

ELECTRIC UTILITY RESTRUCTURING AND THE LOW-INCOME CONSUMER

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What's at Risk: Will Competitors Seek out the Poor?

Advocates of a restructured electric industry put much stock in the process of competition delivering benefits to consumers. A competitive market, these advocates say, will result in lower prices, high quality service, and an explosion in innovation that would never occur under regulation. In addition, they say, any potential consumer abuses should be controlled through a competitive market.

The theory is simple. If a competitive supplier of electricity offers poor quality service, offers service at high rates, or engages in consumer abuses, consumers will simply switch to another company. As a result, abusive suppliers of high cost poor quality service will not survive in the competitive marketplace.

If, however, competition does not exist, the whole theory falls apart and consumers will be left unprotected. That is precisely the case for low-income consumers. Utility consumers such as low-income households are not well-positioned to take advantage of competition in the electric industry. The impacts on low-income consumers are thus less likely to be positive, and more likely to be negative.

The Problem of Size

Positive impacts are less likely to arise because low-income customers are simply not big enough for competitors in the electric industry to aggressively solicit.

In Michigan, for example, one of the states which has experimented with electric competition, in 1995, Consumers Power Company raised electricity rates for its 1.4 million residential users by 8.2 percent (\$42 on a typical annual bill) while lowering rates for the state's 9,000

industrial users by an average of 4.2 percent. The largest and most powerful Michigan industrial consumers such as General Motors and Dow Corning saw rate cuts of up to 20 percent.

Why does this happen? Contrast the situations of a large industrial customer and the typical residential customer in Massachusetts, a state which is aggressively pursuing electric restructuring.

In response to threats by Raytheon (a major defense contractor) to leave Massachusetts, the local electric company offered rate discounts of 20 percent and more for five years, with lower discounts being offered in subsequent years. Even then, Raytheon refused the discount in 1995, arguing that the deeper discount should last longer. Ultimately, a discount was agreed to and approved in January 1996. Raytheon would say only that its deal with Mass Electric would yield "significant savings" on its \$20-million-plus annual electric bill.

In contrast to the bargaining power of a Raytheon, alternative producers of less expensive power do not seek out small users as customers. When compared to large industrial consumers, the potential for profit is lower, the administrative costs of billing and collection are higher, and the marketing costs are higher.

With typical residential bills for Mass Electric Company at just over \$700 a year, for example, it would take nearly 30,000 customers having 30,000 meters read each month resulting in 30,000 monthly bills and the accompanying credit and collection activity to generate the same revenue as Raytheon's estimated pre-discount bill of \$20+ million.

Those Dinnertime Phone Calls

The telecommunications industry is often cited as an example of why this analysis is wrong. Consumers are noted for their annoyance with repeated dinnertime telemarketing calls for long distance telecommunications carriers. The telecommunications industry proves that fears of competitors abandoning the small user market are unfounded, say advocates of competition.

In fact, however, the long-distance industry is indeed beginning to abandon the low use market.

The move of telecommunications giants such as MCI to "dial around" services represents a specific decision to abandon the consumer-by-consumer marketing. An April, 1997 *Wall Street Journal* article reported that "the dial-around approach offers MCI a much cheaper way to sign up the lowest-spending customers in the industry, those who pay \$25 or less a month for long distance and still cling to AT&T. MCI used to spend a fortune marketing to these folks, calling several times in a single night, sending discount pitches through the mail and using other sales gimmicks. MCI now regards this low end of the market as a commodity service almost unworthy of the MCI brand it has spent billions of dollars to promote." In the meantime, according to the *Wall Street Journal*, MCI is focusing its attention on marketing a "premium package of services, including long distance, local, cell phone, paging and Internet access."

Similarly, AT&T plans to substantially scale back its marketing. Noting that the cost of acquiring customers is much higher than the cost of retaining them, AT&T has said it will scale back significantly the practice of sending checks to long-distance customers and will replace that with a less-expensive loyalty program in which customers are rewarded with free long-distance service for staying with AT&T on their premium services.

What's Happened Before?

Experience in other deregulated competitive industries, as well, shows that the small user and hard-to-serve are disadvantaged by business

actions taken to help meet competition.

In 1982, for example, Congress largely deregulated the inter-city bus industry. Within ten years, the number of rural locations receiving regular route inter-city bus service had shrunk by more than 50 percent. A 1992 study by the U.S. General Accounting Office concluded that "the riders who have been losing service are those least able to afford and least likely to have access to alternative modes of transportation."

Summary

A move to a restructured electric industry is likely to end up delivering fewer benefits, and greater harms, to low-income and other small user consumers. Arguments over whether competition, generally, will "work" or not largely miss the point. Low-income consumers and other small users simply do not carry the market power to attract sufficient competitive attention to bring the benefits of competition to them.

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