

# ELECTRIC UTILITY RESTRUCTURING AND THE LOW-INCOME CONSUMER

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## What's at Risk: The Anticipated Impact on Rates

One impact of a restructured electric industry is the likely impact that low-income customers will pay increased bills for electricity.

### Cost-of-service vs. Value-of-Service Rates

Understanding two concepts will help explain this probable rate impact. The first concept is called cost-of-service ratemaking. Under cost-of-service ratemaking, which has historically been the norm under state regulation, state regulators seek to match the rates charged to consumers with the costs incurred in providing those consumers with electricity. There is, in other words, some element of causation. If a customer class causes the utility to incur certain costs, that class pays those costs.

The second concept is called value-of-service ratemaking. Under this approach, prices are set equal to what the market will bear rather than being based on cost causation. Value of service ratemaking takes into explicit consideration the alternatives available to customers. If fewer alternatives are available, the customers will be "willing" to spend more to retain service and prices are thus set higher. Given the lack of alternatives for most low-income consumers, the "value" of electric service is higher and prices are set accordingly.

The reasons that low-income consumers have the fewest alternatives will be familiar to low-income energy service providers. Low-income households tend to be tenants. As a result, they do not have the authority to make energy saving home improvements. In addition, since energy savings go to tenants, landlords do not have the incentive to do so. Low-income consumers do not have the money to invest in energy savings devices. It makes no difference to a poor person

that spending \$100 will save \$130 if he or she does not have the \$100 with which to begin. Low-income consumers do not generally have substantial discretionary energy use. They don't have things to "turn off" in order to save energy.

If the move to value-of-service ratemaking means that captive customers will pay more, which it does, then low-income consumers are likely in line for a series of price increases.

### Fixed vs. Variable Costs

A more subtle form of passing higher costs on to captive users (including low-income consumers) is through a reallocation of fixed and variable costs. The "fixed" costs of a utility system are those costs that do not vary based on the amount of electricity sold. They include headquarters buildings, power plants, executive salaries, and the like. In contrast, the "variable" costs of a utility are those that increase or decrease directly with the amount of energy sold. Thus, for example, fuel costs are variable costs; if you sell more electricity, the utility must burn more coal to produce the power.

Under principles of cost causation, variable costs are charged to the consumers who cause the utility to incur the costs. In contrast, however, there are no accepted means of allocating fixed costs. Accordingly, as the utility industry becomes more competitive, it is likely that the utilities will charge their larger customers close to their variable costs as a means to keep prices down and retain those customers as customers. The result, however, is to allocate the fixed costs of the system to captive customers. As a result, customers with fewer alternatives (such as low-income customers) will bear the largest share of fixed costs while those classes with more

alternatives will be assigned a smaller share. They can thus expect to see increases in price even when the total costs of the utility remain stable or decrease.

### **Unbundling Rates and Services**

Aside from increases in their base rates, one additional way in which low-income consumers will likely face increased prices is through the "unbundling" of rates and services. Debundled service fees can represent a significant increase in "rates" to customers even if base rates remain the same or decrease. Customers who are facing payment troubles, for example, can nonetheless still face significant increases in the monies which they owe to a utility if either the utility debundles existing elements of service and institutes new fees for those individual elements, or, if the utility institutes increases in existing fees for certain elements of service other than those paid for through base rates.

### **Look What's Happened with Banks**

Unbundling is not new to consumers. Banks are the masters of "unbundled" fees. Most consumers have experienced fees for ATM machines that were not previously imposed. Fees are charged to use credit cards. With some banks, fees are charged to have a consumer's checks returned to them in their statement each month (rather than photocopies of the checks). In a competitive industry, these fees need not be cost-based. Since bank deregulation in the 1980s, fees charged by banks have been skyrocketing. Recent newspaper headlines proclaim: "Banks Begin to See Gold in Bounced Checks." Reports state that non-sufficient funds (NSF) fees have risen from an average of \$15.11 in 1990 to an average fee of \$19.35 per check by 1993. The large banks are charging fees averaging 971% more than the processing costs. Researchers have estimated that banks earned in excess of \$1 billion in 1994 from NSF fees alone. Of course, banks charge other fees as well.

### **The Utility Counterpart**

The utility industry is already beginning to adopt

these banking practices. One Vermont utility has proposed to charge consumers a fee every time they are sent a shutoff notice. A Pennsylvania utility proposed charging a fee for "field collection calls," where a company representative personally visits your home and collects money while there.

Other fees that can be expected include fees to pay for the negotiation of a deferred payment plan, fees to cash third party checks at company offices, and fees to have a utility check your bill if you dispute the amount that you have been billed.

### **Summary**

Predictions that competition in the electric industry will result in price savings to all consumers fail to take into account the impact of competition on low-income customers. Whether it is through increases in base rates, or increases in fees for unbundled services, it is likely that a competitive electric industry will impose higher prices on low-income consumers.

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