

TELECOMMUNICATIONS CREDIT AND COLLECTIONS

AND

CONTROLLING SNET UNCOLLECTIBLES

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*Application of the Southern New England Telephone Company
To Amend the Regulations of Connecticut State Agencies*

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INTRODUCTION

This report presents a review of three credit and collection mechanisms proposed by the Southern New England Telephone Company (SNET) as a means to control uncollectibles on the SNET system.¹¹ The three proposed mechanisms that have been set forth include:

1. The redefinition of termination to exclude toll restrictions.
2. The introduction of new restrictions on toll usage that shows abuse or risk of abuse.
and
3. The termination without notice in cases of suspected fraud or material misrepresentation in obtaining service.

The purpose of the review is to respond to the question: should these credit and collection mechanisms be approved by the DPUC. The review includes both legal and economic conclusions and analysis.

The report below is presented in six Parts. *Part 1* sets out the general policy basis of the subsequent discussion. *Part 2* discusses why the SNET proposal restricting *all* toll calling, when used as a blanket credit and collection technique, is both unlawful and bad public policy. *Part 3* examines SNET's proposed treatments when there is either fraud, or a suspicion of fraud, whether it be identification fraud or subscription fraud. *Part 4* discusses the ECOA implications of SNET proposals in this proceeding. *Part 5* discusses a specific problem with redefining the term "service termination" to exclude toll restrictions. Finally, *Part 6* sets out some recommendations and a proposal for future inquiry and action.

¹¹ As discussed below, the uncollectibles, however, may well not be SNET uncollectibles, but rather uncollectibles incurred by various interstate carriers.

PART ONE: THE GENERAL POLICY BASIS

Connecticut regulators should be increasingly concerned about the intertwining of local regulated telecommunications providers on the one hand and interexchange providers unregulated by the state on the other hand. This concern should be heightened in the credit and collection arena. This heightened concern is based on the fact that it is in credit and collection that customers most directly face the loss of their telephone service altogether.¹²⁾ As will be discussed in substantial detail below, for example, the intertwining of SNET and interexchange carriers in the credit and collection arena potentially threatens a customer's entire access to toll service, with little or no regulatory protections available to him.

One overriding policy of the comments below is that, despite the fact that divestiture occurred more than ten years ago, the process of evaluating and revising credit and collection issues in light of divestiture is just now beginning to become prominent. Significant issues relating to the interrelationship between local exchange and interexchange carriers must now be addressed.

The sale of Billing and Collection Services by local exchange companies to interexchange carriers has exacerbated the problems associated with failing to address the issue and, even today, magnifies the need to begin to apply principles to credit and collection consistent with the philosophy of competition between interexchange carriers. Moreover, the sale of Billing and Collection Services emphasizes the need to maintain the distinction between local exchange and interexchange businesses and their respective expenses.

AN ILLUSTRATION OF THE PROBLEMS AND ISSUE

Perhaps the easiest illustration of how credit and collection policies have not been sorted out since divestiture involves the calculation and collection of deposits by the local exchange company. The divestiture of AT&T from local telephone companies affects the "bill" toward which a company should collect a deposit. For example, given the fact that deposits are designed only to protect *the company* against the risk of loss of revenue due to bad debt, SNET has no reason to collect deposits based upon services other than those services provided *by that company*. Revenue other than that associated with services provided by SNET itself, in other words, are not at risk to SNET.

The appropriate size of SNET deposits should be affected by the fact that local exchange and interexchange services are no longer provided by the same company. In Connecticut, for example, SNET seeks deposits set equal to twice the average household monthly consumption. In pre-divestiture days, the customer's combination long-distance¹³⁾ and local charges represented the "monthly bill" for service. Due to the affiliated nature of the companies, whether the bill was for long-distance

¹²⁾ This is not to denigrate the threat to universal service from unaffordable telephone bills. It is merely to state that the direct disconnection of service by the company, even if only the termination of toll service, flows from credit and collection activities.

¹³⁾ For purposes of this evaluation, "long-distance" is defined to mean interstate and inter-LATA. To the extent that the local telephone company also provides intra-LATA service, this analysis does not apply.

service or for local service was largely irrelevant. That situation, of course, is changed today. While SNET may act as billing and collection agent for an interexchange carrier, the interexchange toll charges are not the SNET's revenue and the loss of that revenue would not be a loss to SNET.¹⁴¹

In short, the revenue to be collected by SNET pursuant to a billing and collection agreement is not revenue at risk to SNET. Since the purpose of a deposit (or a demand for immediate payment when bills exceed a certain limit) is to protect *the local company* against the risk of loss, deposits (or other security) collected by SNET should thus not be based upon the interexchange portion of a monthly bill.¹⁵¹

HOW THE ISSUE MANIFESTS ITSELF IN THIS PROCEEDING

The need to evaluate the ramifications of the intertwining of local and interexchange carriers through the credit and collection process is directly presented in this proceeding. All three proposals advanced by SNET in this proceeding --(1) to redefine "termination" to exclude toll restrictions; (2) to introduce new toll restrictions when there is abuse or the "risk of abuse"; and (3) to terminate without notice in cases of fraud or "suspected" fraud, including "subscription fraud"-- directly present the issue of how the interconnectedness of interexchange and local exchange carriers through the credit and collection process affect local exchange customers. In this sense, the term "local exchange customers" is intended to include intraLATA toll calling.

SNET concedes that its actions to control toll usage have nothing whatsoever to do with its provision of regulated utility service. Rather, as the Company's witness stated in Docket 93-06-22, SNET is seeking to meet "measures of performance" set out in its Billing and Collection Service contract with AT&T.¹⁶¹ Consider some of the impacts of the SNET proposals in this proceeding designed to help the Company meet its contractual "measures of performance":

- o By defining "termination" to exclude toll restrictions, a user of SNET intraLATA toll calls can lose access to that regulated utility service due to a disputed bill with an interexchange carrier

¹⁴¹ See generally, Docket 93-06-22, Tr. 81 - 82 and 362 - 363.

¹⁵¹ This is not to say that "a" telephone company should not be permitted to collect security against the risk of loss of uncollectibles attributable to interexchange telephone usage. The only question is *which* company. Moreover, it is not to say that "a" telephone company should not be permitted to set credit restrictions in the form of toll limits. The only question is *which* company.

The appropriate response is to permit/require each interexchange carrier to collection its own deposits, or establish its own security, against uncollectibles. By requiring interexchange carriers to collect their own deposits, or to establish their own security, customers gain the advantage of competition in the interexchange markets. If, for example, a customer believes that AT&T's deposit requirements to be excessive, or if AT&T imposes toll restrictions that are lower than a customer might desire, or if the terms of the security against uncollectibles are unacceptable for any conceivable reason, the customer would have the choice of seeking more favorable terms from a different interexchange carrier. In this fashion, each interexchange carrier would need to balance the need for security against the possible loss of business due to unreasonable, oppressive, or otherwise unacceptable business practices.

¹⁶¹ Docket 93-06-22, Tr. 81 - 82.

while, at the same time, having no recourse at the state level.¹⁷⁾

- o Based on their interexchange calling patterns, a SNET customer, even one who has *never missed a payment*, can have their entire telephone service --local and interexchange-- disconnected *without notice* due to unsubstantiated allegations of "subscription fraud."
- o Based on a customer's interexchange calling patterns, a SNET customer, even one who has *never missed a payment*, can have the period within which to pay the total telephone bill substantially shortened outside the billing cycle, with the total telephone service, including local phone service, placed in jeopardy for nonpayment.

THE PRINCIPLES TO BE APPLIED

As will become evident throughout the comments below, several principles underlie the analysis and conclusions, both as to the appropriate framework within which to evaluate the SNET proposals and as to the appropriate direction in which to move from this proceeding as to telephone credit and collection. Some of those principles include:

1. SNET is a "public utility," with corresponding public utility obligations, including the obligation to serve.
2. Commercial and consumer credit law is binding on Connecticut regulators, as well as on SNET.
3. Interexchange carriers should not be permitted to "opt out" of contract and commercial law restrictions by hiding behind the regulatory oversight of SNET.
4. Collusive, concerted anticompetitive actions by an interexchange carrier cartel is not insulated from challenge by hiding behind the regulatory oversight of SNET.
5. Competition by interexchange carriers should be promoted in *all* aspects of the interexchange market, including interexchange credit and collection activities. Anticompetitive actions by interexchange carriers should be disapproved as bad public policy, even if not found to be "unlawful."
6. Promotion of "universal service" includes access to all levels of toll service.
7. Competition in the promotion of universal service for toll carriers is a desirable policy goal.
8. Credit and collection practices for individual utility companies, including both local exchange and interexchange carriers, should be structured based upon individual decisions by individual

¹⁷⁾ In the West Virginia state supreme court case *Casey v. AT&T Communications*, AT&T and the West Virginia Public Utility Commission have argued that notwithstanding the potential loss of *local* service due to a disputed bill with AT&T, the *only* recourse for the customer regarding the dispute is with the Federal Communications Commission. The West Virginia Public Utility Commission has held three times within the last 18 months that it has *no jurisdiction* over billing disputes involving interstate phone calls.

companies, as constrained by factors such as the economics of the particular company, the competitive pressures facing the individual companies, and the like.

The application of these principles to the SNET proposals now before the Commission will become apparent in the discussions below.

PART TWO: NEW RESTRICTIONS ON TOLL USAGE THAT SHOWS ABUSE OR RISK OF ABUSE IN SNET'S OPINION

SNET proposes to implement certain new toll restrictions on accounts that have toll usage which, when combined with other classwide characteristics, indicates "abuse" or the "risk of abuse" in SNET's opinion. Under SNET's proposal, the new credit and collection proposal would allow the Company to impose toll restrictions when, in the Company's opinion, toll usage is being abused or is at risk of being abused. In SNET's proposal, the Company states that the key factors in making this determination would include credit classification, the length of time the customer has been on the network, the dollars per day of toll usage, and the actual payment and treatment history of the customer since the establishment of telephone service.

The "toll restrictions" would deny access to all 1+ toll service through the SNET network. This would include a denial of access to all interexchange toll carriers as well as to SNET's own toll calling.

This Part examines the proposed SNET restrictions on toll usage for households who have a shorter time on the system, who have less favorable credit reports for non-utility credit, and who have higher rates of toll service. The Part is presented in three sections. *Section A* examines the anticompetitive aspects of the SNET proposal and concludes that the proposal is likely an antitrust violation. *Section B* considers the SNET proposal in light of the economics of allowing or denying customers access to the toll system. *Section C* considers whether the SNET credit and collection proposals represent an inappropriate intertwining of that local exchange carrier with the collection of bills for interexchange carriers.

THE ANTITRUST IMPLICATIONS

The implementation of SNET's proposed credit and collection techniques would have unlawful anticompetitive impacts for consumers and competitors alike in Connecticut. These unlawful impacts would arise in at least three different instances. The SNET impacts would arise in that: (1) they affect competition between SNET and other entities seeking to provide billing and collection services; (2) they affect competition between IXC's who use SNET as a billing and collection agent and IXC's who do not; and (3) they affect competition between carriers who *do* use SNET as a billing and collection agent. Before examining each of these separately, however, it is useful to explore some of the legal and economic principles that are relevant to an evaluation of the competitive impacts of the SNET proposals.

The Outlines of the Relevant Antitrust Law

The essential facility and group boycott doctrines provide generally recognized bases for imposing antitrust liability for unilateral and group refusals to deal. Under the essential facilities doctrine, a monopolist that denies a competitor access to an input considered an essential facility violates Section 2 of the Sherman Act. Under the group boycott doctrine, collective and coercive conduct used as the means to eliminate competition, or compel adherence to cartel demand, violates Section 1 of the Sherman Act.

Within these broad general principles, however, there are certain economic factors that give more cause for concern than others. For example, when an unlawful group boycott cuts off access to a supply, facility, or market necessary to allow competition to operate, from an economic rationale, they can be deemed to be automatically unreasonable. If SNET has exclusive access to an element essential to competition, in other words, the conclusion must be that expulsion will have an anticompetitive impact. Moreover, from an economic perspective, there will be an anticompetitive impact if the inherent conditions are such to prohibit any other reasonable means of entering the market.

It is an unreasonable restraint of trade for a party to foreclose others from the use of an essential facility. A party may not, in other words, use its strategic dominance over a facility controlling access to a market for the purpose of shutting out potential competitors. Where facilities cannot practically be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms.

While one might tend to think of antitrust laws as protecting one firm from the anticompetitive impacts of its competitor, the beneficiary of the competition sought to be protected is the consumer. Accordingly, even if *all* competitors work in concert, the anticompetitive behavior would be economically objectionable if the result is harm to the consumer.

The Basis for Finding an Anticompetitive Impact

Consideration of a number of factors lead to the conclusion that the SNET proposals are unreasonably anticompetitive from an economic perspective. The following four factors are of particular importance:

1. SNET has control of an essential facility: the local telephone network;
2. Competitors in the toll market have no reasonable or practical ability to duplicate the SNET facility;
3. Through its proposed credit and collection techniques, SNET would be denying the use of the facility to toll competitors when a household poses a "risk of abuse" as defined by SNET; and

4. It is feasible for SNET to provide access to toll competitors on terms other than those proposed in this proceeding.

The Essential Facility at Issue: Access is being denied to interexchange carriers through the local telephone exchange operated and controlled by SNET. That facility is "essential" to toll competition. At best it would be economically infeasible for toll competitors to duplicate this facility. Toll competitors have a practical inability to duplicate the facility.

Moreover, clearly, SNET owns and controls the facility. Just as clearly, Billing and Collection Service customers who exercise their contract rights to certain credit and collection techniques control the facility through the exercise of their contract rights.

When implemented, the SNET credit and collection techniques will deny access to all competitors of an IXC having a customer with the credit history, and sufficient billing charges, to be defined by SNET as representing a "risk of abuse" and thus subject to the toll discontinuation.

Based on a consideration of antitrust law, the economic factors and considerations set forth in these comments represent an antitrust violation. From both an economic and legal perspective, the SNET proposals represent an unreasonable anticompetitive restraint on trade. Moreover, even aside from antitrust considerations, from a utility regulatory perspective, the SNET proposals do not fulfill the economic considerations that go into having a utility rate or service be "just and reasonable." While the same economic considerations may lead to the conclusion that there is an antitrust violation, they might also lead to a finding that the anticompetitive impacts are unreasonable under utility doctrine as well.

Competition Amongst Entities Providing Billing and Collection Services: The first area of anticompetitive impact that SNET's proposals will generate is the impact on competition amongst institutions providing Billing and Collection Services. Institutions other than SNET, of course, can provide billing and collection for IXCs. Indeed, entities such as VISA and American Express have sought to develop billing and collection service capability for the industry. The competitive impact arises because of the unique stranglehold that SNET can exercise over the access to toll service generally. Even without the disconnection of service to the network generally, by denying access to toll carriers through the local exchange, SNET stands alone in its ability to deny access to the entire toll industry. Competitors to SNET do not have a similar means of coercion.

No other consumer credit industry has a billing and collection service provider who exercises total control over access to the industry as a whole because of the judgment by one member of the industry that a particular customer (or class of customers) poses a "risk of abuse." Granting SNET the power to implement the credit and collection mechanisms it proposes in this proceeding will virtually ensure that SNET will exert total control over the offer of billing and collection services.

Competition Between Interexchange Carriers Using SNET for Billing and Collection and Those

Who do Not: Approval of SNET's billing and collection proposals will grant a competitive disadvantage to those interexchange carriers who do not use SNET for billing and collection *vis a vis* those carriers who do. This competitive disadvantage arises for several reasons. First and foremost, of course, is that even toll carriers who do *not* subscribe to the SNET Billing and Collection Service will be denied the opportunity to compete for customers who have been deemed by SNET to represent a "risk of abuse" due to high monthly bills owed to one of the IXC's combined with other classwide characteristics who *does* subscribe (or for high monthly bills caused by SNET toll charges). SNET asserts that its proposed credit and collection techniques are necessary to reduce bad debt and to prevent "subscription fraud." However, some carriers may be willing to accept higher levels of bad debt, even if resulting in higher rates, because it is those payment troubled high risk customers, which comprise the market niche those carriers seek to serve.

The effect of the SNET proposals, however, is to deny these carriers, existing or potential, the right to carve out that market niche. The result is that by their coercive and collusive action in preventing the market niche to develop, SNET preserves the customer base for the existing major interexchange carriers. They, in effect, create and maintain a captive market.

Competition Amongst Interexchange Carriers Who Use SNET for Billing and Collection: Some of the anticompetitive impacts amongst interexchange carriers who use SNET for Billing and Collection were discussed above. IXCs should aggressively compete for business. One area of competition should be the area of securing against bad debt. For example, the levels of deposits may and should vary amongst IXCs depending on the level of security desired. Competition amongst the IXCs, also, should lead to innovations in non-cash security. These might include, for example, third party sureties. Indeed, some energy companies today, for example, are substituting attendance at budget counseling sessions for the posting of cash deposits.

Competition should lead carriers to identify and compete for various segments of the payment-troubled population who might be "less risky" in the eyes of the IXC. It is clear today that payment troubled customers do not represent a monolithic class. Different payment troubled customers, in other words, pose different risks. Some simply are careless. Some are on their "way up" or "way down" economically. Some are in temporary economic straights. Some are chronically poor and unable to pay their monthly household bills. The lesson for this proceeding, however, is that given SNET's proposed credit and collection actions, there is no incentive for IXCs to identify the various reasons for nonpayment and to respond to the distinct needs of the various subclasses of payment troubled customers.

Substantial empirical evidence exists supporting the observation that different "classes" of nonpaying customers exist. A late 1985 Pennsylvania State University (Penn State) study looking at payment-troubled households in Pennsylvania¹⁸¹ debunked the myth that nonpaying households are characterized

¹⁸¹ Hyman, et al., "Optimizing the Public and Private Effects of Utility Service Terminations," *Public Utilities Fortnightly*, at 29 (December 29, 1985).

by "deadbeats." The Penn State study found that "payment-troubled households are experiencing considerable socioeconomic stress when compared to the pattern for the average (general) customer sample." The study noted that families encountering payment problems have a higher number of female heads of household, dependents, disabled members, nonmarried heads of households, and unemployed household members while also having lower levels of education, income and home ownership than households that do not experience difficulties.

Just as important for our purposes here, however, the Penn State study found that six of ten customers who had utility payment problems indicated that some unusual condition hindered timely payment of their utility bill.^{9\} Employment related problems (such as being laid off, having reduced working hours, or being unemployed) were most frequently cited as the cause for the receipt of a shutoff notice as well as for the actual termination of service (22% for shutoff notice; 18% for termination of service).^{10\} Unusually high medical expenses (resulting from hospitalization or illness) and unusually high bills (resulting from seasonal usage variations) were the second and third most common reasons cited for the termination of service. (19% and 18% percent respectively). The study concluded: "in view of the lower-income levels and higher number of dependents in the payment-troubled households when compared to the general sample, it is not surprising that these difficulties readily manifest themselves in the form of overdue bills."^{11\}

In contrast, Penn State found that 20 percent of the households with payment troubles reported that they simply lacked adequate income. The reasons underlying household payment problems are set forth in the table below.

COMPARISON OF STUDY GROUPS ON CIRCUMSTANCES SURROUNDING THE OVERDUE BILL		
Unusual Condition for Overdue Bill	NOTICE	TERMINATED
No income. No money	18%	18%
Illness. Medical	15%	19%
Extra high utility or other large bill	22%	18%
Laid off. Less work	21%	21%
Other	14%	16%

^{9\} While the Penn State study labelled "lack of money" as an "unusual condition," that assumption was not made for this report.

^{10\} *Id.*, at 32, Table 2.

^{11\} *Id.*, at 32.

No unusual condition	10%	8%
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The Penn State work is not the only empirical work, however. A 1983 study by the Wisconsin Public Service Corporation was designed "to find out why customers pay late, why they miss payments, what percentage is unable to pay, and what percentage could pay but do not."^{12\} The Wisconsin research broke the study population into five basic groups:^{13\}

- Group 1. The poor and the helpless who blame themselves for their status (19%).
- Group 2. The poor and the helpless who are angry with their life (16%).
- Group 3. The poor who are in transition (12%).
- Group 4. People whose income should be sufficient to pay their utility bills, but who are poor money managers (41%).

^{12\} Michael Kiefer & Ronald Grosse, "Why Utility Customers Don't Pay Their Bills," *Public Utilities Fortnightly*, at 41 (June 21, 1984).

^{13\} Wisconsin Public Service provided the survey firm of Bergo & Matousek with a sample of 1,700 customers in Green Bay who had a history of bill payment problems. Some of these customers had been disconnected. From this sample, 300 door-to-door interviews were completed. The questionnaire took thirty to forty-five minutes to complete and did not identify the utility or the sponsor of the survey.

Group 5. People who can pay their bills but do not (12%).^{\14\}

Wisconsin Public Service described Group 1 (poor who blame selves) as being "very poor. They seem to be standing still economically." According to the utility, these households "spend little on luxuries, have done what they can do to save money, and are still unable to manage on their incomes." Looking at their income versus family size and expenses, the utility concluded, "it appears they really do not have enough to live on."

Group 2 (poor who are angry) was described by Wisconsin Public Service as a group that "feels helpless.* * *they are angry and frustrated with their position." According to the utility, this is the "poorest and least educated" of the nonpayment groups. "This group is down and out and apparently destined to stay down and out."^{\15\}

Group 3 (poor in transition) was described by Wisconsin Public Service as being "somewhat of a mixture."^{\16\} On the one hand, the group includes "some younger, well-educated people* * *who are moving up in the world." On the other hand, the group contains households who appear "either to be rising from hard times or sinking into hard times. This portion is less educated and primarily blue collar."^{\17\}

Group 4 (poor money managers), Wisconsin Public Service concluded, "is the most diverse group in terms of demographics, attitudes, and life-styles."^{\18\} The one common attribute is that the households making up this group "are poor at managing their money. They appear to be either spending beyond their means or to have bill paying priorities which are not realistic."

Wisconsin Public Service reported that for Group 5 (can pay but don't), "there is no apparent reason why they should not be paying their utility bills."^{\19\} The utility, according to the study, "is low on their list of priority" for this group of households. Possibly these households do not pay their utility bills "because they would rather do other things than write out checks or, perhaps, they prefer to spend their money on other priorities."

"Overall," Wisconsin Public Service concluded in this study, "it appears that about half the sample is

^{\14\} *Id.*, at 42.

^{\15\} *Id.*, at 43.

^{\16\} *Id.*, at 43.

^{\17\} *Id.*

^{\18\} *Id.*

^{\19\} *Id.*

quite hopeless, but half can learn to pay their bills with a little coaxing and coaching."^{120\} The detailed study provides much useful information about the nonpaying population. It is important to understand the characteristics which distinguish the households Wisconsin Public Service found to be "quite hopeless." Only in this way can efficient and effective collection mechanisms be designed to address both their particular needs and the needs of the company. The "quite hopeless" customers include those households in Groups 1, 2 and 3.

Finally, a 1989 Washington Natural Gas study, based upon a survey undertaken for the Washington Utility Group, found major differences amongst nonpaying populations also.^{121\} The purpose of the study was to "develop() a mutually acceptable understanding of the ability of delinquent utility customers to pay their energy bills. Is it that most can pay these bills on time, but choose not to, or is it that they truly are unable to pay* * *?"^{122\} The Washington study found results similar to those generated in Wisconsin and Pennsylvania.

In short, Washington Natural Gas summarized its results by categorizing its nonpayers into six groups akin to those groups found in Pennsylvania and Wisconsin. The Washington utility then broke these groups into two broader populations: (1) those who "can pay"; and (2) those who "can't pay." Most payment-troubled customers (64%) can pay, according to the utility. These include the poor money managers (39%), the temporary downers (16%) and the won't pays (8%). A significant minority of payment-troubled households (36%), however, simply "do not have the means to pay."^{123\} These include the new poor (22%), the survivors (9%) and the chronic poor (6%).

In contrast to this empirical analysis, SNET's proposals in this proceeding seek to deem an entire class of customers, defined only by certain classwide characteristics, as representing a "risk of abuse." The SNET credit and collection proposals at issue in this proceeding, in other words, totally close the market to niche IXC's who either do or might seek to serve a "high risk" customer. Unlike the consumer finance industry where niche financiers have been allowed to develop, in the telecommunications industry, proposals such as those advanced by SNET will legitimate efforts by those carriers who subscribe to the SNET Billing and Collection Service to prevent the development of niche financiers. Given those SNET proposals, there is no incentive whatsoever for the interexchange carriers to *understand*, let alone serve, the payment-troubled population.

In addition, the SNET proposals will result in anticompetitive impacts even amongst the IXC's who all subscribe to the SNET Billing and Collection Service. Those anticompetitive impacts will be at least five-fold:

^{120\} *Wisconsin Public Service Corporation: Lifestyle Study: Selected Payment Patterns*, at ii (July 1983). "Those people who cannot pay their bills because of income and family size appear to be doing just about all they can to pay their bills. They are not indulging in luxuries they cannot afford. They're just scraping by." *Id.*

^{121\} This group consists of Washington Natural Gas, Pacific Power and Light, Washington Water Power, Northwest Natural Gas, Cascade, and Puget Power.

^{122\} Mildred Baker, *Utility Collection Customers: Understanding Why They Don't Pay on Time*, at 1 (1989). Baker states that this paper only "represents the interpretations of Washington Natural Gas Company, one of the principal survey sponsors." The broader survey was titled: *Investor Owned Utility Group Credit Customer Survey*, Market Trends Research Corp. (1989).

1. Competition based on risk aversity will be foreclosed. Perhaps one carrier would accept a five percent bad debt, while another carrier would find 2.5 percent "too high."
2. Competition based on the means of redressing nonpayment will be foreclosed. The structure and term of deferred payment arrangements, as well as the decision on whether to offer more than one deferred payment arrangement, will be made uniform amongst all IXC's.
3. Competition based on the determination of the type of security, on the need for security, and on the adequacy of security, will be foreclosed.
4. Competition based on the determination of system economics, as well as the weight to be attributed to system economics, will be foreclosed. Some carriers might accept a somewhat higher level of net bad debt, for example, in order to gain the increased fixed cost contributions from other customers. That competition would be eliminated.
5. Competition based on a greater understanding of payment troubled customers, and an identification and delineation of particular sub-classes of customers, will be foreclosed. Under the SNET proposals, all IXC's will be forced to inappropriately and unreasonably treat all payment troubled customers as a monolithic class.

Controlling Bad Debt as a Justification for Anticompetitive Actions: SNET argues that the credit and collection techniques that it proposes in this proceeding are necessary to control bad debt. The primary flaw in this argument is that it views bad debt in isolation from every other component that goes into the company's cost of service. It may be the case --and it is necessary to emphasize the word "may" here-- that there are legitimate business reasons to reduce bad debt. It may equally be the case that there are alternative legitimate business reasons to turn one's attention either to reducing expenses in other aspects of the utility's business or to increasing revenue.^{124\}

^{124\} See generally, Colton. *Evaluating Public Utility Credit and Collection Activities: Effectiveness and Cost-Effectiveness* (July 1994).

"One analyst recommends that companies concentrate their collection activities on slow payers rather than on customers that demonstrate long-term payment problems. (Kirschbaum). Collections should be primarily directed at customers in the 31 to 60 day range, according to Kirschbaum.

This is the critical time when your cash flow maintains momentum or breaks down. Most people in this category are not ultimately collection problems --merely 'slow payers.' By concentrating your collection efforts here* * *you can accelerate the payment process and enhance positive cash flow.

"Many customers simply do not have enough cash to pay all of their suppliers on time," Kirschbaum notes. "They must choose whom they will pay promptly and whom they will pay in 60 days or 90 days." He concludes that the biggest potential for reducing total company DSO is by accelerating the payment of slow payers in this 31 to 60 day range, rather than by chasing problem debts.

"This observation is confirmed by another recommendation that businesses should spend their "time and efforts to keep good accounts good." (Gross). "Credit employees," Gross states, "are continually pressured by their superiors to collect those 'old' receivables.* * *This results in a pattern of collection that is a total reversal of how it should be handled."

"Changing from "conventional methods of collection" to the "preventative approach" will "dramatically increase the efficiency" of

Reducing bad debt, in other words, is not an end unto itself, but is only a means to the end of providing least cost service.

The SNET proposals are anticompetitive in that they take away from the independent business judgment of the IXCs in how to determine the "appropriate" level of bad debt for their company, how to weigh the significance of any given level of bad debt *vis a vis* other expenses and revenues, how to cost-effectively reduce the level of bad debt, and so forth. The judgment of SNET is imputed to all carriers subscribing to the SNET Billing and Collection Service. In addition, even carriers who do *not* subscribe to SNET's Billing and Collection Service are forced to accept the judgments that SNET makes as to which customers represent a "risk of abuse." Even if those non-subscribing carriers would *seek* to compete for payment troubled customers, or even if they would *seek* to compete on the basis of relaxed security, generous deferred payment arrangements, liberal shutoff policies, and the like, they would be denied access to the facilities necessary to allow them to compete.

Credit and Collection as "Pro-Competition": The notion that strict credit and collection techniques can be "pro" competition because they might reduce costs and thus make toll service more available to more people has no basis. First, as discussed in more detail above, reducing bad debt by indiscriminately denying toll access to all customers deemed to represent a "risk of abuse" by SNET will not necessarily reduce an IXC's cost of service. In fact, relatively few payment troubled customers ultimately end up contributing to a company's bad debt. One certainly cannot simply *assume* that disconnection for nonpayment will result in increased bad debt in every instance (or even in most instances).

Second, reducing bad debt is not the functional equivalent of reducing a utility's cost of service. One
(..continued)

collection efforts, Gross says. Accounts under 60 days past due represent 75 to 80 percent of a modern company's total revenue, while accounts over 60 days past due represent 15 to 20 percent. By concentrating efforts on the 30 to 60 day delinquent accounts, Gross states, "there would be an 85 percent reduction in accounts becoming 60 to 90 days past due."

"Moreover, Gross says, the redirection of collection efforts changes the economics of the expenditure of labor.

Under the conventional approach, the time involved in the actual collection and negotiation of accounts amounts to only ten percent of the total time spent by the collection department. Administration and documentation accounts for 20 percent of their time, and 70 percent of time is involved in pursuit, research, letters, and attempts to locate and contact the debtor. Under the preventative approach, the time involved in the actual collections and negotiations of accounts will rise to 50 percent, a five-fold increase.

"Gross notes that concentrating collection efforts on the 30 to 60 day delinquent accounts will reduce time spent on pursuit, research, attempts to locate and contact the debtor, and the like, to only 20 percent. "As you can see, when it comes to account receivables, time is of the essence for success. Work your receivables at the right time and relinquish them when you should." (Gross at 27; *see also*, Bureau, at 28).

"In sum, DSO counsels that utilities concentrate their attention on consumer debt that is 30 to 60 days past due, rather than concentrating their efforts on the substantially past due. It is this early set of "slow payers" which provides the best opportunity to obtain wholesale reductions in overall company DSO. Due to the sheer magnitude of debt in this category, accelerating slow payments by a few days will yield a larger reduction in total company DSO than will the reduction or elimination of the long-term problem accounts." *Id.*, at 47 - 49 (citations omitted).

factor to consider, for example, would be whether the lost base revenues generated by keeping customers off the toll system would equal or exceed the bad debt that would be generated by keeping this payment troubled population on the system.

Third, whether keeping all payment troubled customers off the toll system will result in reduced cost of service is a function of company-specific economics. Rather than disconnecting a customer's service and writing off that revenue to bad debt, an IXC may wish to carry the customer for an extended period of time on a deferred payment arrangement. The extent to which a company incurs a cost by carrying the customer's arrears for some period of time is a function of that company's weighted cost of capital. To the extent that a carrier can reduce its cost of capital, in other words, that company should be able to "afford" to be more lenient in offering deferred payment terms. From a cost of service perspective, the issue would be which approach yields lower total costs: (1) keeping some payment troubled customers on the system, preserving their fixed cost contributions, and incurring the cost of capital for carrying arrears; or (2) denying all those payment troubled customers access to the toll system and eliminating the bad debt caused by some portion of those customers.

Summary: In sum, three conclusions can be reached as to the anticompetitive impacts of SNET's credit and collection proposals in this proceeding. First, even assuming that the proposals will help reduce bad debt, it is not facially evident that this reduction will result in making toll service more affordable and thus more widely available. No study has ever examined the change in toll usage or penetration per each one percent reduction in bad debt, all else equal. The notion that this change would be significant, or that it would even exist at all, is counter-intuitive.

Second, it is not facially evident that reducing the bad debt caused by some portion of the population by denying access to toll service to all customers deemed by SNET to represent a "risk of abuse" will result in making toll service more affordable and thus more widely available.

Third, it is not facially evident that reducing the bad debt caused by some portion of the population by denying access to toll service to all payment troubled customers can be accomplished with all else remaining equal. Instead, there will be a whole plethora of factors put into play some of which decrease and some of which increase the cost of service. How those factors ultimately play out is unknown.

THE ECONOMICS OF DISCONNECTING SERVICE

In addition to being an unlawful imposition on competition, the SNET credit and collection proposals involving the denial of all toll service based on certain classwide characteristics combined with designated levels of telephone bills inappropriately ignore the differing economic bases for service denials amongst and between toll carriers. The Connecticut DPUC should not approve a policy that effectively institutionalizes a uniform service disconnection policy for unpaid bills for all carriers providing toll service. Service disconnection (or denial) is not a necessary response to nonpayment, and the DPUC should permit (and require) each company to decide its own policies on service denial.

The effect of SNET's proposal regarding abuse or "risk of abuse" of the toll system is to impute SNET's system economics, policy decisionmaking, and competitive position, to all interexchange toll carriers. The toll carriers would be governed by the same SNET policies, irrespective of which carrier is serving the particular customer subject to the SNET proposed collection activities. For all of the reasons outlined below, the DPUC should not approve such a procedure.

Again, it is necessary to look at SNET's role as a public utility. A utility, including a telecommunications company, must constantly assess the cost-effectiveness of its credit and collection practices, including the use of service terminations. The disconnection of service may be viewed as one mechanism, but by no means the exclusive mechanism, to collect a customer's bill. Moreover, given the menu of available collection options, it cannot be assumed that the disconnection of service *a priori* results in the least-cost provision of service. That determination must be made by the local utility. This is why such actions are defined as "operational" decisions. They involve volitional actions on the manner in which credit and collection will be managed.

The term "operational decisions" may reflect a variety of factors affecting a utility decision regarding whether a particular collection activity, such as the termination of service, is appropriate. Moreover, having different companies make different decisions as to the same question may not involve different policy choices so much as they reflect different variables on a particular utility system.

The existence of DPUC regulations regarding service disconnections relates to these independent company decisions only to a limited extent. The activity of disconnecting utility service is expressly a permissive activity. Utility disconnections, in most ways, are entirely up to the utility. DPUC rules governing the disconnection of service merely regulate what is otherwise a permissive business decision by the utility. The DPUC rules establish reasonable procedures to be followed by utilities that elect to terminate services to customers who fail to pay their bills. Disconnections, however, remain a permissive device for utilities to use in attempting to achieve the objective of collecting revenue.

Among the factors to consider in assessing the cost-effectiveness of the disconnect process are the economics of disconnections. The economics of the disconnection or denial of service will turn on a variety of factors. Other factors include: the extent to which a company incurs a working capital expense is one such factor, and the level of that expense as measured by the carrier's weighted cost of capital; the extent to which a company can negotiate reasonable deferred payment arrangements to bring arrears down to affordable levels; the relationship between a carrier's contribution to fixed costs arising from additional customers and the contribution of those customers to net bad debt. It is unreasonable to expect each of these factors to be the same amongst all toll carriers.

A decision to use the disconnection of service as a collection device, in other words, is just that: a decision. Whether or not to disconnect should be driven as much by the economics and finances of a particular utility as by other factors. There is no reason to institutionalize a procedure where the economics of SNET collection cost decisions should govern all toll carriers.

A second factor to consider in service denials is lost revenue. The revenue stream which is lost when customers are removed from the system may also be significant in a utility's decision regarding whether or not to disconnect service as a collection device. Whenever a customer's service is disconnected, two things happen. First, the company avoids the variable cost of delivering that unit of service to the household. Second, the company forgoes the revenue that *would have been* collected from the household but for the disconnection of service. To the extent that the revenue would have exceeded the variable cost of delivering the service, other ratepayers lose a contribution toward the payment of the fixed charges of the company. In this instance, the disconnection of service leaves remaining, paying, customers worse off than had the disconnection not occurred.

In general, there is an advantage to all ratepayers from keeping as many households on the system as possible. So long as households pay the variable costs of delivering the service they consume, other ratepayers are no worse off. To the extent that households pay anything beyond the variable cost of the service they consume, they are making a contribution toward the fixed costs of the system and all ratepayers are better off than they would have been had those households been disconnected. It could thus well be cost-effective to a toll carrier, and to all of the remaining ratepayers of that carrier, to provide payment-troubled customers with service along with some incentive to make some partial payments (even if full payment cannot be made) by deciding *not* to disconnect so long as the customers continue to pay more than the variable cost of providing service. Again, the decision regarding whether or not to provide service should be based on the economics of the individual carrier, not upon a uniform policy enforced by SNET.

The same analysis would apply to deferred payment arrangements. Clearly, it is up to an individual carrier to decide when (or whether) to offer deferred payment arrangements. The risk averseness of all carriers in this regard will not necessarily be the same. AT&T may seek to disconnect service upon one default on a deferred payment arrangement, while MCI may find it acceptable to allow multiple defaults. AT&T may be willing to allow new customers with bad credit histories to carry arrears of \$400, while MCI may only permit arrears of \$200. Implementation of the SNET proposals set forth in this proceeding, however, would impose a uniform credit and collection policy on all carriers, enforced by SNET.

Finally, each individual carrier should make individual decisions as to the means it considers adequate to protect itself against the loss of revenue to bad debt. The denial of service is one such mechanism. However, a carrier could collect deposits against the potential for bad debt. A carrier could seek sureties as a means of security.

By requiring interexchange carriers to decide upon the security against bad debt, customers should gain the advantage of competition in the interexchange markets. If, for example, a customer believes AT&T's deposit requirements to be excessive, or if AT&T refuses to enter into a satisfactory payment plan for the deposit, or if the terms of the deposit are unacceptable for any conceivable reason, the customer would have the choice of seeking more favorable terms from a different interexchange

carrier. In this fashion, each interexchange carrier would need to balance the need for security against the possible loss of business due to unreasonable, oppressive or otherwise unacceptable business practices.

In sum, the disconnection of service is discretionary on the part of a company. Part of the competition between toll carriers should involve the proper exercise of that discretion regarding economics, considerations of lost fixed cost contributions, and risk aversity reflected in deferred payment arrangements and deposits. To approve the SNET application for the three credit and collection techniques it proposes in this proceeding is to allow collusive decisionmaking on how to exercise that discretion. Approving the SNET application is to impose, or at least to impute, a uniform decision to all toll carriers on each aspect of service disconnection discussed above. Such a policy by the DPUC should be avoided.

THE INTERTWINING OF SNET AND INTEREXCHANGE BUSINESSES

Several empirical issues march forward in assessing whether SNET's proposal for toll restrictions inappropriately intertwines the SNET business with interexchange carriers in an effort to control uncollectibles. It is important to remember that it is this need to control uncollectibles that SNET posits is the basis for its credit and collection proposals in this proceeding. SNET states in its Petition:

in 1992, the Company's uncollectibles were \$27.78 million and the Company's costs associated with its collections process was appropriately \$27 million. The Company's uncollectibles have continued to be a concern.

The Commission should be aware, however, that it is not simply the control of *SNET's* uncollectibles that is driving the application for approval of the proposed credit and collection techniques. For example, the \$27.78 million of the "Company's uncollectibles" cited above is somewhat misleading. In response to Data Request LFE-22 in Docket 93-06-22, the Company indicated that its "residence *intrastate* write-offs net recoveries" was only \$10.3 million for the 12 months ending December 31, 1992.^{125\} This \$10.3 million, of course, is SNET's *total* intrastate residential uncollectibles, including uncollectibles caused by local service, intraLATA tolls, and the like. As discussed in more detail below, the intrastate *toll* portion, which is the only portion of the uncollectibles this proceeding would address, would be a relatively minor portion of this amount.

In addition, SNET has conceded that it is *not* the control of intrastate uncollectibles which it is concerned with so much as it is the control of interexchange uncollectibles in order to meet contractual "measures of performance."^{126\} Moreover, the concerns SNET expresses over the size of monthly bills indicates that the concern is as much, if not more, with *interexchange* bills as with intrastate uncollectibles.

^{125\} This 12 month period was chosen since the 1992 uncollectible \$27.78 million dollar figure used by SNET in its application was for 1992.

^{126\} Docket 93-06-22, Tr. 81 - 82.

This conclusion can be drawn from a number of sources. The deposits proposed by SNET, the Company says, are to protect the Company against uncollectibles. The proposed \$120 and \$330 deposits are twice the average monthly bill for all customers and for involuntarily disconnected customers respectively.^{127\} The "average monthly bill" is total *billed* revenue (emphasis added) divided by total residential customers.^{128\} The total billed revenue includes both interexchange billings and SNET jurisdictional billings.^{129\} In addition, "final account dollars" refer to the total dollar amount due on final bills.^{130\} This includes the total final bills written off as uncollectibles.^{131\}

Finally, the following exchange occurred in that same Docket:

"Q. (Bryan) With respect to the toll restriction service that SNET has recently implemented, how do you view that in terms of the overall picture of impact on uncollectibles?

A. (Pruden) I believe offering toll-restriction service will reduce uncollectibles for those customers who may have a hard time controlling their bills and controlling their level of charges that they incur and, therefore, having to pay for them.* * *

Q. (Bryan) So, would you view that as an incidental part of the Company's proposal to reduce uncollectibles or a very significant part?

A. (Pruden) I view toll-restriction as a very significant part."^{132\}

The Company proceeded to testify in 93-06-22 that its primary concern is with high toll usage^{133\} and the greatest problem arising from service disconnections is with toll usage.^{134\}

Given this concern with toll usage, it is important to note for this proceeding that it is not *intrastate*

^{127\} Docket 93-066-22, Data Request response OCC-16.

^{128\} Docket 93-06-22, Data Request response OCC-6, *citing* TE-10.

^{129\} Docket 93-06-22, Data Request response TE-10.

^{130\} Docket 93-06-22, Data Request response OCC-21.

^{131\} Docket 93-06-22, Data Request response OCC-21. Other data request responses making clear that SNET's reported "uncollectibles" include revenues billed for interexchange usage include Company responses to TE-3, TE-4, TE-11 and LFE-18. All cited data request responses are from Docket 93-06-22.

^{132\} Docket 93-06-22, Tr. 214 and 216.

^{133\} Docket 93-06-22, Tr. 558.

^{134\} Docket 93-06-22, Tr. 576.

tolls that drive the uncollectibles experienced by SNET. While direct data is not reported by SNET, data from Docket 93-06-22 can be used. It is assumed for purposes of analysis below that the data is comparable. It seems axiomatic that significant increases in monthly phone charges come in the toll component of an SNET bill. SNET's response to Data Request TE-10³⁵⁾ would support that. While average monthly bills are \$61, SNET reported, the interstate toll (other than 900 or AOS charges) and interstate toll (including 900 and AOS charges) represent almost \$30 (\$29.28 or 48 percent) of that total. More importantly, from the converse perspective, the monthly "fixed" charges (monthly basic service, subscriber line charge, equipment and inside wiring, and installment billing) is only half of the average total bill.³⁶⁾ When compared to the data provided in response to LFE-18 from that same docket, however, it becomes clear that intrastate toll revenues are a relatively small part of the total bill. LFE-18 reports that the average monthly "toll per user" (both intrastate and interstate) is only \$33.42. Assuming that the data is comparable, therefore, it is possible to conclude by subtracting interstate toll charges from total toll charges that the intrastate toll is relatively insubstantial (\$33.42 - \$29.28 = \$4.14).³⁷⁾

This analysis spills over into SNET's claim that it experiences \$27+ million in credit and collection expenses. SNET's credit and collection expenses are largely driven by its need/desire to meet the "measures of performance" set forth in its Billing and Collection Service contract. Indeed, one can ascertain that the collection expenses are not generally primarily caused by the collection of intrastate revenues. For example, the Company has credit and collection treatments are not triggered by arrears that are less than \$50. Irrespective of the credit classification that a customer is in, the *minimum* arrears subject to treatment is this \$50 amount. Accordingly, as the response to Data Request TE-10 would indicate, it is not the SNET jurisdictional billing that is triggering the need for these credit and collection activities.³⁸⁾ It is instead the interexchange toll billing which causes the need for the collection activity, using the SNET's own determination of when it is "worth it" to begin collection treatment.

When one operates on the assumption that the Billing and Collection Service fees completely compensate SNET for the billing and collection activities undertaken on behalf of the interexchange carriers, it is then necessary to conclude that SNET customers, in their capacity as SNET customers, are harmed not at all by "high toll use" customers.³⁹⁾

³⁵⁾ In Docket 93-06-22.

³⁶⁾ The non-interstate toll represents 52 percent of the total average bill. Part of that amount includes "SNET intrastate toll" which, granted, is not a "fixed" charge.

³⁷⁾ One need not conclude that this *precise* amount is correct to reach the more general conclusion that intraLATA calling is a relatively minor part of the total monthly phone bill.

³⁸⁾ The Company's response to Data Request LFE-2 shows that the credit and collection procedures, particularly those leading to the disconnection of service, are undertaken after only *two* bills have been rendered. Thus, there would be less than \$50 of SNET charges in these instances. Moreover, since, by definition, the "greenie" process is initiated between bills, by definition, as well, there would be only one month of SNET charges. Thus, the cost of the "greenie" process is not caused by SNET charges.

³⁹⁾ While SNET might argue that it is just as likely that high toll bills are caused by intraLATA toll calls as interexchange toll calls, the data

While not directly at issue in this proceeding, the ways in which the entire "toll restriction" process encourages the interconnection between SNET and the interexchange carriers should be noted as well. For example:

- o SNET states that toll restrictions will be offered in lieu of a cash deposit. Deposits, however, are based on twice the average monthly bill, including both local charges, intraLATA charges, and interexchange charges. Those deposits can range from \$120 to \$330 if SNET proposals are adopted.
- o SNET states that toll restrictions will be offered in lieu of disconnection, while households retire past due arrears. Those arrears include unpaid total bills, including local, intraLATA and interexchange charges.

In contrast, the proposals advanced in the last Part of these comments will address each of these issues while avoiding the anticompetitive impacts of intertwining the local exchange and interexchange carriers.

In sum, the uncollectibles "problem," as well as the collections "problem" that SNET identifies in support of its proposals in this proceeding are legitimate only if one ignores the distinction between SNET and the interexchange carriers to whom SNET provides Billing and Collection Services. In fact, the credit and collection proposals advanced in this proceeding are not so much to help control SNET uncollectible accounts, as it is to help SNET meet its "measures of performance" set forth in contracts involving the sale of non-utility administrative and financial services to AT&T.

SUMMARY AND CONCLUSIONS

The SNET proposal to place new restrictions on toll usage when, in the opinion of SNET there is an abuse or a "risk of abuse" of the toll network suffers from several legal and policy infirmities. The legal problems which inhere in the proposal are not the types of problems that may be waived by SNET or by DPUC regulators. Now would regulatory approval of such a proposal insulate the proposal from subsequent challenge. The proposal, which involves denying access to *all* toll carriers when SNET finds that its experience with any *one* carrier raises the issue of abuse or risk of abuse, is anticompetitive in nature and is a violation of both Section 1 and Section 2 of the Sherman Antitrust Act. Even if not found to be an antitrust violation, however, the proposal is sufficiently anticompetitive to fail a regulatory test of "just and reasonable."

Aside from the legal problems with SNET's proposal, from a substantive perspective, the proposal fails to consider the different factors which different companies might be expected to use in deciding when, to what extent, and under what conditions, to extend toll service. The SNET inappropriately seeks to

(.continued)

certainly do not support such an assertion.

impute a uniform decision-rule to all interexchange carriers.

Finally, the SNET proposals represent an inappropriate intensification intertwining of the local exchange and interexchange businesses. SNET should not be allowed to use its regulated utility character merely to help it meet contract performance goals established for the sale of non-utility administrative and financial services.

Table 1
Average Monthly SNET Bill

Description	% of Bill	Amount
Monthly Basic Service	34%	\$20.90
Subscriber line charge	6%	\$ 3.50
Equipment and inside wiring	9%	\$ 5.49
Installment billing	3%	\$ 1.83
Interstate toll (other than 900 and AOS)	37%	\$22.57
Other interstate toll (900 and AOS)	11%	\$ 6.71
Total Average Monthly Bill	100%	\$61.00
SOURCE: TE-10, Docket 93-06022		

Table 2
Toll Usage for SNET Residential Customers

# of accounts	1,197,495
Total Toll \$'s (intra and inter)	\$440,014,673
Toll per user	\$33.42
SOURCE: LFE-18, Docket No. 93-0622	

PART THREE: TERMINATION WITHOUT NOTICE WHEN FRAUD OR SUSPECTED FRAUD

This Part looks at SNET's proposal to be permitted to terminate toll service without notice when there is a suspicion of fraud. "Fraud," according to SNET, can be one of two types. First, there is identification fraud, where the person is not who he or she claims to be. Second, there is "subscription fraud," where SNET alleges that a person subscribes to SNET service with no intention of ever paying for it. It is this second type of fraud that these comments consider in particular.

This Part is presented in five sections. *Section A* looks at the source(s) of legal duties that govern SNET behavior when that behavior relates to the suspicion of fraud. *Section B* examines the law of "fraud" generally, in particular, the burden of proof requirements and how those might affect the SNET proposal. *Section C* considers whether SNET's proposal can be made lawful by casting it in a more favorable light, *i.e.*, that SNET isn't *really* alleging fraud, but rather merely an "insecurity" in whether a customer will perform its contractual obligations.^{140\} *Section D* examines whether the SNET proposal can be made lawful by casting it as a response to "anticipatory repudiation" by SNET. Finally, *Section E* discusses why the legal propositions laid out in the first four sections are applicable to interexchange carriers and how the impact of the SNET proposal, intended or otherwise, is simply to insulate those interexchange carriers from their legal obligations by hiding their activities behind the regulatory oversight of what appears on the surface to be SNET collection activities.

In sum, the discussion below concludes that SNET's proposal is not only bad policy, but that it is unlawful as well under the normal common law and contractual obligations governing SNET as a public utility. The illegalities are not illegalities that the Connecticut DPUC can ignore in its regulatory discretion.

THE SOURCES OF LEGAL DUTIES GOVERNING SNET'S BEHAVIOR

The discussion below looks at two aspects of SNET's proposed credit and collection techniques. The discussion first examines the sources of certain legal obligations that SNET bears as a public utility. As a public utility, SNET shoulders certain obligations and is subject to certain legal constraints not imposed upon other industries. The discussion next examines the implications of these legal obligations upon the lawfulness of SNET's credit and collection actions as set forth in this proceeding. The discussion will conclude that SNET's proposals are subject to legal challenge should they be adopted. The legal constraints acting upon SNET are not the types of constraints that can be waived by regulators.

SNET's "Duty to Serve" and How that Duty Relates to Allegations of Fraud

Despite its increasingly unregulated nature, Southern New England Telephone Company (SNET) continues to be a "public utility" in the eyes of the law. While this conclusion may not be in serious

^{140\} "Insecurity," of course, is a term of art in contract law.

dispute, it may be drawn from several considerations. Perhaps most directly, the grant of the power of eminent domain to Connecticut utilities is an indicator that SNET holds itself out to serve the entire public and is, therefore, a public utility.⁴¹ The grant of eminent domain may only be for a "public use." Thus, in giving Connecticut utilities, including SNET, the power of eminent domain, "the legislature must be given credit for intending not to violate the due process clause of the constitution by conferring such power on a corporation for private use."⁴²

It is contemplated that all of the inhabitants in the territory shall be eligible to obtain the service by complying with reasonable conditions. Having endowed the cooperative with the power of eminent domain, the legislature has at the same time imposed upon it the responsibility to reasonably furnish nondiscriminatory service to its members, the members, of course, being the public in the area served.⁴³

A utility with the power of eminent domain organized to serve the public *must* accept all applicants without discrimination.⁴⁴ It matters not whether the utility is natural gas, electric, telecommunications or some other.

In contrast to legislative and constitutional restraints on SNET is the common law duty to serve.⁴⁵ The fundamental common law "rule" requires SNET to serve on reasonable terms all those who desire the service it renders.⁴⁶ If a member of the public has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty of SNET to provide the service.⁴⁷ SNET is under a legal obligation to render adequate and reasonably efficient service impartially, without unjust discrimination, and at reasonable rates.⁴⁸ In short, under the common law, SNET must make its

⁴¹ *Dairyland Power Cooperative*, 82 N.W.2d at 61, citing, *Clarksburg Light and Heat Co. v. Public Service Commission*, 84 W.Va. 638, 100 S.E. 551, 554 (1919) and *Rural Electric Co.*, 120 P.2d at 742.

⁴² *Dairyland Power Cooperative*, 82 N.W.2d at 63.

⁴³ *Id.*

⁴⁴ *Capital Electric Power Association v. McGuffee*, 83 So.2d 837 (Miss. 1955), cited by, *Dairyland Power Cooperative*, 82 N.W.2d at 63.

⁴⁵ See e.g., *Snell v. Clinton Electric Light, Heat and Power Company*, 196 Ill. 626, 58 L.R.A. 284, 63 N.E. 1082 (1902). "There is no statute regulating the manner under which electric light companies shall do business in this state. They are, therefore, subject only to the common law and such regulations as may be imposed by the municipality which grants them privileges." *Id.*, at 1083.

⁴⁶ 64 *Am. Jur.2d*, *Public Utilities*, §16 (1972).

⁴⁷ Annotation, *Liability of gas, electric or water company for delay in commencing service*, 97 *A.L.R.* 838, 839 (1935); see also, 26 *Am. Jur.2d*, *Electricity, Gas and Steam*, §110 (1966) (delay in commencing electric service); 26 *Am. Jur.2d*, *Electricity, Gas and Steam*, §216 (1966) (delay in commencing gas service).

⁴⁸ See e.g., *Arizona Corp. Comm'n v. Nicholson*, 497 P.2d 815, 817 (Az. 1972) (citations omitted).

service available to all members of the public to whom its public use and scope of operation extend, who apply for such service, and who comply with its reasonable rules and regulations.^{149\}

In sum, there is no question but that the general rule is that SNET, as a public utility, has the duty to furnish service to the public. This duty exists independently of statutes regulating the manner in which it shall do business or of contracts with municipalities or individuals.^{150\} The duty is imposed because SNET is organized to do business affected with a public interest and holds itself out to the public as being willing to serve all members of that public.

SNET is Bound by Basic Contract Law as Well

Some customer service protections for SNET customers arise, as well, through the application of basic common law contract principles. The application for utility service submitted to SNET creates a standard contract between SNET and its customers. This relationship is, as a result, governed by fundamental contract principles. There is no question but that the provision of utility service is a commercial relationship governed by the law of contract.^{151\} The contractual relationship is governed by the Uniform Commercial Code (UCC),^{152\} and the breach or denial of service gives rise to an action for breach of contract.^{153\}

THE SIGNIFICANCE OF COMMON LAW AND CONTRACT LAW TO SNET FRAUD PROPOSALS

The discussion above regarding SNET's common law and contract law responsibilities has particular significance to the Company's proposals regarding the control of what it terms "subscription fraud." Neither SNET nor the DPUC operate in a legal vacuum regarding what may and may not be done with regard to allegations of fraud. For example, consider:

^{149\} For excellent discussions of the scope and ramifications of this duty, *see generally*, Comment, "Liability of Public Utility for Temporary Interruption of Service," 1974 *Wash. L. Qtrly* 344, 346, n. 10 (1974); Robinson, "The Public Utility Concept in American Law," 41 *Harv. L.Rev.* 277 (1928); Arterburn, "The Origin and First Test of Public Callings," 75 *U.Penn. L.Rev.* 411 (1927); Burdick, "The Origin of the Peculiar Duties of Public Service Companies," 11 *Columbia L.Rev.* 514 (1911).

^{150\} *See e.g.*, *Morehouse Natural Gas Company v. Louisiana Public Service Commission*, 140 So.2d 646 (La. 1962); *Messer v. Southern Airways Sales Co.*, 17 So.2d 679, 681 (Ala. 1944); *Birmingham Railway, Light and Power Company v. Littleton*, 77 So. 565, 569 (Ala. 1917); *Snell v. Clinton Electric Light Company*, 196 Ill. 626, 58 L.R.A. 284 63 N.E. 1082 (1902); *Gibbs v. Baltimore Gas Company*, 130 U.S. 396 (1888); *Southwest Gas Corp. v. Public Service Commission*, 474 P.2d 379 (Nev. 1970).

^{151\} *Williams v. City of Mount Dora*, 452 So.2d 1143 (Fla. App. 5 Dist. 1984); *see generally*, 64 *Am.Jur.2d, Public Utilities* §28 (1972).

^{152\} *See*, Mallor, "Utility 'Service' Under the Uniform Commercial Code: Are Utilities In for a Shock?," 56 *The Notre Dame Lawyer* 89 (1980); *see also*, Annotation, *Electricity, Gas or Water Furnished by Public Utilities as 'Goods' Within the Provisions of U.C.C. Art. 2 on Sales*, 48 *A.L.R.3d* 1060 (1973).

As a "service," telecommunications would be governed by the U.C.C. by analogy rather than by direct application.

^{153\} *See*, 64 *Am.Jur.2d, Public Utilities* §28 (1972); *see e.g.*, *DeLong v. Osage Valley Electric Valley Electric Co-op Ass'n*, 716 S.W.2d 320 (Mo. App. 1986).

SNET Must Presume Honesty and Fair Dealing

SNET may not adopt a rule requiring deposits, or other security such as the demand for immediate payment, on the theory that a certain class of customers as a whole are dishonest.^{154\} Indeed, the courts have held that "*in the absence of any evidence to the contrary*, (a customer) is presumed to have been responsible for obligations undertaken* * *." (emphasis added).^{155\} The purpose of a deposit is to ensure that "while giving the honest citizen what he pays for, (but) prevent the dishonest from getting that which he will never pay for."^{156\} The demand for immediate payment, being one other type of demand for security, is subject to the same legal rule.

The courts have held that while a company may establish a rule exacting payment in advance in reasonable amounts, or the deposit of security,^{157\} a utility may *not* "assume in advance that consumers will not comply with such reasonable rules for the security of the company as may be embodied in their contracts, nor, in the absence of satisfactory proof, that unusual expense will be incurred in collecting the price of the gas sold."^{158\} Again, whether it is natural gas, or electricity, or water, or telecommunications is irrelevant to the legal principle involved.

This rule is consistent with other legal principles. In actions involving allegations of fraud, for example, most states require that the fraud be proven by "clear and convincing" evidence rather than by a mere preponderance.^{159\} The most common reason advanced for adhering to the "clear and convincing" standard of proof in cases involving fraud:

is the fact that courts are to presume 'honesty and fair dealing.' The requirement that evidence be clear and convincing is to overcome that presumption. According to the Nebraska supreme court, for example, proof of fraud 'must be sufficient to overcome the natural presumption, which is always of considerable force, that men are honest and act from correct motives.'^{160\}

Since the presumption of honesty and fair dealing attaches to all commercial transactions, it becomes even less supportable for SNET, as a public utility with a "duty to serve," to demand a deposit based

^{154\} *Phelan v. Boone Gas Co.*, 147 Iowa 616, 125 N.W. 208, 209 (1910); *see also, Harbison v. Knoxville Water Co.*, 53 S.W. 993, 996 (Tenn. Ch. App. 1899).

^{155\} *Id.*, at 209.

^{156\} *Id.*

^{157\} *Cedar Rapids Gaslight Co. v. City of Cedar Rapids*, 144 Iowa 426, 120 N.W. 966, 971 - 972 (1909).

^{158\} *Id.*, at 972.

^{159\} Colton, "Heightening the Burden of Proof in Utility Shutoff Cases Involving Allegations of Fraud," 33 *Howard L.Rev.* 137 (1990).

^{160\} *Id.*, at 147.

only upon an assumption or "suspicion" of unreliability, absent some evidence in support of that assumption or suspicion.

Non-Discrimination: The Reasonableness of the Basis for a Deposit Demand

The duty of nondiscrimination is one of the marks of a "public utility." Since SNET is a public utility, that duty of nondiscrimination attaches. The obligation to provide nondiscriminatory rates and services is part of the broader "duty to serve."

One of the distinctions between a public utility business and other kinds of business is the duty to serve which attaches to the former. In other kinds of business, obligations rest upon contract, but a different rule applies to a business devoted to public use.⁶¹

* * *

The duty to serve, therefore, is now regarded as a necessary incident to the public utility business.* * *without going into a detailed discussion of all the decisions, we can safely announce the rule that a public utility must render safe, reasonable and adequate service.⁶²

Inherent within this duty to serve is the "rule under modern industrial conditions" that "the public service company shall serve all with equality."⁶³ The obligation of nondiscrimination is, in other words, found within the special obligations of public service companies. "A person having a public duty to discharge is undoubtedly bound to exercise such office for the equal benefit of all."⁶⁴ The duty of nondiscrimination is "a universal principle to protect all who are being served."⁶⁵

The test for nondiscrimination is whether like customers are treated alike. While SNET may distinguish customers based on "such other natural conditions which distinguish them from each other or from other classes,"⁶⁶ "laws designed to enforce equality of service and charges and prevent unjust discrimination require the same charge for doing alike and contemporaneous service under the same or substantially similar circumstances or conditions."⁶⁷

⁶¹ Nichols, *Public Utility Service and Discrimination*, at 121 (1928).

⁶² *Id.*, at 123.

⁶³ *Id.*, at 859.

⁶⁴ *Messenger v. Pennsylvania R.Co.*, 13 Am.Rep. 457; 18 Am.Rep. 754 (1874).

⁶⁵ *Owenboro Gaslight Co. v. Hildebrand*, 19 Ky. L.Rep. 983, 42 S.W. 351 (1897).

⁶⁶ *Arkansas Natural Gas Co. v. Norton Co.*, 165 Ark. 172, 263 S.W. 775, 776 (1924) and citations therein.

⁶⁷ *Nichols*, at 862.

Importantly, the rule requiring nondiscrimination "does not mean a uniformity of rates or prices for services rendered to the public. A 'public business' cannot be required to charge the same rate for services rendered to different classes, or to people differently situated."^{68\} The court explained:

It is only arbitrary discriminations that are unjust. If the difference in rates is based upon a reasonable or fair difference in conditions which equitably and logically justified a different rate, it is not an unjust discrimination. In fact, this question of discrimination narrows itself to a determination of whether a discrimination, conceding it to exist, is just; *i.e.*, based on reasonable grounds, or is unjust; *i.e.*, merely arbitrary.^{69\}

The court concluded: "There is no unjust discrimination if all persons similarly situated affected by like conditions and subject to like circumstances are given the same rate."^{70\} The issue, then for the DPUC, is to decide whether all persons to whom SNET proposes to apply its credit and collection policies regarding suspicion of "subscription fraud" are "similarly situated."

Having characterized the issue as such, the discrimination challenge raised below to SNET's "subscription fraud" credit and collection policy is broad and wide-ranging. The challenge asserts that SNET's classification of customers categorizes those customers in an arbitrary and irrational fashion. The challenge points out how customers SNET "suspects" of subscription fraud exhibit no "natural conditions which distinguish them from each other" and how, instead, they take service under "the same or substantially similar circumstances" as those customers not suspected.

The Special Case Involving Allegations of Fraud

The SNET proposal regarding subscription fraud involves more than a mere claim that a bill has gone unpaid. Under its proposal, SNET explicitly predicates its credit and collection actions on its allegations that the customers so treated represent an unacceptable risk of fraud. Under such circumstances, SNET does not, as it proposes in this proceeding, relieve itself of obligations,^{71\} but instead it subjects itself to a requirement to meet a *higher* burden of proof than in the straight nonpayment case. The common law rules of evidence in most states provide that "fraud" in a contract may not be proved by a mere preponderance of the evidence; instead, SNET, as the party alleging fraud, must make a stronger "clear and convincing" showing.^{72\} Not only is the higher showing

^{68\} *Hargrave*, 792 P.2d at 58.

^{69\} *Id.*

^{70\} *Id.*

^{71\} SNET proposes, among other things, to relieve itself of the need to provide pre-termination notice as well as to establish the non-creditworthiness of customers on an individual basis.

^{72\} The elements of common law fraud include that the party made a false representation; that its falsity was known to that party, or that the misrepresentation was made with such reckless indifference as to the truth or falsity as to impute knowledge; that the misrepresentation was

relevant, but some of the corresponding consequences of the need to make that higher showing are relevant as well. Several affirmative "rules" of law flow from the allegation of fraud that SNET advances.

(..continued)

made with the intent to defraud; that the person not only relied upon the misrepresentation, but had a right to rely upon it with full belief in its truth; that the person would not have done the action from which damage resulted but for the misrepresentation; and that damage directly resulted from the misrepresentation. *Everett v. Baltimore Gas and Electric Co.*, 307 Md. 286, 513 A.2d 882, 889 (1986); *see also, Anderson v. Reynolds*, 588 F.Supp. 814, 818 (D.Nev. 1984); *Servicemaster Industries v. J.R.L. Enterprises*, 223 Neb. 39, 388 N.W.2d 83, 86 (1986); *Pacific Northwest Life Ins. Co. v. Turnbull*, 51 Wash. App. 692, 754 P.2d 1262, 1266 (1988).

The Need for an Affirmative Showing in Support of a Finding of Fraud

When SNET seeks to deny telephone service, it must make an affirmative showing of the reason for the denial. This conclusion flows not from the substantive law of shutoffs as much as it flows from the allocation of the burden of proof in justifying a utility shutoff when challenged. The Maryland state supreme court directly addressed the burden of proof issue in a 1986 case involving Baltimore Gas and Electric Company (BG&E). In *Everett v. Baltimore Gas and Electric*,^{173\} the Maryland court noted that a utility does not have an absolute right to terminate service. According to *Everett*:

BG&E, as a regulated public utility, has an affirmative duty to provide service to the public. In order to discontinue service, it must have grounds for termination* * *. Where a bona fide controversy or dispute exists between the utility and the customer, the utility must show that the proposed termination is justified.^{174\}

The Maryland court concluded:

We hold that where a customer demonstrates a bona fide controversy or dispute as to a proposed termination of service, *the utility* bears the burden of going forward *and* the burden of persuasion in establishing sufficient grounds for termination.^{175\}

This allocation of the burden of proof is nearly universal. The New York courts, for example, have long held that a utility has "a duty to supply service to a customer" and that "any lawful termination of such service, such as for nonpayment of an amount owing, may be accomplished only* * *with the utility company having the burden to justify its shutoff."^{176\} According to the New York courts, "it is clear that when a utility corporation seeks to cut-off an existing energy supply to a residential customer, the burden of proof is upon the utility."^{177\}

The proper allocation of the burden of proof is illustrated in instances where telephone service is alleged to be used for criminal purposes.^{178\} In such cases, the telephone company has been held to have the burden to justify the termination of service.^{179\} According to the D.C. District Court, this

^{173\} 307 Md. 286, 513 A.2d 882 (Md. 1986).

^{174\} *Id.*, at 888 (the customer must allege facts sufficient to show a bona fide dispute, but does not carry any burden of going forward).

^{175\} *Id.*, at 888 - 889 (emphasis added).

.2d 470, 474 (N.Y. City Civ. Ct. 1987) (with citations).

^{177\} *Montalvo v. Consolidated Edison Co. of New York*, 110 Misc. 2d 24, 441 N.Y.S.2d 768, 775 (NY 1981). (citations omitted).

^{178\} See e.g., *Right or Duty to Refuse Telephone, Telegraph, or Other Wire Service in Aid of Illegal Gambling Operations*, 30 *A.L.R.3d* 1143, §6(a) (1970).

^{179\} See e.g., *Pennsylvania Publications v. Pennsylvania Public Utility Commission*, 349 Penn. 184 36 A.2d 777, 781 (1944).

allocation is based in large part on the fact that "a public utility, such as a common carrier, a telegraph company, or a telephone company, must serve all members of the public without discrimination or distinction."^{180\} While the telephone company "may refuse to furnish or may discontinue service," the D.C. court said, "the burden of proof* * *is on the public utility to establish the fact that the service is being used or is about to be used for a criminal purpose."^{181\} Indeed, according to the Illinois courts, a complaint which challenges the disconnection of service "need only set forth the threatened termination of facilities and assert its right to telephone service.* * *(The customer) is at no point required to come forward with evidence, much less testimony, until (the utility) has satisfied this burden (of proof)."^{182\}

In a shutoff situation where SNET alleges fraud, therefore, it is the obligation of SNET to prove all of the facts necessary to justify its shutoff.^{183\} In the fraud situation, SNET must prove among other things that a false representation was made by the customer, *i.e.*, that the customer would pay for service when billed. It is *not* the duty of SNET merely to come forward with evidence; SNET bears the burden of persuasion.

The Need for Clear and Convincing Evidence

In proceedings involving allegations of fraud, SNET must meet its burden of proof by "clear and convincing evidence." This burden differs from most proceedings, where parties may carry their burden of proof through a simple "preponderance of the evidence." One of the seminal cases examining the stricter burden of proof is the 1986 Maryland supreme court decision in *Everett v. Baltimore Gas and Electric Company*.^{184\} According to *Everett*:

Where a utility alleges that a customer engaged in conduct amounting to fraud or to a crime, and such conduct constitutes the sole basis of the customer's alleged responsibility for prior unpaid bills, the utility must prove its allegation by clear and convincing evidence to justify termination of service for non-payment.^{185\}

^{180\} *Andrews v. Chesapeake & Potomac Telephone Co.*, 83 F.Supp. 966, 968 (D.D.C. 1949).

^{181\} *Id.*

^{182\} *Telephone News System v. Illinois Bell Telephone Co.*, 220 F.Supp. 621, 628 - 629 (D.Ill. 1963). Note that this is a stricter rule than that announced by the Maryland court in *Everett* above. *Everett* required the customer to at least initially "demonstrate() a bona fide controversy or dispute as to a proposed termination of service." *Everett*, 513 A.2d at 888. Even in *Everett*, however, the customer did not have the burden of coming forward with evidence to prove its dispute; the customer need only allege facts sufficient to demonstrate the controversy.

^{183\} Viewed from the perspective of the customer, it is *not* the responsibility of the customer to *disprove* the elements of fraud. A utility customer, in other words, is not required to prove residence at one address in order to *disprove* allegations of fraudulently obtaining utility service at a different address.

^{184\} 513 A.2d 882 (Md. 1986).

^{185\} *Id.*, at 891.

The two different issues rolled into this holding --illegal conduct on the one hand and fraud on the other-- will be separated. Allegations of fraud will be examined, while for purposes of this section allegations of criminal conduct will be set aside.

For purposes of this proceeding, it is not the *fact* of the higher evidentiary showing which is so important so much as it is the reasoning which supports the imposition of the higher standard. Two primary reasons have been advanced for adhering to the "clear and convincing" standard of proof in cases involving fraud. Perhaps the most common is the fact that courts are to presume "honesty and fair dealing."^{186\} The requirement that evidence be clear and convincing is to overcome that presumption.^{187\} According to the Nebraska supreme court, for example, proof of fraud must be "sufficient to overcome the natural presumption, which is always of considerable force, that men are honest and act from correct motives."^{188\} The second reason relies on the "aura of guilt" that attaches to a person found to have acted fraudulently.^{189\} As a result of the stigma of dishonesty and bad faith, courts have rejected the notion that evidence must reveal only that it is "more likely than not" that fraud has occurred.

^{186\} See e.g., *Newell v. Krause*, 239 Kan. 550, 722 P.2d 530, 536 (1986); see also, *Credit Union of America v. Myers*, 234 Kan. 773, 676 P.2d 99 (1984).

^{187\} This reasoning is not universal, however. The Montana courts, for example, have stated that while "good faith will always be presumed," the preponderance of the evidence standard nevertheless still governs actions alleging fraud in that state. *Cowan v. Westland Realty Co.*, 162 Mont. 379, 512 P.2d 714, 716 (1973).

^{188\} *Peters v. Woodmen Accident and Life Co.*, 170 Neb. 861, 104 N.W.2d 490, 497 (1960); see also, *Omaha Bank for Cooperatives v. Siouxland Cattle Cooperative*, 305 N.W.2d 458, 464 (Iowa 1981); *Neuhaus v. Kain*, 557 S.W.2d 125, 136 (Tex. Civ. App. 1977); *Rhoads v. Harvey Publications*, 145 Ariz. 142, 700 P.2d 840, (Az. App. 1984).

^{189\} *Riley Hills General Contractor v. Tandy Corp.*, 303 Or. 390, 737 P.2d 595, 603 (1987).

No Element of Fraud to be Supplied by Presumption

When considering the showing that SNET must make to justify its denial of service, the requirement of clear and convincing evidence to prove fraud places some limits on the type of affirmative showing that is adequate. Most importantly for a review of the SNET practice proposed in this proceeding, each element of fraud must be proved; none can be supplied by presumption. Accordingly, for example, an intent to deceive cannot be presumed merely from the fact of nonperformance or misrepresentation.^{90\} Indeed, as discussed above, the beginning presumption in any fraud case is the opposite, that the challenged transaction is based on honest and fair dealing. Fraud may be inferred from circumstantial evidence.^{91\} Evidence may not, however, be simply "consistent" with a finding of fraud,^{92\} but must lead to the logical deduction that fraud has occurred.^{93\} If a transaction is fairly susceptible of two constructions, the one that will free it from the imputation of fraud must be adopted.^{94\} Particularly if circumstantial evidence is the *only* evidence relied upon, the circumstances must be "of such a nature and so related to each other that the conclusion reached is the only one that can be fairly and reasonably drawn therefrom."^{95\}

The limit on presumptions is most significant in precisely the situation that SNET presents in this proceeding. SNET proposes to formalize a policy presuming that customers who meet some classwide profile are presumed to be engaging in "subscription fraud" without consideration of individual circumstances. The discussion above, however, would indicate that the legal analysis of this proposal has two starting points: first, as discussed above, if a person has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty of SNET, as a public utility, to provide the service. Second, there is an initial presumption that the application for service is made consistent with honest and fair dealing. Pulling these two doctrines together leads to the conclusion that SNET may *not* assert, without evidence of a clear and convincing nature, that an applicant will not pay the price for service, and abide by the reasonable rules of SNET, in the future. For SNET to deny service in such a situation because of fraud, it must prove each element of fraud with sufficient persuasiveness to overcome its common law duty to serve all who come and to overcome the initial presumption of fair and honest dealing. Suspicions, doubts or uncertainty, will not suffice to serve as the basis for a denial of any level of service.

^{90\} See e.g., *Callicott v. Acuff Homes*, 723 S.W.2d 565, 568, 569 (Mo. App. 1987); compare, *Farr v. Hoesch*, 745 S.W.2d 830, 832 (Mo. App. 1988).

^{91\} *Rogers v. Hickerson*, 716 S.W.2d 439, 446 (Mo. App. 1986); *Austin v. Wickerson*, 519 P.2d 899, 904 - 905 (Ok. 1974).

^{92\} *Raynor v. Richardson-Merrell*, 643 F.Supp. 238, 243 (D.C.D.C. 1986).

^{93\} *Rigby Corp. v. Boatmen's Bank & Transit Co.*, 713 S.W.2d 517, 540 (Mo.App. 1986).

^{94\} *Funnell v. Jones*, 737 P.2d 105, 108 (Ok. 1985); *Madill Bank and Trust Co. v. Herrmann*, 738 P.2d 567, 571 (Ok. App. 1987).

^{95\} *Servicemaster Industries v. J.R.L. Enterprises*, 223 Neb. 39, 388 N.W.2d 83, 86 (1986).

ASSUMING NOT "FRAUD" BUT MERE "INSECURITY"

One way for SNET to seek to avoid the restrictions placed upon it by its allegations of "fraud" is to recast its concern not as a worry about fraud, but rather merely as a concern over "insecurity" as to future payment.^{196\} In response to this feeling of "insecurity," SNET is proposing to require immediate payments from a certain class of customers. Setting aside whether "insecurity" can be established on a classwide basis under *any* circumstances, as well as whether SNET has made such a class demonstration in this proceeding, this section examines the legal constraints on SNET credit and collection treatment based on the Company's feelings of "insecurity."

Legal Standards To Use in Judging "Insecurity"

The Uniform Commercial Code provides guidance on how to obtain protections against SNET demands for a cash deposit, immediate payment, or other form of security from customers based upon unsubstantiated claims that the Company feels "insecure" about the ability or willingness of the customer to make future payments. Legal guidelines exist for governing the point at which SNET, as a creditor, may claim that it feels "insecure." One place to turn in seeking how the claims of "insecurity" by other creditors have been constrained is the case law developed regarding insecurity clauses.

It does not matter whether the demand for security is one sought at the initiation of service^{197\} or one sought at some later time.^{198\} The strength of the reference to the UCC for evaluating SNET's proposals regarding subscription fraud lies in the standards which the law establishes in defining when declarations are made of "insecurity," as well as in the standards established for determining what "demand for security" might be reasonable under such circumstances.

SNET's proposal reserving the right to demand *immediate* payment of the entire toll bill, notwithstanding the normal due date, in the event that the bill exceeds specified dollar amounts is a classic example of an "insecurity clause." An "insecurity clause" under the UCC provides that a creditor may accelerate the maturity of the underlying debt whenever he "deems himself insecure."^{199\} The issue in this proceeding involves not the *validity* of such a clause, --presumably SNET could exercise an insecurity clause if appropriately established just as in any other commercial transaction-- but rather involves the burden of proof on SNET, as the creditor, to establish "insecurity." It is this issue --that of creditors claiming and being called upon to justify their claims of "insecurity"-- that is the point of comparison between SNET's proposal and any other creditor seeking to accelerate payments

^{196\} As mentioned above, "insecurity" is a term of art within contract law.

^{197\} A deposit is such a demand.

^{198\} The demand for immediate payment when bills reach a certain level is one such example.

^{199\} *White and Summers*, at §27-3, p. 565.

pursuant to the UCC "insecurity clause."^{100\}

The fact is that case law exists under the UCC that establishes guidelines by which to review a claim that future performance is "insecure." UCC Section 1-208 provides that an insecurity clause may be invoked only if the creditor "in good faith believes that the prospect of payment or performance is impaired."^{101\} The interpretations of this basis for an insecurity clause can be divided into three basic schools of thought.^{102\} The first holds that the creditor is the sole judge as to the insecurity of the debt; the only proof needed in this case is whether the creditor in fact deemed himself insecure and proceeded on that basis. The second holds that the danger must rest in some fact or facts in actual existence, regardless of appearances; that there may be an *appearance* of insecurity is irrelevant if there is no insecurity in fact. The third holds that there must be an appearance of insecurity "when viewed in good faith by a man of reasonable prudence."^{103\} The weight of authorities, as well as the sounder reasoning, supports the third approach.^{104\}

Indeed, the rule which "appears to have more often prevailed, in cases directly involving or making a special point in regard thereto"^{105\} is that the person asserting the insecurity clause "is not authorized to do so arbitrarily, but must act in good faith, and also have either reasonable grounds or at least probable cause for believing that he is insecure."^{106\} "The prevailing view seems to be that an arbitrary power is not conferred but the [lender] must act reasonably with probable cause to apprehend a loss* *
*."^{107\}

ASSUMING NOT FRAUD, BUT ANTICIPATORY REPUDIATION OF THE CONTRACT

A final way to conceptualize SNET's demand for immediate payments, or for some other form of security, is to view SNET's collection action as a Company response to anticipatory repudiation of the customer's contract responsibilities.^{108\} Under the contract, SNET has agreed to deliver telephone

^{100\} See generally, Annotation, *What constitutes 'good faith' under Uniform Commercial Code §1-208 dealing with 'insecure' or 'at-will' acceleration clauses*, 61 *A.L.R.3d* 244 (1975); *supplemented*, 85 *A.L.R.4th* 284, 312 (1991).

^{101\} The term "good faith" under the UCC, of course, has a defined meaning. It refers to "honesty in fact." §1-201(19), UCC.

^{102\} *Id.*

^{103\} *Commercial Credit Co. v. Cain*, 190 Miss. 866, 1 So.2d 776 (1941).

^{104\} *Id.*, and citations therein.

^{105\} Annotation, *Validity, construction, and application of insecurity clause in chattel mortgage*, 125 *A.L.R.* 313, 318 (1940). While the cases cited here involve security interests or real property liens, a security interest is not *necessary* for a contract to involve an insecurity clause.

^{106\} *Id.*

^{107\} *Sackett v. Hall*, 478 S.W.2d 381, 384 (Mo. 1972).

^{108\} See generally, Annotation, *What constitutes anticipatory repudiation of sales contract under UCC §2-610*, 1 *A.L.R.4th* 527, 547

service in exchange for future payment by the customer. Anticipated future *nonpayment* would, accordingly, simply be an anticipatory repudiation of the payment responsibilities. The initial question raised in such circumstances is "whether the words or acts of the prospective [customer] constitute an anticipatory repudiation at all."^{109\} Again, we set aside whether SNET can define an entire class of customers, without reference to individual characteristics, as representing a threat of "anticipatory repudiation." Instead, we look at the justification of a finding of anticipatory repudiation itself.

Again, we turn to the Uniform Commercial Code for guidance. The question of anticipatory repudiation is governed by UCC Section 2-609, which states in relevant part:

- (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party, the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

* * *

- (4) After receipt of a justified demand, failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.^{110\}

To invoke the protections of UCC Section 2-609,^{111\} SNET must be able to demonstrate more than "purely subjective concerns which were not rooted in any objective facts that can now be legally equated with reasonable grounds for insecurity."^{112\}

Are There "Reasonable Grounds" for Insecurity.

(..continued)

(1980).

^{109\} *White and Sumner*, at §6-2, p.273. A "minimum requirement" for asserting anticipatory repudiation is that "the party invoking the (anticipatory repudiation) clause must reasonably and in good faith believe that the prospect of payment or performance has somehow been impaired." *Kworka v. Morey*, 541 P.2d 740 (Ark. 1975).

^{110\} UCC, §2-609.

^{111\} SNET can always invoke its credit and collection treatments for nonpayment. This discussion is for those cases when, absent nonpayment, SNET fears anticipatory repudiation because of "subscription fraud."

^{112\} *Cole v. Melvin*, 441 F.Supp. 193, 203 (D.C.S.D. 1977).

Section 2-609 permits review of whether SNET has a reasonable basis to deem itself insecure. The courts can, in other words, determine that SNET (the seller) had *no* reasonable grounds for insecurity upon which to base the demand for a deposit. According to a federal district court in South Dakota, for example, the UCC section "is designed to obviate the necessity of one party guessing whether or not the other intends to perform when he begins to receive signals that cause him concern."^{113\} The "cause for concern," however, must have some demonstrable basis. There must be some "factually established ground for insecurity" that is "rooted in objective facts" rather than in "purely subjective concerns."^{114\}

Moreover, the grounds for insecurity must have come into existence *after* the inception of the contract. "The right to adequate assurances under Section 2-609 only arises when some event has occurred *between the time of contracting and the time of the demand for the assurance*, which causes the party making the demand to have some feeling of insecurity." (emphasis added).^{115\} "Where adequate assurance of performance is already present, and there has been *no change in circumstances* to give rise to reasonable grounds for insecurity, a demand for additional security under Section 2-609 is *not* justified." (emphasis added).^{116\}

What is the Due Performance that SNET May Demand

Even if "insecurity" is established, SNET may only seek "assurance of due performance as is adequate under the circumstances of the particular case."^{117\} What performance might be "due" is subject to judicial review. Thus, for example, upon receiving a demand for adequate assurance, a payment in full of all arrears, as well as a promise to pay future bills within ten days, were, as a matter of law, adequate assurances of performance.^{118\}

SNET's proposals regarding immediate payment are not permitted as an assurance of due performance. To reach this conclusion, one need only recognize the clear distinction between a request for assurance and a "unilateral alteration of the contract terms."^{119\} Such an alteration has often been found, and

^{113\} *Cole v. Melvin*, 441 F.Supp. 193, 203 (D.S.D. 1971).

^{114\} *Id.*; see also, *In Re. Coast Trading Co.*, 26 B.R. 737, 740 (D.Or. 1982); but see, *Turntables, Inc. v. Gestetner*, 52 A.D.2d 776, 382 N.Y.S.2d 798, 799 (1976) (section can be invoked if reasonable grounds for insecurity even if suspicion turns out to be inaccurate).

^{115\} *Nasco, Inc. v. Dahltron Corp.*, 74 Ill.App.3d 302, 392 N.E.2d 1110, 1116 (Ill.App. 1979).

^{116\} *Field v. Golden Triangle Broadcasting*, 451 Pa. 410, 305 A.2d 689, 696 - 697 (1973); accord, *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572, 581 (7th Cir. 1976) (must have change of circumstances for "insecurity" to be found).

^{117\} See, *Northwest Lumber Sales v. Continental Forest Prod.*, 495 P.2d at 750. ("we cannot say that a request for guarantee would have been futile in this case. * * * defendant should at least have been offered the opportunity to suggest a reasonable method of assurance of performance.")

^{118\} *American Bronze Corp. v. Streamway Products*, 8 Ohio App.3d 223, 456 N.E.2d 1245, 1303 (1982).

^{119\} See e.g., *John J. Kirlin v. Gaco Systems*, 80 Md.App. 506, 565 A.2d 114, 117 (1990).

disapproved, when the seller seeks to modify the payment terms. Thus, for example, the seller seeking to impose a contract modification requiring payment to be made in advance, rather than after delivery, was disapproved as a unilateral alteration of the contract and "a repudiation of the contract *by the seller.*" (emphasis added).^{\120\} Moreover, a seller's refusal to perform unless the buyer gave a personal guarantee of payment (or performance) or paid an amount not yet due into escrow was held to be invalid.^{\121\}

In *Design for Business Interiors v. Herson's, Inc.*,^{\122\} the buyer's payments were due within ten days of invoice. When the buyer fell behind in payments, the seller sent a letter refusing future deliveries until the account was brought current.^{\123\} Moreover, the seller said, once the account was brought current, future deliveries would be made only on "pro forma" terms. The court disapproved the right of the seller to impose such a limitation, saying such action found no support in UCC Section 2-609. "This is not a request for assurance," the court said:

but is instead a unilateral alteration of the contract's terms, as well as an express refusal to render performance due under the terms of the original agreement --that invoices and payment were to follow, not precede, delivery.^{\124\}

This refusal to "perform at all unless the other party consents to a modification of his contract rights," the court concluded, was a repudiation of the contract by the seller.^{\125\} This holding is the general rule.^{\126\}

Finally, when a demand is made by the seller, it must be only for "adequate assurance" and not for some type of enhanced performance. So, for example, as a matter of law, a request for advance payment is held *not* to be a demand for adequate assurance.^{\127\} In short, a Section 2-609 demand for adequate assurance is invalid when the assurance requested seeks more than the party making the

^{\120\} *Id.*, at 117, citing, *National Farmers Org. v. Bartlett and Co. Grain*, 560 F.2d 1350 (8th Cir. 1977).

^{\121\} *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572 (7th Cir. 1976).

^{\122\} 659 F.Supp. 1103 (D.D.C. 1986).

^{\123\} *Id.*, at 1111.

^{\124\} *Id.*

^{\125\} *Id.*, quoting, *Restatement (Second) Contracts*, §250, comment d, at 275 (1981).

^{\126\} See e.g., *Miran Invest. Co. v. Medical West Bldg. Corp.*, 414 S.W.2d 297, 302 - 303 (Mo. 1967) (refusal to perform except on execution of personal guarantee not required by contract is repudiation); *National Farmers Organization v. Bartlett and Co. Grain*, 560 F.2d 1350, 1357 (8th Cir. 1977); see generally, Corbin, *Contracts*, §973, at 910 (1951) (refusal to perform except on grounds not included in contract is repudiation) (with citations).

^{\127\} *Dahltron*, 392 N.E.2d at 1116.

demand is entitled to.^{128\}

Despite this law, the unilateral changes in contract terms, as well as the demand for enhanced performance, is *precisely* what SNET is proposing to do. SNET's proposal is unlawful and should be found by the DPUC to be so.

THE RELEVANCE OF CONTRACT, COMMERCIAL AND COMMON LAW WHEN VIEWED IN LIGHT OF INTEREXCHANGE OBLIGATIONS

There are two aspects of the contract, consumer credit and common law obligations laid out above that are relevant to this proceeding. The first aspect is the one discussed in detail above. The contract, common law and consumer credit obligations are legal obligations applicable to SNET as a public utility engaged in a commercial transaction with its customers. These legal obligations are not obligations that SNET can choose to ignore. Nor are they legal obligations that the DPUC can choose to ignore. SNET, as well as the DPUC, must act within the confines of the law. And the law as outlined above is part of the constraints on doing business in Connecticut as a public utility.

From a different perspective, however, the DPUC should recognize what the *interexchange* carriers are seeking to do through these SNET proposals. If an interexchange carrier had a commercial relationship between itself and its customers, uncomplicated by the introduction of the Billing and Collection Service provided through the regulated SNET, it would *never* be permitted to do what SNET is seeking to do in this proceeding. An interexchange carrier, in other words, unregulated by any state commission, would clearly be bound by state law regarding the proof of fraud, the demonstration of commercial insecurity, and the like.

What is happening in this proceeding is that the interexchange carriers are seeking to use SNET and the DPUC to insulate themselves from the controlling hand of consumer credit, common law, and contract law obligations otherwise applicable to commercial enterprises in Connecticut. It seems quite evident that the interexchange carriers are seeking to gain approval of credit and collection procedures through SNET's regulatory process that the courts would never permit of an unregulated commercial enterprise. The interexchange carriers, in other words, while preaching the mantra of competition, are at the same time through these SNET proposals, seeking to avoid the legal constraints placed upon unregulated commercial enterprises.

The DPUC should, as a result, deny the SNET proposals. The DPUC should, in effect, say that:

- o If AT&T believes it is being defrauded by its toll customers, it should undertake the same remedies that any other competitive industry which grants credit undertakes.

^{128\} *U.S. v. Great Plains Gassification Associates*, 819 F.2d 831, 835 (8th Cir. 1987), *citing*, *Pittsburgh-Des Moines Steel*, 532 F.2d at 581 and 582.

- o If AT&T believes that having an individual customer exceed certain credit levels represents an unacceptable "risk of abuse," it should develop the same protections that any other competitive industry which grants credit might develop.
- o If AT&T believes that a certain class of customers, defined by classwide characteristics, represents an unacceptable level of "insecurity," it should be required to demonstrate and protect itself against that insecurity in the same manner as any other competitive industry which grants credit pursues.

The regulatory process should not be used as a shield to protect the competitive interexchange industry from legal obligations imposed on *all* competitive industries by consumer credit law, common law and contract law.

Different proposals for future action and inquiry regarding how to implement these conclusions are included in the last Part of these comments.

Summary and Conclusions

In sum, SNET's proposals regarding both identification fraud and "subscription fraud" run afoul of legal constraints. These legal constraints may not be waived by DPUC regulatory action. Generally, under both SNET's obligations as a public utility and its obligations under standard contract law, SNET must *presume* honesty and fair dealing on the part of its customers. This presumption can only be overcome by an affirmative showing based on objective facts, not mere suspicions or inferences.

Moreover, for SNET to terminate toll service based on allegations of fraud, SNET must make an affirmative showing, based on objective facts and bearing the risk of non-persuasion, that fraud *in fact* has occurred. The showing must be by clear and convincing evidence. The implications of the higher standard of proof involve more than a mere allocation of the risk of non-persuasion. There are certain rules which flow from this evidentiary standard. Perhaps the most important is that fraud must be *demonstrated* by specific facts. The supporting facts must have no alternative inference which is possible other than the existence of fraud. Moreover, SNET may not presume fraud in advance. Indeed, the law makes quite clear that the presumption will be of a non-fraudulent transaction absent evidence to the contrary.

Finally, even if one structures the SNET action not as involving allegations of "fraud," but rather in more typical commercial language (*i.e.*, that of "insecurity" and "anticipatory repudiation"), SNET does not meet the substantive and procedural requirements of the law.

PART FOUR: THE FEDERAL EQUAL CREDIT OPPORTUNITY ACT

One of the most important issues in the control of any public utility is whether the utility extends its rates and services in a nondiscriminatory fashion. The test for this requirement is whether customers in similar situations are treated similarly. Aside from the basic common law utility requirements of nondiscrimination, one of the most important consumer protection statutes in enforcing this nondiscrimination requirement is the federal Equal Credit Opportunity Act (ECOA).^{129\}

The analysis below considers the SNET credit and collection techniques advanced in this proceeding. It concludes that it is inappropriate merely to examine those techniques to determine whether they are facially neutral as to the protected classes set forth in the ECOA. Instead of looking only at facial neutrality, a review of the SNET proposals must also consider the disparate impacts which those proposals have on the protected classes. In this vein, the discussion below has four Sections. *Section A* examines how SNET misconstrued the coverage of the ECOA in its presentations regarding credit scoring in Docket 93-06-22 before this Commission. *Section B* provides an overview of the ECOA statute. *Section C* sets forth a discussion of the basic operation of the "effects test." Finally, *Section D* sets forth an evaluation of the SNET proposals in light of the effects test.

This proceeding does not explicitly present the issue of what credit scoring is appropriate by SNET. Indeed, the issue of credit scoring, according to the Office of Consumer Counsel, will be revisited in Docket 93-06-22 in light of recent DPUC decisions. The DPUC has not approved SNET's proposed credit scoring and now intends to reopen Docket 93-06-22.

Nonetheless, the credit scoring system proposed by SNET permeates the credit and collection processes proposed to be considered in this proceeding. The determination of when there is abuse or risk of abuse of the toll system incorporates the credit scoring process. The determination of when there is the suspicion of "subscription fraud" incorporates the credit scoring process. The determination of when there will be shutoffs (for which toll limitations are offered in lieu thereof) depends upon the credit scoring. The determination of whether, and to what extent, there will be a demand for a cash deposit (for which toll limitations are offered in lieu thereof) depends upon the credit scoring process.

Accordingly, while these comments do not seek to fully analyze the ECOA implications of SNET's proposed credit scoring, it seems necessary for the DPUC to at least be placed on notice that the credit scoring process which underlies the SNET proposals to be considered in this proceeding are subject to significant potential challenge on ECOA grounds.

^{129\} 15 U.S.C. §1691 - 1691f (1989 and 1991 supp.).

THE ERROR OF SNET'S ECOA ANALYSIS IN DOCKET 93-06-22

SNET significantly misconstrued the breadth of the Equal Credit Opportunity Act (ECOA) in its filings with the DPUC in Docket 93-06-22. The filing at issue is the May 10, 1994 letter from Kathleen Carrigan to Robert J. Murphy, with an April 29, 1994, letter by Peter McCorkell (Fair Isaac) attached. In fairness to SNET, the errors arise in the McCorkell letter. In that letter, McCorkell states in relevant part:

The Equal Credit Opportunity Act and Regulation B of the Federal Reserve Board require credit grantors to disclose to consumers their reasons for taking `adverse action' as defined in ECOA and Regulation B.

McCorkell then asserts that Fair, Isaac and Company, Inc. comply with this requirement. The error, however, comes in the next paragraph of the McCorkell letter:

Based on my examination of the detailed specifications for the BEACON credit scoring system, it is my opinion that BEACON does not consider any information which would constitute a `prohibited basis' as that term is defined in ECOA and Regulation B* * *.

The clear implication of the opinion by McCorkell is that if Fair-Isaac does not *explicitly* consider a factor which represents a "prohibited basis" under the ECOA, there can be no ECOA violation. The conclusion that this is the legal theory of ECOA adopted by SNET is supported further by the Company's response to OCC Data Request OCC-23 in Docket 93-06-22, which states that: "the Company did not determine the demographic profile of customers who fall into any credit classification category *since demographic information is not used to determine customer credit worthiness*. The Company analyzes individual credit history to determine each customer's credit classification." (emphasis added). The Company apparently believes, perhaps based on the representation of Fair-Isaac, that if it does not *explicitly* consider demographics, it cannot be in violation of the ECOA.

That reading of the statute, as discussed in detail below, is a gross misrepresentation of the statutory requirements and, a construction that the DPUC and SNET would follow at their peril.

OVERVIEW OF THE STATUTE

There is no question but that the ECOA applies to public utility transactions.^{\130\} The ECOA provides a *limited* exception to *certain* of its requirements for "public utility credit."^{\131\} The exemption applies in those instances where there are "extensions of credit relating to transactions under public utility tariffs" provided that "the charges for such public utility services, the charges for delayed payment, and any discount for early payments" are filed with, reviewed by or regulated "by an agency of the federal government, a state, or a political subdivision thereof."^{\132\}

Unlike Truth in Lending, however, under which *all* actions of a public utility are exempt from coverage should this regulation be found applicable, exemption under the ECOA only gains an exemption from three narrow requirements: (1) certain requirements regarding the treatment of information about marital status;^{\133\} (2) certain requirements regarding furnishing credit information;^{\134\} and (3) certain requirements regarding record retention.^{\135\} Indeed, with most transactions, the mere fact that there is a special exemption for public utilities in these three instances would indicate that the ECOA applies to all other instances.

In general, therefore, SNET would fall within the purview of the ECOA. The ECOA applies to "any creditor," defined to include:

any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit.^{\136\}

The term "credit" is defined by the ECOA as "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer

^{\130\} Official Staff Commentary, ECO-1, §202(3)(a)2 (1991). *See generally*, Donoghue, "The Equal Credit Opportunity Act and Public Utilities," 105 *Public Utilities Fortnightly* 28 (June 5, 1980).

^{\131\} *See generally*, National Consumer Law Center, *Equal Credit Opportunity Act*, at §3.2.3.2.1, for a discussion of the ECOA public utility exemption.

^{\132\} 12 *C.F.R.* §202.3(a) (1991).

^{\133\} 12 *C.F.R.* §202.5(b)(1) (1991).

^{\134\} 12 *C.F.R.* §202.10 (1991).

^{\135\} 12 *C.F.R.* §202.12(b) (1991).

^{\136\} 15 *U.S.C.* §1691a(e) (1989 and 1991 supp.). Regulation B, implementing the ECOA, defines "creditor" to mean "a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit* * *." 12 *C.F.R.* §202.2(1) (1991).

payment therefor.^{\137\} Moreover, the terms "extend credit" and "extension of credit" are defined to mean:

the granting of credit in any form and include, but are not limited to, credit granted in addition to any existing credit or credit limit; credit granted pursuant to an open-end credit plan; the refinancing or other renewal of credit, including the issuance of a new credit card in place of an expiring credit card or in substitution for an existing credit card; the consolidation of two or more obligations; or the continuance of existing credit without any special effort to collect at or after maturity.^{\138\}

Telephone service offered by SNET most certainly involves the extension of credit under these definitions. Given this applicability of the statute, the ECOA prohibits discrimination against an SNET customer or applicant at any stage of a credit transaction on a prohibited basis. Each aspect of this requirement deserves some discussion.

The Definition of "Discrimination" Under the ECOA.

According to the ECOA, to "discriminate against an applicant" for credit means "to treat an applicant less favorably than other applicants."^{\139\} The presence of discrimination in these areas should be determined using an "effects test."^{\140\} The primary attribute of using an effects test is that the results of a practice urged to be discriminatory can be separated from the intention held by the defending party. The "effects test" relies not upon any improper intention by the challenged party, but rather upon the measurement of disparate impacts.^{\141\} The good or bad faith of the defendant, in other words, is irrelevant to any showing that a challenged practice does or does not discriminate against a protected class.^{\142\} The focus, instead, is on discriminatory results.^{\143\} The effects test is used to challenge a

^{\137\} 15 *U.S.C.* §1691a(d) (1989 and 1991 supp.).

^{\138\} Reg. Z, 12 *C.F.R.* §202.2(q) (1991).

^{\139\} Reg. B., 12 *C.F.R.* §202.2(n) (1991).

^{\140\} See e.g., Hsia, "The Effects Test: New Directions," 17 *Santa Clara L.Rev.* 777 (1977); Comment, "Applying the Title VII Prima Facie Case to Title VIII Litigation," 11 *Harv. Civ. Rights - Civ. Liberties L.Rev.* 128 (1976); Note, "Credit Scoring and the ECOA: Applying the Effects Test," 88 *Yale L.J.* 1450 (1979).

^{\141\} See e.g., *General Elec. Co. v. Gilbert*, 429 U.S. 125, 155 (1976) (Brennan, J., dissenting).

^{\142\} See e.g., *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971); *E.E.O.C. v. Local 638*, 542 F.2d 579, 587 (2d Cir. 1976); *U.S. v. Hughes Memorial Home*, 396 F.Supp. 544, 548 (W.D.Va. 1975); *U.S. v. Reddoch*, 467 F.2d 897 (5th Cir. 1972).

^{\143\} Note the difference between constitutional and statutory use of the effects test in this regard. "The United States Supreme Court* * *in 1976* * *proscrib(ed) the nonevidentiary use of disparate impact in constitutional analysis. In so doing, the Court drew a sharp distinction between the constitutional and statutory standards for measuring discrimination." Hsia, 17 *Santa Clara L.Rev.* at 787 (citations omitted). Hsia notes that "against the restrictive constitutional backdrop, however, the statutory schemes requiring the use of the effects test are increasing." *Id.*, at 789 - 790.

pattern or practice of the defendant that results in discriminatory impacts on particular classes.^{\144\} The "effects test" is discussed in greater detail below.

The Extent of the "Prohibited Bases"

The ECOA prohibits discrimination on articulated prohibited bases. The prohibited bases include race, color, religion, national origin, sex, marital status, age, and income based in whole or in part on a public assistance program.^{\145\} A "public assistance program" includes "any Federal, State or local government assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need."^{\146\} Examples of such programs include, but are not limited to, AFDC, food stamps, rent and mortgage supplement or assistance programs, Social Security and Supplemental Security Income (SSI), and unemployment compensation.^{\147\}

The Scope of "All Stages of the Credit Transaction"

The ECOA prohibits discrimination in "all stages of the credit transaction." The implementing regulations define "credit transaction" as including:

every aspect of dealings with a creditor regarding an application for, or an existing extension of, credit including, but not limited to, information requirements; investigation procedures; standards of creditworthiness; terms of credit; furnishing of credit information; revocation, alteration, or termination of credit, and collection procedures.^{\148\}

This definition, of course, assumes that an "application for credit" has been made. The statute defines an applicant as "any person who applies to a creditor directly or indirectly for an extension, renewal, or continuation of credit,"^{\149\} while Regulation B gives a broader definition, including "any person who requests" an extension of credit.^{\150\}

^{\144\} See e.g., *Tomkins v. Public Serv. Elec. & Gas Co.*, 422 F.Supp. 553 (D.N.J. 1976); *Miller v. Bank of America*, 418 F.Supp. 233 (N.D.Cal. 1976); compare, *Olsen v. Philco-Ford*, 531 F.2d 474 (10th Cir. 1976).

^{\145\} 15 U.S.C. §1691(a) (1989 and 1991 supp.). Another prohibited basis is the good faith exercise of rights under the federal consumer credit statutes.

^{\146\} FRB Official Staff Commentary, ECO-1 §202.2(a)-3.

^{\147\} *Id.*

^{\148\} Regulation B, 12 C.F.R. §202.2(m) (1991).

^{\149\} 15 U.S.C. §1691(a) (1989 and 1991 supp.).

^{\150\} 12 C.F.R. §202.4 (1991).

From the perspective of evaluating SNET's proposals in this proceeding, it is important to take a closer look at the language "all stages of the credit transaction." Regulators should be aware of the areas in which SNET's proposals are likely violating the ECOA prohibition against discrimination on designated bases. The basis for the conclusion that the violation exists is set forth in greater detail later.

The Demand for Immediate Payment: Closely related to the denial of credit altogether, under the ECOA, is the refusal to allow a customer to delay payment until some time after the services have been delivered. If SNET, for example, while not formally offering credit, will bill certain customers, allowing them to mail in payment later, while requiring immediate up-front payment from other customers, the ECOA has been triggered. While the FRB exempts this "incidental credit" from many specific ECOA provisions,^{151\} the agency does *not* exclude incidental consumer credit from the general rule against discrimination. Accordingly, discrimination on a prohibited basis as to when a creditor will defer payments, as determined using an effects test methodology, is clearly violative of the ECOA.^{152\}

Credit Limits: The *amount* of credit to be extended is subject to the general ECOA rule against discrimination as well. Thus, a member of a protected class must receive the same credit limit as non-members of that class. The "limit" is not simply to be marked by an absolute denial of credit over the limit. Thus, for example, if a creditor imposes any type of "adverse actions" on customers of a protected class who exceed certain credit limits, the ECOA protections against discrimination have been violated.

Deposits: The ECOA specifically addresses the issue of security deposits (or other collateral) required to secure a consumer credit transaction. The general rule against discrimination applies not only to collateral, but to cosigners, security deposits and other forms of protection. For example, a security deposit (or a *higher* security deposit) may not be sought from public assistance recipients, if it is not sought from others.^{153\}

Credit Terms: Creditors may not discriminate under the ECOA on a prohibited basis concerning credit terms, since that would be to treat the debtor less favorably than others.^{154\} In particular, the creditor may not differentiate on a prohibited basis the length of loans it offers,^{155\} or the timing of payments. Moreover, a creditor may not discriminate as to how many payments it must receive in order to continue delivering goods (or services).^{156\}

^{151\} Regulation B, 12 C.F.R. § 202.3(c).

^{152\} Official Staff Commentary, § 202.3-1.

^{153\} See e.g., *Reed v. Northwestern Bell Telephone Company*, Clearinghouse No. 27,524 (D.Minn. 1981).

^{154\} Regulation B, 12 C.F.R. §202.2(m) defines credit terms as part of a credit transaction. Regulation B, 12 C.F.R. §202.4 prohibits discrimination concerning any aspect of a credit transaction.

^{155\} See, *United States v. General Motors Acceptance Corp.*, Clearinghouse No. 38-902 (D.N.M. 1984).

^{156\} See e.g., *United States v. American Future Systems*, 743 F.2d 169 (3d Cir. 1984).

Loan Servicing: The FRB *Official Staff Commentary* gives "administration of accounts" as an example of the types of dealings between creditor and applicant that is covered by the ECOA's general prohibition against discrimination.^{\157\} Thus, SNET may not discriminate on a prohibited basis concerning the ease of payment or the willingness to restructure or postpone payments.^{\158\}

Treatment Upon Default: When a consumer is delinquent on an account, a creditor may take various steps to collect the amount due or to enforce the credit agreement. Such actions are related to the credit transaction and, under the ECOA, creditors may not treat debtors differently post-default on a prohibited basis. Indeed, Regulation B specifically mentions collection procedures and termination of credit as covered by the Act.^{\159\} The *Official Staff Commentary* states that the general rule against discrimination covers the "treatment of delinquent or slow accounts."^{\160\}

Within the housing area, the Fair Housing Act has been interpreted to bar discrimination in mortgage foreclosure, on the basis that this constitutes one of the "terms or conditions" of the loan.^{\161\} Other examples of post-default practices covered by the ECOA include how soon a creditor cancels a consumer's line of credit and how soon collection procedures begin. Clearly, a utility shutoff is directly analogous to a mortgage foreclosure. Moreover, the disconnection of service is implicated by the ECOA's prohibition on beginning collection procedures sooner based on a prohibited classification.

SNET'S PROPOSALS AND THE "ALL STAGES" LANGUAGE

All three of SNET's proposals relate to the "all stages of the credit transaction" as discussed in detail above.

- o The ECOA specifically addresses the demand for immediate payment, as now requested by SNET.
- o The SNET specifically addresses differing credit limits, as now requested by SNET.
- o The ECOA specifically addresses the differentiation in the level of demands for

^{\157\} Official Staff Commentary, § 202.4-1.

^{\158\} Compare, 24 *C.F.R.* §§ 100.110(b), 100.10(a) (Fair Housing Act ban on discrimination includes these acts within the phrase "terms and conditions" of the credit).

^{\159\} Regulation B, 12 *C.F.R.* § 202.2(m).

^{\160\} *Official Staff Commentary*, § 202.4-1.

^{\161\} *Harper v. Union Savings Association*, 429 F.Supp. 1254 (N.D. Ohio 1977); *Lindsey v. Modern American Mortgage Corp.*, 383 F.Supp. 293 (N.D. Tex. 1974); see also, *Little Earth of United Tribes v. United States Department of Housing & Urban Development*, 675 F.Supp. 497 (D.Minn. 1987), *aff'd*, 878 F.2d 236 (8th Cir. 1989).

deposits, as now requested by SNET.

- o The ECOA specifically addresses "loan servicing," as evidenced by the ease of payment and willingness to postpone payments, as now requested by SNET.
- o The ECOA specifically addresses the timing of payments, and the length of time which payments may be deferred, as now requested by SNET.
- o The ECOA specifically addresses the treatment upon default, including collection steps, as now requested by SNET.

Since every aspect of the SNET proposals now before the DPUC are implicated in the ECOA's non-discrimination dictates, it is necessary to review how discrimination is to be determined and whether the SNET proposals are consistent with this federal statute.

THE BASIC OPERATION OF THE "EFFECTS TEST"

The primary attribute of using an effects test is that the results of a practice urged to be discriminatory can be separated from the intention held by the defending party. The "effects test" relies not upon any improper intention by the challenged party, but rather upon the measurement of disparate impacts.^{162\} In this case, the good or bad faith of SNET, in other words, is irrelevant to any showing that a challenged practice does or does not discriminate against a protected class.^{163\} The focus, instead, is on discriminatory results.^{164\} The effects test is used to challenge a pattern or practice of the defendant that results in discriminatory impacts on particular classes.^{165\}

The Initial Showing

The primary basis for demonstrating a prohibited effect in discrimination litigation^{166\} is statistical

^{162\} See e.g., *General Elec. Co. v. Gilbert*, 429 U.S. 125, 155 (1976) (Brennan, J., dissenting).

^{163\} See e.g., *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971); *E.E.O.C. v. Local 638*, 542 F.2d 579, 587 (2d Cir. 1976); *U.S. v. Hughes Memorial Home*, 396 F.Supp. 544, 548 (W.D.Va. 1975); *U.S. v. Reddoch*, 467 F.2d 897 (5th Cir. 1972).

^{164\} Note the difference between constitutional and statutory use of the effects test in this regard. "The United States Supreme Court* * *in 1976* * *proscrib(ed) the nonevidentiary use of disparate impact in constitutional analysis. In so doing, the Court drew a sharp distinction between the constitutional and statutory standards for measuring discrimination." *Hsia*, at 787 (citations omitted). *Hsia* notes that "against the restrictive constitutional backdrop, however, the statutory schemes requiring the use of the effects test are increasing." *Id.*, at 789 - 90.

^{165\} See e.g., *Tomkins v. Public Serv. Elec. & Gas Co.*, 422 F.Supp. 553 (D.N.J. 1976); *Miller v. Bank of America*, 418 F.Supp. 233 (N.D.Cal. 1976); compare *Olsen v. Philco-Ford*, 531 F.2d 474 (10th Cir. 1976).

^{166\} This may involve employment litigation, housing litigation, or civil rights litigation, as well as the consumer credit litigation at issue in this SNET proceeding.

analysis.¹⁶⁷ Discriminatory impacts can be statistically established in either of two ways. First, as shown in *U.S. v. Georgia Power Company*,¹⁶⁸ a litigant can show that minorities¹⁶⁹ as a class are excluded by the challenged practice at a substantially higher rate than whites. Litigants use this test to show that a particular employment practice adversely affects minority populations as a whole in a disproportionate way. In *Georgia Power*, for example, the company's requirement that all employees have a high school diploma was successfully challenged. "The requirement undoubtedly screens out blacks at a considerably higher rate than whites," the court said.¹⁷⁰ In the South, the court found, in the 25-44 age group, 64.7 percent of white males, 35 percent of black males, 63 percent of white females, and 34.7 percent of black females, had completed high school.¹⁷¹ In *Griggs*, the class disproportionately lacked the factor which would *include* class members among the employed.

A California decision represents the converse situation. A company rule dismissing employees who had their wages garnished was struck down in *Johnson v. Pike Corp. of America*.¹⁷² The California district court found that minority group members suffer wage garnishments substantially more often than others. The court observed that "the proportion of racial minorities among the group of people who have had their wages garnished is significantly higher than the proportion of racial minorities in the general population."¹⁷³ Unlike *Griggs*, in *Johnson*, the class disproportionately had the attribute which excluded them from being amongst the employed. As can be seen, the first statistical test can be used in either of two ways: it can look at an attribute which the affected class has, which attribute serves as the basis for the discrimination. Second, it can look at an attribute which the affected class lacks, which attribute serves as the basis for the discrimination. An attribute that results in discrimination can be either inclusive (*i.e.*, all members possessing a certain characteristic are disqualified) or exclusive (*i.e.*, all members lacking a certain characteristic are disqualified) in nature.

¹⁶⁷ Substantial writing has been done on the use of statistical evidence. Some articles simply review court cases relying on statistical evidence. See *e.g.*, Note, "Evidence: Statistical Proof in Employment Discrimination Cases," 28 *Okla. L.Rev.* 885 (1975); Note, "Employment Discrimination: Statistics and Preferences under Title VII," 59 *Va. L.Rev.* 463 (1973); Montlack, "Using Statistical Evidence to Enforce the Laws Against Discrimination," 22 *Cleve. St. L.Rev.* 259 (1973). Other articles review statistical methods. See *e.g.*, Dorsano, "Statistical Evidence in Employment Discrimination Litigation: Selection of the Available Population, Problems, and Proposals," 29 *Sw. L.J.* 859 (1975); Note, "Beyond the Prima Facie Case in Employment Discrimination Law: Statistical Proof and Rebuttal," 89 *Harv. L.Rev.* 387 (1975); Shoben, "Differential Pass-Fail Rates in Employment Testing: Statistical Proof Under Title VII," 91 *Harv. L.Rev.* 793 (1978); Bogen and Falcon, "The Use of Racial Statistics in Fair Housing Cases," 34 *Md. L.Rev.* 59 (1974).

¹⁶⁸ 474 F.2d 906 (5th Cir. 1977).

¹⁶⁹ Or other protected classes, as set forth in the ECOA.

¹⁷⁰ *Id.*, at 918.

¹⁷¹ *Id.* Similar figures were found for Atlanta in particular. "Statistics show that for males over 18 years of age, 70.7% of the whites finished high school compared with only 46.2% of blacks." *Id.*

¹⁷² 332 F.Supp. 490 (C.D.Cal. 1971).

¹⁷³ *Id.*, at 494. See also, *Gregory v. Litton Systems*, 316 F.Supp. 401, 403 (C.D.Cal. 1970). Employment based on arrests is discriminatory. While blacks nationally comprise 11 percent of the population, blacks account for 27 percent of reported arrests, and 45 percent of arrests based simply on "suspicion." *Id.*

In contrast, the second statistical test looks specifically at the employee population. Using this test in *Bridgeport Guard v. Bridgeport Civil Service Commission*,^{\174\} a *prima facie* case of discrimination was established by comparing the number of minority and white job applicants actually excluded by the challenged practice. In *Bridgeport Guard*, the court examined the results of a written examination administered over five years by a local police department.^{\175\} The court found a *prima facie* case of discrimination established, noting that "the passing rate for whites was 3 1/2 times better than Blacks and Puerto Ricans."^{\176\} A similar challenge was brought against the fire department of the City of New York.^{\177\} The "basic facts" that the court found persuasive established that:

Roughly 11.5% of the 14,168 applicants who entered the examination halls were black or Hispanic. Yet minority members comprised only 5.6% of those who had passed the written, physical and medical examinations at the time of the hearing. Non-minority candidates thus survived the screening process at a rate more than twice that of minority candidates.^{\178\}

It was this discrimination, as shown by the disparate impact upon the specific individuals involved, rather than upon the minority population as a whole, that was disapproved.^{\179\}

The Justification

Even where disparate impacts can be shown, the mere presence of such impacts is often not a sufficient basis to disapprove of a challenged practice.^{\180\} Discriminatory impacts in employment proceedings,^{\181\} for example, can be justified by a showing that the employment practice is a "business

^{\174\} 482 F.2d 1333 (2d Cir. 1973).

^{\175\} *Id.*, at 1335.

^{\176\} *Id.* Fifty-eight percent of the 568 whites who took the exam passed while only 17 percent of the 76 Blacks and Hispanics passed. *See also, Rogers v. International Paper Co.*, 510 F.2d 1340, 1348 - 49 (8th Cir. 1975).

^{\177\} *Vulcan Soc. of N.Y. City Fire Dept. v. Civil Service Commission*, 490 F.2d 367 (2d Cir. 1973).

^{\178\} *Id.*, at 392.

^{\179\} *Id.*

^{\180\} The Second Circuit correctly noted that the disparate impact "does not at all decide the case" but merely places a "burden of justification" on the purveyor of the challenged practice. 490 F.2d at 393. The court observed that some courts have held that while a mere discrepancy between a minority population and an employment population may not of itself establish a *prima facie* case of discrimination, "it does invite inquiry." 482 F.2d at 1335, n.4. Other courts have held that a substantial discrepancy is sufficient to establish a *prima facie* case. *Id.* (citations omitted).

^{\181\} Due to the disparate fact patterns presented in Title VIII fair housing cases, no uniform analytic framework involving a "necessity" defense can be found.

necessity."^{182\} In general, to show a business necessity, an employer must show a significant correlation between the employment practice and "important elements of work behavior which comprise or are relevant to the job."^{183\}

In addition to looking at what *is* a business necessity, however, one must consider what is *not*.^{184\} Perhaps most importantly, mere business convenience has been found to be *not* a sufficiently compelling "necessity" to override discriminatory impacts.^{185\} Economic burdens must rise to the level of making alternatives to the discriminatory practice infeasible. Overall, most cases indicate that a challenged employment practice must satisfy three criteria to fall within the business necessity exemption. First, the practice must relate to a valid business purpose which is sufficiently compelling to override any discriminatory impacts. Second, it must effectively carry out the purpose which it is said to serve. Finally, there must be no less discriminatory alternative that will just as effectively carry out that purpose.^{186\}

In sum, under specific federal statutory authority, discrimination in the areas of employment, housing and credit is prohibited. Under these statutes, discrimination can be demonstrated using an effects test. The effects test holds that the good faith of the person engaging in the challenged practice is irrelevant; if the practice results in discrimination, it is unlawful. Litigation brought pursuant to this legislation generally involves a three-step process. First, the litigant must establish a prima facie case of discrimination by showing the presence of disparate impacts. Second, the person undertaking the challenged practice may seek to justify the practice, notwithstanding the discriminatory impact, on the grounds that it serves an essential business need. Finally, the litigant may seek to show that any essential business need that may exist can be met by alternative means in a less discriminatory manner.

THE POTENTIAL DISCRIMINATION ISSUES FLOWING FROM SNET'S PROPOSALS

Some of the issues raised by SNET's credit and collection proposals include:

^{182\} *Griggs v. Duke Power Company*, 401 U.S. 430, 431 (1971).

^{183\} *Albermarle Paper Co. v. Moody*, 422 U.S. 405, 430 (1975).

^{184\} See generally, Note, "Business Necessity Under Title VIII of the Civil Rights Act of 1964: A No-Alternative Approach," 84 *Yale L.J.* 98 (1974) (hereafter, Business Necessity).

^{185\} See e.g., *Watkins v. Scott Paper*, 530 F.2d 1159, 1181 (5th Cir. 1976); see also, *Robinson v. Lorillard Corp.*, 444 F.2d 791, 799, n.8 (4th Cir. 1970), cert. den., 404 U.S. 1006 (1971) ("while considerations of economy and efficiency will often be relevant to determining the existence of business necessity, dollar cost alone is not determinative."); accord, *Gates v. Georgia Pacific Corp.*, 492 F.2d 292 (9th Cir. 1974); *Mayers v. Ridley*, 465 F.2d 630 (D.C.Cir. 1972) (en banc) (per curiam); *Johnson v. Pike Corp.*, 332 F.Supp. 490 (C.D.Cal. 1971). See generally, Note, "The Cost of Growing Old: Business Necessity and the Age Discrimination in Employment Act," 88 *Yale L.J.* 565, 587 - 95 (1979).

^{186\} Comment, "Applying the Title VII Prima Facie Case to Title VIII Litigation," 11 *Harv. Civ. Rights - Civ. Liberties L.Rev.* 128, 175 - 76 (1976).

Adverse Non-Utility Credit History

To the extent that SNET's proposals incorporate non-utility credit history, which they explicitly do, the SNET proposals will likely have the effect of discriminating based on race, receipt of public assistance, and family status.^{\187\} Treating households with non-favorable non-utility credit histories adversely, as defined by the ECOA and the effects test, would implicate the general anti-discrimination prohibition based on those prohibited bases.

Lack of Credit History

To the extent that SNET's proposals incorporate the lack of credit history, which they explicitly do, the SNET proposals will likely have the effect of discriminating based race, receipt of public assistance, gender, and family status.^{\188\} Treating households which lack a credit history adversely, as defined by the ECOA and the effects test, would implicate the general anti-discrimination prohibition based on those prohibited bases.

No Prior Service

To the extent that SNET's proposals incorporate the lack of prior telephone service, which they implicitly (if not explicitly) do, the SNET proposals will likely have the effect of discriminating based on race, receipt of public assistance, gender, family status, and marital status.^{\189\} Indeed, lack of

^{\187\} Colton, *The Use of Commercial Credit Reports in Assessing the Creditworthiness of Residential Utility Customers* (July 1993). It has "been found that low income consumers frequently acquire poor credit ratings by refusing to complete payments on installment purchases of defective or shoddy merchandise. According to one study, 35 percent of the debtors in default who were studied "gave reasons for their default that implicated the creditor in varying degrees." According to this study, "by far the largest category of credit-related reasons consists of allegations of fraud and deception. Nineteen percent mentioned such wrongdoing by the seller as part of the reason for their default, and for 14 percent of all debtors, it was the *primary* reason." (emphasis added). Among the problems experienced by low-income households included defective merchandise coupled with breach of both express and implied warranties, the delivery of wrong or "used" merchandise, the failure to deliver all merchandise ordered, and deceptive pricing practices.

"The study found that not only were low-income households more likely to face these types of problems, but that they were more likely to pay higher prices as well. Nearly 40 percent of the households who purchased from merchants serving primarily low-income households were not told the true price of their purchase, with the actual cost being understated by more than 25 percent in roughly one-in-five cases. Moreover, the study found that low-income merchants often tend to circumvent interest rate ceilings "by having exorbitant markups on their goods." "Bound by law not to charge more than 18 percent interest on a credit sale, the ghetto merchant does not hesitate to mark up his goods by one, two, or even three numbers, each number, in this quaint jargon of the trade, representing a 100 percent increase of the whole sale price." (citations omitted).

See also, Hobbs, *et al.*, *Consumer Problems with Home Equity Scams* (1989); Keest, *Second Mortgage Lending: Abuses and Regulation* (1991). Keest reports that abusive second mortgage histories are developed, in large part, because "an absence of choice, or a perceived absence of choice, may close some borrowers --particularly minority borrowers-- out of the mainstream lending markets." See also, Keest, "Nature Abhors a Vacuum: High-Rate Lending in Redlined, Minority Neighborhoods in Boston," 9 *NCLC Reports: Consumer Credit & Usury Edition* 21 (May/June 1991).

^{\188\} See, Troutt, *The Thin Red Line: How The Poor Still Pay More*, at 67 - 70 and 80 (June 1993) (access to credit).

^{\189\} See generally, Colton, *Universal Residential Telephone Service: Needs and Strategies*, reprinted in, *Proceedings of the 105th National Meeting of the National Association of Regulatory Utility Commissioners* (1993). "Most of us believe that universal telephone service is the standard in the United States. Yet large portions of the low income population cannot afford telephone service in their homes,

telephone service in one's own name is a discriminatory action *explicitly* considered by the ECOA and Regulation B. Treating households which lack a prior telephone history adversely, as defined by the ECOA and the effects test, would implicate the general anti-discrimination prohibition based on those prohibited bases.

Lack of Use of Financial Services

To the extent that SNET's current security deposit procedure approved by the DPUC incorporates the lack of prior use of financial services such as bank accounts, checking accounts, credit cards and the like, which they do, the SNET procedures likely had the effect of discriminating based race, receipt of public assistance, gender, family status, and marital status.^{\190\} Indeed, segregation of financial services, both use of and access to, based on these grounds, is well established. Treating households which lack a prior telephone history adversely, as defined by the ECOA and the effects test, would implicate the general anti-discrimination prohibition based on those prohibited bases.

SUMMARY AND CONCLUSIONS

In sum, SNET's actions relating to its customers are governed by the federal Equal Credit Opportunity Act (ECOA) in "all stages" of the credit transaction. Since SNET provides service and bills for that service later, it is granting "credit" as contemplated by the ECOA.

Unlike what SNET asserted in the credit scoring proceeding (Docket 93-06-22), however, the ECOA does more than prohibit SNET from explicitly considering prohibited factors in making credit decisions. The ECOA prohibits SNET from taking "adverse actions" which, when viewed from the perspective of an "effects test," result in disparate impacts on protected classes. The SNET proposals in this proceeding would be subject to a successful ECOA challenges on any number of grounds.

(.continued)

and this number has grown since divestiture as the cost of basic service continues to rise. In 1991, while fewer than one out of 100 upper income families did not have a telephone, roughly 25 out of 100 low income families did not.***Certain aspects of this lack of universal service are particularly disturbing. Telephone penetration patterns are not racially neutral, regardless of income. While the national average penetration rate for telephone service is 94 percent, the penetration rate for black households (regardless of income) is only 86 percent. The penetration rate for Hispanic households (regardless of income) is only 86 percent. This racial inequality carries over into the elderly population. Among homeowners, only three percent of older whites are without telephones, compared to eight percent of their black and Hispanic counterparts. Likewise, only eight percent of older white renters do not have telephones, compared to 19 and 18 percent, respectively, of older blacks and Hispanics. Moreover, the racial inequality is a particular problem for the poor. While 75 percent of all households with incomes less than \$5,000 had telephones, only 64 percent of black households and 65 percent of Hispanic households with incomes less than \$5,000 had telephone service." *Id.*

^{\190\} *See generally, Hobbs et al., Effects of Financial Services Deregulation on Senior Citizens* (1990). ("Race and chronically low household income, more than age, account for the major difference in use of financial services markets by consumers. Blacks, Hispanics and other minorities (regardless of income and age) and low-income households are much less likely to use checking accounts, the principal financial service used by the majority of Americans"). Hobbs reported that "71% of [low-income minority families] did not have a checking account in 1977; this increased to 80% by 1983." *Id.*

PART FIVE: IMPLEMENTING TOLL RESTRICTIONS WITHOUT PRIOR NOTICE

SNET proposes to change the definition of service terminations and service disconnections to eliminate the inclusion of "toll restrictions" within that definition. The effect of this change would be to permit SNET to implement toll restrictions without notice. The proposal should be denied.

The SNET proposal is particularly objectionable when viewed in light of the arguments of AT&T in other parts of the country. The case which gives rise for concern is *Casey v. AT&T Communications* in West Virginia. In that case, the local customers filed a formal complaint against AT&T alleging that they had been unlawfully billed for toll telephone calls placed by a third party. The third party, an adult daughter and her boyfriend, made a large number of both intrastate and interstate phone calls from the customers' telephone and billed them fraudulently to third numbers in North Carolina. When the North Carolina numbers denied knowledge of the calls, they were re-billed to the number where the calls had originated.

The daughter had indicated to Complainants that she was using a calling card, when in fact she was not. The first indication to Complainants that something was amiss was when they received a telephone bill with the rebilled third party phone calls on it.

In handling the third party calls, and then rebilling them to Complainants, AT&T violated the tariff which it has on file with the West Virginia PSC regarding Third Party Billing. Indeed, the Complainants argued to the PSC:

The Complainants view this not as a case of disputed rates but rather as a dispute involving the billing practices and services of AT&T with regard to "Bill to Third Party" calls. They do not dispute the amount that they were charged for these bills; rather, they dispute that they were charged *at all*, (emphasis in original), since this procedure apparently violates the AT&T Tariff [filed with the West Virginia PSC] in respect to "Bill to Third Party" calls.

The staff of the PSC agreed that AT&T mishandled the calls in the first instance. On two separate occasions, the PSC staff found that AT&T violated its Tariff with respect to its handling of "Bill to Third Party" calls from residential phones.^{\191\}

During the pendency of the complaint proceeding, however, AT&T filed a letter with the West Virginia PSC indicating that the company had credited the customers' bill for all disputed *intrastate* calls. AT&T then moved to dismiss the case arguing that the jurisdiction of the state PSC over the billing dispute regarding the *interstate* calls was preempted by Federal Communications Commission (FCC) jurisdiction.

^{\191\} Staff memo (September 10, 1993); Staff Memo (October 18, 1993).

The West Virginia PSC agreed, finding that it "lacks jurisdiction to adjudicate billing disputes over interstate calls. . ." In response to the customers' motion to reconsider, AT&T stated: "when AT&T credited the Complainants' account for the small handful of intrastate calls, there were no intrastate issues left for this Commission to resolve. That does not mean, however, that the Complainants are without a forum for their complaint. If they believe AT&T has acted improperly, they can complain to the FCC."

In light of this position by an interexchange carrier for which SNET bills, the DPUC should reject the proposal to allow the imposition of toll restrictions, based in primary part, upon interexchange bills. Under the SNET proposal, toll restrictions could be imposed without notice. The customer experiencing such restrictions, if their bill involves disputed interexchange calls, is then denied virtually all means for recourse. Their toll service is eliminated by the regulated local utility notice and an opportunity to object. And, if AT&T's position prevails, the dispute with the interexchange carrier could not be presented to state regulators, but rather only to the FCC.

The issue is made even more important by arguments advanced by interexchange carriers in other parts of the country as well. Indeed, consider the implications of AT&T arguments in *other* states when combined with the AT&T position in West Virginia. The sale of enhanced services such as Call Forwarding would be outside the state PUC jurisdiction, even though not offered by AT&T, since that service is often used for purposes of handling interstate calls. If the AT&T position is upheld, jurisdiction over these services is threatened. The threat is not insubstantial. *Precisely* this argument -- that since it is used for interstate calls, regulation is outside state PUC jurisdiction-- has been made with regard to "MemoryCall" before the Georgia PSC.

This case, which is now on appeal to the Eleventh Circuit, is Georgia MemoryCall.¹⁹²¹ During 1991, the Georgia Commission was conducting an investigation into allegations of anticompetitive conduct by Southern Bell Telephone Company in its provision of MemoryCall service (electronic voice mailbox service, which is an enhanced service under FCC rules), and on June 4, 1991 decided to issue a "freeze" on all further sales of that service pending its investigation. BellSouth (Southern Bell's parent company) filed a Petition for Emergency Declaratory Relief with the FCC seeking an order that the Georgia Freeze Order was preempted. The FCC agreed with BellSouth and issued such an order. The FCC has taken the position that MemoryCall is a jurisdictionally mixed enhanced service because it views calls that originate in another state and terminate in a MemoryCall computer in Georgia as interstate in nature.

As in West Virginia, there are ongoing financial ramifications to this lack of customer recourse. Even though the remaining unpaid disputed bills between a customer and AT&T are interstate in nature, under Connecticut law, the customer would be threatened with jeopardy to their local and intrastate service in any number of different ways as a result of unpaid bills to AT&T. At least three are readily

¹⁹²¹ Petition for Emergency Relief and Declaratory Ruling filed by the BellSouth Corporation, Memorandum Opinion and Order, 7 FCC Rcd. 1619 (1992), appeal pending sub nom. Georgia PSC v. FCC, No. 92-8257 (11th Cir.), filed March 16, 1992.

evident:

1. The customers would be threatened not only with the termination of their interstate service provided by AT&T, but with the termination by SNET of their intrastate long-distance service as well, if they fail to pay their interstate AT&T bills.
2. The customers would be threatened not only with the demands for the payment of their interstate service provided by AT&T, but with demands by SNET for payment of a late fee on the total outstanding bill, including their AT&T bill, if they fail to pay their interstate AT&T charges.
3. The customers would be threatened not only with the demands for the payment of their interstate service provided by AT&T, but with demands by SNET for payment of a deposit, based on their total monthly bill, including their AT&T bill as well as local and intrastate long-distance service, if they fail to pay their interstate AT&T charges.

The immediate implication of these outcomes for the proceeding now before the DPUC is the untenable position that the SNET proposal places the customer. Gaining pre-toll restriction relief at the state level is precluded since no notice is provided of the pending restriction. Post-toll restriction relief at the state level is precluded since, under AT&T's argument, the exclusive forum for relief is with the FCC.

At least until the jurisdiction of state commissions regarding the review of interexchange carrier bills is determined, the DPUC should not further restrict the ability of consumers to gain redress. If the AT&T West Virginia position ultimately prevails, the SNET proposal to eliminate the need for notice prior to restricting all toll calling for reasons involving unreviewable interexchange bills should be permanently denied.

PART SIX: PROPOSALS FOR FUTURE INQUIRY AND ACTION IN CONTROLLING SNET UNCOLLECTIBLES

Connecticut's future directions (and inquiries) into the control of SNET's uncollectible toll accounts should start with several fundamental propositions:

1. That there is a *difference* between SNET uncollectibles and interexchange carrier uncollectibles, which difference is not eliminated by the sale of Billing and Collection Services by SNET to the interexchange carriers;
2. That the *primary* responsibility for deciding the extent to which interexchange uncollectibles should be controlled, as well as the responsibility for deciding how to implement such controls, should lie with the interexchange carriers themselves, *not* with SNET or with the DPUC;
3. That these two decisions --(1) to what extent should interexchange uncollectibles be controlled, and (2) how should that control be accomplished-- should be done in a way so as to maximize consumer benefits arising from competition between the carriers;
4. That the role of SNET, as a utility regulated by the DPUC, is to promote such competition or, at the least, to do nothing that would inhibit it; and
5. That the primary role of SNET is as a public utility providing telecommunications service to Connecticut consumers, not as an administrative services company providing billing and collection to interexchange carriers. The provision of administrative services such as billing and collection --and by extension, credit screening-- is subservient to the public utility obligations regarding the SNET telecommunications services provided to the public.

In addition to these propositions, the future direction of inquiry should adopt the goals that:

1. The security demanded against the risk of loss due to bad debt --whether it be a cash deposit, a toll restriction, or a demand for immediate out-of-billing-cycle payment-- should, to the maximum extent practicable, reflect the risk imposed by the particular household from whom the security is sought;
2. The utility actions, be they local SNET actions or actions by the interexchange carriers served by SNET's Billing and Collection Service, should, for policy and legal reasons, avoid undue discrimination based on protected classes; and
3. The utility actions should be designed and implemented in a way to promote the attainment and maintenance of universal service at both the local exchange and toll levels.

The techniques that the DPUC should endorse to provide security against uncollectibles flow from

these principles and goals:

Cash Deposits

1. As discussed in detail above, SNET deposits should include *no* increment designed to cover interexchange bills. Thus, for example, the proposed SNET deposit of \$120 should be disapproved as inappropriately including \$60 worth of interexchange charges. The higher proposed SNET deposit of \$330 for some customers is even less appropriate and more objectionable when the decision is made to exclude interexchange charges from deposits demanded by SNET as the local exchange company.
2. SNET deposits should be prohibited from automatically including an SNET toll component. Research shows that "a significant percentage of all households do not place *any* long distance calls. Between 10 and 20 percent of all households place no long distance calls in a given four to six month period, and 5 to 10 percent make no calls in a year."^{193\}
3. SNET deposits should not be based on *average* bills, including average toll usage. A "rule of thumb" in the telephone industry is that 20 percent of the customers generate 80 percent of the revenue. Empirical research bears this out, or at least bears out the impact which a small number of high use customers has on systemwide averages. Research in 1987 showed that the "average" residential long distance bill was more than two times as high as the median bill. While the average monthly long-distance bill was \$13, the median was only \$6. If actual bills are not available as a means for setting a deposit, the deposit should be set using median bills, not average bills. The same "median, not mean" approach should be used for each component of the local bill set forth in Table 1 above.^{194\} To use the "average," in other words, is to misstate (on the high side) the bills generated by the typical customer. The use of a median will present the typical customer better than the use of an average.
4. Interexchange deposits should be established, collected and enforced outside of SNET. The lawfulness of the indicators of "risk" used by any given individual interexchange carrier should be subject to the same controls and constraints as other competitive business enterprises. The policy decision of whether to collect a deposit, and if so how much, should be left to the economics, competitive pressures, and risk aversion of the individual interexchange carriers.^{195\}

Toll Limitations Generally

1. The concept of toll limitations as a legitimate option to be exercised as a means of providing security against bad debt should be endorsed. However, as with deposits, the level of toll limitation should not be uniformly set by SNET for all interexchange carriers. Toll limitations

^{193\} Cooper, *The Telecommunications Needs of Older, Low-Income and General Consumers in the Post-Divestiture Era*, at 49 (1987).

^{194\} This might mean that the median charge for a particular service would be \$0 --inside wiring maintenance, for example-- if half or more of the population does not subscribe to this service.

^{195\} If an interexchange carrier claims that it would cost more to create a system of collecting deposits, then such deposits would save in bad debt for that carrier, the DPUC reaction should be "fine, that's a business decision for you to make with the money, Bono, WA 02178

should be recognized for what they are: an alternative means of securing each respective company against bad debt. They are, in other words, analogous to a credit card issuer's "credit limit."

2. The role of SNET, therefore, should be limited to notifying the respective individual interexchange carriers if toll limitations for individual customers have been exceeded.^{\196\} Upon receipt of such notice, the interexchange carrier can make a choice from several competing options: (a) to de-subscribe the customer to protect the carrier against the potential loss of revenue due to bad debt;^{\197\} (b) to demand a deposit (or an additional deposit) as a means of protection; (c) to demand an accelerated out-of-billing-cycle payment; (d) to determine that the action exceeding the toll limit presents no threat of bad debt, or (e) to decide that the cost of assessing the extent to which, if at all, the customer exceeding the toll limit presents a risk of bad debt outweighs the potential savings in bad debt.
3. The difference between this proposal and the *status quo* is thus two-fold. First, the notice generated by SNET upon a customer exceeding a toll limitation is to the interexchange carrier, not to the customer. Second, SNET would need to implement the technology necessary to be able to customize toll limits.^{\198\}
4. Under this proposal, SNET's sale of Billing and Collection Services would remain precisely that: billing and collection. The proposal would keep SNET out of the "credit screening" business.
5. The role of the DPUC in such a framework would be simply to ensure that the rates obtained for the sale of Billing and Collection Service adequately compensate SNET for the technology necessary to monitor the various toll limits for the interexchange carriers.^{\199\}

Interexchange Toll Limitations

1. The rationality or lawfulness (*i.e.*, non-discriminatory nature) of the interexchange carrier decisions as to security against bad debt would be outside any DPUC regulatory oversight, but would be left to (a) market forces; and (b) existing consumer credit anti-discrimination laws to control.
2. Notwithstanding the belief set forth in the paragraph immediately above, it would be expected that interexchange carriers would develop alternative "packages" of services involving different levels and types of security combined with different toll limits. For example, Package A might

^{\196\} Under the existing system, the customer is either notified, with a demand for immediate payment, or the access to toll service generally is disconnected with or without notice.

^{\197\} *See generally*, Docket 93-06-22, Tr. 523.

^{\198\} Given the different limits for different credit classes today, this ability to customize toll limits may *not* be a change from the *status quo*.

^{\199\} Based on SNET's representations in 93-06-22 as to the limits of switching technology, it would seem that the toll limits would need to be set in limits on minutes of usage rather than in dollars.

involve higher toll limits when combined with a cash deposit or other type of security such as a guarantor letter. In contrast, Package B might offer a "no deposit" service, but only when combined with lower toll limits. Package C might offer higher toll limits, but only if combined with an agreement to make an immediate out-of-billing-cycle payment if the toll limit is exceeded. Package D might offer unlimited toll calling, but only upon an agreement that unpaid toll bills would accrue an "interest" charge from month-to-month. These illustrative packages should not be viewed as proposals, but as conceptual illustrations.

3. In considering toll limits, in other words, the DPUC should realize that it needs to consider *more* than the technology. In addition, it needs to force the development of toll-limit packaging and marketing. The appropriate toll limits for interexchange carriers, in other words, is not an issue for regulatory decision, but one for competition and marketing to establish.^{1200\}
4. As can be seen in this scenario, SNET would thus not be involved with administering the toll limitations. SNET would monitor toll usage through its Billing and Collection Services, and would inform the interexchange carrier in the event that a customer exceeds the toll limitation established by that carrier had been exceeded. That would, however, be the extent of SNET involvement. The responsibility for setting and justifying the limits for each respective carrier, as well as developing and implementing an appropriate reaction if the limit has been exceeded, lies with each respective interexchange carrier.

SNET Toll Limitations

1. This proposal would posit that SNET should not adopt toll limitations for toll service provided by SNET unless and until the Company can show that jurisdictional uncollectibles caused by intraLATA toll service are causing substantial expenses to the Company. Given the following observations, however, it is not likely that SNET can make such a demonstration:
 - a. Roughly 90 percent (86%) of SNET's uncollectibles came from accounts that were involuntarily disconnected for nonpayment in 1993.
 - b. The Company had 56,100 accounts that were involuntarily disconnected for nonpayment in 1993;
 - c. The *average* residential intraLATA toll bill was in the neighborhood of \$5 or less per month as discussed above; and
 - d. *Median* toll bills tend to be lower than *average* bills, as discussed above.

Given these observations, SNET may well be justified in finding that it is possible to find more

^{1200\} Given consumer responses to bills, it is possible that competition on deposit sizes and toll limits will be more active than competition on usage rates. It is easier for a consumer to see that "AT&T is asking for a \$100 deposit while MCI has a no deposit plan" than it is for consumers to compare usage rates. See generally, Colton. "Consumer Information and Workable Competition in the Telecommunications Industry." XXVII *Journal of Economic Issues* 775 (1993).

cost-effective means of reducing total company expenses than in seeking to reduce *intrastate* toll uncollectibles.

The Future of SNET Credit Screening

1. The proposals outlined above should get SNET out of the business of credit screening altogether. This would be consistent with SNET's obligations as a public utility. As discussed above, as a public utility, SNET has a common law "duty to serve." The fundamental common law "rule" requires SNET to serve on reasonable terms all those who desire the service it renders. If a member of the public has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty of SNET to provide the service.
2. Having reasserted that public utility "duty to serve," the DPUC would limit SNET to the collection of reasonable deposits (within the constraints outlined above) to protect the Company against the potential loss of revenue *to the Company*.
3. The SNET proposals regarding credit scoring, risk assessment, and the like, would thus largely be rendered moot. Instead, decisions on credit scoring and risk assessment regarding toll uncollectibles, as well as decisions on how to translate that into the development of adequate security against abuse of potential abuse of the toll system, would be made by interexchange carriers outside the regulatory oversight of the DPUC.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Among the conclusions and recommendations contained in the discussion above are the following:

1. **Conclusions as to Defining "Service Termination" to Exclude "Toll Restriction."**

- a. The redefinition of service disconnections (or terminations) to exclude toll restrictions eliminates an important procedural safeguard for Connecticut jurisdictional customers. AT&T has argued in separate proceedings that customers have no recourse before state Public Utility Commissions regarding disputed interstate bills. According to AT&T, the *exclusive* remedy for consumers is to litigate the dispute before the Federal Communications Commission. If this SNET proposal is adopted, and assuming the AT&T position prevails, "toll restrictions" could be implemented without notice, with no recourse for the consumer before state regulators even if the bills underlying the toll restriction are in dispute.

2. **Remedies for Abuse or Suspicion of Abuse of Toll System.**

- a. The proposed restrictions on all toll use if SNET believes (or merely suspects) that there is an "abuse" of the toll system is a violation of both Section 1 and Section 2 of the Sherman Antitrust Act.
- b. The proposed SNET restrictions are anticompetitive in at least three markets, including: (1) the market of Billing and Collection Service providers; (2) the market of interexchange carriers who do not use SNET for Billing and Collection versus the interexchange carriers who do; and (3) the market involving only interexchange carriers who do use SNET for Billing and Collection.
- c. The proposed SNET restrictions are anticompetitive in that they remove competition amongst interexchange carriers for niche markets involving payment-troubled customers. The SNET proposal eliminates any incentive for interexchange carriers to understand, let alone to serve, these niche markets.
- d. Even if not anticompetitive to the extent of representing an antitrust violation, the SNET restrictions are anticompetitive to the extent of failing to meet the utility's obligation to provide just and reasonable service.
- e. The proposed SNET restrictions wrongly imputes to all interexchange carriers uniform system economics, risk aversion, and credit and collection policymaking decisions, when no reason exists to believe that such uniformity does, or should, exist in fact.
- f. The proposed SNET restrictions inappropriately results in an intertwining of local

exchange and interexchange businesses.

3. Remedies for Fraud or Suspected Fraud, either Identification Fraud or "Subscription" Fraud.

- a. By law, SNET must *presume* honesty and fair dealing by its residential customers in the absence of affirmative, objective, individualized proof to the contrary.
- b. By law, in order to justify the disconnection of toll services, SNET must make an affirmative showing of the justification for the termination, and SNET bears the ultimate burden of persuasion as to the justification on an individualized customer basis.
- c. By law, in seeking to allege and demonstrate fraud (whether identification fraud or "subscription" fraud), no element of the fraud may be supplied by presumption. If circumstantial evidence of "fraud" is used, there must be no legitimate deduction to be drawn from the evidence other than that fraud has occurred.
- d. By law, SNET may not allege that it faces an "insecurity" as to future payment unless such insecurity is based on objective facts that have arisen after the commencement of the service.
- e. By law, if SNET succeeds in showing legitimate "insecurity," it may only demand "due performance," which is the performance called for by the original contract. It may not demand "enhanced performance" such as accelerated payments.
- f. By law, interexchange carriers who fear the nonpayment of toll bills may not gain exemptions from the consumer credit laws, contract law, and common law obligations that are imposed upon other competitive enterprises by using SNET's credit and collection apparatus to collect their bills.

4. The Applicability and Significance of the Federal Equal Credit Opportunity Act.

- a. By law, the federal Equal Credit Opportunity Act (ECOA) governs and constrains the credit and collection activities in which SNET may engage.
- b. By law, credit and collection mechanisms which have the effect of disproportionately adversely affecting protected classes are in violation of the federal ECOA.
- c. The ECOA prohibits more than a failure to notify customers of the reasons for adverse actions. Moreover, the ECOA prohibits more than an explicit consideration of protected factors in granting or denying credit.

- d. By law, the prohibition of adverse actions under the ECOA are to be judged through use of an "effects test." One primary attribute of the "effects test" is that the good or bad faith of the creditor is irrelevant.
- e. While SNET's credit scoring method is not directly at issue in this proceeding, the credit scoring pervades and permeates the entire set of proposals advanced by SNET for consideration.
- f. Under the Equal Credit Opportunity Act's "effects test" requirements, the SNET credit and collection proposals are subject to challenge on at least five different grounds.

5. The Principles to be Applied.

- a. The eight "principles to be applied" articulated starting at page 4 are expressly incorporated into this summary by this reference.

6. Recommendations for Future Actions and Inquiries by SNET and the DPUC.

- a. The concept of toll limitations as a legitimate option to be exercised as a means of providing security against bad debt should be endorsed. However, as with deposits, the level of toll limitation should not be uniformly set by SNET for all interexchange carriers.
- b. The role of SNET, therefore, should be limited to notifying the respective individual interexchange carriers if toll limitations for individual customers have been exceeded. Upon receipt of such notice, the interexchange carrier can make a choice from several competing options: (a) to de-subscribe the customer to protect the carrier against the potential loss of revenue due to bad debt; (b) to demand a deposit (or an additional deposit) as a means of protection; (c) to demand an accelerated out-of-billing-cycle payment; (d) to determine that the action exceeding the toll limit presents no threat of bad debt, or (e) to decide that the cost of assessing the extent to which, if at all, the customer exceeding the toll limit presents a risk of bad debt outweighs the potential savings in bad debt.
- c. The rationality or lawfulness (*i.e.*, non-discriminatory nature) of the interexchange carrier decisions as to security against bad debt would be outside any DPUC regulatory oversight, but would be left to (a) market forces; and (b) existing consumer credit anti-discrimination laws to control.
- d. As can be seen in this scenario, SNET would thus not be involved with administering the toll limitations. SNET would monitor toll usage through its Billing and Collection

Services, and would inform the interexchange carrier in the event that a customer exceeds the toll limitation established by that carrier had been exceeded. That would, however, be the extent of SNET involvement. The responsibility for setting and justifying the limits for each respective carrier, as well as developing and implementing an appropriate reaction if the limit has been exceeded, lies with each respective interexchange carrier.

- e. The proposals outlined above should get SNET out of the business of credit screening altogether. This would be consistent with SNET's obligations as a public utility. As discussed above, as a public utility, SNET has a common law "duty to serve." The fundamental common law "rule" requires SNET to serve on reasonable terms all those who desire the service it renders. If a member of the public has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty of SNET to provide the service.
- f. The SNET proposals regarding credit scoring, risk assessment, and the like, would thus largely be rendered moot. Instead, decisions on credit scoring and risk assessment regarding toll uncollectibles, as well as decisions on how to translate that into the development of adequate security against abuse of potential abuse of the toll system, would be made by interexchange carriers outside the regulatory oversight of the DPUC.