AFFORDABLE PAYMENT PROGRAMS: CAN THEY BE JUSTIFIED?

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Introduction

Affordable payment programs have been developed in recent years by utilities, regulators and advocates in response to the persistent and seemingly intractable problems caused by the inability of many low income customers to achieve full coverage of their utility bills. These programs may be simple in nature, allowing, for example, participants to pay a fixed percentage of their income or percentage of their bill, derived through a pre-determined formula or through negotiation, toward their gas or electric charges. Or, they may be more complex, involving the integration of a variety of components, including: discounted rates; forgiveness of arrears; installation of energy efficiency measures; education in fiscal and energy management; and assistance with obtaining federal and state entitlements and other available services. States including Maine, Rhode Island, New York and Pennsylvania have experimented with such approaches. Affordable payment programs, however, are not without controversy, and detractors proffer as many arguments in opposition to them as proponents advance rationales in support of them. In the final analysis, the central question remains: are affordable payment programs justifiable from an economic and policymaking point of view?

This discussion will present the policy arguments surrounding such programs; it will outline two affordable payment program models currently being tested in New York; and, finally, it will examine the costs and benefits of such programs,

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differentiating between those that are measurable and those that are less easily quantified.

The Problem

In a phrase, the problem is inability to pay. And that problem has many ramifications for utilities, their ratepayers and their regulators.

It is well-documented that low income households devote a greater percentage of their income to energy than do other households.[1] Though, clearly, not all low income customers are payment-troubled, others -- especially those with a "negative cash flow," where expenses exceed income, or those with a meager "positive cash flow" -- do demonstrate and experience a legitimate inability to pay.

This condition not only affects the families involved, by placing them at risk of losing their utility services, but it also impacts utilities, through impaired cash flow and increased expense. The effect on utilities in turn affects all other ratepayers, who must compensate for the resultant revenue shortfall and additional costs.

Income deficiencies manifest themselves in various ways. One set of indicators underlining the severity of the

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[1] See U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services, Division of Energy Assistance, Low Income Home Energy Assistance Program Report to Congress for the most recent fiscal year.

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problem is the statistics utilities regularly report regarding arrears, uncollectibles, terminations and payment agreements. In New York alone for 1993, combined residential arrears stood at almost $21.5 million and aggregate residential uncollectibles amounted to a little over $11 million, both representing about a 12% growth rate from the previous year. At the same time, almost 850,000 deferred payment agreements were negotiated -- over 10% of residential customers required them -- and there were over 255,000 disconnections of residential service for non-payment.[2] In addition, last year (1994), the New York Public Service Commission handled more than 24,000 complaints, about one-third of which were credit-related.[3] It is fair to conclude from these statistics that a significant level of hardship exists among utility customers. But the numbers are, in themselves, only help identify the problem. The key question is: what is the appropriate response.

The Options and the Arguments

There are a number of responses utilities can offer to the inability to pay problem. Each one has its champions, and each has its distinct advantages and disadvantages. The following presents some options and their pros and cons.

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[2] Source: New York State Public Service Commission, Consumer Services Division. This represents the last full year for which data is currently available.

[3] All these represent aggregate residential class figures; they are not separated by sub-sector (e.g., the low income sector).

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1. **Adopt harsh collection policies; accelerate shutoffs.**

This solution insulates good paying customers from the burden of subsidizing the debt of bad paying or non-paying customers. It minimizes collection expenses, arrears and uncollectibles, and limits the financial exposure of the company and its ratepayers. It sends clear signals to customers regarding the treatment they can expect if they fail to pay promptly or at all, and may act as a deterrent to bad payment behavior.

On the other hand, these practices fail to properly distinguish among payment-troubled customers, and overlook the fact that some customers simply can't pay because of lack of resources while others, who have the resources, simply won't pay. Such policies fly in the face of good customer service principles, are overly broad and, worse, are unnecessarily punitive. Such practices would undoubtedly provoke an angry response from advocates, prompt a large volume of complaints from customers to both the utility and the public utility commission, and, perhaps, engender unfavorable media attention, all of which might well lead to a regulatory order for corrective action; all in all, a lose-lose-lose proposition.

2. **Seek legislative relief.**

The argument can -- and has -- been made that unaffordability is a social, not a utility/ratepayer, problem. Proponents of this school of thought contend that the utility's

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responsibility is simply to provide access to and deliver service. The "social compact" or "obligation to serve," incumbent upon utilities as monopoly providers (for the time being, at least) of essential services, ends if the customer does not pay for the services provided.

It has been suggested that it is the responsibility of Congress and state and local legislators to provide subsidies for those who cannot pay for energy costs. Taxpayers, not ratepayers, should bear the burden if that is what elected representatives believe is best for the body politic. Besides, federal programs (like the Low Income Home Energy Assistance Program and the Weatherization Assistance Program) and state programs (like public welfare) already exist. Why should utilities duplicate efforts. Further, if these programs are insufficient to meet the need, then the remedy is legislative, not a regulatory fiat or utility largesse.

The counter argument holds that inability to pay is indeed a utility problem, since those unable to afford the services are <u>utility customers</u> and the effects of their non-payment redound to the detriment of other ratepayers. And, some would construe the "social compact" and "obligation to serve" as extending beyond just providing access and service to ensuring that all efforts are made to retain customers on the system.

While both sides might agree that legislative solutions are preferable, advocates of activism believe the failure of legislatures to act is not an excuse for inaction by other

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branches of government, nor does it absolve of their duty to fulfill their responsibilities to serve the citizens under their purview. Further, they believe that it not the sole responsibility of government to solve the problem. In fact, some argue convincingly, that all involved -- government, the utilities and the customers themselves -- should have a part in the finding the answer.

Concerning the availability of existing programs, not only is it readily apparent that these programs are insufficient to meet the need, but also it is likely that the federal and state commitments to these programs will, at best, lessen and, at worst, disappear.

3. **Do nothing.**

This, of course, has been the way things have operated in the pre-affordable payment plan era, which spans virtually the entire history of utility regulation. This course of (in)action simply allows arrears to mount and uncollectibles to accrue, and places the burden of recouping these revenues, which are rightfully due the utility, from other ratepayers.

Until recently, outstanding debt was a relatively manageable factor that represented a small fraction of utility revenues. However, given the sharp increases in poverty (nationwide, about 15% of the population or over 39.2 million

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Americans in poverty[4]) and uncollectibles (one New York utility's write-off increased from about $4 million in the late 1980's to $13.8 million in 1993 to $16.8 million in 1994),[5] a "business-as-usual" strategy is no longer practical. Further, lest we forget, prudency is still a regulatory pre-requisite for recovery of utility expenses, and, given the growth rate and magnitude of bad debt, regulators might not look too kindly on requests for full recovery of uncollectibles without some attempt on the part of the utility at remediation. Further, allowing costs to climb unchecked is inconsistent with the urgency utilities are feeling to cut costs to prepare for the coming (and, in some quarters, already present) era of competition.

4. **Design and implement an affordable payment program.**

An affirmative action that a utility can take to address the affordability problem is to design an affordable payment program that seeks to mitigate the effects on families and on other ratepayers that result when a large enough group of customers cannot meet their utility payments. This represents a proactive approach. Yet, even before we can discuss program design and cost/benefit matters, there are still other issues that opponents raise that argue against institution of an

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[4] Figures are for 1993. The number of Americans in poverty increased by about 1.2 million from 1992 to 1993. Source: United States Department of Commerce, Economics and Statistics Administration, Bureau of the Census.

[5] Source: New York State Electric and Gas Corporation.

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affordable payment program. The following presents the debate on those points.

a) Why Should Utilities Be Singled Out?

Critics suggest that low income households pay a higher percentage of their income for everything, not just utilities. Why shouldn't food stores, clothing stores, furniture stores and all other businesses provide "affordable payment programs" where these retailers subsidize the costs of these commodities for low income persons?

Supporters note that the critical difference between all those other business enterprises and the utility business is that the utility is the only one that is a monopoly provider of essential services, with, basically, exclusive franchise rights and the concomitant obligation to serve.

b) You Can't Define Affordability

Naysayers point out that affordability cannot be defined. What percentage of income is acceptable to pay for energy or to use as a basis for a payment plan? Three? Four? Six? Without such definition, arbitrariness ensues.

Adherents admit that affordability is difficult to define, but, they point out, most all program designs require some level of judgment as to where to draw eligibility or benefit level lines. Even the setting of a utility's rate of return, they argue, is art, not science, generally requiring a judgment call, based on the best available information. With any

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particular utility in any particular case, the program design defines affordability for that instance. Moreover, so say advocates, under any definition, the pool of potential participants is sufficiently large, and the lack of universally accepted definition of affordability is an insufficient reason to deny assistance to those deserving customers.

c. We're Not in the Business of Giving It Away

Critics submit that utilities are profit-making entities; they are not in the business of giving service away.

Program proponents argue that inability to pay creates a business problem, which requires a business response. Utilities are losing profit and contribution to expenses and fixed costs when customers don't pay their full bills; a soundly reasoned, economically-based program that minimizes utility losses and maximizes customer contributions makes good business sense. Affordable payment programs should be designed to increase the "net back" to utilities (that is, the net revenue collected from customers after collection expenses and other costs are netted out).

d) Residential Rates are Already Subsidized

From a rate design perspective, foes claim, utility rates for residential customers are already below what it actually costs to serve them, and, absent subsidies by other classes currently built into rates, prices would be several times higher than what they are. In other words, residential customers

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are already "getting a break" and "not paying their freight." Any program that adds more costs and subsidies is economically unsound. Moreover, utilities are in a transition to a more competitive environment, and, in such an environment, utilities should not be the only players saddled with incumbent burdens to deal with social problems. Any rise in rates due to the need to pay for these programs places utilities at a competitive disadvantage. Even if these programs can pay for themselves over the long term, in the short run they increase costs and raise rates; in this environment, a luxury utilities can't (no pun intended) afford.

There is another side to this argument. With upward pressure on rates being felt by residential customers during this transition period, where, in some jurisdictions, costs shifts are taking place to reduce historic subsidies of residential customers by the commercial and industrial classes through the closer alignment of prices and costs to serve, and industrial customers are being given price breaks to induce them to remain on the system, it is more important than ever to protect the most vulnerable customers, while at the same time reduce the utility's exposure. It is difficult to reverse almost a century of cost-plus, rate of return regulation without substantial upheaval, which must be mitigated to avoid devastating rate shock. In such an environment, affordable payment programs are necessary and sensible.

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Further, to the extent competition exists in the residential energy market, all competitors should be required to operate on a level playing field. (In the telephone industry, where competition is upon us, all rival telephone companies in the State of New York must either provide Lifeline telephone service or pay into a universal service fund.) However, for now, residential energy customers do not have a choice of providers.

e. What About Free Riders?

If, as part of an affordable payment program, antagonists assert, broad-based discounts are provided to customers on the basis of income only, who are otherwise paying their bill, "free riders" are allowed to gain benefits unnecessarily and cause harm to other ratepayers. Moreover, discount rates send the wrong price signal. Programs that target customers in arrears provide a perverse incentive to stop paying bills in order to qualify for the program.

Adherents contend that free ridership, though admittedly a phenomenon that will occur in any program, is not significant enough to discourage the implementation of programs, and that providing discount rates for those categorically eligible based on objective income guidelines are, by definition deserving of a discount due to their financial condition and their energy burden. Further, properly designed, discounts can come from a combination of customer charges (to the extent that they will cover system average costs) and energy charges (to the

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extent that they come from lower use blocks and cover variable costs) so that incorrect signals can be avoided. Concerning the charge that affordable payment programs provide incentive for customers to stop paying bills, most companies draw participants from a pool of customers who, before a program is even designed and implemented, are in arrears and subject to termination for non-payment or are referred from community organizations. Further, in most, if not all, cases, the need in a service territory will far exceed the company's ability to serve that need. Thus, since the program is not an entitlement, but, rather, a targeted effort that does not involve widespread publicity, it seems unlikely that any significant percentage of potential participants would purposefully not pay bills in exchange for a mere possibility of enrollment.

Affordable Payment Program Models in New York

The following describes two affordable payment program models that have evolved in New York that are currently being piloted by The Brooklyn Union Gas Company (Brooklyn Union) and National Fuel Gas Distribution Corporation (National Fuel). They are by no means the only models available, but they do provide a glimpse of the sort of approaches that such programs can take.

The Brooklyn Union model provides a two-pronged approach -- a broad-based discount combined with a limited "full-scale" program; the National Fuel model provides an integrated

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approach -- a comprehensive set of program components provided to all participants.

The Brooklyn Union Model

In the Brooklyn Union program, a substantial number of residential, non-heating, low income customers will receive an effective discount off of the customer charge of 20%, 26% and 31% in 1995, 1996 and 1997, respectively. (For those customers, the customer charge is frozen for the duration of the program while, for other customers, it increases each year; this results in progressively higher percentage discounts.) The discount will be provided to 12,000 customers in 1995; to 18,000 customers in 1996; and to 27,000 customers in 1997.

A separate service class has been established for participants. The rate is derived by using only those costs associated with service and meters, with capacity charges excluded. In other words, they are charged only those costs which vary as a result of their presence on the system.

An additional 3,000 heating customers over the course of three years will get, in addition to a discount on their customer charge, a customized payment plan, tailored to each participant's individual financial circumstances; arrears forgiveness up to $200 per year if payment agreements are kept; furnace or boiler repair or replacement; energy and financial management education; and assistance in accessing entitlements.

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The National Fuel Model

In the National Fuel model, a fully integrated approach is being tested. The company developed a rate consisting of a reduction in the customer charge in the amount that reflects the uncollectibles portion of that charge (leaving intact the other customer-related costs such as metering and billing). The reduction amounts to about a 44% reduction of this component of the rate. On the energy side, the participant is asked to pay the base cost of gas plus the adjustment (the pass-through mechanism); the margin is eliminated. The ultimate discount is in the 40% to 45% range, depending upon usage. The program will enroll 2,000 customers over a two year period. All 2,000 participants will be provided with an array of other program elements, including a payment plan, arrears forgiveness, energy efficiency assistance, energy education, and, if this year's usage is lower than last year's, a conservation credit.

The Costs and Benefits of Affordable Payment Programs

The acid test is whether the tangible benefits to the utility (and its ratepayers) of the affordable payment program, whether in the form of realized dollars or legitimate avoided costs, are greater than the costs of conducting the program or the cost of not conducting the program at all.

Most of the costs are knowable; regarding benefits, some are easily quantifiable, others less so. The following delves into those costs and benefits in a bit more detail.

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Costs

There are a number of costs that attend the implementation of an affordable payment program. They include:

Outreach costs -- the cost of recruitment. These may include programming costs, design costs (both program and materials), mailing or telemarketing costs, media, or referral arrangements with community agencies.

Administrative costs -- the cost of operating the program. Labor costs (is staff being shifted? added? is other work not being done?), maintenance and tracking of individual cases, and other activities including negotiating individual payment plans are included here. Some of these costs may not be incremental.

Arrears forgiveness -- a write-off that must be absorbed by other ratepayers.

Low income rate or rate discount -- results in a revenue shortfall that must be absorbed by other ratepayers.[6]

Energy and financial management education -- the provision of this service might entail design costs and will certainly entail

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[6] For a description of various types of low income rates, see "Models of Low-Income Utility Rates," Roger Colton, National Consumer Law Center, December, 1993.

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implementation costs in the nature of home visits (the most costly) or workshops (less costly).

Benefits

There are a number of benefits that accrue from the implementation of an affordable payment program. Among them are:

Additional Revenue

These benefits are concrete and can be easily quantified. They include:

a) Increased customer payments: Once a customer is placed on a plan which s/he can afford (and, generally, is assured that no shutoff will occur so long as payment obligations are met), customers tend to make larger, more frequent and more timely payments.

b) Increased receipt of entitlements: Once a customer becomes a plan participant, s/he may be able to access, with or without the company's aid, federal or state entitlements, such as the Low Income Home Energy Assistance Program grant or welfare energy payments, that may go directly to the utility.

Avoided Collection Costs

A number of utility activities are involved in the collection of overdue amounts from customers. Some of these costs are calculable (or reasonably estimable). Telephone calls,

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repeated mailings, processing of returned checks, referrals to collection agencies, the assessment of deposits and late payment charges and the negotiation, processing and maintenance of one or multiple deferred payment agreements are just some of them.[7] In addition, the collection of money owed utilities will generally involve either the utility or the public utility commission, or both, having to process a customer complaint.[8] Service disconnection, which are often followed by reconnection, is the ultimate collection tool utilized.[9]

What becomes tricky is attempting to determine how many telephone calls, written communications, complaints, shutoffs and reconnections were avoided.

Another area of savings might arise out the ability to streamline or redirect the collections workforce. If, as a result of the program, staff could be reduced, then truly quantifiable savings can be realized (i.e., a reduction in salaries and benefits). On the other hand, it is questionable

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7 Some of these costs are discussed in "Energy Policy and the Poor," by Roger Colton, National Consumer Law Center, July, 1990.

8 An attempt to quantify the cost of a complaint to a utility and to a public utility commission was made in "How Good is Your Service and, in the Utility Industry, Does it Really Matter," by John A. Goodman, Technical Assistance Research Program, May, 1983.

9 At least one utility -- Columbia Gas Company of Pennsylvania -- has attempted to calculate the cost of disconnecting and reconnecting service, arriving at a figure, not including personal contact, of about $65 per incidence. See Roger Colton, "Identifying Savings Arising from Low-Income Programs," National Consumer Law Center, June, 1994, p. 2.

FSC, NOV. 1994.

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whether savings are measurable no staff is dismissed, but, rather, the same staff simply works different accounts. It has been argued that no incremental savings are attributable in just redirecting staff collection efforts from one customer to another.

A contrary view holds that indirect benefits exist if collections staff can focus on customers with more likelihood of paying and, in fact, collect more than they otherwise would have if they were continuing to expend wasteful and unproductive time with customers without means.

Reduced Arrears and Uncollectibles

If customers bills are reduced through any means (e.g., discounts, energy efficiency) or customer payments increase over what they otherwise would have been absent the program, then there can be little disagreement over whether the program will lessen arrears and reduce uncollectibles, at least to some extent. The sticky issue is to accurately assess the level of savings.

If bill and/or usage reduction results in a $100 per month bill being reduced to $70, and the customer payments increasing from $20 to $30 per month, for instance, then it could be said that arrears have dropped from $80 to $40 and, arguably, the utility can claim that amount as an avoided cost saving. However, should the utility count the $40 difference as an

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avoided uncollectible? How can it be sure that money, any part of it, would never have been collected?

Another area of potential savings is the reduction in carry costs on those diminished arrears and savings in utility working capital needs.[10] ~~The utility, it is posited, loses the time value of funds the longer bills go uncollected.~~ Moreover, that effect.

Other Benefits

Ancillary, and difficult (if not impossible) to quantify benefits may also exist in connection with the operation of affordable payment programs. Some of these benefits include: retention of customers on the system; prevention of fires and deaths, and the accrual of other health and safety benefits, through the avoidance of disconnects; and the avoidance of social costs attendant to homelessness. Some regulators have, indeed, put all benefits to the utility.

Conclusion

Affordable payment programs come in a variety of shapes and sizes. They also come with a host of questions concerning their policy and cost justifications. All things considered, however, there appears to be sound reasons for implementing an affordable payment program and potential for its success in

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[10] For a detailed methodology concerning the calculation of the working capital benefit, see "Low Income Programs and Their Impact on Reducing Utility Working Capital Allowances," by Roger Colton, National Consumer Law Center, February, 1994.

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reducing minimizing wasteful costs, maximizing revenues and retaining low income customers on the utility system.

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