



WATER CUSTOMER SERVICE CODES
REVIEW 2012

REGULATION OF DEBT MANAGEMENT
POWERS: FINAL DECISION

DECEMBER 2012



An appropriate citation for this paper is:

Essential Services Commission 2012, *Water Customer Service Codes Review 2012, Regulation of debt management powers: Final Decision*, December.

Our reference: C/12/36284



CONTENTS

1	Summary of key points	1
2	Background	3
3	Debt management powers	5
4	To whom will interest apply?	7
5	The maximum rate of interest.....	11
6	Disclosures and notice periods	16
7	Charge over customer property	17
8	Implementation	19



1 SUMMARY OF KEY POINTS

The *Water Amendment Act* came into force in 2012 and has changed the debt management powers of Victoria's water businesses. We have some responsibility over the implementation of the changed powers, and have altered our Customer Service Codes to exercise this responsibility.

The changes will not reduce the strong emphasis in our Customer Service Codes on customer engagement, transparency, and early intervention to resolve debt payment problems.

Our final decisions are:

- water businesses may charge interest on unrecovered amounts
- interest on unrecovered amounts will not apply (or be waived) to customers with concession cards and/or customers in financial hardship
- we will set a maximum, annualised, compounding rate of interest that uses:
 - the 10 year Commonwealth bond rate as the base rate
 - a borrowing margin determined at a price review
- the rate of interest will be updated annually on 31 May, preceding each new financial year and applied from 1 July each year
- all customers, residential and non-residential, will have the same maximum rate of interest
- we will extend the existing disclosure and notice periods in the Urban Code to cover metropolitan water businesses
- a charge on property will apply where the customer owns the relevant property



- we will implement the changes to the Customer Services Codes as of 1 July 2013
- metropolitan water businesses will not be able to charge interest on debt accrued before 1 July 2013
- until 30 June 2013, the transitional interest rate of a maximum of 10 per cent for regional and rural water businesses will apply.



2 BACKGROUND

The *Water Amendment (Governance and Other Reforms) Act 2012 (Water Amendment Act)* amended a number of sections in the *Water Industry Act 1994* (Water Industry Act) and the *Water Act 1989* (Water Act).

These amendments have changed Victorian water businesses' debt management powers (see table 2.1). The two changes covered by this paper are:

- metropolitan businesses are permitted to apply a charge over property to recover debt (regional and rural water businesses already have this power)
- metropolitan water businesses are now able to charge interest on customers' debts (regional and rural water businesses already have this power).

Table 2.1 Summary of debt management powers

	Powers enabled by legislation		
	Metropolitan water business	Regional water business	Rural water business
Charge over property	✓ (new power enabled by legislation)	✓	✓
Garnish rent from tenant	✗	✗ (power removed by legislation)	✗ (power removed by legislation)
Sell customer land	✗	✗ (power removed by legislation)	✗ (power removed by legislation)
Charge interest	✓ (new power enabled by legislation)	✓	✓

We have determined how these changes will be implemented through the *Customer Service Code - Urban Water Businesses* (Urban Code) which covers retail water services and sewerage services, and the *Rural Water Customer Service Code* (Rural Code) which covers irrigation, and stock and domestic services.



Consultation

Our consultation process on the changes to the Customer Service Codes was carried out in three stages: the release of a consultation paper; a public forum; and the release of a draft decision.

Our consultation paper, *Water Customer Service Codes Review 2012, Regulation of debt management powers: Consultation paper*, was released in September 2012. We received written submission on this paper and also conducted a public forum on Monday 17 September 2012 to discuss the consultation paper and the questions it raised.

Submissions to the consultation paper and the public forum have been taken into account in this Final Decision.

Our draft decision, *Water Customer Service Codes Review 2012, Regulation of debt management powers: Draft decision*, was released in October 2012. We received submissions from the following interested parties:

- a joint submission from: the Consumer Utilities Advocacy Centre, Consumer Action Law Centre, Victorian Council of Social Services (VCOSS), Community Information and Support Victoria, Uniting Care Kildonan, National Seniors Australia, Financial and Consumer Rights Council, and St. Vincent de Paul Society Victoria. This submission is referred to as the 'joint submission'
- Central Highlands Water
- Coliban Water
- East Gippsland Water
- Gippsland Water
- Goulburn-Murray Water
- Lower Murray Water
- South Gippsland Water
- Southern Rural Water
- Wannon Water
- Yarra Valley Water.

Comments from these submissions have been taken into account in this Final Decision.



3 DEBT MANAGEMENT POWERS

The *Water Amendment Act* provides that the Commission may make a Code relating to water businesses charging customers interest on unrecovered amounts, and on recovering unrecovered amounts via a charge over a customer's property. These debt recovery powers have been available to regional water businesses for many years and may now apply in metropolitan areas.

The *Water Amendment Act* enables the Commission to make Codes which provide for any matter relating to the recovery of debts by water businesses including:

- specifying any person or class of person in respect of which powers to charge interest on unrecovered amounts may be used; and
- the maximum rate of interest that may be charged on unrecovered amounts¹; and
- whether a charge on a person's property under section 274(4A) of the *Water Act* will apply.

In making its decisions, the Commission has been guided by the purpose of the legislation as described in the Second Reading Speech on the *Water Amendment Act*²:

The Water Act will keep two debt management powers, being the ability to charge interest on unpaid moneys and providing that debts owed to a water corporation form a charge on the land to which they relate.

It is appropriate to leave these remaining debt recovery powers in the Water Act to assist the water corporations in recovering potentially significant debts of hundreds of thousands of dollars accrued by some large commercial water users.

It is not fair for all water customers to subsidise the cost of these debts through the price of water.

¹ Prior to the *Water Amendment Act*, the Governor in Council set the maximum rate of interest that could apply.

² VicHansard Second Reading Speech 15 March 2012 *Water Amendment (Government and Other Reforms) Bill 2012*, p. 1053.



However, the bill will also ensure that a water corporation's use of these two remaining powers can be regulated by the Essential Services Commission through a customer service code for water services, in consultation with the community, to make sure use of these powers is appropriate and sensitive to the needs of those in our community facing financial hardship.

We interpret the second reading speech to mean that:

- water businesses should be able to charge interest
- the Commission should set an interest rate cap that is fair, taking into consideration:
 - the commercial needs of the water businesses
 - the impact on customers more widely
 - the needs of customers in hardship.

When exercising our powers we are guided by our legislated objective to promote the long term interests of Victorian consumers having regard to the price, quality and reliability of essential services.



4 TO WHOM WILL INTEREST APPLY?

The *Water Amendment Act* provides us with the power to specify any person or class of person on whom powers to charge interest on unrecovered amounts may be used.

When deciding to whom interest will be charged we have taken several considerations into account:

- the Second Reading Speech, which indicated that the Government intended that the power to charge interest was to apply broadly with the exception of customers in hardship
- customers should meet the costs of the services they have received from a water businesses
- water businesses should only use their debt management powers to recover the costs they incur as a result of customer non-payment.

In our draft decision, we proposed that interest would apply to all customers except for customers in hardship and customers on concessions.

Stakeholder feedback

Submissions on our draft decision included three main types of comment:

- support or opposition to our proposal
- opposition to our proposal on the basis that it would be administratively difficult
- that such exemptions would result in incentives for customers who were able to pay, not paying their debts.

Some submissions supported our proposal that concession card holders should be exempt from interest charges. Wannon Water said that concession card holders should not be charged interest on overdue amounts. The joint submission stated that interest should not be charged on any debt, but if interest must be charged, customers with concession cards and/or customers in hardship should be exempt.



In addition, the joint submission stated that customers who had lodged an application for a concession card should not be subject to legal action or restriction.

The joint submission also said that:

- customers on payment plans and those who had demonstrated a commitment to pay should not be charged interest
- water businesses needed to provide more support to customers to meet their payment obligations.

Some submissions did not agree with our proposal to make concession card holders exempt from interest charges. Central Highlands Water, Coliban Water and East Gippsland Water said that interest should apply to concession card holders.

Some specific comments included:

- East Gippsland Water said that all customers should be subject to the same penalties for non-payment.
- South Gippsland Water said that concession card holders should be charged interest because they already received a reduction in their accounts and that exempting concession card holders discriminated against self-funded superannuation retirees who did not receive the same benefits but may still face the same financial challenges.

Some submissions argued that it would be administratively complicated to exempt customers on concession cards from interest charges. Comments included:

- Yarra Valley Water stated that there are administrative costs in not charging interest to concession card holders because many customers move on and off concession eligibility over the course of a year.
- East Gippsland Water stated that “some customer groups regularly move in and out of concessional benefits and this will incur increased administration effort and cost to decide when interest stops and starts or is exempted.” East Gippsland Water requested clarification on when interest should be waived.
- South Gippsland Water questioned whether a customer should only be exempt from interest if they hold a concession card on the day their bill is issued or are they exempt if they hold a concession card during any day of the billing period.



South Gippsland Water stated that if pensioners knew they were not being charged interest they may not pay their accounts and would be put at risk of restriction for non-payment.

Discussion

In our view, a maximum interest rate should apply to water customers with exemptions as described below. It is important that customers who are able to pay their debts to water businesses do so and do not oblige other customers to subsidise their lack of payment. The possibility of interest charges will provide an incentive for customers to pay their water bills on time.

The Commission will set a maximum rate of interest, but water businesses are not obliged to charge interest, or may charge it at a lower rate.

The Water Act provides us with the ability to exempt classes of customers from interest payments. Our view is that we have a responsibility to ensure that customers in financial difficulty are not unduly disadvantaged by the debt management process.

Our view is that concession card customers and customers in hardship should be exempt from interest charges to protect low income and vulnerable customers.

With regard to possible administrative difficulties for water businesses, our view is that given that water businesses already have relevant concession card holders and customers in hardship identified in their systems, this option is feasible for water companies to implement. We have amended the Urban Code to include a definition of eligible concession cards based on the concessions identified in the Victorian Department of Human Services' *'State concessions and hardship programs 2010–11'*.³

Our view is that the exclusion of concession card holders from interest charges will not be unduly onerous for water businesses. Information provided by the Department of Human Services suggests that most concession card holders have a concession card for an extended period of time, thus making the possibility of an individual frequently moving in and out of concession status less common. In any event, if a customer is frequently going on and off concession because of changes

³ Department of Human Services; *State concessions and hardship programs 2010–11*, March 2012, p. 3.



in employment status or health they should also be considered for hardship assistance.

Our view is that these exemptions will not provide strong incentives for delaying or avoiding repayment of debt by those exempted from interest. This is particularly so given that water businesses have a range of debt management tools.

Final decision

- Water businesses may charge interest on unrecovered amounts
- interest on unrecovered amounts will not apply (or be waived) to customers with concession cards and/or customers in financial hardship.



5 THE MAXIMUM RATE OF INTEREST

We are required by the *Water Amendment Act* to decide on the maximum rate of interest that may be charged on unrecovered amounts. The *Water Amendment Act* specifies that:

The Essential Services Commission may fix a maximum rate

- by expressing it as a percentage; or
- by tying it to a specific floating institutional rate charged for loans or paid for borrowings by a public or commercial institution.

In our considerations on this matter we were guided by:

- the Second Reading Speech which indicated that the purpose of the interest charge was to recover the costs of non-payment
- our principle that water businesses should only use their debt management powers to recover the debt and interest costs they incur as a result of customer non-payment.

In our draft decision we proposed to set a maximum, annualised, compounding rate of interest that used:


- the 10 year Commonwealth bond rate as the base rate
- a borrowing margin determined at a price review.

Our draft decision included an indicative maximum interest rate of 6.7 per cent.

Stakeholder feedback

Submissions on our draft decision on how to set a maximum interest rate covered three main areas:

- the level of the interest rate for rural customers needed to be higher than the indicative figure of 6.7 per cent to match customers' other interest costs
- there should be different interest rates for different categories of customers

- 
- the need for the interest rate to be higher to cover administrative costs associated with debt recovery.

Some submissions did not think the indicative interest rate of 6.7 per cent in our draft decision was appropriate given rural customers' other interest costs.

Lower Murray Water was concerned that if the interest rate was not above business lending rates, customers would use their water bills as a source of credit. Lower Murray Water said this was a bigger problem in rural areas where the agriculture sector is experiencing difficulties and farmers are having a harder time obtaining finance.

Southern Rural Water said that the interest rate should be at least 10 per cent and should be higher than current overdraft rates.

Coliban Water said that the rate of interest should be a higher rate than customers' alternative interest rates to incentivise customers with debts to engage with their water business.

Coliban Water recommended that the Commission consider changes in the level of the Financial Accommodation Levy when setting the debt margin.

Wannon Water does not support setting a higher interest rate for rural customers provided that the penalty interest rate is set with reference to the *Penalty Interest Rates Act 1983*. It did not agree with the Commission's view that having a penalty interest rate is inconsistent with the *Water Act 1989*.

Some submissions discussed the need for the interest rate to be higher to cover the administrative costs associated with debt recovery.

East Gippsland Water stated that the code sets out 'to define a rate of interest that reflects the costs to a business of non-payment', but the Commission had not taken into consideration the administrative costs of calling customers, sending out letters, visiting customers, and taking legal action or restricting customers.

Coliban Water said that there are a number of costs involved in debt collection beyond the cost of holding debt.



South Gippsland Water said that exempting concession card customers from interest charges will require them to arrange modifications to their billing systems with their programmers which would cost approximately \$3500.

Goulburn-Murray Water (G-MW) suggested charging an additional 2 per cent on top of any interest rate to cover administration costs, as is done by IPART in NSW. G-MW stated that the interest rate should be high enough to cover a water business's cost of debt, act as a deterrent, and to fund administrative costs of managing the debt.

The following submissions discussed the issue of different interest rates for different classes of customers.

G-MW said that there should be different interest rates for residential and commercial customers. This is because commercial customers use water as an input in production and have a higher cost of debt than residential customers. G-MW said that when the interest rate had been reduced to 10 per cent (by the transitional arrangements in the Customer Service Code) there had been an increase in outstanding debts greater than 90 days. If the interest rate were to drop a further 3.3 percentage points to 6.7 per cent, the debt could potentially increase again. G-MW said that an interest rate of 6.7 per cent is less than half of what the majority of its customers would pay on unsecured debt and less than the penalty that would be charged by other suppliers.

Southern Rural Water's (SRW) submission did not support one consistent interest rate across all classes of customers. SRW stated that there should be a different interest rate for rural businesses because SRW was concerned about the prospect of becoming a cheap source of rural finance. SRW said that agribusiness overdraft rates at 14 November 2012 ranged from 7.67 per cent to 13.5 per cent, which is higher than the indicative interest rate in the Commission's draft decision. SRW said that keeping the interest rate below the overdraft rate incentivised customers to pay as late as possible resulting in more staff time pursuing debt recovery and more costs to the overall customer base. SRW said that the interest rate should be at least 10 per cent and should be higher than the current overdraft rates.

SRW said it did not have sufficient methods to ensure that customers paid their bills on time. Currently, SRW can stop supply to irrigation customers if they did not pay their bills. However, some customers do not pay their bill at the end of the



irrigation season, have their water turned off and do not pay until the next season when they require water again. SRW said that it is their policy to only use water restrictions as a last resort. SRW said that it could not restrict unregulated license holders. Therefore the only action they could take against them for non-payment is to cancel the licence.

Lower Murray Water is concerned that if the interest rate is not above business lending rates than customers will use their water bills as a source of credit.

East Gippsland Water said that all customers should have the same maximum rate of interest but noted that different mortgage, commercial and personal loan rates provide different motivations for customers to pay.

Discussion

In general, responses favoured our approach to interest rate setting.

The discussion on the appropriate rate of interest focussed on the rural sector in which water costs were business inputs, debts were more likely to be managed in a commercial context and where changes in financial incentives could change customer behaviour.

In our consideration of the maximum interest rate for rural areas the following matters were weighed heavily.

Our view is that the interest rate should reflect the costs to the water business of overdue debt rather than providing water businesses with funds that exceed the costs of overdue debt. If the process of debt management increases businesses' costs, they can apply for a charge to cover their real costs of debt management through the price review process if these exceed the administration costs already provided for.

Our view is that water businesses have sufficient powers to compel payment and that interest charges are not the only available means. Water businesses, including rural water businesses, have tools to manage debt in addition to the interest rate which have not been used extensively in the past and could be relied on more to recover debt. Such tools include suspension or restriction of supply service and legal action. Our discussions with, and submissions from, rural businesses showed



a reluctance to use some of the existing debt collection tools such as legal action. It appears appropriate, as in other industry sectors, to adopt legal action where commercial customers' debts are large. An interest rate higher than the cost of unpaid debt would provide an incentive for businesses to passively manage debt rather than intervene early in cases of non-payment. The changes to debt management powers brought about the *Water Amendment Act 2012* will require rural businesses to consider changes to their debt management practices.

Our view is that the differential between our indicative rate and the overdraft rates available to rural commercial customers is unlikely create substantial problems of incentives for non-payment. We observed that many businesses do not apply interest and this does not unduly affect their financial circumstances. Large commercial debts, where incentives could play a role, are the more obvious candidates for legal action, where a penalty rate could also be available.

We will monitor data of debts owed to water businesses to ascertain the impact of the new interest rate.

The transitional interest rate of 10 per cent will continue to the end of June 2013 to enable businesses to make changes to billing systems and debt management processes.

Final Decision

We will set a maximum, annualised, compounding rate of interest that uses:

- the 10 year Commonwealth bond rate as the base rate
- a borrowing margin determined at a price review.

The Commission will update its calculation based on market conditions on 31 May each year. The interest rate to be applied would then remain fixed from 1 July for the coming financial year. All customers, residential and non-residential, will have the same maximum rate of interest. The interest rate would be indicated on customers' bills according to the disclosure requirements in the Codes.

As an indication of the possible interest rate to apply from 1 July 2013, if the rate were set under present conditions, it would be 6.9 per cent.



6 DISCLOSURES AND NOTICE PERIODS

It is important to ensure that consumers are provided with information about interest powers, by specifying disclosure and notice periods that must be adhered to by water businesses prior to debt management powers being used.

In our draft decision we proposed to extend the existing disclosure and notice periods in the Urban Code to cover metropolitan water businesses.

Stakeholder feedback

The joint submission strongly supported the Commission's decision to extend the existing disclosure and notice periods in the Urban Code to cover metropolitan water businesses.

Final decision

We will extend the existing disclosure and notice periods in the Urban Code to cover metropolitan water businesses.



7 CHARGE OVER CUSTOMER PROPERTY

Under Section 4F(2) of the amended *Water Industry Act 1994*, the Commission must decide for all water businesses:

whether a charge on a person's property under section 274(4A) of the Water Act 1989 will apply.

The charge over a property means that the water business can recover money owed to it, both principal and interest, when a property is sold, if the debt belongs to the property owner.

This charge was available to rural and regional businesses but has only been available for use by metropolitan businesses for their water and sewerage services since the passage of the *Water Amendment Act 2012*.

In our draft decision we proposed that the charge on property apply to all water customers.

Stakeholder feedback

Some submissions supported the extension of powers that allow a water business to place a charge over a property if a customer does not pay their water bill to metropolitan water businesses. Wannon and East Gippsland Water said that a charge over a property should apply.

The joint submission:

- did not support the application of the charge over property
- said that if a charge were to apply, it is essential that the costs associated with lodging and removing a charge over a property not be passed on to customers once the debt had been repaid. The water business must also remove the charge once the debt has been repaid.



Discussion

Our view is that the charge over property provides water businesses with a means of recovering debts that would otherwise be paid by other customers. We expect that water businesses will make full use all of the available tools of debt management and avoid passively managing debt.

Final decision

A charge on property will apply where the customer owns the relevant property.



8 IMPLEMENTATION

In our draft decision we proposed that

- we would implement the changes to the Customer Services Codes as of 1 July 2013
- metropolitan water businesses would not have the ability to charge interest retrospectively
- until 1 July 2013, the transitional interest rate of a maximum of 10 per cent interest for regional and rural water businesses will apply.

Stakeholder submissions

Water businesses described the difficulties they could face implementing the changes. These comments were outlined in Chapter 5. From our discussions with water businesses, they made clear that they would prefer additional time to make adjustments to their systems.

Discussion

Our view is that the changes to the debt management parts of the Customer Service Code should commence on 1 July 2013 to provide metropolitan water businesses with time to adjust their billing systems.

Our view is that a transitional maximum interest rate of 10 per cent should apply to regional and rural water businesses until 30 June 2013 after which a new rate will be applied. This will provide these businesses with time to adjust to the changes in the interest rate on 1 July 2013.

Our view is that metropolitan water businesses should not be able to apply interest on debt accrued prior to 1 July 2013 given that they cannot charge interest until 1 July 2013.



Final decision

Our final decisions are:

- we will implement the changes to the Customer Services Codes as of 1 July 2013
- metropolitan water businesses will not be able to charge interest on debt accrued before 1 July 2013
- until 30 June 2013, the transitional interest rate of a maximum of 10 per cent for regional and rural water businesses will apply.