APPENDIX 4: BILLING END USERS – SA WATER'S STATUTORY DEBT RECOVERY AND SECURITY PROVISIONS

Final Inquiry Report: Inquiry into Reform Options for SA Water's Drinking Water and Sewerage Prices

December 2014

Enquiries concerning this report should be addressed to:

Essential Services Commission of South Australia
GPO Box 2605
Adelaide SA 5001

Telephone: (08) 8463 4444
Freecall: 1800 633 592 (SA and mobiles only)
E-mail: escosa@escosa.sa.gov.au
Web: www.escosa.sa.gov.au

Contact officer: Kara O'Sullivan

The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit www.escosa.sa.gov.au.

TABLE OF CONTENTS

GLOSSARY OF TERMS

Bad debt	A debt that is considered unlikely to be paid
CBA	Cost benefit analysis
Commission	The Essential Services Commission of South Australia
Debt	A sum of money owed by a person or an entity to another
Debt write-offs	Where a debt or part of a debt is removed from the accounts
Debtor	A person who owes money to another
Debtor days	A ratio used to work out how many days on average it takes a company to be paid for what it sells
End user	A person who actually uses a water or sewerage service
First charge	A security for a debt or obligation attaching to the property of the debtor that is to be satisfied before any other charges are paid out of the proceeds of sale of that property
Landowner	a person who owns land to which a retail service is provided by SA Water
Lands Titles Office	Lands Titles Office, Department of Planning, Transport and Infrastructure SA
NPV	Net present value
Payment default	A failure to pay an amount owing to a person or corporation as required by the terms of a contract
Provision of bad debt	An allowance created to recognise the potential loss arising from the likelihood of incurring bad debts
SA Water	South Australian Water Corporation
SA Water customer	a person who owns land in relation to which SA Water provides a retail service and includes: • where the context requires, a person seeking the provision of a retail service; and • in prescribed circumstances – a person supplied with retail services as a consumer or user of those services (without limiting the application of this definition to owners of land); and

	• a person of a class declared by the regulations under the Water Industry Act to be customers
Security	An asset pledged as a guarantee of the fulfilment of the repayment of a debt
Sewerage service	Has the same meaning as given to the term in the Water Industry Act
Title or Certificate of Title	A document that records information relevant to a parcel of land, including ownership and any registered interest such as charges
Water service	Has the same meaning as given to the term in the Water Industry Act

1. SA WATER'S STATUTORY DEBT RECOVERY AND DEBT SECURITY PROVISIONS

1.1 Background

The Inquiry has considered the impact of billing an end user of water and sewerage services (rather than the owner of land).

In doing so, it undertook cost benefit analyses for moving to end user billing, under a number of reform scenarios, concluding that:

- The end-user of a retail service should be SA Water's customer (rather than the property owner)
- The current provisions in the *South Australian Water Corporation Act 1994* (**SA Water Corporation Act**), which confer on SA Water the right to secure debts through a statutory charge on land, and the right to sell land to satisfy a debt, should be repealed.

This document provides further detail on the Inquiry's considerations relating to the issue of SA Water's statutory debt recovery, and debt security, provisions.

1.2 Inquiry's considerations

The Inquiry's recommendation for the removal of SA Water's statutory debt recovery and security rights is made on the basis that:

- it is not efficient for SA Water to have debt security and recovery right over and above other market participants (as this conflicts with the principle of competitive neutrality[1]);
- if end users are to become customers then, in the case of tenancies, the owner of the land on which a retail service is consumed by the customer should not be required to provide security for the debts of that customer.

Under the terms of the SA Water Corporation Act, SA Water obtains a first charge over a property to which a water or sewerage retail service is provided, for any amounts owing to SA Water for that service. The charge need not be registered on the title. At the time of sale of the property (which SA Water is advised of through arrangements with the Lands Titles Office), SA Water can enforce that charge.

That Act also provides SA Water with a right to effect the sale of land to which a water or sewerage retail service is provided, in the event that there is a payment default in relation to that service, and payment has remained in arrears for two years.

---

[1] Competitive neutrality aims to promote efficient competition between public and private businesses. Specifically, it seeks to ensure that government businesses do not enjoy competitive advantages over their private sector competitors simply by virtue of their public sector ownership. The Australian and all State and Territory Governments have agreed to implement competitive neutrality policies (refer to http://www.pc.gov.au/agcnco/competitive-neutrality).

It is recommended that SA Water's ability to recover debts from the landowner, and to use land as a security, be removed. Removing this power does not reduce risk to society but, rather, transfers the risk from landowners to SA Water.

1.2.1 Value to SA Water of First Charge Provision

The estimate of the potential impact of removing the first charge provision is based on assessing the potential impact on bad debt, in terms of the experience of other equivalent entities (i.e. a greater level of debt write-offs). It is recognised that any policy change of this nature can also have a potential one-off impact on profit and loss and cash flow.

As Victorian water entities are able to bill tenants directly for water usage and sewage disposal charges, the potential impact of removing first charge on land has been assessed by applying the Victorian experience using two approaches.

1.2.1.1 Approach 1 – Bad Debt/Total Debt

This approach estimates the amount of bad debt that SA Water would be likely to write off were it to experience the levels of bad debt writes-offs as a percentage of total debt that Victorian water entities experience.

Using the experience of Yarra Valley Water, City West Water, South East Water, Barwon Water and Southern Water over the same period, with the respective simple averages weighted by the Victorian water entities' respective customer bases, results in 'bad debt/total debt' value of 6.7 per cent.

The SA Water 'bad debt/total debt' has been calculated using the simple average of its performance over the 2009/10 to 2012/13 period, at 0.27 per cent.

The remitting ratio of 6.74 /0.27 per cent is then applied to the average value of SA Water debt write-offs over the period, to determine the estimated marginal impact of $3.1 million per annum.

At a discount rate of 6 per cent, this would represent a net present cost of $51.2 million.

1.2.1.2 Approach 2 – Bad Debt/Sales Revenue

This approach estimates the amount of bad debt that SA Water would be likely to write off were it to experience the same levels of bad debt writes-offs as a percentage of billed sales as its Victorian counterparts.

The procedure adopted is the same as for Approach 1, but with sales revenue values substituted for total debt.

The outcome is an increase in bad debt write-offs of around $4.0 million, a net present cost of $68 million, at a discount rate of 6 per cent.

Both approaches would appear conceptually reasonable, so the approach taken has been to determine the mid-point between the two approaches,[2] resulting in an estimated increase in debt write-offs per annum of around $3.6 million (net present cost of $60 million).

1.2.1.3 Change in Provision for Bad Debt

The increase in bad-debt write-off would result in the requirement for a one-off step increase in the provision for bad debt, which would adversely impact SA Water's Profit and Loss in a single year. Using the mid-point between Approach 1 and Approach 2, this results in a required provision value of around $3.6 million. Given the current provision of approximately $0.1 million, an increase in provision of $3.5 million would be required.

1.2.1.4 Debtor Days

Another area requiring consideration is whether increases in the level of bad debt would impact on debtor days, which might have a cash flow impact for SA Water.

The Inquiry has reviewed the percentage of debt greater than 60 days for a sample of entities. This review shows that SA Water has a relatively high percentage of debt outstanding at more than 60 days (21 per cent average over the period sampled).[3] This compares with the weighted average figure of 17 per cent for the sampled Victorian water entities.

On the basis of the sample taken, SA Water would appear to be already operating with debtor days at a level that might be expected were it to be billing tenants directly and, hence, no estimate of additional impacts for this area is considered warranted.

---

[2] It is noted that the 2012/13 SA Water financial statements comment that *the underlying revenue recognition principle is to recognise revenue in the period it is earned, rather than billed* (page 10). This may be one reason why both approaches do not arrive at the same estimate (i.e. it suggests that the bad debt figures may not align with the time period over which the revenue is determined), although even the reported bad debt written-off amount would be expected to relate to an earlier period than that applicable to most of the total debt. Nevertheless, for the purposes of this analysis, the two approaches are considered to produce estimates that are broadly consistent.

[3] In SA Water's case the figure used is % of debt past due more than 69 days.

The Essential Services Commission of South Australia

Level 1, 151 Pirie Street Adelaide SA 5000

GPO Box 2605 Adelaide SA 5001

T 08 8463 4444

E escosa@escosa.sa.gov.au | W www.escosa.sa.gov.au