Addressing Residential Collections Problems Through the Offer of New Services in a Competitive Electric Utility Industry

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In responding to a competitive retail electric industry, policymakers can promote more than simply a choice in the selection of service providers. Consumer choice in the type of service purchased, also, might help address collections problems. The traditional electricity service provided by a local distribution utility, in other words --unlimited service provided with billing after the fact-- need not be the sole type of service provided. The thesis of this paper is that some new services can be introduced that will increase both the convenience to customers and the business efficiency to utilities.

This paper posits that utilities need not simply provide a stick to use in an after-the-fact fashion against customers who do not pay their bills. Instead, a creative (and competitive) utility could develop a system of incentives for customers to enter into payment mechanisms that would ensure prompt payment of their bills. The new payment mechanism would represent a new type of service.

Service Disconnections and a Competitive Industry

One ominous side to the emergence of a competitive electric industry involves the threat that a competitive electric industry will seek to scale back its traditional "obligation to serve" to small users and abandon any pretense of pursuing the goal of universal service. This fear is based on the reality-based observation that utilities will simply refuse to seek work-outs with customers who are facing payment troubles. The observation is "reality-based" if for no other reason than the fact that Southern California Edison has already cited competition as the primary reason to change its collection practices. In that case, Southern California Edison chose to treble its service disconnections (up to one-half million customers in 1995 alone), citing competition as the main reason it was calling in debt.[1]

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[1] Southern California Edison's efforts were chronicled in Karp, Michael, and Geoffrey Crandall, ***Integrated Resource Planning and the Low-Income Customer: Leveraging Federal WAP Funds with Utility DSM Dollars***, presented to National Regulatory Research Institute's Biannual Regulatory Information Conference (Sept. 1994).

Given the Southern California Edison approach, what residential customers can expect is a reduced level of tolerance for inability-to-pay. Stricter, not smarter, credit and collection approaches will be the rule. Efforts to scale back substantive protections such as winter shutoff moratoria will be initiated. And a refusal to acknowledge the economic, let alone the social, impacts of the potential loss of essential electric service will be the norm.

THE EFFECTIVENESS OF SERVICE DISCONNECTIONS

Overall, the reliance which utilities such as Southern California Edison place on the disconnection of service as a collection mechanism is seriously misplaced. A report by the Consumer Services Division of the New York Public Service Commission concluded, for example, that there is little relationship between the use of service disconnections and the success of a utility in collecting bills.[\2\] According to the New York study, "surprisingly, we found that companies with good [Final Termination Notice] credibility, showing a high level of service termination levels where customers do not respond to their final notice, also tended to have the higher uncollectible rates. In a customer survey, one mid-west utility found service termination to be a useful collection tool for only 12% of its payment-troubled customers. This limited usefulness of service terminations as a collection tool, and the revenue loss resulting from its use, may explain this finding."

The New York report said that "it appears that the use of an array of collection tools targeted to various types of collection situations is most productive in reducing collection rates." The New York report recommended:

> Based on our involvement in these cases, the experiences reported by various companies, and the analysis in the attached report, we believe that utility collection operations should:
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> o identify payment-troubled customer problems types in order to mold effective collection programs;
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> o develop comprehensive collection information systems;
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> o implement collection programs designed to resolve customer payment problems and characterized by personalized attention; and
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> o design mechanisms, where possible, to evaluate various collection practices.

The findings of the Bureau of Consumer Services of the Pennsylvania Public Utilities Commission corroborate the findings and recommendations of the New York Commission. BCS is no "push-over" when it comes to collections. BCS states quite plainly that:

> It is clear that there are some customers who are unwilling to exercise good faith in attempting to pay for service. It is the position of the Bureau of Consumer Services that termination is a reasonable practice when all other collections methods, including

\2\ Sawyer and Teumin, ***Gas and Power Utility Uncollectibles and Collection Activity***, Consumer Services Division, New York State Public Service Commission.

> properly negotiated payment arrangements, have been attempted in good faith and have failed.[3]

Nonetheless, after empirical analysis, BCS concluded that "the role of notices and terminations is not as vital as has often been suggested."[4] BCS said that "it can be inferred. . .from these (improved collections) that methods other than the two primary collections tools can lead to control of or even improvement of collections performance."[5]

BCS questioned whether there was a relationship between collections activities and collections performance. "If the main collections methods play anything like the vital role ascribed to them by utility representatives, then collections performance ought to be closely linked to the extent to which those methods are used."[6] The "main collection methods" referenced by BCS include: (a) sending disconnect notices; and (b) the actual termination of service. BCS then concluded:

> collections activities do not appear to be related to collections performance. . .no significant correlation was found between changes in collections performance and changes in collections behavior. In other words, the handling of either of the primary collections activities does not appear to affect collections performance.[7]

Again, the "primary collections activities" referenced by BCS were: (a) sending disconnection notices; and (b) the actual termination of service.

After examining innovations in collections amongst four different companies, BCS then concluded "it appears that performance can be improved without resorting to more frequent use of notices and service termination."[8] Indeed, BCS concluded in language particularly applicable to many utilities today:

> few companies have shown interest in either self criticism or innovation where collections are concerned. Despite this, improvements are technically well within the grasp of all major electric and gas companies. The major impediment to such advances is one of attitude or intention, and this has proven to be much more resistent to solution than any purely technical problem.[9]

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[3] BCS, ***Utility Payment Problems: The Measurement and Evaluation of Responses to Customer Nonpayment***, at 25 (1983).

[4] *Id.*, at 68.

[5] *Id.* The two tools referenced by BCS include shutoff notices and the actual termination of service.

[6] *Id.*, at 57.

[7] *Id.*, at 59.

[8] *Id.*, at 63.

[9] *Id.*, at 71.

In 1992, after another extensive empirical review of collection activities in Pennsylvania, the Bureau of Consumer Services reaffirmed its findings from a decade earlier. Again, BCS acknowledged that:

> termination or the threat of termination causes some customers to make either full or partial payments. Termination of middle and upper income customers does not pose serious risks to health and safety because these are customers who have the financial means to pay the utility.

Nonetheless, despite this explicit acknowledgement, according to the 1992 BCS report on controlling uncollectible accounts: "historically, neither the volume of termination notices sent nor the number of service terminations completed appears to be significantly related to collections performance."[10]

ADDRESSING COLLECTIONS THROUGH NEW SERVICES

Having concluded that the traditional reliance on shutoffs and shutoff notices does not well-serve the utility interested in collecting money, the issue becomes what might a utility do instead. One new service through which to address the payment problems of some households is a *Direct Billing Plan* for paying utility bills. Such a payment scheme would be modelled on insurance and related industries who directly draw payment of bills from a customer's checking account at the time the bill is rendered. There would seem to be two approaches to establishing such a system. On the one hand, a utility could offer this in lieu of some type of credit and collection measure. On the other hand, the *Direct Billing* could be offered with a variety of financial and non-financial incentives whether or not a collections problem exists.

Direct Billing as a Credit and Collection Tool

Like any other credit and collection mechanism, a *Direct Billing Plan* is not a strategy that would universally be beneficial for all customers; nor would it be an effective payment scheme for all customer classes. *Direct Billing*, for example, is not contemplated as a low-income program.[11] Nonetheless, from amongst the many types of nonpayers,[12] a *Direct Billing Plan* might be of particular benefit to:

- o Customers who have marginal, but adequate, resources to meet all of their month-to-month expenses if they budget carefully.

- o Customers who have some "external" problem which inhibits their payment. Several

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[10] BCS, ***Final Report on the Investigation of Uncollectible Balances, Docket No. I-900002***, at 80 (1992).

[11] This is true for several reasons. On the one hand, the penetration of checking accounts is not particularly high within the low-income community. On the other hand, even for those households with checking accounts, unless a household has a reasonable assurance of having sufficient funds at any given time to pay a utility bill --this is a situation not likely to occur for low-income households-- direct billing would not be appropriate.

[12] *See generally*, Colton, ***Credit and Collection Strategies in a Competitive Electric Utility Industry*** (May 1995) (identifying eight types of nonpayers).

types of such problems can be identified. These customers might be functionally illiterate. They may be "linguistically isolated," a term-of-art which means that no person over the age of 14 in the household speaks English. They may be physically or mentally incapacitated or infirm.

- o Customers who are simply poor money managers. This group is to be distinguished from the first group above because the incomes of these customers are not necessarily marginal.

Utility industry data shows that many of the residential customers owing arrears of 31 days old or older are *not* low-income households. For these customers, it would behoove a utility to make considerable effort to move those customers onto regular payment plans. Moreover, even customers who are on active deferred payment arrangements, let alone defaulted payment plans, often have arrears of 30 days old or older. *Direct Billing* would help address these problems.

For these various customer classes, a utility might offer a one-time incentive payment for people to enter into a *Direct Billing Plan.* The program would entail, for example, a $25 - $40 payment if the customer enters into the program and remains on it for 12 months. In addition, the utility could offer additional incentives, such as waiving finance charges on an arrears being paid through a *Direct Billing Plan.*[13] As a result of these incentives, a customer who owes a $200 arrears would receive cash benefits of $40 plus 1.25 percent on the unpaid balance. If this customer pays her arrears off in equal monthly installments over 12 months, the waived late payment fee plus $40 payment would provide the customer almost $55 in cash.

The alternative to a *Direct Billing Plan* is not attractive. One utility, for example, estimated the average collectability of non-agreement arrears (of all ages) to be 66.5 percent.[14] In contrast, the estimated collectability of arrears subject to active agreements (of all ages) was 78.2 percent. Moreover, the average collectability of 60+ day non-agreement arrears was estimated to be 60.4 percent while the estimated collectability of 60+ day subject to active agreements was 77.1 percent. As can be seen, there is a value to the utility of moving delinquent customers from having non-agreement arrears to having arrears subject to deferred payment arrangements. The collectability increased from 12 to 17 percent depending on the age of the arrears.

For this utility, it would be even more important to move *defaulted* payment plans onto a *Direct Billing Plan.* The company estimated the average collectability of arrears on defaulted payment agreements to be only 11.9 percent.[15] The estimated collectability of arrears subject to active agreements was 78.2 percent. Moreover, the average collectability of 60+ day arrears on defaulted payment agreements was estimated to be 5.3 percent, while the estimated collectability of 60+ day arrears subject to active agreements was 77.1 percent. Again, therefore, the value to the utility of moving customers with arrears on to deferred payment arrangements is evident.

\13\ The direct billing program would likely need to involve having the customer be on an equal monthly payment plan as well.

\14\ "Subject to arrears" includes all accounts with accounts receivable 30 days old or older.

\15\ "Subject to arrears" includes all accounts with accounts receivable 30 days old or older.

On average, therefore, it is possible for a utility to target its promotion of a *Direct Billing Plan* (including the payment of incentives for customers to enter into such a Plan) so that it would come out ahead simply on collectability.\16\

It is important to note that the advantages to the utility relate to both current bills and arrears. The advantages to the company from addressing the current bill include eliminating working capital requirements to the maximum extent possible, since there are no lag days after the bill is rendered. The utility adopting a *Direct Billing Plan* eliminates credit and collection and increases its collectability to 100 percent for the direct billing customers. The only way for the household to "default" is to make an affirmative decision to stop paying, to affirmatively decide that it is better to forego the cash benefits plus waived late fee than to pay through the direct billing mechanism, and then to notify the company to stop the direct billing. If the customer does this, however, the company does not have to pay the bonus and the company reinstates the late fee.

The intent behind the offer of a *Direct Billing Plan* in these circumstances is for a company to use its credit and collection process to sign problem customers up for the plan. Whenever there is a "consequence" to be imposed by the company --this might be a returned check fee, a service disconnection, a late payment fee, and the like-- the company could offer the customer a one-time sign-up incentive payment and waiver of the consequence if that customer enrolls in the *Direct Billing Plan*. For example, offers might include:

- o Waiver of a required deposit and the sign-up bonus;
- o Waiver of a late fee plus the sign-up bonus;
- o Waiver of a returned check charge plus the sign-up bonus.

Again, the sign-up bonus is only paid after the household remains on the plan for the designated period of time (*e.g.*, 12 months).

Collections Advantages Not Related to Arrears

Offering a *Direct Billing Plan* need not be used simply as a collection tool for payment-troubled customers. Utilities are not always best-served by concentrating their collections efforts on their long-term problem payers. Instead, a collections manager may obtain a greater positive financial impact for the utility by concentrating collection activities on slow payers rather than on customers that demonstrate long-term payment problems. By concentrating collection efforts here, utilities can accelerate the payment process and enhance positive cash flow. This observation is confirmed by the oft-heard recommendation that businesses should spend their time and efforts to keep good accounts good.

The *Direct Billing Plan* recommended above advances this approach to collections. *Direct Billing*

\16\ Finally, the intent is that once a customer enters onto a direct billing plan within the context of paying off arrears, the customer will choose to *stay* on the plan (or at least not choose to get off the plan) once the arrears are retired. When you consider the benefits and costs over a time period longer than the period over which the arrears are retired, the company comes out *substantially* ahead.

concentrates attention on accelerating payments during the early days of an accounts receivable and provides the best opportunity to obtain wholesale improvements in overall company cash flow. Due to the sheer magnitude of debt in this category, in other words, accelerating slow payments by a few days will yield a larger reduction in total company accounts receivable than will the reduction or elimination of the long-term problem accounts.

As a result, a utility should seek to provide "non-financial incentives" as well as the financial incentives addressed above to encourage non-payment-troubled customers to move on to the *Direct Billing Plan*. What is meant by "non-financial incentives" is for a company to solicit partners to provide incentives to keep people on the program after the first 12 months. Such "non-financial incentives," which may be somewhat of a misnomer, might involve, for example, entering into agreements for airlines to provide frequent flyer miles for every dollar of utility bill paid through a *Direct Billing* program. In addition, the company would almost certainly need to offer to waive all or part of the customer charges for persons entering into the *Direct Billing* program.\17\

The purpose of the non-financial incentives is two-fold.

- o First, the program should not be directed *only* towards customers with arrears (even though the highest benefits would flow from customers in arrears). A company would benefit, in other words, by moving households paying on Day 20 to being households who pay on Day 1.

- o Second, it would presumably increase collectability as well. It would prevent *any* participating bills from going past the 30-day mark and it would push the collectability of current bills upwards toward 100 percent.

Either way --accelerating payments or increasing payments-- the company wins. Even for those customers who always pay their bill "on time," the company would get payment sooner and thus improve its financial condition.

In sum, the "non-financial incentives" are important for a utility to expand its *Direct Billing Plan* beyond those customers who are in arrears.

SUMMARY AND CONCLUSIONS

In sum, many utilities are approaching credit and collection in the new competitive world through use of an after-the-fact, heavy-handed collection approach. The message to customers seems to be: "if you do something wrong, we'll get ya'." This approach is often ineffective and almost always costly and inefficient. In addition, it creates a poor image of the company in the community, which is ultimately counterproductive. What the analysis proposes is that rather than engaging simply in after-the-fact collection processes, public utilities could benefit by developing ways in which both the company and the customer could *truly* benefit. The proposals advanced above are designed with that goal in mind.

\17\ Indeed, considering what goes into a customer charge, there would need to be some discount on the customer charge simply to reflect the reduced costs associated with direct billing.

In responding to a competitive retail electric industry, in other words, utilities can promote more than simply a choice in the selection of service providers. Consumer choice in the type of service purchased, also, can help address many of the payment problems faced by public utilities. While services such as *Direct Billing Plans* can never fully address the needs of *low-income* households, such services nonetheless have a function within a certain niche market. Utilities should seek them out in lieu of the traditional collection methodologies which rely heavily on service disconnections and the threat of disconnections.