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"Ability to Pay" Comprised of Many Factors in Payment Plan Negotiations

NOTE TO READERS

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Fisher, Sheehan & Colton
Public Finance and General Economics
34 Warwick Road, Belmont, MA 02478
(voice) 617-484-0597 *** (fax) 617-484-0594
(e-mail) roger@fsconline.com

IN NEGOTIATING DEFERRED PAYMENT PLANS, "ABILITY-TO-PAY" HAS MANY FACETS THAT SHOULD BE CONSIDERED

One nearly universal rule imposed upon public utilities when residential customers fall into arrears is that customers should be provided with an opportunity to enter into a deferred payment arrangement through which to retire those arrears.

In addition, while certainly not universal, it is *generally* the case that state utility commission regulations provide that a utility should consider designated factors in deciding whether payment plan terms such as the amount of downpayment or the period of months over which the arrears may be repaid are "reasonable."[1] Factors include such things as the length of time an arrears has been outstanding and the reason the underlying bill has been unpaid.

A failure to take into account all designated factors would make a deferred payment arrangement unlawful on two grounds. First, a failure to take all factors into account would be a substantive violation of Commission regulation in many states. If an arrearage payment under a payment plan is *un*affordable because the utility has not considered ability-to-pay, for example, the plan fails to meet the requirements of state utility regulations. The substantive nature of the violation is important in that the consumer would argue that correct application of the substantive requirements of the law would have yielded a different, and more affordable, result.

[1] *See e.g.*, IDAPA 31.21.01.313 (2001) (Idaho); 83 Ill. Adm. Code 280 Appx. D (2001) (Illinois); CMR 65-407-860 (2001) (Maine); 4 CSR 240-13.060 (2001) (Missouri); MONT. ADMIN. R. 38.5.1415 (2001) (Montana); 52 Pa. Code § 56.97 (2001) (Pennsylvania); 16 TAC § 7.45 (2001) (Texas); Wis. Adm. Code PSC 113.0404 (2001) (Wisconsin).

Second, a failure to consider all relevant factors in developing a payment plan would give rise to a procedural challenge to the payment plan. Decisions that fail to take into account all prescribed relevant factors are universally held to be legally "arbitrary and capricious." This procedural objection differs from the substantive violation in that it would not necessarily yield a different result. A utility could argue that it would offer the same plan even after considering all relevant factors. The company could not, of course, *know* this to be the case unless and until it had undertaken such consideration.

CIRCUMSTANCES OF CONCERN

A variety of utility actions give rise for concern over whether ability-to-pay has been appropriately considered in the determination of a payment plan. Three practices stand out:

- **Standardized payment plans:** A utility that offers a single standardized payment plan through which customers may repay arrears is, by definition, not taking ability-to-pay into consideration. By its very nature, a uniform, or standard, payment plan does not vary based on different factors that might distinguish one customer from another. A utility may not be found to offer a single standardized plan *and* be in compliance with regulatory requirements that prescribed factors be taken into account.

- **Maximum payment plan length:** A utility that imposes a maximum payment plan term on its customers is not taking into account ability-to-pay. A maximum term of six months for customers, irrespective of whether the customer has an ability-to-pay, cannot be said to take into account the regulatorily-imposed factors. If a maximum payment plan term cannot be met within the ability-to-pay of a customer, it is the maximum term rather than the regulatory requirement that must give way.

- **Deadlines for completion of payment plan:** Utilities that set arbitrary deadlines for completion of a deferred payment plan are likely in non-compliance with the regulatory requirement that negotiation of a payment plan take into account ability-to-pay. Many utilities, for example, require payment plans to retire arrears before the beginning of the next winter heating season. If such a requirement is imposed irrespective of whether the customer in arrears has income at 100% or 300% of the Federal Poverty Level, or irrespective of whether the plan begins in April or August, the utility can hardly be said to have taken into account ability-to-pay.

The above observations, of course, assume that the limitations are placed on payment plans by utility policy rather than by regulation. A utility operating under a regulation or statute imposing payment plan limitations, despite the contradiction of those limitations with a separate requirement that ability-to-pay be taken into account, has greater justification for its actions.

A tariff, on the other hand, even a tariff approved by a Commission, is subject to challenge in court if contrary to Commission regulation.

PAYMENT PLAN TERMS

The length of the payment plan should not be the exclusive payment plan term that is subject to differentiation based on ability-to-pay. Another term that could well be subject to challenge is the downpayment required on a deferred payment arrangement. A single uniform standardized downpayment requirement imposed in lieu of a downpayment differentiated based on ability-to-pay may be subject to challenge.

Substantive Requirements

One of the primary factors to be taken into account in assessing the reasonableness of a deferred payment arrangement is the ability-to-pay of the customer seeking the arrangement. The discussion below looks at the various factors that flow from the seemingly simple term "ability-to-pay." The phrase "ability-to-pay" is often treated as being synonymous with "level of income." If a household's income is sufficiently high,[2] the reasoning goes, the household is deemed to have an ability-to-pay its home energy bills. Taking into account the "ability-to-pay" of the poor, however, should involve *more* than simply taking into account income level.

Absolute Income.

First and foremost arising from the phrase "ability-to-pay" is the absolute income of the household. A household with limited income is likely also to have a limited "ability-to-pay" outstanding arrears through a deferred payment arrangement. Taking "absolute income" into account in a consideration of "ability-to-pay" would revolve around home energy burdens. A home energy burden is a household's energy bill as a percentage of income. An affordable home energy burden is generally deemed to be in the range of between 6% and 8% for electric and home heating combined.

Home energy burdens should be used to limit arrears payments through a consideration of the "ability-to-pay" factor. Assume that a household has an income of $600 per month ($7,200 a year) and an average monthly utility bill of $100. With an existing home energy burden of nearly 17% ($100 / $600 = 0.166) relating simply to current bills, it would be difficult for a utility to require an additional arrears payment of $50 per month, thus pushing the home energy burden up to 25% ($150 / $600 = 0.25).

Relative Income.

A second component of "ability-to-pay" would be the relative income of the household. Relative income can be portrayed in terms of Federal Poverty Level. The generally accepted measure of "being poor" in the United States today indexes a household's income to the "Federal Poverty Level" published each year by the U.S. Department of Health and Human Services (HHS).

The Poverty Level looks at income in relation to household size. This measure recognizes that a three-person household with an annual income of $6,000 is, in fact, "poorer" than a two-person household with an annual income of $6,000. The federal government establishes a uniform "Poverty Level" for the 48 contiguous states. Since 100 percent of Poverty Level is generally considered to be too low to be a reasonable demarcation of "being poor," other estimates range from 150 to 200 percent of Poverty or more. A household's "level of Poverty" refers to the ratio of that household's income to the Federal Poverty Level. For example, the year 2005 Poverty Level for a two-person household was $12,830. A two-person household with an income of $6,415 would thus be living at 50% of Poverty. A two-person household with an income of $19,245 is said to be living at 150% of Poverty.

[2] While the question of what income is "sufficiently high" is explicitly set aside for purposes of this discussion, the reader can gain guidance from the determination of what constitutes a "livable wage." ***Working Hard—Earning Less***, National Priorities Project: Northhampton: MA. http://www.natprior.org/grassrootsfactbook/jobgrowth/jobgrowth.html. Further guidance can be gained from a review of self-sufficiency budgets. A calculation of self-sufficiency standards for about 20 states can be found at the World Wide Web site of Wider Opportunities for Women. http://www.sixstrategies.org/resources/resources.cfm. In addition, the Economic Policy Institute has an on-line calculator that allows the user to calculate a "basic family budget" by number of parents and children, state, and area within the state. http://www.epi.org/content.cfm/datazone_fambud_budget. The Center for Children in Poverty has an on-line "family resource simulator" that allows the user to determine net available resources for 13 different states given different assumptions about state, location within the state, family structure, and number and age of children. http://www.nccp.org/modeler/modeler.cgi.

A utility would be hard-pressed to argue that deferred payment arrangements can lawfully be uniform over customers of all poverty levels consistent with a legal requirement that the utility take "ability-to-pay" into account.

Discretionary Income.

One facet of ability-to-pay involves not merely the level of income, but the level of discretionary income available to pay utility bills. In turn, discretionary income has several aspects to it that a low-income household should insist that a utility take into account when negotiating a deferred payment plan. On the one hand, discretionary income relates to household composition. A household with three children under age five (with significant child care expenses) may well have less discretionary income than a household with three school-age children. An older person with substantial medical expenses may well have less discretionary income than a younger person without such expenses.

Child-related expenses should always be considered when taking into account ability-to-pay and discretionary income. Not only do months with back-to-school expenses result in lower discretionary income (and thus lower ability-to-pay), but months during the early cold-weather season, when winter clothes for children (sweaters, coats, boots, gloves) are routinely replaced, impose identifiable seasonal reductions in a household's discretionary income.

Fragility of Income.

One attribute of the ability-to-pay of low-income households is the "fragility" of their income.[3] The fragility of income considers the *stability* of income as one aspect of the ability-to-pay, particularly for the working poor. Income for the working poor, in particular, can be erratic and unpredictable. A working poor customer may not *know* in April what his or her income is going to be in July or August.

This income attribute of working poor households has been recognized in a variety of contexts. The evaluation of one asset-building program, for example, reported that "staff and participants thought the budgeting worksheet. . .became obsolete almost immediately because participants' incomes were very unstable."[4] One major barrier to savings and asset accumulation by working poor households involves their "irregular incomes."[5] Individuals have been found to view saving and systematic budget planning as not worthwhile because of the inability to predict income and labor-market conditions.[6]

Working poor families tend to find themselves in hourly wage jobs, often marked by considerable income fluctuations due to the number of hours they are called upon to work. According to the Urban Institute,[7] even aside from the level of wages, the presence of hourly wages and unpredictable hours mark occupations that are the province of the working poor.

A second factor contributing to the instability of income of the working poor involves the paid leave benefits provided. The absence of paid vacation and sick leave can directly affect the

[3] Roger Colton (2002). ***A Fragile Income: Deferred Payment Plans and the Ability to Pay of Working Poor Households***, National Fuel Funds Network: Washington D.C.

[4] Dianne Lazear (September 1999). ***Implementation and Outcomes of an Individual Development Account Project***, at 12, Center for Social Development, Washington University: Saint Louis (MO).

[5] *See e.g.*, David Smyth (1993). *Toward a Theory of Savings*, in James Gapinski (ed.). ***The Economics of Savings***, at 47 – 92, Klewer Academic Publishers: Boston; Franco Modigliani (1986). "Life cycle, individual thrift, and the wealth of nations," ***American Economic Review***, 76(3): 297-313.

[6] Arthur Kennickell, Martha Starr-McCluer, and Annika Sunden (1997). "Saving and Financial Planning: Some Findings from a Focus Group," ***Financial Counseling and Planning***, 8(1):1-8.

[7] Acs, Gregory, Katherin Ross Phillips and Daniel McKenzie (May 2000). ***Playing by the Rules but Losing the Game***, at 10 – 11, Urban Institute: Washington D.C.

ability of a household to maintain a deferred payment arrangement over time. A person working 35 hours a week on hourly wages may lose three days of work simply due to a sick child missing school and requiring care. If no leave time exists for that employee, the sick child translates into permanently lost wages. Personal illness, too, results in permanently lost wages, whether illness keeps a worker away from his or her job for a day, for two days, or for a week.

Seasonality of Ability-to-Pay.

The seasonality of ability-to-pay should take into consideration the seasonal stream of income for many low-income households. The seasonality of income appertains not merely to agricultural workers, but also to workers in traditional service industries, such as in food establishments and accommodations. Construction and transportation work, also, is frequently seasonal in nature. A failure to account for the seasonality of income will overstate household ability-to-pay in many circumstances.

The seasonality of ability-to-pay, however, does not relate exclusively to household income. The seasonality of ability-to-pay may well also relate to household expenditures. The discretionary income available for arrearage payments through deferred payment plans depends on the activities within a family at any given point in time. A household with two school-age children, for example, is likely to have less discretionary income during the summer months than during the school year. Not only will this household possibly have child care expenses that did not exist during the school year, but it is virtually certain that the household will have food expenses (lunches) that did not exist during the school year.

Indeed, the lack of summer lunch programs is a substantial concern within the low-income nutrition advocacy community. One nutrition advocacy organization reports that: "When the school bell rings to signal the start of summer vacation, millions of children who receive free or reduced price breakfast and lunch at school during the regular school year no longer have access to those meals. And their working parents, many of whom are struggling with stagnant wages and rising health care, energy and housing costs, must find a way to provide these meals for their children during the summer months." [8]

While some summer nutrition programs exist, on average, only 18 children participate in these summer nutrition programs for every 100 children who receive free or reduced price school lunches. In the _best_ states, only 40 children receive summer nutrition assistance for every 100 who participate in the free or reduced school lunch program.

The increased expenditures to households are substantial during the summer, thus reducing ability-to-pay on a seasonal basis. Even a net expense of $4 per child per day for a two-child family yields an additional summer expense of $40 a week ($4/child x 2 children x 5 days/week), or $200 a month during the summer months. This increased expenditure certainly reduces the "ability-to-pay" of a low-income household during the non-school months.

Ability to Meet Exigencies.

One of the biggest attributes of the ability-to-pay of low-income households is their lack of sufficient income to create savings that would be available to meet household exigencies. The 2006 FSC evaluation of the Georgia REACH project, for example, reported that "one corollary issue frequently identified in the REACH risk assessments, however, involved both the lack of a savings account and the inability to develop personal resources to allow a cushion to use in responding to financial exigencies (either

[8] See, generally, Food Research and Action Center (2006). ***Hunger Doesn't Take a Vacation: Summer Nutrition Status Report***, FRAC: Washington D.C.

increased expenses or decreased household income)."[9]

Georgia REACH participants also identified "lack of control over expenses" as one of their primary household financial problems. Indeed, the inability to respond to unexpected household expenditures was the second most commonly identified household financial concern, immediately behind the generic observation of "insufficient income."

PROCEDURAL REQUIREMENTS.

In addition to the substantive facets of ability-to-pay discussed above, the low-income advocate should be familiar with certain process issues relating to the consideration of ability-to-pay in the negotiation of payment plans.

Obligation to "Offer" an Affordable Payment Plan.

Many utilities place the onus on customers to propose payment plan terms that comply with regulatory requirements. These utilities approach the negotiation of payment plans from the perspective that customers should identify those circumstances in which payment plans are not affordable. The argument by these utilities is that if a customer proposes a payment plan, the terms of that payment plan must, by definition, meet the requirements of any underlying commission regulation regarding what factors must be taken into account.

Other utilities propose initial payment plans that do not take into consideration the factors required by regulation. These utilities require a customer to *reject* the utility's first payment plan proposal in order for the utility to move its proposed terms toward compliance with commission regulation. The utility argues that it will, eventually, make available a payment plan in compliance with commission regulations, if called upon to do so, but only if the customer rejects all non-compliant plans first offered by the utility. Such a utility argues that it is not required to make a compliant payment plan offer as its *first* offer of payment plan terms so long as it is willing *eventually* to make such an offer.

These approaches would appear to be in contravention of explicit regulatory requirements. State utility commission regulations frequently require the utility to *offer* a payment plan that is in compliance. Under such a regulation, the obligation of the utility is proactive. The utility does not serve as a passive spectator in accepting a payment plan proposal by the customer. To argue that such an approach is acceptable fails to recognize the substantive difference in bargaining power between the two parties. This difference is particularly pronounced when a utility is dealing with a low-income customer.

Low-income advocates should insist that a utility offer a payment plan that is in compliance with all regulatory requirements from the beginning of customer contact.

Void "Ab Initio"

A payment plan on which a customer has defaulted, but which was in non-compliance with commission regulations regarding a consideration of ability-to-pay should not simply be subject to "cure." A non-compliant payment plan is void ab initio. Its terms are not subject to enforcement in any manner.

If a customer defaults on a non-compliant payment plan, the legal infirmities result the conclusion is that the plan never existed in any legal sense. Any new agreement is not a second payment plan. Nor is it a "renegotiation" of the prior plan. It is an original agreement subject to all of the regulations that appertain to first payment plans.

Signature as Waiver by the Customer.

[9] Roger Colton (2006). ***Georgia Reach "Project Energize": Final Program Evaluation***, at ES-11, prepared for Georgia Department of Human Resources: Atlanta (GA).

Low-income customers need to beware of agreeing to payment plan proposals that are not affordable. Frequently, utilities require customers to sign payment plan agreements. These agreements provide that a customer ***should not sign*** an agreement with which they are in disagreement.

As with utility arguments that companies should be allowed to accept payment plan proposals first offered by a customer, rather than complying with regulatory requirements to *offer* a payment plan taking ability-to-pay into account in the first instance, the importance attached to customer signatures seems to fail to take into account the disparate bargaining power of the respective parties.

Before assigning determinative significance to a low-income customer signature "agreeing" to an unaffordable payment plan, the advocate should determine whether such a signature was a voluntary, well-informed, assent or whether it was an agreement based upon a failure to know and understand the options available to the customer and the rights of the customer.

SUMMARY

For more information on how to review the reasonableness of deferred payment plans for low-income arrears, readers may contact FSC directly at:

Roger[at]fsconline.com

Fisher, Sheehan and Colton, Public Finance and General Economics (FSC) provides economic, financial and regulatory consulting. The areas in which *FSC* has worked include energy law and economics, fair housing, affordable housing development, local planning and zoning, energy efficiency planning, community economic development, poverty and telecommunications policy, regulatory economics, and public welfare policy.