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UTILITY REFUNDS AND LOW-INCOME CONSUMERS

A substantial part of the Kansas *ad valorem* tax refund coming back to Missouri natural gas customers should be set aside for low-income rate affordability purposes, according to Fisher, Sheehan & Colton, Public Finance and General Economics (FSC). In testimony filed with the Missouri Public Service Commission on behalf of the Missouri Office of Public Counsel (OPC), FSC recommended that 30% of the refund to which Missouri Gas Energy was entitled should be set aside for low-income rate relief.

The Kansas Ad Valorem Tax Case

The Kansas *ad valorem* tax litigation has been in progress for years. It involves alleged producer price overcharges in the period 1983 through 1988. During that time, consumers were charged for certain taxes in violation of the Natural Gas Policy Act (NGPA). Both FERC and the courts have held that the producers must refund the overcharges.

Refunds and Customer Mobility

Customers who were overcharged in their utility bills at the time the *ad valorem* taxes were inappropriately included in natural gas rates, FSC told the Missouri PSC, are entitled to receive the amount of their overpayments returned to them. However, customers who are currently on the MGE system but who did *not* make such overpayments are not entitled to those refunds. Providing refunds to customers who did not pay the overcharge in the first instance is simply providing those customers with a windfall, FSC said.

There is certainly no vested entitlement for all current customers to receive a portion of the Kansas *ad valorem* tax refund merely because they happen to be a current customer.

Because of the confluence of several factors, it will be difficult, if not impossible, to *refund* the overcharges to those customers who originally *paid* the overcharges.

First, the time period that has elapsed since the overcharges occurred is so substantial, it would be extraordinary if the Company has retained the customer records from the time of the overcharges. It would, as a result, be impossible to even identify the customers who paid the overcharges.

Second, even for those customers who were identified as customers, because of the lack of customer records, it would be impossible to ascertain the amount of the refund, which any given customer is entitled to receive.

Third, even if the Company could identify each customer, along with the refund to which each customer was entitled, the Company would need to *find* each customer to provide the refund. Due to the frequent turn-over in utility customers, the process of finding those customers would be difficult, if not impossible, to accomplish at all. In any event, it would be very expensive.

Mobility and “Cy Pres” Funds.

For all of these reasons, the Kansas *ad valorem* tax refunds should be treated as a cy pres award and devoted to a system use that will generate system benefits. FSC proposed that a portion of the Kansas *ad valorem* tax refunds be used to capitalize a low-income affordability fund to help pay for the use of fixed credits as an alternative to traditional credit and collection strategies directed toward low-income payment-troubled customers. This fund would, consistent with the creation of cy pres funds, generate systemwide impacts that would benefit all customers on the MGE system.

The Supporting Data

The Kansas *ad valorem* tax refund relates to a period of alleged overcharges beginning in October 1983 and extending through June 1988. Given the lengthy period of time since the point at which the overcharges were made to customers, it would be impossible to refund those overcharges to the customers who paid them in the first instance.

First, the Company, itself, acknowledges that there is more than a 30% turnover in its customer base each year. In addition, it is possible to gain further insights into the turnover in a particular geographic area through two public information sources. First, one can examine U.S. Census data. Using this data, FSC examined the mobility of households from the counties in which Kansas City, Joplin and St. Joseph are located.

According to the U.S. Geological Survey, those counties include Andrew, Buchanan, Clay, Jackson, Jasper and Platte. Census data on the year in which householders moved into their current unit in these counties showed that the householder moved into his or her 1990 housing unit after 1985 in from 45% (Andrew County) to 60% (Jasper County) of the time. The percentages would thus be much higher today. (2000 Census data is not yet available.)

The Census also tracks the location of residences five years before the Census is taken. The data for the six MGE counties studied by FSC showed that from six percent (Andrew County) to nearly 20% (Jasper County) of all persons lived in another state in 1985 (relative to the 1990 Census). From 16% (Buchanan County) to nearly 40% (Platte County) lived in a different county but remained in Missouri.

This Census data accurately reflects conditions even today, FSC said. The Internal Revenue Service (IRS) maintains annual migration data which relies on the filing address of tax returns each year. FSC examined this IRS migration data from the 1997 to 1998 tax year (the most recent information available) for the six study counties. The data is not entirely complete since not all

households file tax returns (including the low-income population which earns insufficient income to file a tax return). Nonetheless, the IRS data base presents an authoritative look at migration patterns. The IRS data showed that total one-year migration rates range from 6.3% (Buchanan) to 9.2% (Clay).

Both the Census and the IRS migration data for MGE customers understates the extent to which customers may have moved off the MGE system, FSC said, for two reasons. First, a household need not move out of the state to move out of the MGE service territory. MGE serves a relatively small portion of total Missouri natural gas customers. Second, a household need not move out of the MGE service territory to cease being an MGE customer. The household may move to a housing unit with a different fuel or it may move to a unit with utilities included in rent. The data above, therefore, states the minimum churn in MGE customers on an annual basis, as well as over time.

Low-Income Mobility

Low-income customers would be particularly adversely affected by the impact of mobility on the ability to obtain appropriate refunds, FSC found. Low-income households, overall, have a much higher mobility than do households in general. The annual Census reports based on the Current Population Survey document this conclusion, FSC said, citing, Current Population Survey (March 1999), *Geographical Mobility: March 1998 to March 1999, Detailed Tables*, at Tables 11, 12, 17 (detailed tables revised and posted to Internet, November 2, 2000).

The median duration of residence for people overall is 5.2 years. This means that half of all persons have lived in their current home for a longer period and half have lived there for a shorter period. The median duration of residence for low-income people is much lower.

In addition, FSC said, there are differences between specifically identifiable populations. People who rent their homes, for example, tend to live in their residence for a shorter time than homeowners do--a median duration in their current

residences of 2.1 years, compared with 8.2 years for people living in owner-occupied housing units. One-third of people living in renter-occupied housing units in March 1998 moved in the previous year (33.4%), while in contrast, only 1-in-12 people in owner-occupied housing moved during the same period (8.2%). Low-income households tend to be disproportionately renters.

As can be seen, there is an even smaller likelihood that low-income customers who paid the *ad valorem* tax overcharge can be located and reimbursed for their overpayment. In addition, it would be even more expensive to have any success in locating any of the low-income customers that originally paid the overcharge.

The Cy Pres Doctrine

The fact that it would impossible to make refunds to appropriate customers, combined with the expense of locating those customers who would be legitimately owed a refund, combine to form a basis to create a low-income affordability fund, FSC said. A legal doctrine referred to as the *cy pres* doctrine provides Missouri regulators with the legal basis to set aside some portion of the Kansas *ad valorem* tax refund as a low-income affordability fund.

The doctrine of *cy pres*, FSC noted, originated in the law of charitable trusts. In that context, it provides that when the literal terms of a trust become impossible to follow, the funds should be put to the "next best use" in accord with the purposes of the trust. In litigation, and the award of damages, the use of *cy pres* remedies is often referred to as "fluid recovery." Fluid recovery is used to distribute the residue of a fund created by settlement or judgment when the claims rate is likely to be less than 100 percent. The method of *cy pres* generally adopted is the creation of a separate fund, either through a new project or through an existing organization, consistent with the purposes of the litigation.

A general discussion of *cy pres* can be found, FSC said, in the following articles: James McCall et al., "Greater Representation for California Consumers--Fluid Recovery,

Consumer Trusts Funds and Representative Actions," 46 Hastings Law Journal 797 (1995); Gail Hillebrand and Daniel Torrance, "Claims Procedures in Large Consumer Class Actions and Equitable Distribution of Benefits," 28 Santa Clara Law Review. 747 (1988); Kerry Barnett, "Equitable Trusts: An Effective Remedy in Consumer Class Actions," 96 Yale Law Journal 1591 (1987); Natalie DeJarlais, "The Consumer Trust Fund: A Cy Pres Solution to Undistributed Funds in Consumer Class Actions," 38 Hastings Law Journal 729 (1987).

The *cy pres* doctrine is particularly used in those situations where the persons who are entitled to a distribution of damages (in this case rate refunds) change constantly as well as where the persons who are entitled to a distribution of damages are difficult to identify. In a situation where these factors exist, such as in the Kansas *ad valorem* tax refund, creation of a *cy pres* fund is appropriate. Utility refunds have been singled out as particularly appropriate for *cy pres* treatment.

It would not be accurate to say that the *cy pres* fund proposed for the distribution of Kansas *ad valorem* tax refunds go to benefit only low-income customers. Instead, the fund would be used as a supplemental source of revenue that would offset the difference between the bills charged at the standard residential tariffed rate and bills charged at the fixed credit tariffed rate. In the absence of the fund, these costs would be reallocated to the customers taking service under the standard residential rate. In addition, FSC said, affordable fixed credit rates generate systemwide benefits for all customers.

An MGE Affordability Fund

The specific fund proposed for Missouri Gas Energy assumed that MGE would receive \$50 million in Kansas *ad valorem* tax refunds either through judicial resolution of the pending cases or through settlement. FSC proposed that MGE use 30% of those funds to capitalize an affordability fund to help fund a fixed credit tariffed rate for low-income customers. Capping a drawdown from that fund at \$2.5 million annually would allow the fund to operate with a "full"

disbursement of \$2.5 million each year for nine years. In the tenth year, a disbursement of \$1.6 million would exhaust the last dollars left in the fund.

These benefits assume that the fund *corpus* earns an annual 10% return. To the extent that a higher return is achieved, FSC said, a longer funding period would result. A lower return would shorten the period in which a distribution of \$2.5 million could be made.

A Colorado Precedent

A Missouri decision to set aside part of the *ad valorem* tax refund would be consistent with how other states have treated the refund, FSC said. For example, FSC noted, each Colorado investor-owned utility is required to set aside 25% of the Kansas *ad valorem* tax refund as low-income rate affordability assistance. This set aside is done either pursuant to agreement between the utility and the Colorado Energy Assistance Foundation or by direct order of the Colorado Public Utility Commission. For Public Service Company of Colorado, this low-income set aside involved \$3,262,368.

Persons interested in receiving a copy of the full FSC testimony proposing *cy pres* treatment for the refund of Kansas *ad valorem* tax refunds (Missouri: April 2001) can send a request to:

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Fisher, Sheehan and Colton, Public Finance and General Economics (FSC) is a research and consulting firm with offices in Belmont (MA), Scappoose (OR), and Iowa City (IA).

FSC specializes in providing economic, financial and regulatory consulting. The areas in which FSC has worked include infrastructure financing, public enterprise planning and development, natural resource economics, community economic development, telecommunications, public sector labor economics, planning and zoning, regulatory economics, energy law and economics, fair housing, and public welfare policy.

Fisher, Sheehan & Colton
Public Finance and General Economics
34 Warwick Road, Belmont, MA 02478-2841
617-484-0597 *** 617-484-0594 (fax)
editor@fsconline.com (e-mail)
<http://www.fsconline.com>
