

IN THIS ISSUE

**Deferred Payment Plans and
Municipal Water Utilities**

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**A MUNICIPAL WATER UTILITY THAT IS NOT
REGULATED BY A STATE PUBLIC SERVICE
COMMISSION MUST STILL OFFER DEFERRED
PAYMENT PLANS FOR ARREARS**

Defining the customer service rights of customers of a municipal water utility, when that utility is not regulated by a state public service commission, was the issue faced by Fisher, Sheehan & Colton, Public Finance and General Economics, in a recent federal court case.

In this case, multiple water customers of an "unregulated" municipal water utility had their service terminated (or threatened to be terminated) for nonpayment. Some of the customers had service terminated (or were threatened with service termination) even though they had agreed to pay their arrears over time. Others faced collection activity when the water utility refused to allow deferred payments, even though the customers requested a deferred payment plan.

The water utility justified its refusal to continue to honor existing payment plans (on which customers had not defaulted), or to negotiate new payment plans, by saying that if customers needed or wanted deferred payments, they would be required to get a loan from a financial institution. Under those circumstances, the utility would be paid and the customer would owe his or her debt to the lender.

The municipal utility asserted that state utility commission regulations that required water and sewer utilities to offer deferred payment plans were not applicable since the utility was not regulated by the state. Only privately owned water utilities are regulated by state PSC requirements.

FSC disagreed. In testimony filed on behalf of the customers, FSC offered three rationales for having the court require the municipal water utility to offer deferred payment arrangements.

- Payment plans were required by the utility's contract with its customers;
- Payment plans were required by the commercially reasonable standards of the utility trade; and
- Disconnecting utility service without offering a payment plan was an "unfair" trade practice under state statutes.

Implied Contract Terms

The Uniform Commercial Code (UCC) can be used to establish contract terms for a water utility that is not regulated by a state PSC, FSC said. Since water is a "good," the terms of the UCC apply.

The UCC can be used to import the rules of a state PSC into the governance of municipal water utility customer service practices. The contract between a municipal water utility and its customers includes that part of their bargain that may be found in usage of trade, FSC said. These sources are relevant not only to the interpretation of express contract terms, but may themselves constitute terms.

The admissibility of usage of trade flows from the fact that there is a justifiable expectation that the usage of trade will be observed. According to FSC, a party is always held to conduct generally observed by members of his chosen trade because the other party is justified in so assuming unless he indicates otherwise. In other words, when a customer enters into an agreement with a municipal water utility, FSC said, the "agreement" is not just the stark words of the contract, but is those words as construed in the commercial setting in which they arose and were used. The course of dealing, as well as the trade usage, supplement, qualify and explain the meaning of the basic standard terms.

The role of usage of trade is to "fill gaps" in the written agreement between the two parties to the contract. FSC cited the UCC as rejecting any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon. Instead, contracts are to be read on the assumption that the usage of trade was taken for granted when the document was phased. Unless carefully negated, they have become an element of the meaning of the words.

In this case, there was no written contract between the utility and its customers. No piece of paper existed, signed by both parties, laying out the terms of a contract. The terms of service, such as deposit rules, payment plan rules, disconnect rules, and other customer service rules, did not appear in any written form.

Since the water utility was a monopoly utility, no bargaining occurred over either the terms of service or the price of service. FSC said that particularly in light of the fact that the water utility did not have customer service terms explicitly set forth in a written contract or tariff, customer expectations as to what constitutes the provisions of their "agreement" with the utility were to be filled in by industry custom and usage.

Commercially Reasonable Standards

State PSC regulations are also relevant in establishing the standards for assessing whether the water utility's actions comply with the requirement that all merchants abide by reasonable commercial standards in the conduct of their affairs. In this regard, FSC said, while the PSC regulations would not be directly applicable to the REC, they would be evidence of what "reasonable commercial standards" might be.

The duty to abide by reasonable commercial standards inheres in the UCC's requirement that all parties act in good faith. For merchants, in particular, FSC cited UCC Section 2-103, which provides that "[g]ood faith" in the case of a merchant means honesty in fact and the

observance of reasonable commercial standards of fair dealing in the trade.”

Unfair Trade Practices

Finally, FSC noted that a majority of state Unfair and Deceptive Acts and Practices (UDAP) statutes prohibit “unfair practices.” Under this standard, FSC said, existing PSC regulations could well serve as an “established concept of unfairness” even though the municipal water utility was not directly subject to the regulations.

The water company’s practice should be found to be “unfair” when it is contrary to PSC regulations, particularly when it could cause substantial injury. In addition, FSC said, in analyzing the unfairness concept, it is important to keep in mind the monopoly enjoyed by the water company. This status makes the water utility’s practices particularly oppressive and capable of causing injury; since consumers have no alternative place to turn for service.

The water company’s shutoff practices should be declared “unfair” even though the practices were not specifically proscribed by state statute. Using the PSC regulations as a standard of fairness, FSC argued that it was unfair to disconnect service if there is a medical emergency. FSC argued, also, that it was unfair to refuse to offer adequate deferred payment plans as well as to cancel existing payment plans on which no payment default had been experienced.

Sources of the Water Utility Obligation

FSC turned to a variety of sources to determine what a customer’s reasonable expectations would be and what commercially reasonable standards are generally applied in the water utility industry.

FSC first determined custom and usage for utility disconnect procedures. FSC noted that the state PSC regulations represented a written trade code that memorializes reasonable standards of conduct for public utilities. The PSC regulations have all the factual attributes of a trade code for the municipal water utility, FSC said. There is

no final expression of an “agreement” between the water company and its customers. There is no written agreement as to the terms of service. Even those terms that had been expressed by the water utility were subject to the need for explanation.

For the most part, however, FSC said, the terms of service are replete with gaps. Given the inferior bargaining position that residential customers have relative to a monopoly utility, the reasonable expectation of the customers would be that the water company would observe normal custom and usage.

FSC then noted that the PSC regulations require the offer of payments plans to residential utility customers who are behind on their bills. These payment plans are to take into account, among other things, ability to pay. The regulations require a clear and believable pretermination notice. This notice is not simply to notify the customer of a pending shutoff, but is also to notify the customer of the fact of recourse and the procedure for achieving recourse.

The regulations require the delay of service termination in the event of a medical emergency. The existence of such an emergency is a medical decision for a qualified health professional and is not based on whether a customer can, in the opinion of the utility, abandon his or her home. The PSC regulations establish clear standards for the issuance of medical certificates and require an established written procedure for accessing such a delay in service termination.

The regulations ban the disconnection of service for collateral matters. The regulations ban the issuance of disconnect notices when there is no present intent to disconnect. They require that disconnect notices be reissued when they become stale. The regulations create specific criteria for taking deposits as well as specific criteria for the refund of those deposits.

Second, FSC reviewed the tariffs of more than 40 private and municipal water utilities in the same state as the water utility whose practices were being challenged. A tariff incorporates the

written terms of service which govern the customer/company relationship. The tariffs FSC reviewed demonstrated what typical industry practice was with respect to certain customer service practices. While not uniform in their particulars, FSC said, the tariffs did reveal a consistency in practice.

The tariffs that were reviewed made clear that the industry practice of the state's municipal water utilities included: (1) to set forth customer service terms in written form; (2) to offer deferred payment plans for customers in arrears who claim an inability to pay an outstanding bill in full; (3) to honor existing payment plans so long as payments on such plans are kept current; (4) to provide for the delay of service terminations when such a termination would create or exacerbate a medical emergency determined by a health professional; (5) to prohibit terminations of service for collateral matters; (6) to establish written procedural standards regarding the terms of service, the condition of service, and the procedures for service disconnection for nonpayment, as well as the mechanism for avoiding, challenging or appealing a proposed disconnection for nonpayment.

Finally, FSC found that the conclusions regarding industry custom and usage in the specific state in question were supported by a review of similar materials nationwide. FSC reviewed the state regulations governing water and wastewater utilities for every state public utility commission that regulates water and wastewater companies. These regulations make clear that the industry standards of reasonable behavior include: (1) offering deferred payment plans for customers in arrears who claim an inability to pay; (2) delaying service termination, when such a termination would create or exacerbate a medical emergency, as determined by a qualified health professional; (3) prohibiting service terminations for matters collateral to the provision of water service; (4) requiring written procedures through which to challenge a proposed service termination; and (5) establishing written standards to apply in any

appeal of a utility decision adversely affecting a customer's service.

FSC testified that the regulations of water utilities are designed to articulate what customer service terms represent reasonable behavior on the part of a utility and its customers, what customer service terms are needed to protect health and safety, and what customer service terms strike a reasonable balance between the legitimate interests of a water utility in getting paid and the legitimate interest of a customer in maintaining service.

FSC concluded that the custom and usage of the state's water utilities, as well as the industry code memorialized in the state PSC's regulations, as well as the custom and usage revealed in water customer service regulations adopted by state utility commissions throughout the nation, are well known throughout the industry. Each piece of information that was reviewed was publicly available. In addition, others have used the information to establish standards for their conduct.

The Conclusions as to A Water Utility's Obligations

FSC in its testimony that to the extent that the terms of the contract between the water utility and its customers include the usage and custom of the utility industry as evidenced by industry practice and trade code, the reasonable expectations of the water utility customers would be that they would be treated consistently with the state PSC's regulations as a trade code, consistently with industry practice evidenced by the tariffs of water utilities in the state, and consistently with industry practice evidenced by the practice and procedure of regulated water utilities nationwide.

FSC further concluded that to the extent that the municipal water utility is bound by a duty of abiding by commercially reasonable standards, the provisions of the state PSC regulations, the industry practices evidenced by the tariffs of water utilities in the same state, and the industry practice evidenced by the water regulations of

utility regulators nationwide, evidence commercially reasonable standards of practice and procedure regarding the collection of unpaid utility bills.

FSC finally concluded that to the extent that a municipal water utility is bound by a duty to act “fairly” in its treatment of residential customers, the provisions of the state PSC regulations, the industry practices evidenced by the tariffs of the water utilities in the same state, and the industry practice evidenced by water regulations of utility regulators nationwide establish a standard of fair and reasonable conduct.

FSC ultimately concluded that the water utility in question acted unlawfully in disconnecting (or threatening to disconnect) its residential customers in non-compliance with the reasonable customer service regulations that FSC had identified.

Interested persons may obtain a copy of the FSC testimony by sending an e-mail to:

info@fsconline.com

Persons interested in reading the law (including citations of authority) for the principles discussed above may read: Roger Colton. Using State Utility Commission Regulations to Control the “Unregulated” Utility, Clearinghouse Review, (August/September 1993).

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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.