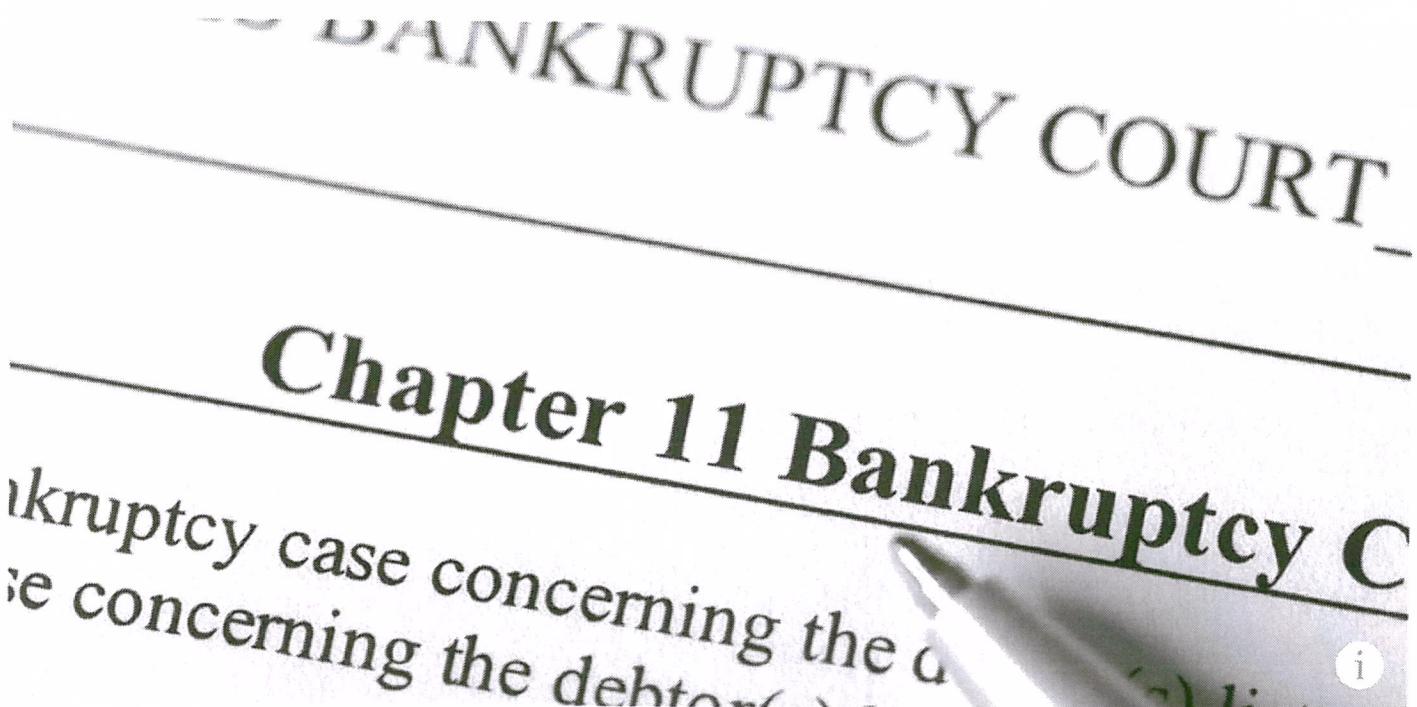


FEATURE

Strategies to Reduce Pre-Petition Losses

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Due to COVID-19 concerns, medium and large commercial bankruptcies are increasing. So, what prudent credit/collection steps are smaller municipal gas utilities (confronted sparingly with debtors with material charges) taking before the customer files for bankruptcy?

When a commercial customer files for Chapter 11 bankruptcy, utilities and debtor customers are familiar with the options for the assessment of "assurance of payment" for post-petition accounts, which, in 2005, Congress defined in Section 366(c) (1)(A) of the Bankruptcy Code, as:

- "(i) a cash deposit;
- (ii) a letter of credit;

- (iii) a certificate of deposit;
- (iv) a surety bond;
- (v) a pre-payment of utility consumption; or
- (vi) another form of security that is mutually agreed on between the utility and the debtor or the trustee."

Utilities with material amounts of post-petition exposure to debtors are seeking to obtain reasonable amounts and forms of assurance of payment, instead of the "crumbs" proffered by debtors in the large Chapter 11 bankruptcy cases, such as placing 15 days' worth of charges into an escrow account maintained at their banks – which does not provide adequate protection to a utility with a 60-day billing cycle (charges from first day of billing period until last day; assume no pay and issuance of disconnect notice).

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Smaller utilities often do not require security deposits or their equivalent from the largest customers. Their view is that they do not expect XYZ Inc., who has paid timely for years, to file for bankruptcy. That view may expose the utility to considerable risk. Typically, when a large customer files for bankruptcy, a utility could confront a large pre-petition debt. Many Chapter 11 cases crater or pay only pennies on the dollar for general, unsecured debt. Assuming a monthly invoice of \$50,000 and a 60-day billing cycle, this is a pre-petition loss of about \$100,000. For a small, municipal utility, a loss that large could precipitate its own insolvency.

What is the small municipal gas utility to do? It should implement these recommendations:

1. Enact pro utility credit/collection laws.
2. Obtain a security deposit/commercial equivalent; e.g., letter of credit or advance payment agreement, equal to the number of days in billing cycle, calculated at the highest monthly bill formula; require for all large customers, whether existing or new.
3. Semi-annually, monitor amount of current charges; adjust amount of deposit/commercial equivalent, equal to current charges.
4. Retain deposit/commercial equivalent as long as account is active.
5. Repeal laws requiring refunding deposits to prompt-paying customers.
6. Pay interest upon deposits in amount equal to rate paid by local banks; adjust rate semi-annually.
7. Reduce length of monthly billing cycle by issuing invoice close to last day of billing cycle; reducing number of days until due date; issuing default notice immediately after due date; and actually terminating, after last day in cure period.
8. Besides monthly billing, offer alternate billing cycles and security deposit/commercial equivalents. The customer chooses an option. In exchange for a lower deposit, the customer consents to less time to make payments and cure periods in default notices. With more frequent due dates (with amounts lower than

one monthly invoice), and more frequent chances of receiving default notices, customers are more aware of amounts due and when and may be more likely to pay. This requires more administrative work for the utility; still, the extra work is worth it in terms of likelihood of payment.

9. Require each customer to pay for all charges it incurs, without having to increase rates through bad debt expense adjustments imposed upon all other customers. Lower bad debt expense benefits all customers – through lower rates.
10. Alternative billing procedures can enhance a utility's cash working capital requirements. Examples: Reducing number of days outstanding for invoices may impact lead/lag studies positively; and lowering borrowing requirements could benefit all customers; i.e., lower rates.

Implementing these recommendations may be quite beneficial. They will improve the likelihood of obtaining payment for pre-petition invoices. Typically, investor-owned utilities are requiring commercial customers to post large deposits. Why should your small utility be saddled with large, pre-petition claims? Armed with a pre-petition security deposit, Section 366(c)(c)(4) of the Bankruptcy Code permits a utility to setoff/apply it against unpaid, pre-petition charges automatically and without an order from a bankruptcy court. Selling natural gas on 100 percent unsecured credit may result in large losses.