

CREDIT
AND
COLLECTIONS
IN THE
UTILITY INDUSTRY
2004

Reprinted with permission



Chartwell

Your link to the energy library

CHAPTER 5

Balance transfers

Examining the hidden costs and effectiveness of bad-debt balance transfers to active accounts

ACKNOWLEDGEMENTS

The authors would like to thank the following individuals for their assistance in gathering this important data: Robin W. Segur, Section Manager, Credit and Collections, Consolidated Edison Co.; Tony Simas, Manager, Credit & Collections, NSTAR Electric/Gas; and Chuck Bedall, Supervisor Revenue Recovery, Dominion Virginia Power Co.

Editor's note: This chapter is a special contribution by Bruce A. Gay, President, Monticello Consulting Group Ltd., and Robert M. Hall, Vice President, Marketing, InoVision, a Marlin Company LLC.

Utilities across the U.S. and Canada are focusing on bad debt and its overall impact on financial performance. As part of most debt recovery programs, nearly all electric and gas utility companies transfer charged-off (bad debt) balances to active accounts, if and when the former ratepayer (debtor) applies for new service or is found with an active account. These balance transfers consist primarily of residential and small commercial charged-off accounts. Individual state regulations, local rules and company procedures often dictate how balance transfers are handled, but utilities have long-considered the process of transferring old debt to active accounts a very successful and effective collection process.

The assumption with bad-debt transfers is that an active account holder will be motivated to maintain service and pay the current bill, as well as any outstanding debt from a previous account. Recently, however, due to the increased industry emphasis on reducing bad debt and cost cutting, two companies serving the utility industry have examined the actual, long-term performance of the balance transfers. In association with several large utility companies, Bruce A. Gay of Monticello Consulting Group and Bob Hall of InoVision have developed a comprehensive case study on the topic.

This chapter will summarize the results of the study, including how different utilities handle transferring bad debt, discuss the "hidden" costs of transfers and provide actual results of the long-term economic effectiveness of the process. The authors also identify targets for process improvement and discuss their conclusions.

Consolidated Edison, NSTAR Gas and Electric and Dominion Virginia Power participated in the case study. Each company provided 12 months of detailed, historical information on their bad debt balance transfers, including transferred balance amounts and subsequent payment history for at least 12 months. In addition, complete post-transfer delinquency history data was collected for each account, including the number of disputes, deferred payment agreements, delinquent notices sent, and termination activity. The latter data was used to analyze the associated or hidden costs of transfers.

How utilities handle bad debt transfers

Utilities find debtors responsible for charged-off accounts in several ways. At the time of application for new service, many companies check name and social security numbers of applicants against their database of charged-off accounts. In other cases, utilities routinely check their entire active customer-base for matching personal information from charged-off accounts. Once an individual or company is

matched to a charged-off debt and an active account, the utility then transfers the balance to the active account, either manually or automatically, depending on the situation and company procedure.

In some states, utility companies can deny service to and demand payment from applicants with outstanding debt obligations. In other states, utilities cannot deny service to applicants with an outstanding debt. A typical bad-debt balance transfer process is shown in Figure 1. The entire process is illustrated to highlight post-transfer activities and the handling of subsequent delinquency on the transferred account, which is the basis of the case study.

Once the transfer of bad debt is executed, many utility companies record the transaction as a 100% recovery of the balance that was transferred. There are, however, a number of problems with recording transfers as a full recovery. First, it ignores the very real possibility the actual collection could be less than 100%, or that the old debt will never be paid. Next, booking the transfer balance as a full recovery may erroneously reduce FERC 903 Charge-Off accounting balances, resulting in a distorted view of a utility company's financial picture.

Bad-debt balance transfers also present accounting problems and other process issues for utilities. For example, once a transfer is completed, many companies treat the old delinquent balance as a current receivable vs. an aged receivable. As a result, the debtor is afforded additional time before delinquency action is under-

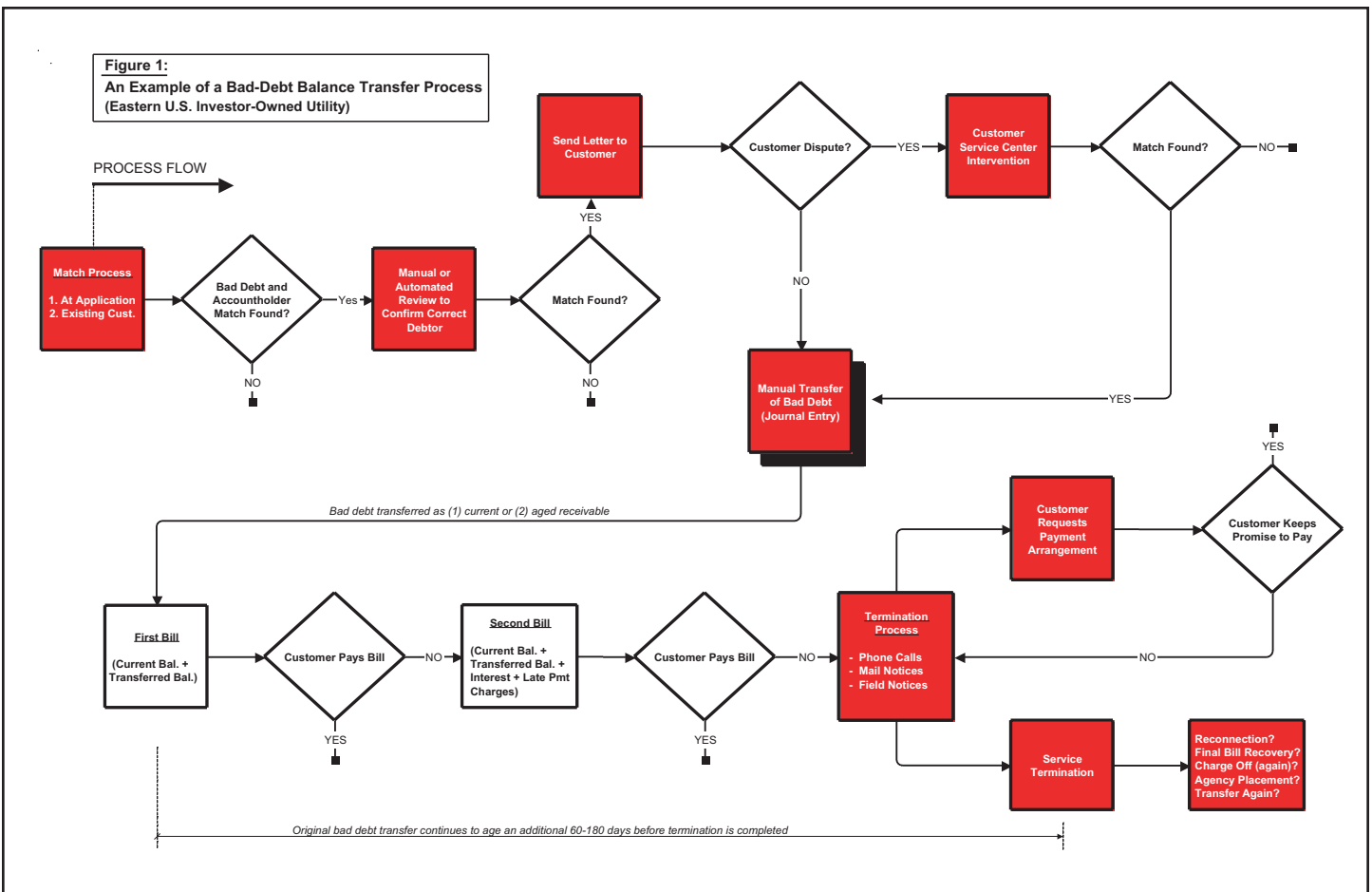


Table 1: Hidden Cost Example

	Annual Costs
Manual Transfers to Active Accounts	\$53,994
Calls to Phone Answering Center	\$31,390
Disputed/Escalated Customer Inquiries	\$73,001
Deferred payment Agreements	\$49,080
Out-Bound Collections (Courtesy) Calls	\$27,120
Handling Over-the-Counter Payments	\$23,558
Total Annual Hidden Costs: *	\$258,143

* Note: Represents key cost-intensive activities only. Other cost activities not shown

Table 1 is based on an analysis of associated balance-transfer costs for one participating utility over a 12-month period.

taken on the active account. Ultimately, termination is delayed and the overall delinquency is potentially increased. Moreover, by transferring the bad debt to the active account, many utilities are required to grant the account holder liberal payment arrangements on the old debt as well as any new delinquency. Consequently, both the transferred debt balance and any new receivable are at risk of non-payment and further aging.

The hidden costs associated with transfers

Utilities have traditionally viewed the costs associated with bad debt transfers as minimal, with little negative impact to the company. In reality, there is a significant level of work associated with the transfer process that spills over and impacts other areas, including such groups as the customer contact center, power distribution, and mail distribution. As illustrated in red in Figure 1 on the previous page, various groups are required to handle customer inquiries, disputes, correspondence, deferred payment agreements, delinquency notices and termination activity on post-transfer accounts. Many of these steps cannot be avoided and are dictated by regulatory agencies, such as a state public service commission.

Furthermore, all these steps add costs. For the participating utilities, the average annual hidden costs ranged from \$20 to \$46 per transfer. Of course, each utility has different processes and labor cost structures, which explains the variation in these per unit transfer costs. Nonetheless, when these hidden costs are added to the actual, long-term net benefit of transferred debt, utilities are surprised to learn that their overall bad-debt balance transfer process is yielding much less than realized. In fact, in some cases, the long-term economic results are negative, with subsequent write-offs exceeding all the cumulative payments on the original transferred balances.

An example of these hidden costs is illustrated in Table 1, shown at the top of the page. The key cost-intensive activities represented in the table include the labor to manually transfer balances, handle disputes and inquiries, process payment agreements and receive payments. As shown in Table 1, one participating utility had annual costs of over \$258,143 associated with its bad-debt transfer program. These costs directly offset its post-transfer recoveries, and should be deducted in order to obtain an accurate net recovery for the program.

Table 2: NSTAR Electric & Gas

	Total Bad-Debt Bal. Transferred (12 Month Period)	Cumulative Payments on Old Debt (12 Months After Transfer)	Subsequent Charge-Offs (Accounts Charged-Off Again)
Total Dollars	\$559,335	\$316,017	\$315,782 *
Percentage of Total Dollars	100%	56%	56%
Total Accounts	2,123	1,341	579
Percentage of Total Accounts	100%	63%	27%

* *Note: 64% of total new charge off balance is from previous transferred dollars; and 36% is from the transferred "to account."*

Table 2 shows the amount of charged-off debt transferred to active accounts during a 12-month period at NSTAR, along with amount recovered on those accounts and subsequent charge-offs.

The long-term results

In addition to process and handling costs associated with post-bad-debt transfers, the long-term financial results were analyzed at each utility in the case study. Specifically, accounts with bad-debt balance transfers were analyzed over a one-year time period. Payment history, balance and account status information was then collected for each account after a 12-month time period.

Table 2 shows the results at NSTAR Electric and Gas. In this case, NSTAR transferred \$559,335 worth of charged-off debt to active accounts during a 12 month time period. One year after the date of transfer, cumulative payments on the original transferred balances totaled \$316,017. That is, after 12 months, 63% (1,341 accounts) of the debtors had paid about 56% (\$316,017) of the original bad debt balance.

However, further analysis reveals that 27% (579 accounts) of the debtors subsequently charged-off again for an additional \$315,782, which represents a combination of old debt and new account charges. In the final analysis, NSTAR Electric and Gas subsequently charged-off almost the same exact amount as it had recovered on payments from accounts with bad-debt transfers.

Table 3, shown at the top of the next page, shows similar results using data associated with new services at Dominion Virginia Power. In this case, Dominion transferred over \$707,489 worth of charged-off debt to new accounts during 2001, creating an initial average balance of \$192 at the time of turn-on. One year later, a review of these same accounts showed that the balances had increased 116% to a total due of \$1,528,577, creating an average balance of \$415. According to Chuck Bedall, supervisor revenue recovery at Dominion, "one of the significant findings during the review was the fact the traditional practice of transferring bad debt charge-offs to active accounts was not only counter productive, it also created larger account balances at the new service account which ultimately charged off in amounts equal to or greater than the original charge-off transfer amount."

Conclusions

Collection and recovery managers at utility companies are increasingly focusing on reducing bad debt and improving overall collection processes. Clearly, bad-

Table 3: Dominion Virginia Power

	Total Number Transfers to New Accounts (Turn Ons) (During 2001)	Account Balances on Original 3,683 accountss (12 months Later)
Total Accounts	3,683	
Total Dollars	\$707,489	\$1,528,577 *
Average Account Transfer / Balance	\$192	\$415
Percentage Increase		116%

* Note: Includes balances from previous transferred dollars and unpaid balances from "To Account"

The chart in Table 3 shows that account balances at Dominion actually increased 116% 12 months after the charged-off debt was transferred to active accounts.

debt transfers play an important role in a utility's overall collection program. However, it is evident from the case study that the actual results may be drastically less than expected or assumed at many utility companies. To accurately measure the effectiveness of a balance transfer program, hidden costs, as well as the long-term financial results, need to be identified and measured.

Once costs and long-term results are measured, utilities have an opportunity to dramatically improve their transfer programs (i.e., collections) through process improvement, including the selection of debtors and accounts for transfers, the sequential prioritization and handling of post-transfer delinquencies and alternative recovery programs, including third-party collections and the sale of certain accounts.

Several of the companies participating in the case study have already initiated changes aimed at improving their transfer processes. For instance, Dominion Virginia Power now requires payment of any old debt within 10 days of account activation. Other companies are reviewing process changes in light of the case study results.

The authors are continuing their research on the handling of bad debt at utility companies, including bad-debt balance transfers. This case study is ongoing and additional, in-depth results are expected in the future. Readers are encouraged to contact the authors for additional information. Bruce A. Gay can be reached at (610) 240-7960 or bruce.gay@comcast.net. Bob Hall can be reached at (704) 847-8828 or bob@inovisioninc.com.

w w w . c h a r t w e l l i n c . c o m

Chartwell Inc.
2964 Peachtree Road NW
Suite 250
Atlanta, GA 30305
(800) 432-5879
(404) 237-9099
Fax: (404) 237-5334



Chartwell

Your link to the energy library

Reprinted with permission

©Chartwell Inc., 2004