

ELECTRIC UTILITY RESTRUCTURING AND THE LOW-INCOME CONSUMER

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What's at Risk: The Potential for "Redlining"

The issue of redlining in a competitive electric industry has been raised by consumer advocates who fear an industry disinterest in residential customers generally, and in hard-to-serve or payment-troubled residential customers in particular. Indeed, in many of the sets of "principles" being promoted around the country to govern restructuring the electric industry, an anti-redlining provision has merited explicit consideration.

What's "Redlining"?

The primary emphasis of redlining concerns involves the definition of geographic areas based primarily on racial/ethnic and/or socio-economic factors. A group of advisory committees to the United States Committee on Civil Rights has defined *insurance* redlining as "canceling, refusing to insure or to renew, or varying the terms under which insurance is available to individuals because of the geographic location of a risk."

Similarly, redlining within the home mortgage industry has been defined as "the process of drawing or outlining a geographic area within which lending will be denied due to the composition or characteristics of the area."

Irrational vs. Unlawful

Redlining is objectionable whether or not it is economically irrational. A decision to redline may well be an economically rational decision. One example may involve the decisions of the automobile insurance industry to engage in the practice of "territorial rating." Under such a system, auto insurers set policy premiums based in large part on the geographic location of the insured. Locations in large urban areas and inner

cities are deemed to be more risky, and therefore more expensive to serve, than suburban areas. Accordingly, the rates charged to the predominantly low-income and minority auto owners in these areas are consistently higher than non-urban, non-poor, non-minority locations. The thing is, the conclusion that urban customers are more risky, and thus more expensive to serve than non-urban customers, may be true. Thus, while the geographic-based decisionmaking may be "redlining," it is nonetheless economically rational.

Similarly, just because bank lending patterns are racially discriminatory does not *ipso facto* mean that they are economically irrational. It may well be that households in certain geographic areas of the city, as a class, do not have the financial resources to support home mortgages. Even more possible, households in certain geographic areas of a city may not, without further inquiry, satisfy the indices of "creditworthiness" which historically have supported a decision to grant a mortgage. No question exists but that if a bank or other financial institution would pursue a further inquiry, it may ultimately discover the creditworthiness of the individual households in this area. Nonetheless, to pursue such an inquiry may be expensive and considered unmerited by the profit potential from that area.

In the alternative, a bank may simply decide that it can generate the same number of loans for an equal dollar value in a different geographic area of the city *without* engaging in the additional inquiry. In the absence of the additional expense of the further inquiry, the profit margin per loan may be higher and a profit-maximizing enterprise may rationally be drawn to the second geographic area. In sum, ultimately, while the creditworthiness of the households in both areas

of town may be equal, the transaction costs in making the creditworthiness decision may be vastly different, thus affecting the profit margin and the decision to serve. In this instance, even if unlawful, the decision of the financial institutional to redline is not economically irrational.

Potential Redlining Decisions

Potential redlining decisions that could be expected from a competitive electric industry include:

Refusal to serve: Electric service providers could decide not to serve particular geographic areas. These might include inner cities, where heavy concentrations of poverty might threaten the easy collection of revenue. They might include various areas where lower incomes are viewed as associated with lower use and thus lower profit potentials. This refusal to serve could be evidenced not simply by a refusal to serve (as in the home mortgage industry), but by the cherry-picking found in telecommunications. A decision to serve *only* high income suburban areas, in other words, excluding every other place, would be a type of redlining.

Territorial pricing: Electric service providers could decide to vary the price for service based on geographic location. Like insurance companies who increased prices based on "territorial ratings," electric companies could allege that the cost of serving particular geographic areas (such as low-income and minority neighborhoods) is higher and thus merits correspondingly higher prices.

Lack of infrastructure development: Electric service providers could decide to refuse to provide newer technology that permits either a diversification of service or a higher quality service. The infrastructure needed to permit the time-of-day pricing, or real time pricing, underlying retail wheeling sales could be denied to markets that industry participants simply do not wish to serve.

Lack of facility development: Akin to the absence of branch banks, electric service providers could refuse to serve certain geographic areas simply by deciding not to develop a presence in those areas. It is reasonable to expect service to follow facilities.

Level and type of service: Electric service providers could refuse to provide the same quality of service based on geographic considerations. A decision to offer certain neighborhoods or communities service based only on prepayment meters or service limiter adapters would be a type of redlining.

Summary

Just as redlining has been an issue in banking, insurance, and the telecommunications industry, it should be expected in a competitive electric industry as well. The fact that redlining decisions have been made does not necessarily mean the industry is acting irrationally. Indeed, the redlining may be motivated by economic considerations. If universal electric service is to be maintained, vigilance against redlining (economically rational or not) must be maintained as well.

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