

**Review of TRANSCO  
provision for bad debts**

Supplemental to TRANSCO  
regulatory reset filing for 2006-2010

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## **1 Introduction**

This note records the outcome of LECG's review of TRANSCO's forecast provision for debt write offs during the second regulatory period. As required by section 4.11.4 (d), this report assesses whether TRANSCO's forecast is reasonable with respect to recovery of bad debts and a strategy for improving debt collections is provided.

## **2 Summary of conclusions**

TRANSCO's forecast with respect to bad debts is reasonable. It has in place an effective strategy for reducing the level of bad debts incurred over the forecast period and for ensuring collections, where required, subject to legal obligations.

The level of bad debts being incurred is equivalent to 0.2% of total annual operating expenditure. TRANSCO is forecasting a steady reduction in bad debts over the forecast period, from 0.2% to 0.15%. This reduction reflects the implementation of improved credit control.

As contractual arrangements inherited from NPC roll-off, TRANSCO is able to implement improved credit management, notably by way of a requirement for customers to provide security deposits or bank guarantees. This can be expected to reduce the level of bad debts incurred. Inherited contracts are long duration and roll-off only gradually. Many inherited contracts will still be in place at the end of the regulatory period. Accordingly, there needs to be a provision for some bad debts.

## **3 Process**

This report was prepared on the basis of information supplied by TransCo in a memorandum dated 22 July and discussions at a meeting with TransCo's finance group on 19 August 2005.

## **4 Current status of bad debtor levels**

Transco currently has a modest bad debtor problem. Bad debts are modest as a percentage of revenue.

A low level of bad debtors is not unexpected given TRANSCO's position in the electricity supply chain. Its customers are other utilities and large end-use customers. This compares with distributor/retailers, whose customers include small business and households.

The table below illustrates the historic level of bad debts as a percentage of total regulated revenue, for the period following the NPC rate unbundling. The average bad debt over the period is 0.2%.

Year	2003	2004	2005 (6 months)
Regulated revenue PhP Mn	23,959.76	24,220.18	12,369.40
Bad debts expense PhP Mn	44.33	49.71	25.53
% of regulated revenue	0.185%	0.205%	0.206%

In part, the current debtor problem reflects TRANSCO's inheritance of contractual arrangements from NPC. Under these inherited arrangements, TRANSCO is not able to require a security deposit or bank guarantee from customers.

The current credit and collection policies now operated by TRANSCO may be applied fully only to new customers or as existing contracts are terminated and renewed. These measures can be expected to result in an even lower level of bad debtors.

## 5 Forecast bad debts

Over the second regulatory period, TRANSCO is forecasting a gradual reduction in the level of bad debtors. This reflects the phased implementation of TRANSCO's credit and collections policy made possible as inherited contracts are renewed. Under these policies, on contract renewal, customers will be required to meet a credit worthiness test and may be obliged to deposit a bond or bank guarantee.

Accordingly, TRANSCO is forecasting a steady downward trend in bad debtors as a percentage of regulated revenue over the second regulatory period. TRANSCO's forecast with respect to the trend in bad debts is reasonable.

TransCo's forecast is provided in the table below.

	2006	2007	2008	2009	2010
Bad debt provision PhP Mn	70	86	103	123	146
Proportion of SMAR	0.20%	0.19%	0.18%	0.16%	0.15%
SMAR PhP Mn	34,969	45,627	58,984	75,839	97,511