FSC'S LAW & ECONOMICS INSIGHTS

Issue 99-6 **Fisher, Sheehan & Colton, Public Finance and General Economics** **Nov/Dec 1999**

IN THIS ISSUE

NOTE TO READERS

ON-LINE DELIVERY

This month presents the third issue involving the bi-monthly electronic delivery of *FSC's Law and Economics Insights*. Previous issues of the newsletter can obtained at FSC's World Wide Web site:

http://www.fsconline.com/news/news.htm

If you do *not* wish to continue to receive this publication, simply send an e-mail addressed to:

unsubscribe@fsconline.com

If you know of someone who you believe would like to receive this free electronic newsletter, send their name and e-mail address to:

subscribe@fsconline.com

CURRENT PROJECTS

Colorado Utility Merger

Public Service Company of Colorado (PSCO) should be required to fund a Community Energy Partnership Program (CEPP) as a condition of its proposed merger with Northern States Power Company, according to recent testimony filed by FSC before the Colorado Public Utilities Commission. In testimony filed on behalf of the Colorado Energy Assistance Foundation (CEAF) and Catholic Charities, FSC said that the proposed CEPP was necessary to ensure that the company "passes on" merger-related benefits to low-income consumers.

According to FSC, traditional merger analysis holds that merger-related efficiencies are only relevant in an inquiry into the legitimacy of a merger to the extent that they: (1) are "merger-specific," and (2) are likely to be "passed on" to consumers in the form of lower prices. The FSC testimony addressed the second half of this inquiry: the "passing on" requirement. The passing-on requirement was first formally described by the Federal Trade Commission's 1984 decision in American Medical International and has been articulated time and again since.

Without a CEPP, FSC said, low-income consumers will receive a disproportionately small share of the merger savings. FSC noted that two major areas of merger savings that PSCO identified involve cost reductions associated with capital investment in information systems and reduced labor expenses in the area of customer service. Over $96 million in savings were attributed to those two areas alone.

PSCO proposes to "share" the savings generated by the merger with customers through the mechanism of a rate freeze. This mechanism, in effect, allocates merger savings back to individual customers on a per unit of energy (kWh or ccf/therms) basis. If a customer uses more energy, under the theory of distributing benefits via a rate freeze (or a rate rollback), the customer receives a higher proportion of the savings returned to him or her in the form of a bill that is lower than it would have been without the merger. This method of shared savings does not change if there is a rate rollback rather than a mere freeze. Even if there is a rate rollback, the savings are passed through to end-use consumers on a per-ccf and a per-kWh basis.

Distribution Problems

The low-income issue arises because of the difference in the way in which merger savings are generated and the way in which those savings are distributed, FSC said. Information system savings, as well as customer service savings, are a function of the number of customers on the PSCO system. The savings are distributed, however, based on the energy consumption. "If you have residential savings. . .that are produced on the basis of numbers of customers, and if you then distribute those benefits on the basis of units of energy consumption, there will be a disproportionate distribution of benefits to high use customers," FSC said.

That distribution harms low-income consumers. It is universally found, FSC said, that low-income customers use less energy on a per household basis than do average residential customers. Hence, while low-income customers represent 17% of all PSCO customers, they represent only eight percent (8%) of all PSCO energy use. On a per thousand dollar basis, therefore, if benefits are distributed on the basis of usage (8%) rather than numbers of customers (17%), low-income customers will "lose" roughly $90 for each $1,000 of merger-generated benefits.

In Colorado, the total misallocation of low-income savings is roughly $8.7 million.

FSC proposed the creation of CEPP to recapture the benefits that are misallocated away from low-income consumers. CEPP would be a source of grant funds for local agencies in the PSCO service territory. CEAF would distribute CEPP funding, on application, upon a finding that the funds would be effectively used in locally-controlled efforts to redress the payment problems of low-income PSCO customers.

One purpose of the fund is to provide local flexibility to meet locally determined needs. The uses of the fund, FSC said, can be as varied as the identified local needs and the identified local strategy for addressing those needs. One such use might be allowing local fuel funds to use grant dollars to match additional local contributions to the fuel fund; providing guarantees in lieu of a cash deposit; providing crisis assistance; providing targeted cash assistance for current bills (including targeted rate subsidies to households with special needs); providing downpayments on deferred payment plans; or providing matching credits for customer payments toward arrears.

Other Merger Precedent

FSC said that programmatic remedies are common responses to impacts that adversely affect low-income consumers in a merger setting. It cited as one example the recent merger of Butterworth Health Corporation with Blodgett Memorial Medical Center in Michigan. In that proposed merger, the principal claim of "efficiency savings" involved claims of "capital avoidance." Concerns were raised, however, that the capital avoidance really involved excluding the offer of products and services that consumers would otherwise demand from an unmerged hospital.

In response to these concerns, the federal court hearing a challenge to the merger required the merging hospitals to enter into a consent decree to implement a "Community Commitment" plan proposed by the hospitals as a condition of allowing the merger to proceed. The Community Commitment provided a binding commitment by the hospitals "not to raise prices *or otherwise injure the community. . .*"

(emphasis added). The Community Commitment has five elements: (1) a freeze on prices and charges; (2) a freeze on prices to managed care plans to pre-merger levels; (3) a commitment to limit margins; (4) a commitment to the medically underserved and needy; and (5) a commitment to governance of the merged hospitals with community input.

In addition, the merger of two corporate parents of three hospitals in central Pennsylvania was recently allowed by the Pennsylvania Attorney General's office on the condition that the merged entity pass on at least 80% of the net savings to consumers through reduced prices (or limited actual price increases for existing services), and low-cost or no-cost health care programs for the indigent. Moreover, Massachusetts recently settled its objections to the merger of that state's second and third largest HMOs on the latters' agreement to freeze group rates for one year, double enrollment in the Medicare risk program, and spend $4 million on services placed at risk by the merger, such as health care for the homeless, violence prevention, and AIDS prevention.

Similar programmatic responses have been adopted by utility regulators as a condition to proposed utility mergers, FSC noted. In California, for example, the SBC/Pacific Bell merger was specifically conditioned on the implementation of a Community Partnership Commitment, under which PacBell promised to fund $80+ million in education and community technology projects over the next ten years. Similarly, in Ohio, based on testimony regarding the disproportionate sharing of merger savings for the poor, the stipulated agreement endorsing the proposed SBC/Ameritech merger was conditioned on Ameritech's funding a $12+ million commitment to consumer education, technology diffusion, and community computer centers.

FSC proposed that CEPP be administered by the Colorado Energy Assistance Foundation. CEAF is the non-profit fundraising organization created by the Colorado Commission for Low-Income Energy Assistance. Created by the Colorado legislature in 1989, the Commission is appointed by the Governor. CEAF is governed by a board of directors that includes energy vendors, social service providers, and other energy professionals.

A copy of FSC's PSCO merger testimony may be obtained by sending an e-mail to: insights@fsconline.com.

Alternatives to Level Payment Plans

Low-income advocates, as well as the energy providers serving low-income consumers, must become better at introducing innovative payment arrangements that address particular payment problems, an Illinois task force was told in December. Illinois legislation created a task force charged with developing recommendations on means through which low-income fuel assistance can be distributed in that state. The task force must deliver a report to the legislature by the end of 2000.

The task force consists of representatives of community-based organizations, investor-owned gas and electric utilities, municipal utilities, rural electric cooperatives, regulators, legislators and fuel assistance service providers.

FSC principal Roger Colton was asked to present a two-day workshop to the task force on low-income energy problems and programs to address those problems. According to Colton, too many low-income program proposals do not recognize the distinctions that lie behind different payment problems. Citing the maxim "when your only tool is a hammer, you tend to see every problem as a nail," Colton told the task force that levelized monthly budget billing plans were too frequently viewed as the <u>only</u> budget payment plan option available to address potential payment problems. He suggested at least four other options as payment plan examples that address specific low-income payment problems without depending on levelized bill amounts:

Option #1

o Customer population helped: Limited fixed income

- Problem: Customer receives bill and income on sufficiently different dates that there is always a late payment, even though the payment is always made.
- Payment plan solution: Pick-A-Date. The utility allows the customer to select the date of the month on which the customer will receive the bill. If the social security check comes on the 10th, for example, the customer might pick the 11th as the date on which to receive his or her utility bill.

Option #2

- Customer population helped: Low and moderate fixed income population.
- Problem: Certain times of year have higher expenses that impinge on fixed income (e.g., Christmas, back-to-school) which poses problems to the "fixed income" type of income stream.
- Payment plan solution: Skip-A-Month. Customers can annually sign up to skip a month's bill at a time when they have historically run short of cash due to reasonably expected expenses (e.g., December or January when the Christmas bills come in; August or September when back-to-school bills come in). The anticipated bill for that month is spread in equal eleven equal installments over the rest of the year. The payment fits into their "fixed income" but frees up money at a time when they need to have part of their fixed income to use for something else.

Option #3

- Customer population helped: Fixed income with non-utility heat source.
- Problem: Non-electric winter heating bills impinge on ability to make winter electric bill payments.
- Solution: Utility offers a non-level billing plan, with higher electric bill payments in the summer and lower electric bill payments in the winter. Colton said that when heating bills are known to be high, we will propose that the electric company give customers a break by providing a lower electric bill. The difference is made up in the non-peak heating season. So the electric bills will go up when the heating bills are down. The effect is to even out the total energy bill to make it easier for the customer to pay.)

Option #4

- Customer population helped: Employee laid off due to plant closing but who has reasonable future earnings potential.
- Problem: Substantial, but temporary, interruption in income creating inability-to-pay home energy bill, mortgage, and other month-to-month expenses.
- Solution: Utility offers to defer payment on some substantial portion of the home energy bill for a limited period of time of expected unemployment with deferred bill payments to be spread out over a period of months after the unemployed person again obtains employment. Subject to utility-established maximums (perhaps 3 - 6 months), employee is allowed to select the period of time over which he or she needs to defer utility bill payment.

For more information on utility payment plans, readers may send an e-mail to: insights@fsconline.com.

Mobile Home Sales by Park Owner: Undisclosed Conflict of Interest as Deceptive Practice

A mobile home park engages in an unfair and deceptive practice when it serves as the exclusive listing service for the used mobile homes of park tenants without notifying the tenants that it also acts as the selling agent for its own new homes, according to recent FSC testimony filed in a proceeding challenging such practices.

The facts presented were substantially as follows: should a tenant of the mobile home park in question wish to sell his or her home at the park, the tenant may use the mobile home park as their listing agent. If this choice is made, the park is the exclusive selling agent; a commission will be charged by the park even if the home is sold without the assistance of the park. The park becomes the exclusive listing service without revealing that the park, itself, directly competes with the sale of the tenant's used home by serving as the selling agent of the park's own new homes.

The Park's Conflicts

Despite its status as the exclusive listing agent for the tenant's used mobile home, there is a distinct economic incentive to sell new mobile home park homes from the perspective of the park, FSC said. While the park makes little or no "profit" on a tenant-owned home, it makes a substantial profit merely on the sale --aside from lot rentals that is-- of a new mobile home park home.

In addition, the process of selling news homes involves the mobile home park buying a home outright from a vendor. The home is usually financed through a local lender. When the home is sold, the loan on that particular home is retired. So long as the mobile home is in "inventory," therefore, the mobile home park is incurring the carrying costs on the loan, with no offsetting source of revenue. Only the sale of the mobile home will eliminate the ongoing carrying costs.

The mobile home park has a substantial interest in the sale of the mobile home from the perspective of lot rentals as well. A new mobile home "for sale" by the park represents a vacancy, an unrented lot. It generates no lot rental income. In contrast, a tenant-owned home is generating income from the incumbent tenant. It will continue to do so until the tenant leaves the park (for whatever reason). Moreover, the buyer of a tenant-owned home takes an assignment of the tenant's lease (including lot rent). As a result of these three factors, the sale of a tenant-owned home merely supplants an existing stream of revenue from the incumbent tenant with a replacement stream of revenue of equal value. In contrast, the sale of a park-owned home represents a stream of incremental revenue which directly contributes to an increase in total net profit to the mobile home park owners/managers.

The mobile home park has an income incentive to sell new mobiles homes, also, because of the park's ability to reestablish lot rental fees when the incoming tenants does not take an assignment of an existing lease. Upon the sale of a tenant-owned home, the buyer takes an assignment of the existing lease for the remainder of the lease term. That lease not only specifies the current lot rental price, but serves as a limitation on the future lot rental fees as well. Annual lot rental fee increases are generally limited to no more than $25. In contrast, the rental of a lot associated with a new unit allows the mobile home park to set a new lot rent unconstrained by a previous rental. According to mobile home park officials, any differences in the price of lot rents is attributable solely to length of time that a tenant has stayed in a particular lot.

Tenant Pressures to Use Park as Listing Agent

FSC noted the pressures placed upon the tenant to list his or her used home through the mobile home park. A substantial incentive exists for tenants of a mobile home which the tenant wishes to sell on-site to list that home through the mobile home park. Overlaying this system of incentives, and making that system stronger and more cogent, is the immobility of the sited mobile home.

Once placed, a sited mobile home tends to be permanent for a variety of technical and economic reasons. As a result of these factors, the only real option that an existing tenant has to a sale of his or her home in the park is to sell the home as scrap to be removed from the park. The scrap value of a home is generally but a fraction of the resale value of the home. If a serious potential can be raised that this risk will be realized, the tenant has an incentive to act to avoid the risk. By creating the risk, therefore, the mobile home park creates the incentive to avoid the risk.

One source of incentive that the mobile home park thus wields is the lease provision which provides that a mobile home which is ten years old (or older) may not remain in the park. This threat that a tenant may be directed to remove a mobile home is particularly acute given the technical and economic mobility of a mobile home.

The fact that the 10-year provision is unreasonable and unenforceable does not eliminate the efficacy of its gatekeeper value. The mobile home park 10-year regulation at least presents the risk that, if ordered to remove a mobile home from the mobile home park, the tenant would be forced to scrap the home before the loan is repaid and well before the home reaches the end of its useful life. Avoiding this risk would be a powerful incentive to having the home listed through, and sold by, the mobile home park, itself.

A second incentive through which the mobile home park might exercise disproportionate power over a tenant is through the approval process over a prospective purchaser. The lease provides with respect to the purchaser of a home sited in the mobile home park that: "no purchaser thereof, or any person taking through or under such purchaser, or lessee, shall have any right or privilege, nor shall they be entitled to receive any Lease from Lessor, or any assignment of any existing lease then held by Lessee. It is understood that Lessor may refuse, without reason, and for any reason whatsoever, to issue a Lease or assignment of Lease to such person or any person claiming by, through or under Lessee or Lessee's purchaser."

A third mechanism through which the mobile home park can maintain power over a tenant involves the regulation concerning the condition of the home. The regulation states that for a sale to be approved by the mobile home park, "the mobile home sought to be sold must be in good condition, habitable, clean, contain proper skirting as authorized by Lessor, and otherwise visually appear in good condition and repair."

If the mobile home park finds noncompliance with this regulation, "then Lessee must remove the mobile home from the Park within 14 days after the date of any sale, transfer, or conveyance of such mobile home." Due to the technical and economic immobility of mobile homes discussed elsewhere, however, this provision would likely force the mobile home to be sold for scrap.

The forced removal of the mobile home, however, is not the only sanction which the mobile home park can impose upon an existing tenant or a purchaser taking title through an existing tenant. Short of forced removal, this provision can be used to impose thousands of dollars of "repairs" on a prospective purchaser (or seller). The alternative to making such repairs is the potential forced removal of the mobile home from the park. The tenant has little, if any, leverage to use in responding to a mobile home park finding that the home subject to sale is not in "good condition [or] clean" or "contain proper skirting as authorized by the lessor" or "otherwise visually appear in good condition and repair." In the absence of such leverage, the tenant could effectively realize substantially less revenue from the sale of his or her mobile home.

Actual Enforcement Irrelevant

According to FSC, whether or not the mobile home park actually enforces such regulations or actually wields the power retained by the mobile home park through its lease provisions is beside the point. In ascertaining the mechanisms through which the mobile home park can enforce its market power, the appropriate inquiry is into what the mobile home park retains the right to do, not into what the mobile home park has done.

Impact of Low-Income Status

The perception of risk as identified immediately above is heightened to the extent that the tenants in the mobile home park are unable to absorb that risk. As the incomes of mobile home park tenants decrease, and as the proportion of total household assets represented by the mobile home increases, the risks --real and perceived--faced by the provisions cited above increase as well. Low-income and fixed-income consumers, as well as those for whom their home is their major asset, can least afford to run afoul of one of the regulations discussed above, with the loss (or significant devaluation) of their home as a result.

Unfair and Deceptive Practice

FSC concluded that the sales listing of existing homes by mobile home park tenants is an unfair and deceptive practice prohibited by law. The mobile home park sales representatives, at a minimum, have competing loyalties to the mobile home park employer and to their clients who rely upon the sales agents as their exclusive listing service. The divided loyalties are substantial, irreconcilable, and undisclosed to one of the parties to the transaction, *i.e.*, the existing tenant as potential seller.

In addition, FSC said, the undisclosed competing loyalties are, at a minimum, within the penumbra of legal protections offered to consumers. From a real estate perspective, a sales agent has the same obligations of undivided service and loyalty that the law imposes on a trustee. A broker has a fiduciary duty to act in the best interest of, and to obtain the best price and terms possible for his or her principal. The broker must act with reasonable diligence and such skill as is ordinarily possessed by persons of common capacity engaged in the same business. From a straight agency perspective, as well, an agent has the duty of undivided service and loyalty.

The situation presented by the mobile home park listing service, however, creates an inherent conflict of interest. As an agent of the tenant/seller, the sales agent has the duty to obtain the highest price on the best terms for a home. However, as the agent of the mobile home park, the employee has a duty to obtain maximum financial benefits to the park. The mobile home park employee has the impossible task of doing both. In seeking to fulfill the one obligation, the sales agent necessarily violates the other.

A copy of the full analysis of the mobile home listing service can be obtained by sending an e-mail to: insights@fsconline.com.

Fisher, Sheehan and Colton, Public Finance and General Economics (FSC) is a research and consulting firm with offices in Belmont (MA), Scappoose (OR), and Iowa City (IA).

***FSC* specializes in providing economic, financial and regulatory consulting. The areas in which *FSC* has worked include infrastructure financing, public enterprise planning and development, natural resource economics, community economic development, telecommunications, public sector labor economics, planning and zoning, regulatory economics, energy law and economics, fair housing, and public welfare policy.**

Fisher, Sheehan & Colton
Public Finance and General Economics
34 Warwick Road, Belmont, MA 02478-2841
617-484-0597 * 617-484-0594 (fax)**
editor@fsconline.com (e-mail)
http://www.fsconline.com