

US utility debt sale has improved, with sellers and purchasers working more harmoniously and providers becoming more focused on financial performance. **Bruce Gay** looks at the factors which have spelt success

US debt lessons



The overall debt sale market in the United States (US) has grown since the late 1980s. Some industry experts estimate the total annual charge-off sales market now exceeds \$60bn.

Until the late 1990s, most debt sales originated from banks and other consumer credit issuers. Today, a number of service-based industries, including electric and gas utilities, are discovering the benefits of selling bad debt.

Numerous utilities have sold portfolios. Dozens of others are seriously considering selling off their charged-off debt. Several of the larger, investor-owned utilities are now selling receivables under forward-flow contracts.

US utility trends

The US electric and gas utility industries are becoming less regulated and more competitive. Over the last two decades, federal acts have stimulated competition.

During the mid-1990s, several states passed legislation which would eventually allow end-use consumers the ability to choose their electric generation suppliers.

Many of the same states began to allow new competition for local distribution companies (LDCs) in supplying natural gas to retail consumers. Currently, two-thirds of the states have increased retail competition for residential and small commercial consumers.

As electric and gas industries move toward de-regulation and increased competition, energy providers are becoming more focused on financial performance.

Industry consolidation is also underway, forcing companies to look for new revenue opportunities. Outsourcing of non-core functions is gaining popularity throughout the industry.

Utilities recognize the need to improve collections practices. Many collection and recovery managers are starting to outsource their receivables management activities due to the high capital cost of an in-house collection operation, and the difficulty of developing collection expertise.

Vendors specializing in receivables management are proving to be more cost efficient.

One of the newest recovery tools for utility companies is selling bad debt.

Distressed debt

Electric and gas providers have found numerous benefits to selling their charged-off accounts.

- Increased cashflow.
- Improved financial performance recovery.
- Reduced administrative costs.
- Elimination of uncertain collection results.
- Elimination of aged accounts.
- Improved management productivity.
- Sends message debts will not be forgiven.

Initially US utility companies were concerned about the benefits and risks of selling bad debt. Since the concept was new in the industry, many executives had to be convinced there were sound economic reasons to sell delinquent accounts rather than continue traditional collection activity.

Moreover, there was significant concern on how a sale would be viewed by the state public utilities commissions. Some experts did not think it would be allowed under the existing regulations.

Aside from the regulatory issues, utilities worried about negative publicity from debtor complaints or legal actions. Utilities feared sold account holders would inundate call centers with complaints, causing an outcry among existing customers. Excessive and prolonged call centre activity could even negate the financial benefits of a sale.

Other utility companies were troubled with the idea of losing control of accounts after the sale, fearing debtors may be subjected to unlawful collection practices.

Best practices

Since the late 1990s, nearly all US utility debt sales have been successful. As the utility debt sale market evolves, sellers and buyers are developing best practices.

The initial concerns utilities had regarding regulatory constraints, legal issues and negative publicity have been overcome through a systematic approach.

First, utility companies are recognizing the need to outsource and build benchmarks to measure their collections performance.

Once a utility has a handle on its recovery performance and associated costs, it is in a better position to build a solid case,

analyzing the economic value of a sale of charged-off accounts.

The key component of a successful utility debt sale is to find a reputable buyer with a competitive price. As a result, most US utility debt sales are completed in a competitive bid process called request for proposal (RFP).

With this process, sellers send potential purchasers bid packages, which include bidding requirements, purchase agreement and a data file of accounts. The bidders perform their due diligence on the data file and contract terms to price the portfolio and assess risk.

The most effective process for sellers and buyers is to allow for full negotiation of price, as well as contract terms and conditions.

It is at this stage sellers and buyers start to develop a sense of trust and business relationship.

Buyer-seller trust

Price is not the most important factor in selling a utility portfolio. Utilities want to make sure they can trust the buyer to handle the accounts in a professional way, with a minimum of complaints and negative publicity.

Utility debt requires certain expertise to purchase, service and manage a portfolio. Delinquent utility customers often question meter readings, usage and bills.

Consequently, utilities often look for buyers with some experience in servicing utility-type accounts. Until recently there were only a limited number of purchasers looking to buy utility debt. As the market grows, more buyers are entering, affording more selling options to utility companies.

Purchasers are also learning how to work better with utility sellers. Buyers realise flexibility is essential when working with utility companies. Utilities look for reputable purchasers who will be in business long after the sale.

In the end successful sellers and buyers maintain good communication and continually measure their performance and make incremental adjustments.

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