

**DETERMINING THE COST-EFFECTIVENESS
OF IMPOSING CUSTOMER DEPOSITS
FOR UTILITY SERVICE**

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Given the problems that low-income households face today with high energy bills¹ as well as with high telephone bills,² it is vitally important for policymakers to ensure that undue burdens are not placed on already overburdened households. Little question exists but that low-income households simply do not have sufficient funds to pay their utility bills.³ This lack of funds carries over to the payment of deposits.

An onerous and unnecessary deposit which jeopardizes continuing service to a low-income household can pose a serious threat to the home, health and perhaps even life of the consumer. As the U.S. Supreme Court has noted, "utility service is a necessity of modern life; indeed, the discontinuance of water or heating for even short periods of time may threaten health or safety."⁴ Similarly, an Ohio federal district court stated that "the lack of heat in the winter time has very serious effects upon the physical health of human beings, and can easily be fatal."⁵

The loss of telephone service because of unpayable deposit demands⁶ can, as well, be an equally threatening event.⁷ The lack of telephone service jeopardizes continuing energy service by denying a household any ability to enter into payment plans, make contact with social service agencies, or otherwise respond to its inability to pay.

In addition to these serious impacts on consumers, onerous and unnecessary deposit demands are bad business from the perspective of the utility and its ratepayers as well. This recognition is based on two fundamental principles. These principles are so well-accepted, they are not open to serious question:

¹National Consumer Law Center, *Energy and the Poor: The Forgotten Crisis* (May 1989).

²National Consumer Law Center, *Telephone Customer Service Regulations in the Post-Divestiture Era: A Study of Michigan Bell Telephone Company* (July 1988).

³See, National Consumer Law Center, *Losing the Fight in Utah* (January 1989) (Utah LIHEAP recipients have average income of \$6,400 to meet minimum needs budget in that state of \$9,708). See also, National Consumer Law Center, *Meeting the Energy Needs of Low-Income Pennsylvanians Through Percentage of Income Plans* (November 1986) (two person Pennsylvania household at 100 percent of the federal Poverty Level has income of \$7,050 to meet minimum needs budget of \$8,445).

⁴*Memphis Light, Gas and Water Division v. Craft*, 436 U.S. 1, 18 (1978).

⁵*Palmer v. Columbia Gas Co. of Ohio*, 342 F.Supp. 241, 244 (N.D. Ohio 1972) (citations omitted); see also, *Stanford v. Gas Service Company*, 346 F.Supp. 717, 721 (D.Kan. 1972). An excellent canvass of cases is found in *Montalvo v. Consolidated Edison Company of New York*, 110 Misc.2d 24, 441 N.Y.S.2d 768, 776 (N.Y. 1981).

⁶A 1987 Michigan study found that 60 percent of those households who lacked telephone service cited unaffordable deposits as a primary reason. See, Michigan Citizens Lobby, "Low Income Households in the Post-Divestiture Era: A Study of Telephone Subscribership and Use in Michigan" (October 1986).

⁷See, e.g., National Consumer Law Center, *An Evaluation of Low-Income Utility Protections in Maine: Winter Requests for Disconnect Permission* (July 1988). (80 percent of households who were disconnected during the winter months lacked telephone service.)

oThe sole purpose of a deposit is to minimize the possible money loss to the utility due to nonpayment of bills.

oThe collection of deposits must lead to the provision of least-cost service to ratepayers as a whole.

Unfortunately, despite their universal acceptance, these principles are often ignored when public policy considering deposits is considered. The purpose of this evaluation, therefore, is to outline an analytic framework within which utility demands for deposits are to be considered. The purpose of this analysis is not *ipso facto* to lessen the demands for deposits. The purpose rather is to rationalize the demands for deposits. If unnecessary deposits can be eliminated, benefits will redound both to the utility and to the low-income population.

In order to perform this type of economic analysis, several pieces of information are necessary. First, the function which a deposit is to serve must be precisely defined. Second, the effectiveness in accomplishing that function must be measured. Finally, the costs of accomplishing that function must be determined.

THE FUNCTION OF A DEPOSIT

The function of cash deposits required of utility customers is generally defined within the context of bad debt.¹⁸¹ That context, however, needs some detailed exploration. Bad debt is an expense to the utility just like any other expense. As such, it is an expense that a utility can and should seek to reduce where possible. The reduction of bad debt, however, is not an end unto itself. Also like any other expense, a utility is not justified in spending more on the means to reduce bad debt expense than the savings that are generated through such an effort. The goal of a utility, in other words, is to minimize *total* expenses to the ratepayers, not simply to minimize bad debt expenses.

The collection of a cash deposit is one means to gain protection against the potential loss of revenue through bad debt. The deposit serves the function of security to protect against the risk of default. As an expense avoidance mechanism, however, a utility's deposit scheme must be subjected to an economic analysis just like a self-insurance plan which might be pursued in lieu of the purchase of insurance policies, just like backing out oil-fired capacity with coal, just like maintaining compensating bank balances in lieu of paying bank fees, and the like. Again, the ultimate goal is the provision of least-cost service.

THE COSTS OF A DEPOSIT

To require deposits from customers is not without cost to remaining ratepayers. The costs are of two types: (1) out-of-pocket expenses; and (2) foregone revenues. Each must be examined in turn.

¹⁸¹For purposes of this analysis, "bad debt" will be deemed to be coterminous with uncollectibles.

The collection of deposits involves out-of-pocket expenses to the utility. When a utility collects a deposit, it must undertake to do several things. It must obtain credit information from some source. Frequently that source will be a "consumer reporting agency." In such instances, the utility must take particular actions to ensure compliance with the terms of the federal Fair Credit Reporting Act, a statute that imposes certain obligations on the users, as well as the distributors, of "consumer credit reports." Second, the utility must service the deposits. In particular, it must keep track of the deposits in such a manner that they can and will be refunded at the appropriate times. Finally, the utility must often pay interest on the deposit. That interest is usually set at a rate that compensates the customer for the loss of the time use of the amount of the deposit.⁹¹

In addition, demanding a deposit from a customer who cannot afford to pay it may well cost the utility in foregone revenue. In the event a low-income customer cannot afford to pay a deposit, that customer is denied service. Whenever a customer's service is denied, two things happen. First, the company avoids the variable cost of delivering that unit of energy to the household. Second, the company forgoes the revenue that *would have been* collected from the household but for the denial of service. To the extent that the revenue would have exceeded the variable cost of delivering the energy (whether it be gas or electricity), other ratepayers lose a contribution toward the payment of the fixed charges of the company. In this instance, the denial of service leaves remaining, paying, customers worse off than had the disconnection not occurred.

THE SYSTEMWIDE SAVINGS FROM DEPOSITS

A utility must justify its collection of deposits in light of the costs inherent in obtaining and maintaining them. A utility, in other words, must demonstrate that the collection and maintenance of deposits reduces its uncollectible accounts in an amount at least equal to all costs associated with the collection and maintenance of such deposits, including the payment of reasonable interest.

Without such information, remaining customers may well be paying for a myth. That myth is that the collection of deposits results in a reduction of bad debt and *thus the reduction of overall utility expenses*. Even if the premise is true (that deposits help reduce bad debt), the conclusion does not necessarily follow.

Determining the cost-effectiveness of deposits involves an examination of two different issues: (1) whether a deposit should be required; and (2) if so, what level the deposit should be. Each of these aspects is examined below.

Whether a Deposit Should be Required: Aside from basic fairness, for deposits to be cost-effective from a utility's business perspective, they must result in a reduction in uncollectibles at least equal to the cost of obtaining and servicing the deposits. In order for this reduction to occur, the customers from whom deposits are demanded must represent a risk of loss to the utility. If, in other words, the customer does not represent a potential situation where the utility will experience a

⁹¹If it is not, it should be.

permanent loss of arrears, any deposit collected from that customer --whatever the size-- has no relation to the risk of loss due to uncollectibles. In that instance, to collect a deposit will impose only costs on the system and result in no benefits to offset those costs.

Two situations exist in which utilities often collect unjustified deposits. First, the automatic imposition of a deposit after a disconnection for nonpayment is not justifiable. Second, the imposition of a deposit based on a bad credit history reported for non-utility transactions is not justifiable.

The first way in which utilities oversecure themselves is to automatically seek deposits after a disconnection for nonpayment. To automatically seek deposits in such circumstances may appear to be facially attractive at some cursory level of analysis. To demand deposits in such instances, however, in fact, does not *a priori* represent a rational means of protecting against the risk of bad debt. The underlying question is whether and to what extent the disconnection of service is an indicator of the risk of loss due to bad debt.

A disconnection of service, standing alone, provides no information as to the risk of revenue loss to the utility. Indeed, most data supports the opposite conclusion: that the disconnection of service tends to successfully coerce payment from households in arrears, thus *minimizing* the risk of loss due to bad debt from those households. Most households, for example, are reconnected to the system. Moreover, most households pay some substantial part (though not all) of their arrears before being reconnected to the system. For those households, while the arrears may not be entirely paid prior to reconnection, the utility enters into deferred payment agreements whereby the arrears underlying the disconnection are retired over time.¹⁰ As can be seen, therefore, the mere disconnection of service, standing alone, does not represent a risk of loss due to bad debt.¹¹

In deciding upon whether a deposit is justified, the risk of late payment should be distinguished from the risk of permanent loss. The costs associated with late payment cannot be addressed through a deposit. A deposit is to protect against loss due to bad debt. The disconnection of service, standing alone, is no indication of the risk of permanent loss to the utility through bad debt. Data from a recent proceeding before the Vermont Public Service Board indicates that a disconnection of service really represents little threat of permanent loss. As Table A shows, most households who are disconnected remain off the system for but a few hours. Even disconnected households, in other

¹⁰In most states, to be reconnected, a household must make a downpayment toward the arrears equal to a designated portion of the outstanding bill and enter into a payment plan for the remainder. The existence of an outstanding bill at the time of reconnection, therefore, does not necessarily represent a risk of permanent loss. Indeed, the fact that such an arrears is made subject to a deferred payment agreement should reduce the risk of permanent loss.

¹¹At most, the disconnection can be said to represent a risk of loss. To determine the appropriate security, however, one must take the amount at risk and multiply it times the chance that the loss will indeed be experienced. A utility which faces a 20 percent chance that it will lose \$400 to bad debt, in other words, is justified in collecting only \$80 in a deposit.

words, in reality continue as customers on the utility system and the utility obtains payments from them. Similar findings have been made with other utilities.

TABLE A TIME BEFORE RECONNECTION FOR DISCONNECTED HOUSEHOLDS IN VERMONT /1/	
Company	Time Before Reconnection
Allied	Less than 12 hours
Barton	2 hours
Citizens	Less than 24 hours ¹²⁾
Cent Verm Pub Serv	24 hours
Franklin	3 hours
Green Mountain Power	Less than 24 hours
Hardwick	2 - 3 hours
Hyde Park	Less than 24 hours
Lyndonville	4 hours
Morrisville	4 - 6 hours
Northfield	4 hours
Orleans	Less than 24 hours
Stowe	3 hours
Vermont Marble	2 hours
Wash Elec Co-op	Less than 24 hours

A second failing in the determination of whether deposits should be sought is the use of third-party, non-utility, credit information. Utilities who use third-party supplied information as a basis for deposit demands may face particular problems with justifying their deposits on cost-effectiveness grounds. Third party information is used by some companies to determine whether or not new applicants for service are "creditworthy." Rather than directly denying service, a utility simply requires a household deemed to be non-creditworthy to post a cash deposit.¹³⁾

¹²⁾Before the Vermont Public Service Board, Docket 5308, Direct Testimony and Exhibits of Roger D. Colton, presented on behalf of the Department of Public Service (October 1989).

¹³⁾In this fashion, a utility may in effect deny service even though such denial does not occur "directly." Making a deposit a prerequisite to obtaining service, when the deposit is beyond the financial ability of the household to

The use of third-party supplied credit information as a basis for making utility deposit decisions constitutes a problem when the third party information is not itself comprised of utility payment histories. Substantial research has found that consumers tend to pay their utility bills before paying nearly any other outstanding credit (other than rent or mortgage obligations). As a result, information from a credit reporting agency that indicates a lack of creditworthiness based on non-utility transactions does not provide useful information as to a customer's likelihood of paying a home utility bill.

As can be seen, to collect a utility deposit from a household which does not pay its Sears bill imposes only costs, and gains no benefits, for the utility system. Unless nonpayment of a non-utility bill is an indicator of risk to the utility --a conclusion disproved by existing literature-- collecting a deposit provides security against a non-existent risk, to the financial detriment of the remaining ratepayers who must pay the cost of maintaining the deposit.

The denial of service --even if indirect as discussed above-- for non-utility related reasons is a violation of long-standing utility regulatory principles proscribing the denial of service for "collateral" matters. It matters not to other ratepayers whether a household fails to pay its Sears bill, for example, if that household *will* pay its utility bill. Given the fact that nonpayment of non-utility bills has little relevance to whether utility bills will be paid, basic fairness requires that third-party credit information on non-utility transactions not serve as a basis for deposit demands.

What Level Should a Deposit Be: The best way to ensure that deposits are cost-justified on a systemwide basis is to ensure that they are cost-justified on an individual basis as well. In addition to needing to justify seeking a deposit with which to begin, the utility needs to justify the size of a deposit in individual instances as well. The size of a deposit in individual cases relates to whether a utility is oversecured. It is necessary to determine whether the amount of security bears any relationship to the risk of loss to which the utility is subjected.

Conceptually, the risk of loss to a utility is the same as the risk of loss to any other creditor serving debtors who may default. The risk involves all of the different possible types and combinations of default: large, small, partial, total, temporary and permanent. The probability that each will occur, and the loss were each to occur, should be factored into the analysis. To accomplish this, each individual probability is multiplied times the amount of the loss if that particular loss occurs. Utility deposit practices often do not differentiate between the different types of risks that consumers may represent to the system. As a result, utilities tend to oversecure themselves, to the substantial financial detriment of their remaining ratepayers, in a number of ways.

One means by which utilities oversecure themselves against the risk of loss by collecting an excessively large deposit is to impose maximum permissible deposits automatically. Some Public Utility Commissions, for example, permit a utility to collect a deposit equal to *no more than* twice the

pay, nevertheless constitutes a denial of service, however indirectly.

average monthly bill for a customer.¹⁴ Work undertaken by NCLC in Pennsylvania, Michigan and elsewhere, however, has found that the affected utility automatically sets deposits *at* twice the average bill. To automatically set the deposit amount at the allowed maximum is most likely to over-secure against losses since it is probable that households do not frequently represent the maximum risk.

To automatically set a customer's deposit at the maximum permissible level is an abuse of discretion as well. A maximum deposit amount set by PUC regulation implies the use of discretion to set a deposit "up to, but not to exceed" the designated amount. The cap implies, in other words, that deposits are generally to be somewhere below the maximum. To illustrate this point, one can instructively compare state utility commission regulations concerning the offer of deferred payment plans for arrears. Many commissions require that utilities offer payment plans of *at least* 12 months in length. If, given such a regulation, a utility were to offer payment plans of *only* 12 months and no more, the utility action would be in violation of the "at least" language. The deposit issue is the same issue except at the other end of the scale. If a Commission sets a maximum deposit, it should seek to ensure that no utility is routinely requiring the maximum and no less.

A second means by which a utility tends to oversecure itself is by basing its deposit demand on the largest monthly bill (or some multiplier thereof). This policy assumes that out of twelve monthly bills, the bill most likely to remain permanently unpaid is the largest. No empirical basis has been proffered for this assumption. Indeed, the fact that a permanently unpaid bill might be the highest bill in any twelve month period would happen only by happen-chance.

The policy of collecting based on the largest bill appears to be based on the notion that the greater the security the better. As can be seen, however, collecting greater security creates no benefits, and instead creates uncompensated costs, when the increase is not matched to an increased risk due to bad debt. For a deposit to be cost-effective, it must reduce bad debt expense by an amount at least equal to the costs of obtaining and maintaining the deposit. If the risk of loss is not the highest monthly bill, then such a match does not occur.

A third means in which utilities oversecure themselves is by holding deposits for longer than is necessary to protect themselves against bad debt. One rule that utilities often adopt is that deposits will be refunded upon a customer establishing "good credit standing" with the utility. "Good credit standing" is then defined as twelve consecutive months without receipt of a disconnect notice. The question as to cost-effectiveness thus resolves itself into whether receipt of a disconnect notice is any indicator of the risk of permanent loss of revenue to the utility due to bad debt. In the one instance where this issue has been directly addressed, the National Consumer Law Center found no connection between the receipt of shutoff notices and the actual disconnection of service (let alone between the receipt of a shutoff notice and the permanent loss of service and thus revenue due to bad debt). Consistently fewer than ten percent of all disconnect notices result in an actual disconnection of service for Michigan Bell Telephone, NCLC found. The relationship between disconnect notices

¹⁴Similarly, some state Commissions permit the collection of a deposit equal to no more than twice the maximum monthly bill. The important language is the "no more than."

and disconnections was studied over a four and one-half year period. NCLC concluded that "to define 'unsatisfactory payment history' through use of a mechanism which fails to measure what it purports to measure in more than 90 percent of the cases is irrational at best."^{15\}

The relationship between disconnect notices and bad debt is even more tenuous than the connection between disconnect notices and the actual disconnection of service. NCLC's Michigan Bell report found that "a minuscule portion of accounts which become delinquent at any given time will go on to also become uncollectible." Indeed, NCLC found, over the four and one-half year period of the study, the number of disconnect notices exceed(ed) the number of uncollectible accounts by 600 to 700 percent per quarter.

It is important to remember that deposits are to protect the utility against the permanent loss of revenue due to bad debt. They are *not* designed to compensate the utility for the carrying costs caused by late payments. That is the function of a late payment charge. Neither are deposits to be held by utilities as punishment for poor payment practices on the part of a utility's customers. Again, the function of a deposit is to protect the utility against the possible loss of revenue due to bad debt. Accordingly, given the information discussed above, if a utility refuses to refund a deposit because of the receipt of shutoff notices, without more, the utility is likely incurring the expense of holding a deposit without attaining any of the advantages which go to offset that expense. The utility, in other words, is forcing its ratepayers to pay for an unnecessary and unreasonable insurance policy against a risk that has not been shown to exist.

One excellent example of this mismatch involves two particularly vulnerable populations: the elderly and the poor. These households often subsist month-to-month on public benefit checks. This might involve AFDC, SSI, Social Security and the like. For many, there is a mismatch between the receipt of a utility bill (when the utility engages in cycle billing) and the receipt of the public assistance check. If a billing due date is the 15th of each month, notwithstanding the fact that the public assistance is not received until the 25th, it is likely that there will be continuing "late" payments. In this instance, the household --who may particularly miss the cash devoted to the deposit-- will receive no refund despite the fact that the late payment each month represents no indication of risk due to bad debt at all.

In sum, from a least-cost perspective, a utility should not be permitted to systematically oversecure itself against loss. Even aside from the impacts on its applicants, to the extent that a utility pays an interest expense with no hope of a corresponding reduction in bad debt (because its security exceeds its risk of loss), the utility is acting to the financial detriment of its remaining ratepayers. By oversecuring against loss, the utility company is in effect buying an insurance policy that exceeds the value of the loss to be guarded against.

ALTERNATIVES TO DEPOSITS.

^{15\}In addition, even of that ten percent of households which indeed are disconnected, it is important to remember that most are quickly reconnected, without risk of permanent loss of revenue to the utility.

Given the costs of maintaining deposits, it is in the best financial interests of utilities to seek non-cash alternatives to the collection of deposits. The primary alternative is the solicitation of third-party sureties. A surety is a third-party agreement to take responsibility for a household's bill up to some designated limit. It does not involve the transfer of cash. It is instead an agreement (or contract) to pay.

Sureties: Sureties provide an excellent alternative to the collection of cash deposits. By definition, a surety would offer an alternative to low-income households who might not otherwise have access to sufficient funds to provide an up-front cash deposit. Moreover, since the utility does not hold customer cash in a surety situation, there is no need to provide compensation for the time use of the customer's money. A large part of the expense with maintaining security against loss is thus avoided.

Several utility actions should be encouraged, perhaps even required, in an effort to substitute non-cash forms of security for the cash deposit.

oFirst, utilities should be required to *offer* to accept surety agreements in lieu of a cash deposit whenever a need for security is found to exist. Mere acceptance of a surety (when offered at the customer's initiative) places the utility in too passive of a role. If a household could provide a surety, but is not aware of the surety alternative, the utility is incurring unnecessary expenses to service a cash deposit to the financial detriment of its remaining ratepayers.

oSecond, irrational limitations on surety arrangements should be eliminated. No reason is apparent, for example, why a surety should be a customer of the same utility.^{16\} A family member, for example, who lives in a neighboring town outside the utility service territory may be an absolutely adequate surety. Neither is there reason why a surety should be an individual (as opposed to an institution such as a neighborhood association or church). There is no reason why the qualifications of a surety for a utility bill should be any more stringent than the qualifications of a surety for any other type of consumer credit.^{17\}

From a straight cost analysis, utilities who determine a need for security in any given instance are well served by seeking out and obtaining non-cash security. The surety situation provides the benefits of security without the expenses of servicing a cash deposit.

Equal payment plans: Households placed on equal payment plans may represent a lesser risk to utilities. As a result, deposits for these households can be either reduced or waived. Equal payment

^{16\}The general rule is that a utility may not disconnect service for nonpayment on a surety agreement. Therefore, there is no collection advantage to having the surety be a customer of the utility.

^{17\}For example, how many banks require that sureties be a customer of the same bank?

plans (or budget billing plans or the like) reduce risks in two ways. First, equal payment plans often provide prepayment of high winter bills. If plans are structured so as to start payments in the warm weather months, households build up a credit when their equal monthly payments exceed their actual usage. In this fashion, the risk of permanent loss due to nonpayment is reduced for any given high winter bill. Second, equal payment plans facilitate household budgeting. A study of the Rhode Island Percentage of Income Payment Plan (PIPP) by the University of Rhode Island, for example, found that the aspect of the program that clients liked most --outside of more affordable payments-- was the fact that they knew far in advance exactly what payment they would be required to make every month.

In the event that a household may not be able to afford a deposit, a utility should offer that household an equal monthly payment plan as a deposit alternative. By reducing the risk of nonpayment, the deposit could possibly be cost-effectively reduced or waived.

LIHEAP recipients: The cost-effectiveness of deposits for households receiving LIHEAP assistance can well be questioned. LIHEAP provides cash grants to apply toward the payment of winter home heating bills. This assistance reduces the risk of permanent nonpayment to the utility in two ways. First, the receipt of public assistance makes it more likely that the household will pay its winter heating bill in a timely and complete fashion. Second, even if the bill is not completely paid, the risk of permanent loss is reduced. Through LIHEAP, the winter heating bill is by definition offset by revenue equal to the amount of the LIHEAP grant. If a utility has a risk of permanent loss, therefore, its risk has been reduced by half or more. As a result, a utility should reduce or waiver deposits for households who receive LIHEAP benefits.

SOME UNIQUE TELEPHONE ISSUES

Because of its state of flux, the telephone industry in particular poses unique deposit issues. This industry represents a situation where one utility collects the bills for multiple companies. Moreover, it represents an industry where competitive and non-competitive services are provided by the same utility. The implications of these observations are discussed in detail below.

With telephone customers in particular, even aside from cost-effectiveness considerations, deposits are an important issue. Work done throughout the country has found that households not having telephone service cite the unaffordability of deposits as a major contributing reason. Moreover, the lack of telephone service can ramify throughout the household's social and economic affairs. The National Consumer Law Center, for example, found that the lack of telephone service impeded the ability to maintain home heating service.¹⁸⁾ Moreover, the Montana Supreme Court identified the lack of a telephone as a significant "barrier to employment."¹⁹⁾

¹⁸⁾See, note 7, supra, and accompanying text.

¹⁹⁾*Butte Community Union v. Lewis*, 745 P.2d 1128, 1131 (Mont. 1987).

Deposits for Long-distance Service: Telephone deposit policies should be significantly revised in light of AT&T divestiture.^{120\} The divestiture of AT&T from local telephone companies affects the "bill" toward which a company may collect a deposit. Given the fact that deposits are designed only to protect the company against the risk of loss of revenue due to bad debt, local telephone companies have no reason to collect deposits based upon services other than those services provided by *that company*. Revenue other than that associated with services provided by the local company itself are not at risk to the local company.

The appropriate size of telephone deposits is affected by the AT&T divestiture. As with the energy utilities, deposits are often set equal to some multiplier of a household's consumption. Deposits equal to twice the maximum monthly bill and twice the average monthly bill are common requirements. In pre-divestiture days, the customer's combination long-distance^{121\} and local charges represented the "monthly bill" for service. Due to the affiliated nature of the companies,^{122\} whether the bill was for long-distance service or for local service was largely irrelevant. That situation, of course, is changed today. While the local operating company may act as billing and collection agent for AT&T (or for other interexchange carriers), the interexchange toll charges are not the operating company's revenue and the loss of that revenue would not be a loss to that operating company.

The conclusion that revenue collected by a local operating company for interexchange carriers under a billing and collection agreement is not at risk to the local company flows from the contractual arrangement between the two utilities. The interexchange accounts are purchased at a price equal to the value of the account minus an uncollectible factor. The local company is thus protected against loss due to uncollectibles. Moreover, the local company is not even at risk of loss due to working capital requirements resulting from nonpayments or late payments. The accounts are purchased minus a "cash lag factor" to compensate for that impact.

The fact that accounts are purchased has no impact on the analysis. If the actual uncollectibles differ from the projected uncollectibles that serve as the basis for the discount, there is a periodic true-up whereby the local company and the interexchange carrier remedy the difference. In the New England Telephone Company contract in Rhode Island, for example, there is contract language providing that to the extent that the interexchange carrier's amounts for anticipated uncollectibles exceed its realized uncollectibles, the local telephone company will remit such amounts to the interexchange carrier. To the extent that the carrier's amounts for anticipated uncollectible are less than its realized uncollectibles, the local company will bill the carrier. In Michigan, this language is incorporated directly into the billing and collection tariff.

^{120\}This section is based on work undertaken by NCLC for the Michigan Divestiture Research Fund, a research arm of the Michigan Public Service Commission. See, note 2, *supra*.

^{121\}For purposes of this evaluation, "long-distance" is defined to mean interstate and inter-LATA. To the extent that the local telephone company also provides intra-LATA service, this analysis does not apply.

^{122\}This assumes the local company is a Bell company.

In short, the revenue to be collected by a local telephone operating company pursuant to a billing and collection agreement is not revenue at risk to the local company. Since the purpose of a deposit is to protect the local company against the risk of loss, deposits collected by local telephone companies should thus not be based upon the interexchange portion of a monthly bill.

This is not to say that a telephone company should not be permitted to collect security against the risk of loss of uncollectibles attributable to interexchange telephone usage. The only question is *which* company. The appropriate response is to permit each interexchange carrier to collect its own security against uncollectibles. Only in that way are the costs of obtaining and maintaining deposits appropriately matched with the benefits that arise from the deposits.

Moreover, by requiring interexchange carriers to collect their own deposits, customers gain the advantage of competition in the interexchange markets. If, for example, a customer believes AT&T's deposit requirements to be excessive, or if AT&T refuses to enter into a satisfactory payment plan for the deposit, or if the terms of the deposit are unacceptable for any conceivable reason, the customer would have the choice of seeking more favorable terms from a different interexchange carrier. In this fashion, each interexchange carrier would need to balance the need for security against the possible loss of business due to unreasonable, oppressive or otherwise unacceptable business practices.

In short, a local telephone company should be permitted to collect a deposit based upon bills rendered for service provided by that company. Given the constraints relating to matching deposits to the potential risk of revenue loss to the company, anything else is unacceptable both from a cost-effectiveness perspective and from a fairness perspective.

Deposits for Deregulated or Detariffed Services: Telephone deposit policies should be significantly revised, also, in light of the ongoing process of deregulating (or detariffing) substantial numbers of telephone services. The collection of deposits stands as a substantial obstacle to having low-income households obtain monopoly-provided local exchange service. The collection of deposits is justified, notwithstanding this result in some instances, because the utility is found to need protection against the loss due to bad debt. The underlying assumption behind this balancing of interests (i.e., the interest of the consumer in service versus the interest of the company in protection against bad debt), however, is that the rates which serve as the basis for the deposit have been reviewed by a regulatory agency and found to be "just and reasonable."

When a service is deregulated or detariffed, that underlying assumption is no longer valid. Whether the deregulated service be some type of "enhanced service" (such as call-forwarding), a service contract for inside-wiring, or inter-LATA (or interstate) service, any deposit that is to be collected for security against nonpayment should be collected apart from deposits associated with monopoly-provided local exchange service. To provide the protection which has historically been provided, deposits collected by local telephone companies should be collected only for services offered pursuant to tariffs approved by the state public utilities commission.^{123\}

^{123\}As with long-distance service, deposits for detariffed services could well be collected. They simply cannot be

SUMMARY

Expenses associated with the collection of deposits by a public utility should be subject to the same cost analysis as any other public utility expense. The utility must engage in efforts to provide least-cost service to all ratepayers. In this regard, the purpose of deposits must be used as the benchmark for evaluating deposits. Given the fact that deposits are designed to protect a utility against revenue loss due to bad debt, to be cost-effective, a utility's deposit scheme must be shown to result in savings in uncollectibles at least equal to the expense of obtaining and maintaining the deposits.

This cost-effectiveness analysis should be applied to evaluating whether deposits should be demanded at all as well as to assessing the appropriateness of the size of particular deposits when some type of security is necessary. If there is a systematic mismatch between the amount of cash deposits held by a utility, and the risk of loss to that utility, the utility's ratepayers are being penalized by unreasonable utility behavior.

collected by the local telephone company, making monopoly provided local service contingent upon their payment.