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IN THIS ISSUE

Identifying and Addressing Barriers That Impede Use of Budget-Billing

NOTE TO READERS

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UTILITY PRACTICES CAN IMPEDE USE OF BUDGET-BILLING, BUT CAN BE OVERCOME WITH REASONABLE POLICIES

Budget-billing is generally considered to be an effective tool for certain limited income customers to use in avoiding short-term arrears on utility bills. While budget-billing cannot address a structural mismatch between household resources and household expenses, it can serve a variety of objectives for households where annual income is relatively adequate to pay annual bills.

Levelized monthly budget-billing provides the opportunity for customers with marginal incomes to pay their annual home energy bills in equal monthly billing amounts over the course of the year irrespective of the actual monthly bills the customer incurs.[1]

Levelized budget-billing offers three advantages to the economically marginal consumer.

- First, a levelized bill helps take the peak off seasonal weather-sensitive usage. High monthly bills that might present a problem in any particular severe weather month –that month can reflect either cooling needs or heating needs—are instead spread over several months.

- Second, a levelized bill helps provide certainty to the customer regarding what his/her payment responsibility will be.

[1] Many levelized budget-billing plans provide for occasional adjustments to the budget amount to reflect unanticipated changes in the customer's bill, up or down. While such adjustments can prevent a large "make-up" bill at the end of the year, or prevent a need for the customer to substantially overpay the bill, only to have it refunded at year's end, levelized budget-billing plans with adjustments that occur too frequently lose the budgeting advantages which the levelized amount is intended to impart.

Rather than trying to "fit" an unexpectedly high summer cooling bill into a warm weather budget that is already strained because of the loss of the children's participation in the free and reduced school lunch/school breakfast program, a customer will know at the beginning of the summer cooling season what level of utility bill to expect each month.

- Finally, a levelized monthly budget-billing plan represents a type of "forced savings" for economically marginal households. Rather than needing to set aside an estimated portion of the cold weather heating bills, in anticipation of accessing those savings to pay heating bills in cold weather months, the levelized monthly budget-billing creates an obligation to pay the time-shifted winter bill when those bills are rendered a little at a time during the lower-usage months. The "overpayment" is accrued by the utility as a bill credit and applied to the higher-cost months as appropriate.

The Advantages of Budget-billing in Tacoma

The advantages of budget-billing were recently identified in a study FSC performed for Tacoma Power customers. The study examined typical monthly bills for Tacoma Power. The typical annual bill for a TPU customer was $836, or almost exactly $70 per month. The bills, however, showed a distinct seasonal pattern, however, ranging from a low of $45 (August) to $47 (July) up to a high of $103 (February) to $108 (January).

The TPU data shows that the advantages normally attributed to budget-billing would attach to Tacoma Power bills as well. Budget-billing would serve the forced savings function in Tacoma. If customers enter their budget-billing plan during the non-winter months –increases in Tacoma Power usage occur primarily in the months of December, January and February—they will effectively be called upon to prepay their higher winter bills. Since bills for December ($97), January ($108) and February ($103) reach more than twice as high as the lower months (July: $47; August: $45; September: $46), this prepayment function can be significant.

Moreover, budget-billing would make electric bills more predictable. TPU customers would, FSC said, have a reasonable expectation of paying $70 each month (given a 12-month budget-billing plan). This levelizing of payments would provide greater help during the high cost months than it would impose burdens in the lower cost months. In the three highest cost months, customers would experience bill reductions of $38 (January), $34 (February), and $27 (December). In contrast, there would be moderate bill increases in the three lowest cost months (July: $23; August: $25; September: $24). In two months, the budget bill amount is effectively the same as the normal bill (April, November).

The reductions found for the high cost months for TPU customers can be of substantial benefit to a low-income household. For a household with an income of $700 per month ($8,400 a year), the reduction of the December through January bills (averaging $33 a month) equals roughly five percent of the household's monthly income.

The Collections Impact of High Seasonal Bills

While Tacoma Power does not maintain data on monthly arrears (either on an aggregate or on an average customer basis), or on either the number of accounts in arrears or the dollars of revenue in arrears, FSC found that several conclusions could be drawn from the limited data that was available from that utility.

As measured by the number of customers seeking payment extensions for current bills, seasonally high bills result in noticeably more nonpayment. Significantly more payment plans are "activated" in the warm weather months (lagged by one month to reflect arrears).

Clearly, more customers were seeking arrangements to pay past-due utility bills in the high cost months. Beginning in January (for bills rendered in December), there is a noticeable increase in the number of payment plans that are activated. The number of January payment plans (6,008) is 33% higher than the 4,500 payment plans activated in October and November, immediately preceding the higher cost winter months.

Over the course of the five months in which payment plans would be sought for higher cost winter bills (ranging from January for December bills to May for April bills), FSC noted, Tacoma Power customers sought nearly 40% more payment plans (31,745 during cold weather bill months vs. 22,804 for warm weather bill months).

Moreover, the way in which TPU's winter arrears move through the system has been particularly evident in the past few years. Conclusions can be drawn from the monthly aging buckets for arrears. A February bill that is due, but not paid, in March would be 30-days in arrears in April; it would be 90-days in arrears in June. The flow of the increased high-cost winter arrears through the aging buckets, pushing the 90-day arrears as a percentage of total receivables higher during the warm weather months before receding as year wanes, was found for TPU in each year of the three-year period studied.

Finally, the impact of the seasonal nonpayment is evident from data showing how the collection process plays itself out. As customers either do not succeed on payment plans, or otherwise work their way through the collection process, accounts owing money are eventually assigned to the collection agency for treatment.

As the accounts come out of the winter months, the average dollar amount per account assigned to collections increases, before receding as the year wanes. Again, it is important to take account of the lag between the time an arrears is incurred and the time it works its way through the process sufficiently to be assigned to collections.

In 2007, of the five months where the per-account arrears was higher than the annual average of those accounts assigned to collections, four were in the months of May through September. In 2008, of the five months where the per-account arrears was higher than the annual average of those accounts assigned to collections, all five fell in the months of April through September.

The data on arrears and collections that is available for TPU paint a consistent picture. One observation that is significant is that, while the puzzle is incomplete, all of the pieces of the puzzle show the same patterns and tell the same story. The seasonality of Tacoma Power bills results in a sharp up-tick in nonpayment of those higher seasonal bills. As a result, there is a corresponding increase in the responsive collection activities during the higher-cost cold weather months. The seasonal patterns do not appear to be confined to one year, but rather recur from year-to-year. As a result of these seasonal patterns of nonpayment:

- The utility incurs a cost to maintain its cash flow to replace unpaid billed revenues;
- The utility incurs an opportunity cost as existing staff are devoted to addressing the increased workload associated with the seasonal nonpayment; and
- The utility experiences an increased risk of ultimate nonpayment as some customers leave the system due to their inability to pay.

Much of this nonpayment, however, is avoidable through budget-billing.

EXPANDING THE USE OF BUDGET-BILLING

FSC recommended that Tacoma Public Utilities expand the use of budget-billing in its residential customer base. The utility should both take those actions necessary to offer budget-billing as a widespread billing option and increase the number of budget-billing options that are available.

Removing Barriers to Budget-billing

Part of the efficiency of using a budget-billing plan to improve the seasonal affordability of home energy involves the extent to which such plans are available to those customers who would most benefit from them. If budget-billing is made available only to persons who have the capacity to pay their bills irrespective of the time-shifting inherent in the levelized payment, the plan, while perhaps a sound money management tool, offers no "energy assistance" benefit for improving affordability.

It would be unreasonable to expect a utility to promulgate billing regulations that explicitly make levelized budget-billing *un*available to low-income customers who might most benefit from it. Public utilities do, however, often tend to promulgate internal procedures that have the *effect* of excluding the poor from taking advantage of levelized Budget Bills.

In addition to the practice of offering only annual budget-billing plans, which practice *is* specifically referenced in TPU policies, utilities often adopt availability criteria that have the effect of excluding the poor. Three such availability criteria stand out:

- **Minimum residency requirements:** Using the reasoning that effective estimates for budget-billing depend upon a minimum billing history, some utilities limit the availability of budget-billing only to customers who have a minimum of 12 months of residency at the address for which they seek the budget-billing. The frequent mobility of low-income customers, particularly low-income tenants, would tend to exclude low-income customers under such an availability criterion.

- **Limits on arrears:** Many utilities require customers to be free of arrears in order to enter into levelized budget-billing plans. Unfortunately, it is the *presence* of arrears that may well be the indicator of a need for budget-billing. Those customers that have a marginal ability to pay, but simply cannot afford the higher winter bills associated with heating load, can be expected to exhibit particular payment patterns. Rather than excluding customers with arrears from budget-billing, TPU would be well-served to seek out those customers who have seasonal arrears combined with a documented willingness to pay *something* during the winter heating months, even if that "something" is less than full payment.

- **Commencement date:** Many utilities restrict the months in which a customer may enter a budget-billing plan to the late spring and early summer months. Companies adopting this procedure do not view budget-billing as a mechanism to levelize high winter bills. Instead, they view budget-billing as a mechanism through which to obtain prepayment of a customer's winter bills.

  Low-income customers needing to shave the spike off of home heating bills may well not *know* of the benefits, or even of the existence, of levelized budget-billing during a late spring/early summer enrollment period. Indeed, it is likely that it is an unaffordable winter bill that brings the household into contact with the utility, or with an energy assistance agency that can steer the customer onto a levelized budget-billing plan beginning in the winter months.

Increasing Budget-Billing Options

In addition to removing barriers to participation in budget-billing, FSC recommended that TPU offer an alternative budget-billing option. According to FSC, experience counsels that many customers do not wish to enter into budget-billing that significantly increases their warm weather month bills. Even though the whole purpose of budget-billing is to time-shift part of a bill, the realization that the elimination of the high winter bill *also* means the corresponding elimination of the low summer bill (assuming a heating customer) creates a barrier to budget-billing enrollment.

Given this recognition, FSC said that TPU would be well-served to offer something other than an *annual* budget-billing plan. A "winter-only" plan would help guard against the high winter bills while also preserving the low-cost summer months for the customer.

Arrearage data clearly shows that many customers are simply engaging in short-term time-shifting of high winter bills without the structure of a budget-billing plan. Increases in monthly arrears for the residential class as a whole truly begin with the January bill. Moreover, by May, those arrears are being significantly paid down.

To allow customers to move some of that time-shifting *forward* rather than having it merely be *backward* would be consistent with the desire to keep bills paid, and the demonstrated inability to make that happen in the high cost winter months. To move some of those January through March dollars forward to the lower cost months immediately preceding winter should help lower arrears without running afoul of the customers' desires to retain their low-cost summer bills.

BUDGET BILLING INITIATIVES FROM OTHER UTILITIES

A variety of utility companies, along with utility commissions, are paying increasing attention to the desirability of increasing budget-billing. For example, FSC noted, in 2005, the Tennessee state utility regulatory commission faced circumstances of substantially increased arrears as a result of spiraling natural gas prices.

In response to this problem, the Tennessee Regulatory Authority "approved a budget billing plan under which a natural gas customer who cannot pay his or her monthly bill in total will be enrolled automatically in an equal payment plan."[2]

Based on the customer's historical usage, the company divides the customer's bill into 12 equal monthly payments; the payments are then trued up annually with the actual bill received by the customer.[3] The Tennessee program succeeded in reducing service disconnections without imposing undue risk on the state's utilities. Indeed, the program was extended due to its success.

While FSC did not recommend exactly this mandatory approach for TPU, it did recommend that TPU make budget billing available irrespective of arrears status, irrespective of length of residence, and irrespective of the date a household seeks to begin its Budget Bill.

Duke Energy's (Indiana) Budget-Billing

Duke Energy provides a budget plan closest to the seasonal billing previously discussed. Under the Duke Energy (Indiana) "budget-billing" tariff –Duke also offers a year-long "equalized monthly payment plan" that more closely reflects the annual plans discussed above—a customer's bill for the forthcoming quarter (3-month period) is calculated based on 1/12th of the bill for service at the customer's premises for the immediately preceding 12-month period.

At the end of the first quarter, the bill for the *next* three months is recalculated, again to equal 1/12th of the bill service at the customer's premises for the then-immediately preceding 12-month period.

Each 3-month budget-billing plan, in other words, is calculated based as a 1/12th portion of

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[2] Historically, a customer was allowed to enter into a levelized budget billing plan only during the warm weather months, in order to pre-pay some portion of the expected heating bills for the forthcoming winter.

[3] "Winter Heating Bills," 3747 PUR Util. Reg. News 6 (December 9, 2005). TRA Docket 05-00281 (Order issued October 17, 2005).

the bill from the immediately preceding 12-month period.

Once a year, at the end of each 12-month increment, the company calculates the difference between the cost of service billed, and the actual cost of service, and either adds or subtracts (as appropriate) $1/12^{th}$ of that difference from each of the next twelve months to be sent to the customer.

Budget-Billing and Low-Income Discounts

Finally, utilities are increasingly conditioning the grant of their low-income discounts on an agreement by the discount recipients to move to levelized budget-billing. In 2009, for example, Xcel Energy, doing business as Public Service Company of Colorado (PSO), implemented a percentage of income-based rate discount requiring participants to take service under budget-billing. So, too, do electric utilities operating the Maryland Electric Universal Service Program (EUSP), as well as the natural gas utilities operating the Indiana Universal Service Program (USP), require participants to take service under budget-billing. FSC recommended that TPU adopt a mandatory budget-billing requirement for its low-income discount.

SUMMARY AND CONCLUSIONS

Previous TPU analyses have recommended that the utility place a greater reliance on budget-billing. In its June 30, 2008 *Benchmarking Report* for Tacoma Public Utilities, UtiliPoint International recommended that Tacoma Public Utilities "should consider" offering "budget payment plans to customers who indicate they have cash flow issues."

FSC's TPU report again noted the appropriateness of that recommendation. As indicated above, the use of budget payment plans can be promoted and utilized in a variety of ways.

Promoting the increased use of budget-billing would help Tacoma Public Utilities respond to much of the seasonal nonpayment currently experienced on the utility system.

The seasonal nonpayment affects not only customers, but it affects the utility as well. The impact of seasonal nonpayment on 90+ day arrears shows the impact on utility cash flow. The impact of seasonal nonpayment on the number of customers seeking deferred payment arrangements shows the impact on utility customer service staff. The impact of seasonal nonpayment on the level of arrears being referred to collections shows the impact on utility risk of write-offs.

To respond to this seasonal nonpayment, TPU should expand both the availability of budget-billing and the range of budget-billing options.

For help in assessing the adequacy of budget billing policies and practices in a particular state, or for a particular utility, contact:

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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.