantive proportion of the retailers' estimated system costs are attributable to default assistance, as illustrated in Figure 3.2. The proportion of system costs that the retailers attributed to default assistance was greater than the estimates provided by TBS for the preliminary assessment.

FIGURE 3.2 BREAKDOWN OF SYSTEM COSTS



SOURCE: ACIL ALLEN ASSESSMENT BASED ON TBS ESTIMATES AND RETAILERS' INFORMATION REQUESTS

For the purposes of assessing the system costs, as submitted by the retailers, by the type of assistance, we have assumed the following breakdown of system costs:

— standard assistance – 10 per cent
— tailored assistance (repay arrears) – 20 per cent
— tailored assistance (arrears on hold) – 20 per cent
— default assistance – 50 per cent.

The retailers identified that the costs associated with system changes would be higher if required to be delivered within a short timeframe and if the changes coincide with another major initiative. The retailers identified that, with the proposed timeframe for implementing the new payment difficulty framework, the system changes that are currently being made as part of the Power of Choice initiative would coincide with the changes required to implement a new payment difficulty framework.

For the purposes of our analysis, we have not included any premium associated with coincident initiatives.

3.5 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 difficulty 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, the preparation of training materials, and the delivery of training courses.

For the purposes of the preliminary assessment, upfront process changes (other than the delivery of training courses) were 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 3.3.

TABLE 3.3 UPFRONT PROCESS CHANGES THAT MAY BE REQUIRED TO MEET THE NEW OBLIGATIONS UNDER THE PAYMENT DIFFICULTY FRAMEWORK AS PROPOSED IN THE NEW DRAFT DECISION

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
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

3.5.1 Training

For the purposes of the preliminary assessment, it was assumed that all customer service agents required to respond to Victorian customers will need to receive some training on the process changes associated with the new payment difficulty framework. The costs of the training included the cost of training direct call centre staff, indirect call centre staff (managers and supervisors), and the trainers.

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

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

The number of direct call centre staff was estimated based on:

- the number of calls forwarded to an operator in 2015-16, as set out in Table 3.4, indexed by the expected Victorian population growth to 2017-18 (1.8 per cent per year[17])
- an assumption 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 was assumed to be $60 per hour.

The number of indirect call centre staff was 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 was estimated assuming that each training session has up to 25 participants and the hourly cost is $100.

For the purposes of the preliminary assessment, the training costs that were estimated for each of the nine retailers, whose policies, procedures and practices for managing customers in payment difficulty were reviewed, are also provided in Table 3.4.

TABLE 3.4 NUMBER OF CALLS ANSWERED BY AN OPERATOR, 2015-16

Retailer	Number of calls answered by an operator – 2015-16	Training costs estimated for preliminary assessment
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*

The training costs submitted by the retailers were higher than estimated in the preliminary assessment. While the hourly rates that were assumed in our analysis were broadly similar to the hourly rates submitted by the retailers, the training costs were higher due to:

- training a larger number of staff
- increased training costs upfront and/or over time due to the increasing "divergence" between the Victorian and national requirements for managing customers facing payment difficulty.

The retailers can either have one call centre that services all customers nationally, or separate call centres that service the customers in each jurisdiction. If there is one call centre that services all customers nationally, then all customer service staff need to be trained on the Victorian-specific payment difficulty framework. If there is a separate call centre that services only Victorian customers, then only those customer service staff need to be trained on the Victorian-specific payment difficulty framework.

For the purposes of the preliminary assessment, we assumed that only customer service staff servicing Victorian customers would need to be trained. We accept that it is likely to be more efficient to have one call centre that services all customers nationally, and that, under that model, all customer service staff will need to be trained.

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

In addition, the retailers submitted that training would need to be extended more broadly across the business to include, for example:

… members of our Regulatory Compliance, Products and Pricing, Hardship, Credit and Collections, Billing, Onboarding and Concessions teams.[18]

The training costs estimated using assumptions from the preliminary assessment are compared to the training costs submitted by the retailers in Table 3.5.

TABLE 3.5 TRAINING COSTS – PRELIMINARY ASSESSMENT AND AS SUBMITTED BY THE RETAILERS

	Cost per customer		
	Minimum	Maximum	Customer weighted average
Preliminary assessment	$0.05	$0.28	$0.09
Submitted by retailers	$0.14	$1.75	$1.30

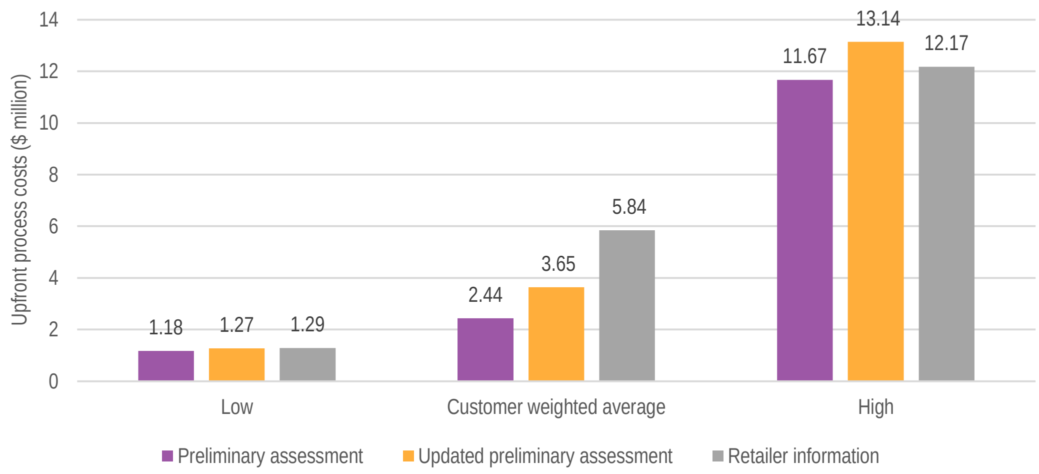
SOURCE: ACIL ALLEN, INFORMATION SUBMITTED BY THE RETAILERS

For the purposes of the analysis in this report, we will substitute the training costs estimated for the preliminary assessment with the training costs submitted by the retailers.

3.5.2 Upfront process costs, including training costs

The upfront process costs (including training costs) as submitted by the retailers are compared to the costs estimated for the preliminary assessment and for the updated preliminary assessment in Figure 3.3. While the customer weighted costs submitted by the retailers are significantly higher than the costs estimated using those assumptions, the range of costs is similar. This may be due, in part, to the particular mix of retailers that responded to the information request.

FIGURE 3.3 ESTIMATED UPFRONT PROCESS COSTS, INCLUDING TRAINING COSTS



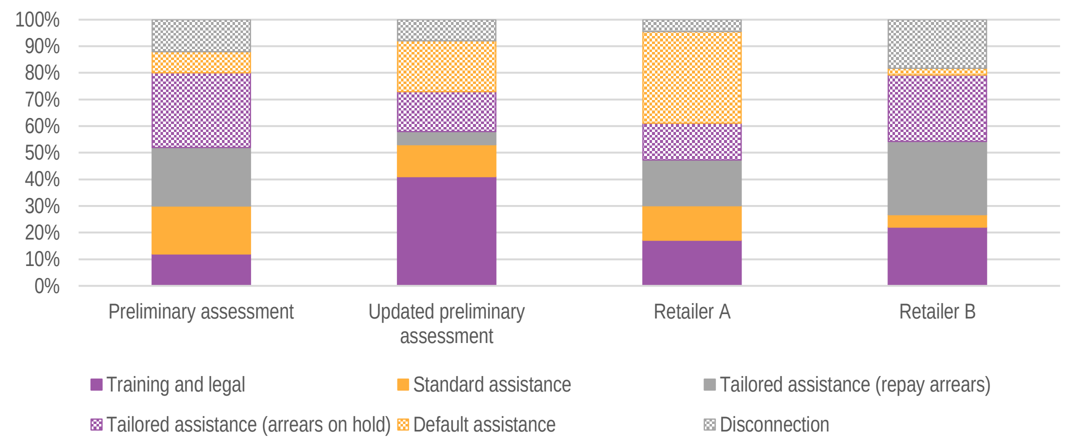
Note: One retailer provided total upfront costs which we have disaggregated for the purposes of this analysis

SOURCE: ACIL ALLEN ASSESSMENT BASED ON RETAILERS' INFORMATION REQUESTS

A breakdown of the upfront costs by the type of assistance, as submitted by two of the retailers, is compared to the breakdown estimated for the preliminary assessment and the updated preliminary assessment, in Figure 3.4. The proportion of upfront costs that the retailers attributed to training was higher than estimated for the purposes of the preliminary assessment. As discussed in section 3.5.1, we accept that the training costs incurred by the retailers with the introduction of a new payment difficulty framework are likely to be higher than the original assumptions.

[18] Provided in confidence in response to the Information Request

FIGURE 3.4 BREAKDOWN OF UPFRONT PROCESS COSTS



SOURCE: ACIL ALLEN ASSESSMENT BASED ON RETAILERS' INFORMATION REQUESTS

For the purposes of assessing the upfront process costs, as submitted by the retailers, by the type of assistance, we have assumed the following breakdown of upfront costs:

— set up, miscellaneous and consequential costs – 31 per cent
— standard assistance – 9 per cent
— tailored assistance (repay arrears) – 22 per cent
— tailored assistance (arrears on hold) – 19 per cent
— default assistance – 18 per cent.

3.6 Ongoing operating costs

With the introduction of the new payment difficulty 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 managing customers facing payment difficulty, which are discussed in section 3.7.

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

— 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[19])
— 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 difficulty 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 difficulty and are subsequently disconnected
— the length of calls to the call centre – short (5 minutes), medium (15 minutes) or long (30 minutes)

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

— 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).

We have adopted the same approach to this analysis.

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. These are discussed in the following sections.

The cost of calls, as submitted by the retailers, was less than assumed for the purposes of the preliminary assessment. It varied between $40.13 and $66.83 per hour, with a customer weighted average of $57.75 per hour.

The cost of written information, as submitted by the retailers, was similar to that assumed for the purposes of the preliminary assessment. It varied between $1.10 and $4.00, with a customer weighted cost of $1.92.

The remaining estimates submitted by the retailers are provided in Table 3.6.

3.6.1 Proportion of customers on various types of assistance

Assumptions for preliminary assessment

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 in a retailer's hardship program and were on payment plans.

The review of retailers' policies, procedures and practices for managing customers facing payment difficulty indicated that around 5.0 per cent of residential customers face payment difficulty, 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 use.

We assumed that those customers that face payment difficulty and are on a bill smoothing arrangement or deferred payments (1.3 per cent of residential customers) will receive standard assistance under the new payment difficulty framework. We assumed that the retailers will offer three of the five payment options to which customers are entitled under standard assistance. We assumed that retailers will offer payment smoothing, different payment periods and deferred payment. In the absence of any information, we 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 assumed that customers currently on a payment plan will receive tailored assistance or default assistance.

We 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 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 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.

We 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.

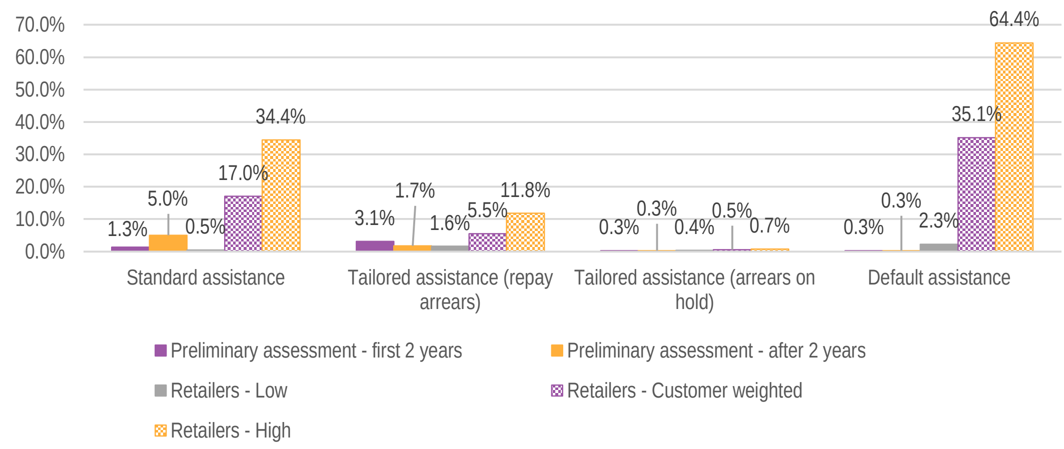
We assumed that the proportion of residential customers on a tailored assistance payment plan, repaying arrears over a two year period and paying the full on-going cost of energy use, will decrease two years after commencement of the new framework as they pay their arrears and transition to standard assistance, such as payment smoothing, different payment period or deferred payment. We 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 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 was 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.

Information submitted by the retailers

The proportion of customers on each type of assistance, as submitted by the retailers, is compared with the assumptions for the preliminary assessment in Figure 3.5.

FIGURE 3.5 ESTIMATED PROPORTION OF CUSTOMERS ON VARIOUS FORMS OF ASSISTANCE



SOURCE: ACIL ALLEN ASSESSMENT BASED ON RETAILERS' INFORMATION REQUESTS

None of the retailers indicated a change in the proportion of customers on each type of assistance over time. In response to the assumption in the preliminary assessment that the estimated proportion of customers on tailored assistance repaying arrears would decrease after two years, EnergyAustralia commented that:

ACIL Allen's assumed outcome is possible but it cannot be verified in anyway or asserted with any confidence. ACIL Allen will need to provide clear and defensible assumptions about the number of customers receiving different forms of assistance and how that might evolve over time, including appropriate sensitivity analysis. .. We recognise that it will be difficult for ACIL Allen to do this without input from retailers.[20]

[20] EnergyAustralia, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 19 June 2017, page 23

Given the dearth of information submitted by the retailers and the uncertainty associated with estimating the proportion of customers that will receive assistance under the new payment difficulty framework, the updated analysis in this report includes three scenarios:

1. no change over time in the proportion of customers receiving each type of assistance
2. a phased reduction in the proportion of customers receiving tailored assistance and that are repaying arrears, over a period from year three to year ten
3. a step reduction in the proportion of customers receiving tailored assistance and that are repaying arrears, at the end of year two (consistent with the preliminary assessment).

For the purposes of this analysis, the changes in the proportion of customers receiving assistance are the same as the assumptions for the preliminary assessment. When analysing the information submitted by the retailers, the reduction in the proportion of customers receiving tailored assistance and repaying arrears is assumed to be 30 per cent. We have not assumed a commensurate increase in the proportion of customers receiving standard assistance, as the proportion of customers on standard assistance, as estimated by the retailers, is relatively high.

Figure 3.5 indicates that the proportion of customers receiving tailored assistance and repaying arrears, as estimated by the retailers, was higher than the assumptions for the preliminary assessment. This was due to the mix of retailers that responded to the information request. While approximately 3.7 per cent of Victorian residential customers were on payment plans in 2015-16, 4.6 per cent of the residential customers supplied by the retailers that responded to the information request were on a payment plan. For the purposes of the analysis, we have therefore considered a scenario in which the costs associated with providing tailored assistance and repaying arrears, and the avoided costs associated with managing payment plans for those not currently in the hardship program, are scaled back so that the proportion reflects a state-wide value.

The proportion of customers receiving tailored assistance and with arrears on hold, as estimated by the retailers, is slightly higher than the assumptions for the preliminary assessment. This is most likely due to an overall increase in the proportion of customers in the hardship program since 2015-16, offset by the mix of retailers that responded to the information request. While approximately 0.9 per cent of Victorian residential customers were in a hardship program in 2015-16, 0.8 per cent of the residential customers supplied by the retailers that responded to the information request were in a hardship program. For the purposes of the analysis, we have therefore considered a scenario in which the costs associated with providing tailored assistance with arrears on hold, and the avoided costs associated with managing customers currently in the hardship program, are scaled up so that the proportion reflects a state-wide value.

While the low end of the ranges of the proportion of customers receiving standard assistance and default assistance, as estimated by the retailers, were reasonably consistent with the assumptions in the preliminary assessment, the customer weighted average and the high end of the ranges were significantly higher.

The rationale for the retailers estimating a high proportion of customers on standard assistance was that the proportion was consistent with the proportion of customers currently receiving standard assistance. If that is the case, the incremental costs associated with providing standard assistance under the proposed payment difficulty framework will not be material. While the retailers' estimated costs for providing standard assistance under the new payment difficulty framework will be higher than estimated using the assumptions in the preliminary assessment, the costs avoided by not providing that same type of assistance under the current framework will also be higher.

The proportion of customers that will receive default assistance under the new payment difficulty framework, as estimated by the retailers, varies over a wide range. As this is a new type of assistance, the retailers have adopted varying interpretations of the requirements for default assistance. Many retailers provided no rationale for estimating the proportion of customers that would receive default assistance, but those that did provide a rationale indicated that the number of disconnection warning notices issued was a reasonable proxy. Origin Energy, for example, submitted that:

Ultimately, we expect that Default Assistance will result in a high rate of customers being offered an automatic payment plan …[21]

On the basis of the retailers' assumptions, it is therefore unsurprising that the proportion of customers estimated by them is significantly higher than estimated using the assumptions for the preliminary assessment.

EnergyAustralia identified that:

Payment difficulty is also a function of numerous factors outside retailers' control – such as energy prices, other household expenditure items and income levels.[22]

This is well recognised. This assessment, and the preliminary assessment, have been undertaken on the basis that all other variables are held constant. The estimates are not projections of the proportion of customers on various forms of assistance, but estimates assuming all else equal.

3.6.2 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 difficulty, was 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 difficulty 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.

In their responses to the information request, the retailers have provided estimates of the number of calls to or by them and the length of those calls. These estimates are provided in Table 3.6.

3.6.3 Ongoing operating cost assumptions by obligation

The assumptions that were applied to each of the proposed new obligations for the purposes of the preliminary assessment are compared to the information submitted by the retailers in Table 3.6. The assumptions are similar, other than the proportion of customers receiving the different forms of assistance.

The retailers' submissions identified an additional category of ongoing operating costs that had not been included in the preliminary assessment:

More resources devoted to Ombudsman complaints because the Framework (by codifying standards) creates new grounds for contesting disconnections and other decisions.[23]

A confidential retailer submission referred to the increased costs allowed for the ombudsman in KPMG's assessment of the customer impacts.[24] The retailer suggested that:

… for each dollar spent on EWOV case fees, $2 is spent resourcing our customer advocacy team.

[21] Origin Energy, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 16 June 2017, page 16
[22] EnergyAustralia, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 19 June 2017, page 23
[23] Origin Energy, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 16 June 2017, page 21
[24] KPMG, *Payment difficulties framework, Assessment of Customer Impacts, Preliminary paper for the Essential Services Commission of Victoria,* 9 May 2017, pages 47-50

KPMG assumed that:

> *… the [payment difficulties framework] PDF incentivises customers to be more engaged in managing their energy supply costs and usage. As a result, KPMG anticipates total expenditure for EWOV to initially increase in the early years of the forecast period as customers seek assistance in understanding the new measures. While total expenditure for these organisations will reduce in later years, customers will become more engaged and therefore more aware of their energy costs, how best to manage or reduce their energy usage, and be more adept at identifying payment options which align to their financial capacity.*[25]

We support the inclusion of additional retailer costs associated with responding to questions from the ombudsman's office.

KPMG modelled three scenarios – a high, base and low scenario. Under the base scenario, and assuming a 1 January 2018 commencement date for the new payment difficulty framework, KPMG estimated that the ombudsman's costs would increase by 20 per cent in 2018 and 2019, decreasing linearly to a 20 per cent reduction in 2027. KPMG relied on the ombudsman's total expenditure for FY2016 ($3.2 million) as the basis for its assessment.

On this basis, we have assumed that the retailers' costs will increase by $1.3 million (in 2016 dollars) in aggregate in 2018 and 2019 to respond to the ombudsman's queries, with the increase declining linearly to a $1.3 million decrease (in 2016 dollars) in 2027. On an annual basis, this represents an average increase in the retailers' costs of $0.05 per customer.

For the purposes of determining the net present value of the retailers' costs, the increase in costs to respond to the ombudsman's queries has been delayed by twelve months relative to KPMG's analysis with the delay in the commencement of the new payment difficulty framework to 1 January 2019.

[25] KPMG, *Payment difficulties framework, Assessment of Customer Impacts, Preliminary paper for the Essential Services Commission of Victoria,* 9 May 2017, pages 49-50

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

Obligation		Assumptions used to estimate ongoing operating costs	
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
Standard assistance			
Payment smoothing	% of customers that take up option	0.43% in the first two years, increasing to 0.91%	0.2% - 8.7% (6.6%)
	% of customers that call retailer to take up option	100%	81% - 100% (87.5%)
	Length of call	Medium	10 – 20 minutes (15.1 minutes)
	Frequency of bills	Monthly (8 additional bills per annum)	Quarterly
	% that receive paper bills	50%	30% - 95% (66.1%)
Different payment period	% of customers that select option	0.43% in the first two years, increasing to 0.91%	0.0% - 0.9% (0.3%)
	% of customers that call retailer to take up option	100%	81% - 95% (90.1%)
	Length of call	Short	10 – 20 minutes (14.1 minutes)
	Frequency of bills	50% monthly (8 additional bills per annum), 50% fortnightly (22 additional bills per annum)	Quarterly
	% that receive paper bills	50%	50% - 95% (65.7%)
Delayed payment	% of customers that select option	0.43% in the first two years, increasing to 0.91%	0.0% - 24.8% (10.1%)
	% of customers that call retailer to take up option	100%	81% - 100% (92.8%)
	Number of payments delayed per annum	1	1
	Length of call	Short	10 – 20 minutes (15.0 minutes)
Advance payment	% of customers that select option	0%	0%
Payment plan (anticipated arrears)	% of customers that select option	0%	0.0% - 0.1% (0.0%)
	% of customers that call retailer to take up option		81%
	Length of call		10 minutes
	Frequency of bills		Quarterly
	% that receive paper bills		44%

Obligation		Assumptions used to estimate ongoing operating costs	
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
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%	1.6% - 11.8% (5.5%, or 4.5% when scaled to a state-wide estimate)
	% of customers that call retailer to take up option	100%	89% - 100% (92.2%)
	Length of call to take up option	Long	14 – 45 minutes (18.1 minutes)
	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	1% - 90% (11.2%)
	% of customers that call retailer with new proposal	100%	100%
	Length of call to take up option	Medium	10 – 45 minutes (17.7 minutes)
	Written advice to customer		
Specific information on lowering energy costs	Phone call – included in phone call on payment plan		0 – 3 additional calls (0.2)
	Length of additional calls		16.1 – 45.0 minutes (19.1 minutes)
	Written advice to customer	100%	40% - 100% (74%)
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%	0.0% - 0.7% (0.5%, or 0.6% when scaled to a state-wide estimate)
	% of customers that call retailer to take up option	100%	81% - 100% (89.6%)
	Length of call to take up option	Long	15 – 30 minutes (18.9 minutes)
	Written advice to customer		

Obligation	Assumptions used to estimate ongoing operating costs		
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
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	1% - 100% (30.9%)
	% of customers that call retailer with new proposal	100%	100%
	Length of call to take up option	Medium	14 – 30 minutes (25.7 minutes)
	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%	0.0% - 0.7% (0.5%)
	Length of call	Long	16 – 35 minutes (27 minutes)
	Cost of appliance replacement, and for arranging appliance replacement	$350	$233 - $500 ($313)
Practical assistance to help lower energy costs – information on progress	% of customers on tailored assistance with repayment of arrears on hold	0.29%	0.0% - 0.7% (0.3%)
	Frequency of information to customer	Quarterly	Quarterly – annually
	Written communication		
	% of these customers that call in response to information	20%	
	Length of call	Medium	
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	

Obligation		Assumptions used to estimate ongoing operating costs	
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
Payments not made by due date	% of customers on tailored assistance	3.42% in the first two years, decreasing to 2.0%	2.5% - 12.3% (5.8%)
	% that will miss two consecutive payments each fortnight	25% (650% on an annualised basis)	27.4% - 85.7% (61.2%) on an annualised basis
	Length of call	Medium – for those not paying full cost of on-going energy use Short – other	14 – 45 minutes (20.8 minutes)[a] 15 – 30 minutes (15.5 minutes)[a]
Default assistance			
Payment of arrears by monthly instalments	% of customers put on default assistance	0.29%	2.3% - 64.4% (35.1%)
	% of customers that call retailer to revert to other types of assistance (the costs of which are captured under that type of assistance)	20%	10% - 95% (91.8%)
	Length of call	Medium	15 – 30 minutes (22.8 minutes)
	Written advice to customer		

[a] Estimated based on information provided by retailers

SOURCE: ACIL ALLEN, RETAILERS' INFORMATION REQUESTS

3.6.4 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 are 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%
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

The information submitted by the retailers represented 86.4 per cent of residential electricity customers in 2015-16.

3.7 Avoided operating costs

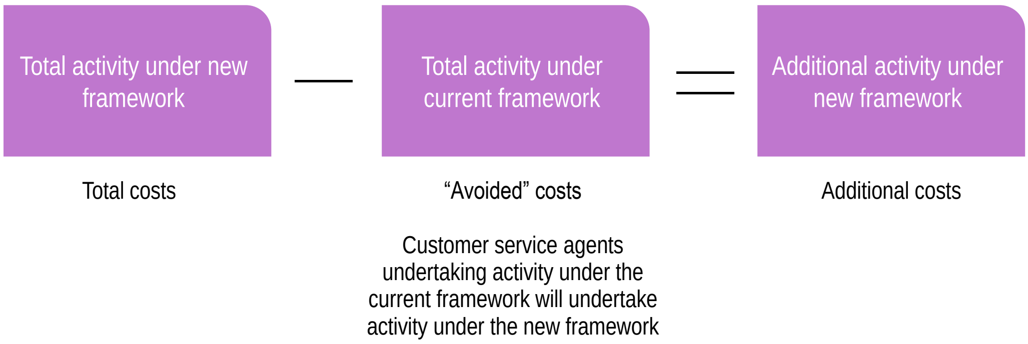
The avoided operating costs are the costs avoided by the retailer by discontinuing current activities for managing customers facing payment difficulty with the commencement of the new activities under the new payment difficulty framework.

EnergyAustralia did not agree that costs would be avoided as the new framework:

- *involves substantial changes to existing practices*
- *introduces new concepts and automated processes that retailers must capture in their billing systems*
- *is far more complex and rigid than present practices …*
- *increases the number of contact points between customers and retailers creating the potential for confusion and misunderstanding, and for EnergyAustralia, creates the need for substantial and costly changes to payment plans, as well as the actual increased cost of the communications (i.e. print, post, SMS costs, etc.)*
- *creates situations where processes, payment plans and status within the framework can be varied considerably over time, i.e. customers can move between different forms of assistance under a range of circumstances*
- *where compliance obligations are unclear, particularly in terms of information that retailers can obtain and rely on.*[26]

The incremental costs associated with the new payment difficulty framework have been estimated by considering the full costs associated with the new framework and deducting the estimated costs associated with the current framework, as illustrated in Figure 3.6.

FIGURE 3.6 CALCULATION OF THE INCREMENTAL COSTS ASSOCIATED WITH THE NEW PAYMENT DIFFICULTY FRAMEWORK



The customer service agents that are currently managing customers facing payment difficulty will be undertaking activities under the new payment difficulty framework. If the activity undertaken by the customer service agents under the new payment difficulty framework is costed, then the costs associated with the existing activity must be netted off so that only the incremental costs are considered.

In some cases, where there is no change in the activities undertaken under the new payment difficulty framework compared to the current framework, those costs have not been considered in the estimate of the incremental costs.

The avoided operating costs have been estimated using the same methodology used to estimate the ongoing operating costs. The assumptions that were applied in the preliminary assessment to estimate the avoided operating costs are compared to the assumptions submitted by the retailers in Table 3.8.

[26] EnergyAustralia, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 19 June 2017, page 25

TABLE 3.8 OPERATING COSTS AVOIDED BY THE NEW PAYMENT DIFFICULTY FRAMEWORK

Obligation	Assumptions used to estimate ongoing operating costs		
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
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	0.0% - 0.7% (0.4%, or 0.4% when scaled to a state-wide estimate)
	% that call retailer to be put on payment plan	100%	81% - 100% (90%)
	Length of call to place customer on payment plan	Medium	12 – 30 minutes (15.3 minutes)
	Number of calls made by/to retailer per annum to discuss payment plan / length of calls	Four / Medium	3 – 10 (8.8) 12 – 30 minutes (15.3 minutes)
	Number of calls to discuss energy efficiency / length of call	One / Long	
	% of customers contacted re lowering use		0.0% - 0.7% (0.4%)
	Length of call re lowering use		12 – 30 minutes (16.7 minutes)
	% of customers contacted re assistance available		0.0% - 0.7% (0.4%)
	Length of call re assistance available		10 – 30 minutes (12.8 minutes)
	% that do not pay on time / length of call	20% per fortnight / Medium	Included above
	Number of pieces of written communication per annum	4	2 – 3 (2.5)
	Average cost of providing practical assistance		$0 - $730 ($277)

Obligation	Assumptions used to estimate ongoing operating costs		
		Preliminary assessment	Information provided by retailers (Customer weighted mean in brackets)
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	0.4% - 11.8% (5.5%, or 4.4% when scaled to a state-wide estimate)
	% that call retailer to be put on payment plan	100%	89% - 100% (92%)
	Length of call to place customer on payment plan	Medium	14 – 30 minutes (16.1 minutes)
	Number of calls in relation to payment plan		1.0 – 8.6 (1.8)
	Number of pieces of written communication per annum	2	
	% of customers contacted re lowering use		0.0% - 2.3% (0.7%)
	Length of call re lowering use		20 – 40 minutes (21.5 minutes)
	% of customers contacted re assistance available		0.0% - 2.3% (0.7%)
	Length of call re assistance available		10 – 30 minutes (10.0 minutes)
	Number of pieces of written communication per annum		1 – 2.8 (1.2)
	% of customers receiving practical assistance		
	Cost of providing practical assistance		
Current customers facing payment difficulty but not on a payment plan	% of customers currently facing payment difficulty but not on a payment plan	1.3%	0.2% - 34.4% (15.8%)
	% that call retailer	100%	81% - 100% (88.5%)
	Length of call to place customer on bill smoothing or deferred payment	Medium	10 – 20 minutes (15.1 minutes)
	Number of pieces of written communication per annum	1	

SOURCE: ACIL ALLEN, RETAILERS' INFORMATION REQUESTS

3.8 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 difficulty 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 difficulty.

3.8.1 Disconnections

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

The impact of the new payment difficulty 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 difficulty 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 assumed a number of scenarios for the purposes of the preliminary assessment. As a worst case, we assumed no change in the rate of disconnections. We also assumed two scenarios with a decrease in the rate of disconnections.

Of the 0.29 per cent of residential electricity customers that were assumed to be placed on default assistance, we assumed that 20 per cent will contact their retailer and will be offered tailored assistance. The remaining 80 per cent were 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 did not know the current rate at which customers that are facing payment difficulty are disconnected, we estimated that this proportion is similar to the current rate based on data in the Commission's 2015-16 Energy Market Report[27].

Under both the current and proposed arrangements, we 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 assumed that the time to complete a 'disconnection checklist" would be 30 minutes under both the current and new frameworks and that the average customer has 1.67 accounts.

We 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 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.

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

Three retailers provided information on the rate of disconnection under the new payment difficulty framework:

- one estimated a decrease in the rate of disconnection from 0.002% to 0% on the basis that they would not be disconnecting customers identified as being in financial difficulty
- another indicated that the rate of disconnection is impossible to predict, but estimated a decrease from approximately 0.5% as the definition of arrears appeared to prevent disconnection on the first missed bill
- the third estimated no change.

On the basis of the information provided by the retailers, and consistent with the preliminary assessment, the sensitivity analysis considers the retailers' incremental ongoing operating costs if the disconnection rate is:

- 100 per cent of the current disconnection rate
- 80 per cent of the current disconnection rate
- 60 per cent of the current disconnection rate.

The retailers provided widely varying estimates of the time to complete a 'disconnection checklist' under the current and new payment difficulty frameworks. The time to complete a 'disconnection checklist' under the current framework was estimated to vary between 10 and 25 minutes, with a customer weighted average of 15.4 minutes, and the time to complete a 'disconnection checklist' under the new framework was estimated to vary between 10 and 60 minutes, with a customer weighted average of 30.1 minutes.

As the retailers estimated an increase in the time to complete a 'disconnection checklist' under the new payment difficulty framework, additional costs are estimated to be incurred under the base case (100 per cent of the current disconnection rate).

3.8.2 Bad debts

Under our base case, we assumed that there is no change in the bad debts written off by retailers with the introduction of the new payment difficulty 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, the preliminary assessment included an estimate of the impact of the new payment difficulty 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.

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

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

For the purposes of the preliminary assessment, we 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).

The retailers generally disagreed with this assumption. Of the four retailers that provided information on bad debts:

- One retailer estimated bad debts to be immaterial, but noted that extensive modelling is required to provide a more accurate estimate which could not be undertaken within the timeframe.
- The other retailers estimated increases in bad debts of 20 per cent, 52 per cent and 96 per cent. One of these retailers provided no rationale for the increase, another indicated that it was due to the definition of arrears and the separation of payment for arrears and energy use, and the third retailer

raised concerns that customers will have much higher debts before they are required to engage and there will be a much higher likelihood of long term failure to complete a payment plan.

In response to submissions on the new Draft Decision, the Commission made changes to the definition of arrears and provided retailers with options as to how they would treat the payment for arrears and energy use. Despite these changes, one retailer confidentially submitted that:

… we continue to hold the view that debt will increase in aggregate, it will be held for a longer period and retailers will face greater bad debt provision as a consequence. This is due to the following:

– *Coverage – retailers would still be obligated to offer tailored assistance to all Victorian customers regardless of their circumstances rather than those who request help or show indicators of hardship*
– *Duration – payment plans apply for a maximum of two years and customers can request an extension (which we anticipate retailers will generally be obligated to accept based on the [Commission's] previous guidance material)*
– *Incentive effects – allowing for repayment over a prolonged period enables customers to de-prioritise energy payments, particularly when they could be struggling to pay other bills.*

There is significant uncertainty as to the impact of the new payment difficulty framework on bad debts. While there may be reasons for the average bad debt to increase, as identified by one retailer, the average bad debt could decrease with the provision of more timely assistance by some retailers and the provision of practical assistance.

With the changes made by the Commission to the definition of arrears and the flexibility for managing the payment of arrears and energy use subsequent to its Draft Decision, we have assumed that any increase in average debt will be less than estimated by the retailers.

Given the uncertainty in any change to the average debt under the new framework, the sensitivity analysis on bad debts considers variations in the disconnection rate and the following variations on the average debt assumption:

— 30 per cent decrease
— 15 per cent decrease
— no change
— 15 per cent increase
— 30 per cent increase.

3.8.3 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 difficulty 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[28] to $59.0 million in July 2016 to $63.8 million in December 2016[29]. While the 2015-16 debt reported may not be directly comparable to the debts reported in 2016[30], the trend for an increase in debt is clear.

For the purposes of the preliminary assessment, we assumed that the average debt for customers that are currently in the hardship program to be $1200 and for the remaining customers facing payment difficulty and on a payment plan to be $450. These estimates were based on our estimates at the time of the Hardship Inquiry, increased in line with the increase in the total debt.

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

There was insufficient data provided by the retailers to inform these estimates of average arrears quantitatively, although Origin Energy, for example, stated that:

– *Debt will be held longer for customers because more will shift to a 24 month payment plan.*
– *Customers will accrue more debt which will lead to an additional financial burden being held by retailers; more of that debt will have to be written off because it has been allowed to increase.*[31]

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

Given the uncertainty associated with this assumption, this report considers three scenarios in terms of the proportion of customers that will receive assistance under the new payment difficulty framework:

1. no change over time in the proportion of customers receiving each type of assistance
2. a phased reduction in the proportion of customers receiving tailored assistance and that are repaying arrears, over a period from year three to year ten
3. a step reduction in the proportion of customers receiving tailored assistance and that are repaying arrears, at the end of year two (consistent with the preliminary assessment).

These three scenarios will be applied to the analysis of arrears. When analysing the information submitted by the retailers, the reduction in the proportion of customers receiving tailored assistance and repaying arrears is assumed to be 30 per cent.

As discussed above, it is uncertain whether the average debt for customers facing payment difficulty will remain unchanged. The average debt may decrease under the new payment difficulty framework if:

— customers facing payment difficulty 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.

Conversely, the average debt may increase for the reasons identified by one retailer.

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

— decreased by 30 per cent
— decreased by 15 per cent
— unchanged
— increased by 15 per cent
— increased by 30 per cent.

As discussed above, the increase in average debt considered is less than estimated by the retailers with the change made by the Commission to the definition of arrears and the increased flexibility for retailers to manage the payment of arrears and energy use, subsequent to its Draft Decision.

We have 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.

3.9 Impact on retailers of tariff changes and energy efficiency

In its report to the Commission on the impact of the payment difficulty framework on customers, KPMG identified benefits for customers associated with switching to a better tariff and lowering their energy consumption. These impacts are largely distributional.

Any benefits to customers from switching to a lower tariff will be a cost to the retailer.

[31] Origin Energy, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 16 June 2017, page 21

If a customer lowers their energy consumption in response to advice provided under the framework:

- the retailers' revenues will reduce as the customer will pay less for energy
- the retailers' costs will reduce as the retailer will pay less for energy and for network services
- the network businesses' costs will not change as their costs are driven largely by peak demand for energy, rather than energy consumption
  - electricity network businesses' revenues are regulated under a revenue cap and so the costs will be recovered from other customers
  - gas network businesses' revenues are regulated under a price cap and so any benefits to customers and retailers will be a cost to the gas network businesses
- the costs incurred by electricity generators and gas producers will reduce based on the variable costs of supply.

In summary, any benefits to customers from lowering their energy consumption will be a cost to others, but will have little impact on retailers.

As these impacts are largely distributional, they are not considered further in this report.

4 COSTS ASSOCIATED WITH EACH TYPE OF ASSISTANCE

The costs associated with each type of assistance under the new payment difficulty framework have been estimated by considering a range of costs.

The lower end of the range is the costs estimated for the preliminary assessment, based on the costs estimated for each of the nine retailers whose policies, procedures and practices were reviewed for the Hardship Inquiry, updated based on information submitted by the retailers.

The upper end of the range is the costs as submitted by the retailers. These costs have been adjusted based on our assessment of the impact of changes that have been made by the Commission in finalising the payment difficulty framework.

To protect the anonymity of the 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 difficulty, 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 difficulty framework
— ongoing operating costs – costs that are incurred annually by the retailer to manage customers facing payment difficulty under the new framework
— avoided costs – the costs avoided by the retailer by discontinuing current practices for managing customers facing payment difficulty with the commencement of the new payment difficulty 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 either the nine retailers whose policies, procedures and practices were reviewed for the Hardship Inquiry, or for the retailers that submitted information in response to the information request. The maximum is the highest cost per customer estimated for each of the retailers. The customer weighted average is the cost per customer estimated by weighting each of the retailer's costs per customer by the relevant 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 3.8, this chapter does not consider the incremental costs associated with disconnections, the financing costs associated with debt, and bad debts. These issues are separately considered in chapter 6.

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.

As discussed in section 3.5.1, the training costs in the preliminary assessment were underestimated and have been increased for the purposes of this report. Costs associated with responding to the ombudsman, as discussed in section 3.6.3, are also included in this category as an ongoing operating cost.

The costs submitted by the retailers for the set up, and for miscellaneous and consequential amendments, include only the costs associated with training customer service agents and costs related to disconnection. No upfront system costs are included in this category. Accordingly, the scope of changes captured in this category is less for the information submitted by the retailers than using the assumptions for the updated preliminary assessment.

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
Updated preliminary assessment			
Upfront cost	$1.82	$8.92	$4.49
Ongoing operating cost (per annum)		$0.05	
Information as submitted by the retailers			
Upfront cost	$0.40	$3.77	$1.81

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

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
Updated preliminary assessment			
Upfront costs	$0.14	$4.46	$1.15
Ongoing operating costs (per annum)			
On commencement of framework	$0.33		
With an increase in the proportion of customers	$0.70		
Information as submitted by the retailers			
Upfront costs	$1.59	$7.32	$2.26
Ongoing operating costs (per annum)	$0.07	$4.43	$2.20

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

The upfront costs for standard assistance as submitted by the retailers are higher than estimated using the assumptions updated from the preliminary assessment. This may be due, in part, to the allocation of some of the costs that were categorised as set-up costs to standard assistance by the retailers.

The ongoing operating costs for standard assistance, as submitted by the retailers, are higher than estimated using the assumptions updated from the preliminary assessment. This is most likely to be due to the higher proportion of customers that the retailers estimate will be receiving standard assistance, as illustrated in Figure 3.5.

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
Updated preliminary assessment			
Upfront cost	$1.18	$5.14	$1.94
Ongoing operating costs (per annum)			
On commencement of framework		$3.91	
With a decrease in the proportion of customers		$2.14	
Information as submitted by the retailers			
Upfront costs	$3.25	$15.22	$4.79
Ongoing operating costs (per annum)	$1.03	$61.18	$2.15 ($1.73 when scaled to a state-wide estimate for the proportion of customers)

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

The upfront costs submitted by the retailers are higher than estimated using the assumptions updated from the preliminary assessment. This may be due, in part, to the allocation of some of the costs that were categorised as set-up costs to tailored assistance, with arrears being repaid, by the retailers.

The customer weighted ongoing operating costs for tailored assistance with arrears being repaid, as submitted by the retailers, are lower than estimated using the assumptions updated from the preliminary assessment. However, the high end of the range of the costs submitted by the retailers is significantly higher than estimated using the assumptions updated from the preliminary assessment. This high cost is driven by a relatively high number of calls of relatively long duration that one retailer expects to have with its customers.

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
  - 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
Updated preliminary assessment			
Upfront cost	$0.80	$8.90	$3.58
Ongoing operating costs (per annum)	$2.28		
Information as submitted by the retailers			
Upfront cost	$3.21	$14.86	$4.62
Ongoing operating costs (per annum)	$0.00	$3.07	$2.08 ($2.34 when scaled to a state-wide estimate for the proportion of customers)

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

The upfront costs submitted by the retailers are slightly higher than estimated using the assumptions updated from the preliminary assessment. This may be due, in part, to the allocation of some of the costs that were categorised as set-up costs to tailored assistance, with arrears on hold, by the retailers.

The customer weighted ongoing operating costs for tailored assistance with arrears on hold, as submitted by the retailers, are lower than estimated using the assumptions updated from the preliminary assessment. They are similar when the proportion of customers on this type of assistance is scaled to a state-wide estimate for the proportion of customers.

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
Updated preliminary assessment			
Upfront cost	$0.48	$2.10	$0.85
Ongoing operating costs (per annum)	$0.02		
Information as submitted by the retailers			
Upfront cost	$7.63	$33.50	$9.80
Ongoing operating costs (per annum)	$0.05	$12.24	$6.88

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

The upfront costs and ongoing operating costs for default assistance, as submitted by the retailers, are significantly higher than estimated using the assumptions updated from the preliminary assessment.

In its submission on the new Draft Decision, EnergyAustralia identified that the system costs associated with default assistance would be high as default assistance:

> *… introduces new payment schedules (e.g. monthly instalments for the repayment of arrears under Default Assistance where the majority of our customers receive their bills quarterly) and assistance that is triggered by payment rather than following discussions between our contact centre staff and customers.*[32]

The ongoing operating costs submitted by the retailers are very high relative to the costs estimated using the assumptions updated from the preliminary assessment as the proportion of customers that the retailers estimate to be offered default assistance is significantly higher than estimated using those assumptions, as illustrated in Figure 3.5.

The retailers provided no indication as to the costs that would be avoided if the payment difficulty framework does not include default assistance.

Not all the upfront costs associated with default assistance, as submitted by the retailers, will be avoided if the payment difficulty framework does not include default assistance. The system costs will include a fixed component, which will be allocated to default assistance and will be incurred regardless of whether default assistance is required, and a variable component, which will be avoided if default assistance is not required. We estimate that 50 per cent of the upfront costs that have been allocated to default assistance by the retailers will be avoided if default assistance is not required.

All ongoing operating costs for default assistance would be avoided if default assistance is removed from the framework.

4.5 Costs avoided

The retailers currently incur ongoing operating costs to manage customers facing payment difficulty that are on payment plans. With the introduction of a new payment difficulty framework, that activity is directed towards managing customers facing payment difficulty under the new framework, the costs of which are captured in the preceding sections.

The estimated range of costs that are avoided by the retailers by implementing the new payment difficulty framework is summarised in Table 4.6.

TABLE 4.6 ESTIMATED RETAILERS' COSTS THAT ARE AVOIDED UNDER THE NEW PAYMENT DIFFICULTY FRAMEWORK

Nature of costs	Cost per customer		
	Minimum	Maximum	Customer weighted average
Ongoing operating costs (per annum)			
Updated preliminary assessment	–$9.25	–$2.14	–$6.52
Information as submitted by the retailers	–$9.08	–$0.69	–$5.44 (–$5.31 when scaled to a state-wide estimate for the proportion of customers)

SOURCE: ACIL ALLEN AND RETAILERS' INFORMATION REQUESTS

The avoided costs submitted by the retailers are lower than the avoided costs estimated using the assumptions updated from the preliminary assessment.

[32] EnergyAustralia, *Submission on the Commission's New Draft Decision – Safety Net for Victorian Consumers Facing Payment Difficulties*, 19 June 2017, page 24

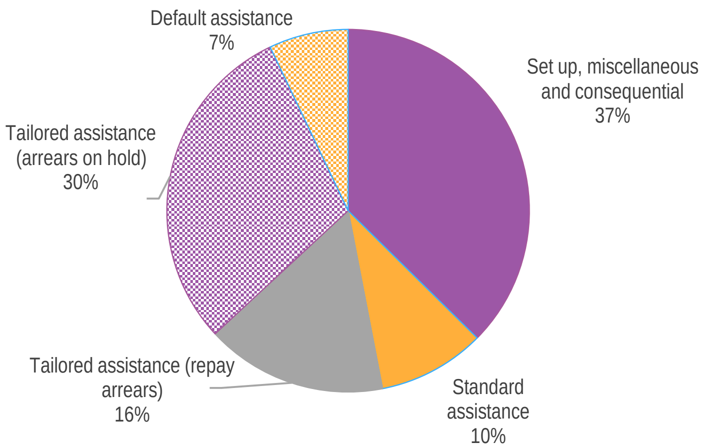
4.6 Summary

A breakdown of the estimated upfront costs and the annual ongoing operating costs (excluding the avoided costs, disconnection costs, financing costs associated with debt, and bad debts) associated with the new payment difficulty framework, by type of assistance, on a cost per customer basis, is illustrated in Figure 4.1. This breakdown includes the costs associated with default assistance.

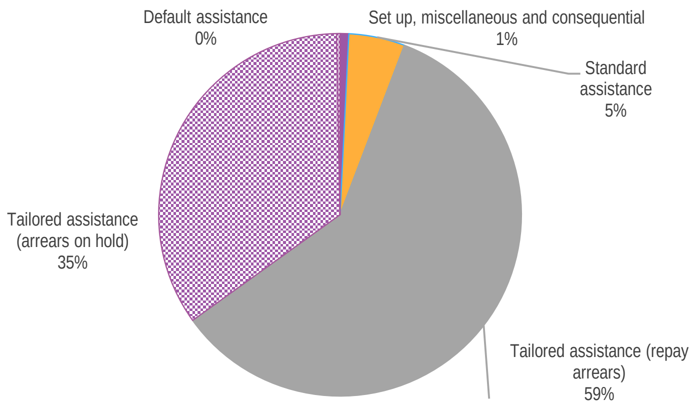
FIGURE 4.1 BREAKDOWN OF ESTIMATED UPFRONT COSTS AND ONGOING OPERATING COSTS, BY TYPE OF ASSISTANCE, ON A COST PER CUSTOMER BASIS

Updated preliminary assessment

Estimated upfront costs
($12.00 per customer)

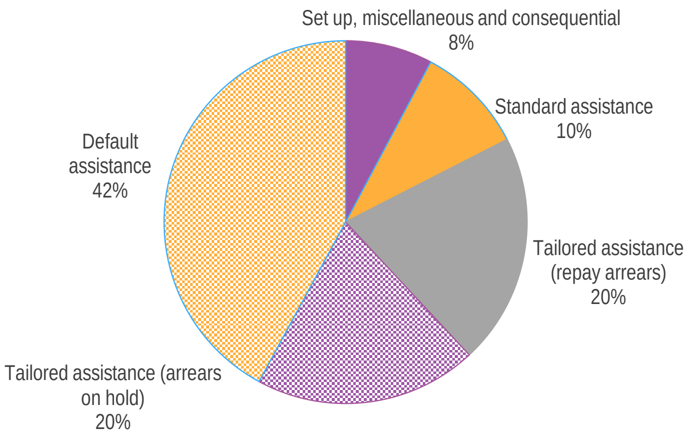


Estimated ongoing operating costs (per annum)
(Total cost $6.59 per customer
Incremental cost $0.07 per customer)

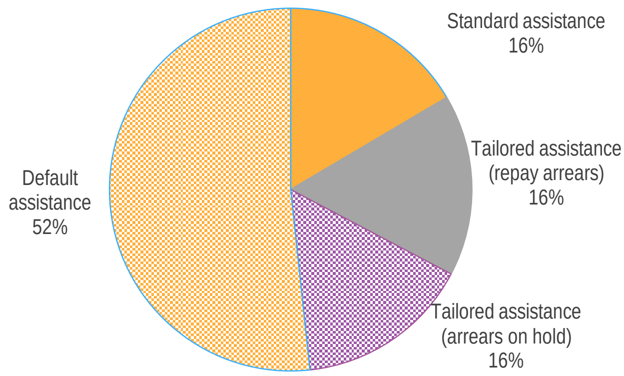


Information submitted by the retailers

Estimated upfront costs
($23.28 per customer)



Estimated ongoing operating costs (per annum)
(Total cost $13.31 per customer
Incremental cost $7.87 per customer)



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

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP, RETAILERS' INFORMATION REQUESTS

The upfront costs and the ongoing operating costs submitted by the retailers are significantly higher than estimated using the assumptions updated from the preliminary assessment.

The updated preliminary assessment indicated that tailored assistance for customers with arrears on hold has the highest upfront costs and tailored assistance for customers repaying arrears has the highest ongoing costs, as the proportion of customers assumed to access that type of assistance is higher than for the other types of assistance.

The retailers have estimated that the upfront and ongoing operating costs associated with default assistance are the highest of each of the types of assistance, and substantially higher than the updated preliminary assessment.

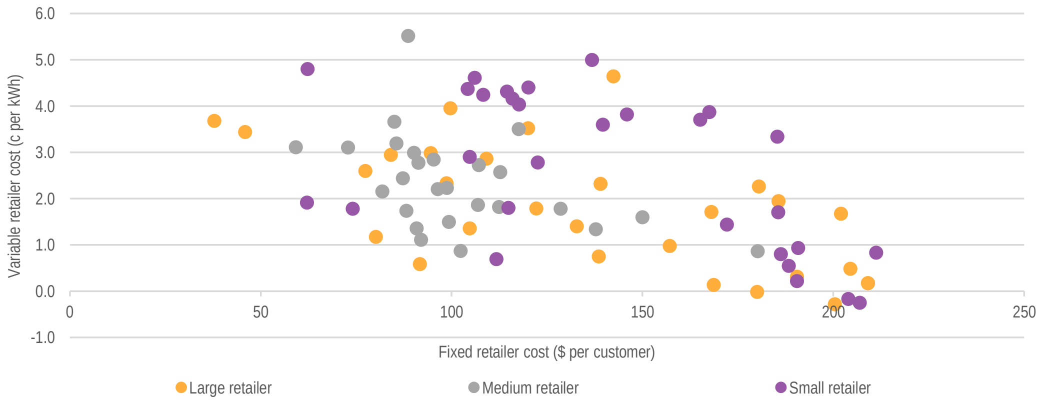
If the proportions of customers are scaled to the state-wide estimates then, based on the information submitted by the retailers, the total ongoing operating costs decrease from $13.31 to $13.15 on a cost per customer basis, and the incremental ongoing operating costs reduce from $7.87 to $7.83 on a cost per customer basis. The costs associated with tailored assistance (with arrears being repaid) reduce from 16 per cent to 13 per cent of the ongoing operating costs, and the costs associated with tailored assistance (arrears on hold) increase from 16 per cent to 18 per cent of the ongoing operating costs.

If default assistance is removed from the framework then, based on the information submitted by the retailers, it is estimated that the upfront costs would reduce from $23.28 to $18.38 per customer, the total ongoing operating costs would reduce from $13.31 per customer to $6.43 per customer (or from $13.15 per customer to $6.27 per customer if the proportions of customers are scaled in line with state-wide estimates) and the incremental ongoing operating costs would reduce from $7.87 per customer to $0.99 per customer (or from $7.83 per customer to $0.95 per customer if the proportions of customers are scaled in line with state-wide estimates).

5 ESTIMATED COSTS FOR PROVIDING ASSISTANCE 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 5.1.

FIGURE 5.1 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 new payment difficulty framework will be of a similar order of magnitude across all retailers, on a cost per customer basis.

The cost per customer by type of assistance is provided in Table 4.1 to Table 4.6. These tables provide the costs estimated using the assumptions updated from the preliminary assessment and based on information submitted by the retailers. 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[33]).

The average cost per customer and the total costs across all retailers are set out in Table 5.1 and Table 5.2, respectively. As discussed in section 3.8, this chapter does not consider the incremental costs associated with disconnections, the financing costs associated with debt, and bad debts. These issues are separately considered in chapter 6.

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

TABLE 5.1 ESTIMATED COST PER CUSTOMER ASSOCIATED WITH PROVIDING ASSISTANCE UNDER THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS

Type of assistance	Weighted average cost per customer				
	Updated preliminary assessment		Information submitted by the retailers		
	Upfront	Annual ongoing operating cost	Upfront	Annual ongoing operating cost	
				As submitted	Scaled to state-wide estimates for proportions of customers
Set up, miscellaneous and consequential amendments	$4.49	$0.05	$1.81		
Standard assistance	$1.15	$0.33	$2.26	$2.20	$2.20
Tailored assistance, arrears being repaid	$1.94	$3.91	$4.79	$2.15	$1.73
Tailored assistance, arrears on hold	$3.58	$2.28	$4.62	$2.08	$2.34
Default assistance	$0.85	$0.02	$9.80	$6.88	$6.88
Sub total	$12.00	$6.59	$23.28	$13.31	$13.15
Less avoided costs	$0.00	–$6.52	$0.00	–$5.44	–$5.31
Total	$12.00	$0.07	$23.28	$7.87	$7.83
Total (if default assistance not required)	$11.58	$0.05	$18.38	$0.99	$0.95

Note: Columns may not add due to rounding. It has been assumed that 50 per cent of the upfront costs and 100 per cent of the ongoing operating costs associated with default assistance will be avoided if default assistance is removed from the framework.

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

TABLE 5.2 ESTIMATED TOTAL COSTS ASSOCIATED WITH PROVIDING ASSISTANCE UNDER THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS

Type of assistance	Costs incurred by all retailers				
	Updated preliminary assessment		Information submitted by the retailers		
	Upfront	Annual ongoing operating cost	Upfront	Annual ongoing operating cost	
				As submitted	Scaled to state-wide estimates for proportions of customers
Set up, miscellaneous and consequential amendments	$11,246,924	$128,000	$4,535,399		
Standard assistance	$2,880,362	$835,991	$5,656,831	$5,508,955	$5,508,955
Tailored assistance, arrears being repaid	$4,852,948	$9,802,646	$12,010,071	$5,395,654	$4,339,983
Tailored assistance, arrears on hold	$8,965,643	$5,706,756	$11,576,202	$5,202,941	$5,853,309
Default assistance	$2,118,224	$39,987	$24,546,951	$17,238,206	$17,238,206
Sub total	$30,064,101	$16,513,380	$58,325,424	$33,345,756	$32,940,452
Less avoided costs		–$16,344,933		–$13,637,898	–$13,315,913
Total	$30,064,101	$168,447	$58,325,454	$19,707,858	$19,624,539
Total (if default assistance not required)	$29,004,989	$128,460	$46,051,979	$2,469,652	$2,386,333

Note: Columns may not add due to rounding. It has been assumed that 50 per cent of the upfront costs and 100 per cent of the ongoing operating costs associated with default assistance will be avoided if default assistance is removed from the framework.

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

The total upfront cost per customer associated with introducing the new payment difficulty framework is estimated to be in the range of $12.00 to $23.28, with the net ongoing operating cost estimated to be in the range of $0.07 to $7.87 per customer per year. If default assistance is removed from the framework, the total upfront cost per customer is estimated in the range of $11.58 to $18.38, with the net ongoing operating cost estimated in the range of $0.05 to $0.99 per customer.

If default assistance is removed from the framework, the total upfront cost across all Victorian energy retailers is estimated to be in the range of $29.0 million to $46.1 million and the net annual operating cost is estimated to be in the range of $0.1 million to $2.5 million per year.

If the proportion of customers on tailored assistance is scaled in line with the state-wide estimates, the impact on the total ongoing operating costs, based on the information submitted by the retailers, is not material.

6 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 difficulty are provided in this chapter.

6.1 Disconnections

It has been assumed that, under the current and new payment difficulty frameworks, 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 on an annual cost per customer basis in Table 6.1, and as the total annual cost to retailers in Table 6.2.

TABLE 6.1 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' COSTS, INCREMENTAL ANNUAL COST PER CUSTOMER

Scenario	Updated preliminary assessment	Information submitted by retailers		
		Minimum	Maximum	Customer weighted average
Base case (current rate of disconnection)	$0.00	$0.00	$0.14	$0.05
80% of current rate of disconnection	–$0.03	–$0.01	$0.09	$0.03
60% of current rate of disconnection	–$0.06	–$0.02	$0.04	$0.00

SOURCE: ACIL ALLEN BASED ON INFORMATION SUBMITTED BY THE RETAILERS

TABLE 6.2 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS ON THE RETAILERS' COSTS, TOTAL ANNUAL INCREMENTAL COSTS

Scenario	Updated preliminary assessment	Information submitted by retailers		
		Minimum	Maximum	Customer weighted average
Base case (current rate of disconnection)	$0	$0	$339,073	$134,546
80% of current rate of disconnection	–$76,166	–$29,376	$218,557	$71,469
60% of current rate of disconnection	–$152,332	–$58,752	$98,041	$8,392

SOURCE: ACIL ALLEN BASED ON INFORMATION SUBMITTED BY THE RETAILERS

The costs associated with disconnections as estimated, based on information submitted by the retailers, are higher than estimated using the assumptions updated from the preliminary assessment. The variation is driven by the estimates for the time to complete a 'disconnection checklist' under the current and new payment difficulty frameworks.

We assume that the time to complete a 'disconnection checklist' will be the same under the current and new payment difficulty frameworks (30 minutes). By way of contrast, at one extreme, a retailer has assumed that the time to complete a 'disconnection checklist' is 10 minutes under the current and the new frameworks. At the other extreme, a retailer has assumed that the time to complete a 'disconnection checklist' will increase from 20 minutes under the current framework to 60 minutes under the new framework.

6.2 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, on an annual bad debts per customer basis, in Table 6.3 and, as the total annual bad debts to retailers, in Table 6.4.

TABLE 6.3 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS AND AVERAGE DEBT ON THE RETAILERS' BAD DEBTS, INCREMENTAL ANNUAL BAD DEBTS PER CUSTOMER

Scenario	Average level of debt				
	30% decrease	15% decrease	No change	15% increase	30% increase
Base case (current rate of disconnection)	-0.82	-0.41	0.00	0.41	0.82
80% of current rate of disconnection	-1.20	-0.88	-0.55	-0.22	0.11
60% of current rate of disconnection	-1.59	-1.34	-1.09	-0.85	-0.60

SOURCE: ACIL ALLEN

TABLE 6.4 ESTIMATED IMPACT OF A CHANGE IN THE RATE OF DISCONNECTIONS AND AVERAGE DEBT ON THE RETAILERS' BAD DEBTS, TOTAL INCREMENTAL ANNUAL BAD DEBTS

Scenario	Average level of debt				
	30% decrease	15% decrease	No change	15% increase	30% increase
Base case (current rate of disconnection)	-$2,056,489	-$1,028,244	$0	$1,028,244	$2,056,489
80% of current rate of disconnection	-$3,016,183	-$2,193,588	-$1,370,992	-$548,397	$274,198
60% of current rate of disconnection	-$3,975,878	-$3,358,931	-$2,741,985	-$2,125,038	-$1,508,092

SOURCE: ACIL ALLEN

As would be expected:

- as the rate of disconnection decreases, the bad debts that are written off by the retailers decreases
- as the average debt for customers that are disconnected decreases, the bad debts that are written off by the retailers decreases.

6.3 Arrears

For the purposes of the preliminary assessment, we assumed that, when the new framework commences, 0.95 per cent of customers on tailored assistance with arrears on hold will have an average debt of $1200, and 2.75 per cent of customers on tailored assistance and repaying arrears will have an average debt of $450.

We have considered a number of scenarios in which the proportion of customers on tailored assistance and repaying arrears reduces. We have assumed that the proportion reduces from 2.75 per cent to 1.34 per cent (a decrease of 1.41 percentage points) in further analysing the estimates from the preliminary assessment, and a reduction of 30 per cent in analysing the information submitted by the retailers (a reduction from 5.53 per cent to 3.87 per cent).

Given the uncertainty as to the average level of debt for customers facing payment difficulty, 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 6.5. As the number of customers increases over time, the aggregate debt levels across all retailers will increase accordingly.

TABLE 6.5 ESTIMATED IMPACT AT A POINT IN TIME OF A CHANGE IN THE AVERAGE DEBT FOR CUSTOMERS FACING PAYMENT DIFFICULTY

	Average debt				
	30% decrease	15% decrease	No change	15% increase	30% increase
Updated preliminary assessment – at commencement of new framework					
Incremental debt per customer [a]	-$7.13	-$3.57	$0.00	$3.57	$7.13
Incremental debt across all retailers	-$17,870,254	-$8,935,127	$0	$8,935,127	$17,870,254
Incremental financing cost [b]	-$895,513	-$446,756	$0	$446,756	$895,513
Updated preliminary assessment – reduction in proportion of customers on tailored assistance and repaying arrears from 2.71 per cent to 1.24 per cent					
Incremental debt per customer [a]	-$11.59	-$8.98	-$6.37	-$3.76	-$1.15
Incremental debt across all retailers	-$29,037,754	-$22,495,663	-$15,953,571	-$9,411,479	-$2,869,388
Incremental financing cost [b]	-$1,451,888	-$1,124,783	-$797,679	-$470,574	-$143,469
Information submitted by retailers – at commencement of new framework					
Incremental debt per customer [a]	-$8.82	-$4.41	$0.00	$4.41	$8.82
Incremental debt across all retailers	-$22,095,387	-$11,047,693	$0	$11,047,693	$22,095,387
Incremental financing cost [b]	-$1,104,769	-$552,385	$0	$552,385	$1,104,769
Information submitted by retailers – 30 per cent reduction in proportion of customers on tailored assistance and repaying arrears					
Incremental debt per customer [a]	-$13.99	-$10.69	-$7.39	-$4.09	-$0.79
Incremental debt across all retailers	-$35,056,985	-$26,786,777	-$18,516,569	-$10,246,361	-$1,976,153
Incremental financing cost [b]	-$1,752,849	-$1,339,339	-$925,828	-$512,318	-$98,808

[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 6.5 indicates that the total debt for customers facing payment difficulty varies significantly as the average debt for customers facing payment difficulty varies. However, the changes in the retailers' financing costs associated with this debt are less material.

As the proportion of customers on tailored assistance and repaying arrears is assumed to decrease, the debt for customers facing payment difficulty is expected to reduce significantly:

- by $16.0 million using the assumptions from the preliminary assessment on the proportion of customers on tailored assistance and with no change in the average debt per customer
- by $18.5 million using the retailers' assumptions on the proportion of customers on tailored assistance initially and our assumptions of a 30 per cent reduction in the proportion of customers on tailored assistance and with no change in the average debt per customer.

The retailers' total debt will increase (or decrease) as the average debt increases (or decreases).

The financing costs associated with the retailers' debt will increase (or decrease) as the cost of capital increases (or decreases).

7 TOTAL IMPACT OF THE PAYMENT DIFFICULTY FRAMEWORK ON THE RETAILERS

In this chapter, the total impact of the new payment difficulty framework on the Victorian energy retailers is considered. The total impact includes the upfront costs and ongoing operating costs, which are discussed in chapter 5, and the costs associated with disconnection, bad debts and financing of arrears, which are discussed in chapter 6. The total impact is represented as an annualised cost (in section 7.1) and as the net present value (NPV) over a period to 2028 (in section 7.2). The total impacts have been calculated based on the assumptions updated from the preliminary assessment and the information submitted by the retailers.

In calculating the total impact of the new payment difficulty framework on retailers, we have used the customer weighted average costs and have assumed that the Commission:

- removes default assistance
- changes the definition of arrears
- provides the retailers with flexibility in managing payments for arrears and energy use.

In addition, it assumes the rate of disconnections remains unchanged.[34]

The Commission has decided to increase the minimum outstanding amount for disconnection to occur in Victoria from $120 (exclusive of GST) to $300 (exclusive of GST), as applies in other jurisdictions. The potential cost savings associated with this alignment between Victorian and national arrangements has not been taken into consideration in assessing the total impact of the new payment difficulty framework.

7.1 Annualised cost

Table 7.1 presents the upfront and ongoing operating costs in a comparable way by depreciating the upfront costs over a ten year period. The information submitted by the retailers has been analysed based on the proportions of customers on each type of assistance as submitted by the retailers, and with the proportions of customers adjusted (or scaled) to align more closely with the expected state-wide estimates.

The annualised costs are also presented as a proportion of the retailers' revenue, assuming that the retailers' revenue from the electricity and gas markets is in the order of $8 billion.[35]

[34] This assumption is not a prediction or a forecast of the future rate of disconnections. As discussed in earlier, chapters, no change in the level of disconnection is the most conservative assumption that can be adopted for they costings. Sensitivity analysis for lower rates of disconnection would result in lower costs than discussed in the remainder of this chapter.

[35] Estimate of retailers' revenue calculated based on the Australian Energy Regulator's revenue determinations for the electricity and gas network businesses, and estimates of the network component as a proportion of the total retail bill.

TABLE 7.1 ESTIMATED ANNUALISED COST ASSOCIATED WITH THE NEW PAYMENT DIFFICULTY FRAMEWORK, ALL RETAILERS ($2017)

Cost category	Updated preliminary assessment		As submitted by the retailers		As submitted, with proportion of customers scaled to state-wide estimates	
	Cost per customer	% of retailer revenue	Cost per customer	% of retailer revenue	Cost per customer	% of retailer revenue
Upfront costs amortised over 10 years	$1.16	0.04%	$1.84	0.06%	$1.84	0.06%
Costs of new framework						
Operating costs	$6.57		$6.43		$6.27	
Disconnection costs	$0.15		$0.13		$0.13	
Bad debts	$2.74		$2.74		$2.74	
Financing costs	$1.19		$1.47		$1.26	
Subtotal	$10.65	0.33%	$10.76	0.34%	$10.39	0.33%
Costs of current framework						
Operating costs	-$6.52		-$5.44		-$5.31	
Disconnection costs	-$0.15		-$0.05		-$0.05	
Bad debts	-$2.74		-$2.74		-$2.74	
Financing costs	-$1.19		-$1.47		-$1.26	
Subtotal	-$10.60	0.33%	-$9.70	0.30%	-$9.36	0.29%
Total annualised costs	$1.21	0.04%	$2.90	0.09%	$2.86	0.09%

Note: Columns may not add due to rounding. Assumes no change in the average debt

SOURCE: ACIL ALLEN WITH SYSTEM COSTS INFORMED BY ANALYSIS BY TBS CONSULTING GROUP; RETAILERS' INFORMATION REQUESTS

Table 7.1 indicates that the upfront costs associated with implementing the new payment difficulty framework is between $1.16 and $1.84 per customer per year, or between 0.04% and 0.06% of the retailers' annual revenue, for ten years.

The annual costs associated with the current framework, including the costs associated with payment plans and the hardship program, disconnection, bad debts and financing costs associated with arrears are estimated to be between $9.36 and $10.60 per customer, or between 0.29% and 0.33% of the retailers' annual revenue.

With the introduction of the new framework, these annual costs are estimated to increase to between $10.39 and $10.76 per customer, or between 0.33% and 0.34% of the retailers' annual revenue. This represents an annual increase of between $1.21 and $2.90 per customer, or between 0.04% and 0.09% of the retailers' annual revenue.

If there is a modest increase in the average debt for customers on tailored assistance under the new framework[36], the annual costs are estimated to increase to between $10.99 and $11.39 per customer, or between 0.34% and 0.36%. This represents an annual increase of between $1.80 and $3.53 per customer, or between 0.06% and 0.11% of the retailers' annual revenue.

7.2 Net present value

The NPV of the total impact of the payment difficulty framework on all retailers, is summarised in Table 7.2. We have calculated the NPV using a discount rate of 4 per cent per annum, consistent with the Government's guidance for regulatory proposals.[37]

36 Assuming a 15 per cent increase in average debt

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

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 continues at 1.8 per cent per annum, and have escalated the costs and benefits accordingly.

It is assumed that the upfront costs will be incurred in 2018 in preparation for a 1 January 2019 commencement date. The ongoing operating costs are assumed to be incurred from 1 January 2019 to 2028.

We have tested the NPV for the estimates using the updated assumptions from the preliminary assessment and the information submitted by the retailers, no change in the average debt and a 15 per cent increase in the average debt from 1 January 2020. Sensitivity analysis has also been undertaken with:

— no change in the proportion of customers receiving tailored assistance and repaying arrears, and no associated benefits from reduced financing costs
— a phased reduction in the proportion of customers receiving tailored assistance and repaying arrears, with the associated benefits from reduced financing costs progressively accruing from 2022
— a step reduction in the proportion of customers receiving tailored assistance and repaying arrears after two years, with the associated benefits from reduced financing costs accruing in their entirety from 2022.

Table 7.2 indicates that there is a broad range within which the retailers’ costs to implement and operate the new payment difficulty framework will lie, depending on the assumptions that are made. The NPV of the retailers’ costs is most likely to lie within the range of $18 million to $78 million, assuming:

— no requirement for default assistance
— a change to the definition of arrears subsequent to the Commission’s new Draft Decision
— the retailers have flexibility to manage payments for arrears and energy use
— no reduction or a phased reduction in the proportion of customers on tailored assistance and repaying arrears
— no increase or a modest increase in the average debt[38].

[38] For the purposes of the analysis, assumed up to a 15 per cent increase

TABLE 7.2 NPV OF THE TOTAL IMPACT OF THE NEW PAYMENT DIFFICULTY FRAMEWORK ON ALL VICTORIAN ENERGY RETAILERS

	NPV ($2017)							
	Updated preliminary assessment				Information submitted by the retailers			
Customers on tailored assistance	No change	No change	Phased decrease	Step decrease	No change	No change	Phased decrease	Step decrease
Average debt	No change	15% increase	No change	No change	No change	15% increase	No change	No change
Upfront system and process costs	$27,889,412	$27,889,412	$27,889,412	$27,889,412	$44,280,749	$44,280,749	$44,280,749	$44,280,749
New framework								
Ongoing operating costs – standard assistance	$6,569,554	$6,569,554	$9,231,760	$12,010,249	$43,291,566	$43,291,566	$43,291,566	$43,291,566
Ongoing operating costs – tailored assistance	$125,453,957	$125,453,957	$112,488,666	$98,957,067	$83,287,994	$83,287,994	$81,694,295	$73,609,566
Disconnection costs	$3,362,203	$3,362,203	$3,362,203	$3,362,203	$2,784,404	$2,784,404	$2,784,404	$2,784,404
Bad debts	$60,519,660	$68,600,015	$60,519,660	$60,519,660	$60,519,660	$68,600,015	$60,519,660	$60,519,660
Financing costs	$26,294,863	$29,805,653	$23,961,111	$21,525,423	$32,511,858	$36,852,717	$29,803,180	$26,976,190
Subtotal	$222,200,238	$233,791,382	$209,563,401	$196,374,603	$222,395,482	$234,816,696	$218,093,105	$207,181,386
Current framework								
Avoided costs – payment plans and hardship program	-$128,445,013	-$128,445,013	-$128,445,013	-$128,445,013	-$107,172,046	-$107,172,046	-$107,172,046	-$107,172,046
Disconnection costs	-$3,362,203	-$3,362,203	-$3,362,203	-$3,362,203	-$1,187,854	-$1,187,854	-$1,187,854	-$1,187,854
Bad debts	-$60,519,660	-$60,519,660	-$60,519,660	-$60,519,660	-$60,519,660	-$60,519,660	-$60,519,660	-$60,519,660
Financing costs	-$26,294,863	-$26,294,863	-$26,294,863	-$26,294,863	-$32,511,858	-$32,511,858	-$32,511,858	-$32,511,858
Subtotal	-$218,621,740	-$218,621,740	-$218,621,740	-$218,621,740	-$201,391,418	-$201,391,418	-$201,391,418	-$201,391,418
Total	$31,467,910	$43,059,054	$18,831,073	$5,642,275	$65,284,813	$77,706,027	$60,982,436	$50,070,717

Note: 4 per cent discount rate over a period to 2028

SOURCE: ACIL ALLEN BASED ON SYSTEM CHANGE COSTS PROVIDED BY TBS CONSULTING GROUP AND INFORMATION SUBMITTED BY THE RETAILERS

APPENDICES

A INFORMATION REQUEST

An Information Request was prepared to enable retailers to submit comprehensive information so that the retailers' impacts could be more accurately assessed for the Commission's Final Decision, compared to the preliminary assessment for the new Draft Decision.

The Information Request was prepared in an Excel spreadsheet and consisted of the following worksheets:

— Introduction – explained the purpose of the Information Request and collected contact details for the retailer

— General – collected information on the number of customers, and costs associated with the call centre, training, and written communication

— General information – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected 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 – collected information on the number of customers facing payment difficulty that are currently being disconnected and are expected to be disconnected under the new framework, and their associated bad debts.

ACIL ALLEN CONSULTING PTY LTD
ABN 68 102 652 148

ACILALLEN.COM.AU

ABOUT ACIL ALLEN CONSULTING

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WE PROVIDE SENIOR ADVISORY SERVICES THAT BRING UNPARALLELED STRATEGIC THINKING AND REAL WORLD EXPERIENCE TO BEAR ON PROBLEM SOLVING AND STRATEGY FORMULATION.