COLLECTING WATER BILLS IN EASTON, PENNSYLVANIA

BY:

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INTRODUCTION

My name is Roger Colton. I am a principal in the firm Fisher Sheehan & Colton, Public Finance and General Economics. My office is in Belmont, Massachusetts. My educational background consists of a Bachelor's degree from Iowa State University (1975), a law degree from the University of Florida (1981), and a Masters degree (economics) from Antioch University (1993).

My professional work relates primarily to public utility regulation. At present, I am under contract to do projects for various state and federal agencies, and community-based organizations, including the New Hampshire Public Utilities Commission, the New Jersey Division of Ratepayer Advocate, the Maryland Office of Peoples Counsel, the Pennsylvania Office of Consumer Advocate, the Illinois Citizen's Utility Board, the U.S. Department of Health and Human Services, the Heat and Warmth Fund (Detroit), and the Colorado Energy Assistance Foundation (CEAF). I also work directly for industry. In the past year, I have been under contract with Entergy Services Corporation (a multi-state utility holding company) (Little Rock, AR), Cleco Power Corporation (Alexandria, LA), and Missouri Gas Energy Company (Kansas City, MO).

My activities include work involving credit and collection issues, as well as customer service issues, for water utilities. In the past year, I have been involved with litigation involving the Philadelphia Water Department, the Pennsylvania American Water Company, the Columbus (Ohio) water department, and Consumers Illinois Water Company. Each of these cases have involved credit and collection and/or customer service issues.

I publish extensively on public utility matters. A list of my publications, as well as a list of the cases in which I have appeared as an expert witness, is attached as part of my curriculum vitae appended to this statement as Attachment 1.

As part of my work in this proceeding, I have reviewed the following materials from the litigation:

- All pleadings and briefs filed by each party;
- All depositions taken by counsel for plaintiffs;
- All financial statements, audits, appropriation ordinances, and general ledger sheets provided to Plaintiffs' counsel;
- All Easton bylaws and ordinances provided to Plaintiffs' counsel;
- Various other documents obtained by Plaintiffs' counsel through discovery in this proceeding.

The purpose of my review is five-fold:

- I will review the reasonableness of Easton Water's policies and procedures leading up to and including the termination of water service to plaintiffs;

- I will review the procedures involved with the reconnection of water service after a disconnection for nonpayment;

- I will review the reasonableness of Easton Water's post-disconnect policies and procedures relating to the collection of water bills (and other services billed in tandem with water);

- I will review the reasonableness of the late payment fees and interest charges imposed by Easton Water; and

- I will review the equality of treatment of plaintiffs in this proceeding relative to other Easton Water customers.

Throughout my review, I will refer to the Easton water utility either as Easton Water or as the Water Department. I mean those terms to refer to the same entity unless the context of my comments clearly dictates otherwise. References to "Easton" are to the City of Easton unless the context clearly indicates otherwise.

EASTON WATER AS A PUBLIC UTILITY

No question exists but that when the City of Easton acts in its capacity of providing water service to its customers, it is acting in the capacity of a public utility. When I say "pubic utility" in this sense, I do not mean a regulated company subject to the oversight and control of the Pennsylvania Public Utility Commission (PUC). I do mean a utility that has certain characteristics, is provided with certain perquisites, and is imprinted with an obligation to serve.

Easton Water is a state-sanctioned monopoly. Other water companies, for a variety of reasons, may not enter the Easton service territory and compete for the business of customers that Easton Water serves. In other commercial contexts, the provision of a good, of which water is clearly one, by a monopoly supplier would be considered anti-competitive. A utility, however, generally has an exclusive service territory. Consumers have no real alternative to obtaining water supplies from Easton Water.

In its capacity as a state-sanctioned monopoly, Easton Water provides an essential service. While not impossible to replace, water service is considered to be a practical necessity of modern life. Water is essential to the life, health and safety of Easton customers. The discontinuance or denial of water service affects a household in all aspects of its physical, economic and social well-being.

The fact that this essential service is controlled by a monopoly-provider makes it even more essential that Easton Water be held to reasonable commercial standards in its treatment of customers, even during the collection process. There is no doubt that Easton Water possesses the kind of power that has raised a responsibility to use that power fairly and in accord with minimum requirements of fundamental fairness. Because of unequal bargaining relationships, Easton Water customers have a specific vulnerability to the potential for coercive abuse of the seller/customer relationship.

One primary justification for imposing an obligation to serve on public utilities such as Easton Water, as well as strict standards of commercially reasonable behavior, therefore, is that as a state-sanctioned monopoly: (1) Easton Water has power over a vulnerable party; and (2) as the stronger party, Easton Water has the opportunity to exploit that power.

Pennsylvania has a specific interest in ensuring that water service terminations occur so as to minimize the dangers to payment-troubled customers. It is commonly accepted that the termination of utility service presents real dangers to the households who have service disconnected but who are unable to pay. In addition, insisting that customers pay unreasonably high bills, even in arrearage situations, can lead to substantial harms. A variety of studies show that customers often will go without food, go without medical care, and go without paying other bills in order to pay their home utility bills.

In sum, there are serious health and safety implications arising from the termination of utility service and those safety implications are well known. As a result of these observations, an obligation to serve is imposed on public utilities. This obligation to serve requires a public utility such as Easton Water to provide, on a non-discriminatory basis, reasonably adequate service to all customers who pay or agree to pay the reasonable rates of the utility and abide by the just and reasonable regulations of the utility.

These observations have a variety of ramifications for Easton Water:

- It heightens the standard of care imposed on the utility to be exercised by the company in the denial, interruption, or disconnection of service;
- It tightens the standards against which the commercial reasonableness of utility actions will be judged;
- In balancing consumer and company interests in determining the fundamental fairness of utility actions, it heightens the weight to be afforded customer interests in judging whether the actions of a utility meet standards of fundamental fairness.

CONTRACTS AND COMMERCIALLY REASONABLE BEHAVIOR

There are a variety of sources to which I turn to determine what a customer's reasonable expectations would be from Easton Water and what commercially reasonable standards are generally applied in the water utility industry.

The first question I face is what are the reasonable expectations of an Easton Water customer when they take service from the Department. There is no written contract between Easton Water and its customers. No piece of paper exists, signed by both parties, laying out the terms of a contract. The terms of service, such as deposit rules, payment plan rules, disconnect rules, and other customer service rules, do not appear in any written form. No bargaining occurs over either the terms of service or the price of service. Given that Easton Water does not have customer service terms explicitly set forth in a written contract or tariff, customer service expectations as to what constitute the provisions of their "agreement" with Easton Water are filled in by industry custom and usage.

I have determined custom and usage for utility disconnect procedures through three inquiries.

First, I find that Chapter 56 of the Pennsylvania PUC's regulations represents a written trade code that memorializes reasonable standards of conduct for public utilities. Chapter 56 has all the factual attributes of a trade code for Easton Water. There is no final expression of an "agreement" between Easton Water and its customers. There is no written agreement as to the terms of service. Indeed, Easton Water has sought to change the terms of service over time. Even those terms that have been expressed by Easton Water are subject to the need for explanation. For the most part, however, the terms of service are replete with gaps. Given the inferior bargaining position I have previously discussed for residential customers, the reasonable expectation of the customers would be that normal custom and usage would be observed by Easton Water.

Chapter 56 requires the offer of payments plans to residential utility customers who are behind on their bills. These payment plans are to take into account, among other things, ability to pay. Chapter 56 requires a clear and believable pretermination notice. This notice is not simply to notify the customer of a pending shutoff, but is also to notify the customer of the fact of recourse and the procedure for achieving recourse. Chapter 56 requires the delay of service termination in the event of a medical emergency. The existence of such an emergency is a medical decision for

a qualified health professional and is not based on whether a customer can, in the opinion of the utility, abandon his or her home. Chapter 56 establishes clear standards for the issuance of medical certificates and requires an established written procedure for accessing such a delay in service termination. Chapter 56 bans the disconnection of service for collateral matters. Chapter 56 bans the issuance of disconnect notices when there is no present intent to disconnect. Chapter 56 requires that disconnect notices be reissued when they become stale. Chapter 56 creates specific criteria for taking deposits as well as specific criteria for the refund of those deposits.

Second, I have reviewed the tariffs of more than 40 private and municipal water utilities in the Commonwealth of Pennsylvania. A tariff incorporates the written terms of service which govern the customer/company relationship. The tariffs I have reviewed demonstrate what typical industry practice is with respect to certain customer service practices. While not uniform in their particulars, the tariffs do reveal a consistency in practice.

The written tariffs I have reviewed make clear that the industry practice of water utilities in Pennsylvania include:

- To set forth customer service terms in written form;
- To offer deferred payment plans for customers in arrears who claim an inability to pay an outstanding bill in full;
- To honor existing payment plans so long as payment son such plans are kept current;
- To provide for the delay of service terminations when such a termination would create or exacerbate a medical emergency determined by a health professional;
- To prohibit terminations of service for collateral matters.
- To establish written procedural standards regarding the terms of service, the condition of service, and the procedures for service disconnection for nonpayment, as well as the mechanism for avoiding, challenging or appealing a proposed disconnection for nonpayment.

Finally, I find that my conclusions regarding industry custom and usage in Pennsylvania are supported by a review of similar materials nationwide. I have reviewed the state regulations governing water and wastewater utilities for every state public utility commission that regulates water and wastewater companies. These regulations make clear that the industry standards of reasonable behavior include:

- Offering deferred payment plans for customers in arrears who claim an inability to pay;
- Delaying service termination, when such a termination would create or exacerbate a medical emergency, as determined by a qualified health professional;
- Prohibiting service terminations for matters collateral to the provision of water service;
- Requiring written procedures through which to challenge a proposed service termination;
- Establishing written standards to apply in any appeal of a utility decision adversely affecting a customer's service.

I find that the terms and practices contained in Chapter 56 and in the tariffs of other water utilities in Pennsylvania are commonly known, used and accepted as reasonable standards of conduct throughout the utility industry in Pennsylvania. The regulations of water utilities are designed to articulate what customer service terms represent reasonable behavior on the part of a utility and its customers, what customer service terms are needed to protect health and safety, and what customer service terms strike a reasonable balance between the legitimate interests of a water utility in getting paid and the legitimate interest of a customer in maintaining service.

The custom and usage of Pennsylvania's water utilities, as well as the industry code memorialized in the Pennsylvania PUC's Chapter 56 regulations, as well as the custom and usage revealed in water customer service regulations adopted by state utility commissions throughout the nation, are well known throughout the industry. Each piece of information I reviewed is publicly available. The information is used by others to establish standards for their conduct. Over the past 13 year period, for example, I have done considerable work regarding the Philadelphia Water Department and the Philadelphia Gas Works. (Until recently, PGW was not regulated by the PUC.) In my work regarding both of those municipal utilities, Chapter 56 was viewed as being, while not applicable as direct regulation, a written memorialization of what constitutes reasonable behavior of a public utility in Pennsylvania.

In addition, the National Association of Regulatory Utility Commissioners has periodically surveyed the customer service regulations and terms of service. The National Consumer Law Center has published a manual on customer service regulations. The Pennsylvania PUC published a model water tariff. Considerable legal literature, much of it written by myself, documents these customer service regulations. The American Water Works Associations has published literature on customer service regulations.

What I conclude is as follows:

- To the extent that the terms of the contract between Easton and its customers include the usage and custom of the utility industry as evidenced by industry practice and trade code, the reasonable expectations of Easton customers would be that they would be treated consistently with Chapter 56 as a trade code, consistently with industry practice evidenced by the tariffs of water utilities in Pennsylvania, and consistently with industry practice evidenced by the practice and procedure of regulated water utilities nationwide.

- I further conclude that to the extent that Easton Water is bound by a duty of abiding by commercially reasonable standards, the provisions of Chapter 56, the industry practices evidenced by the tariffs of water utilities in Pennsylvania, and the industry practice evidenced by the water regulations of utility regulators nationwide evidence commercially reasonable standards of practice and procedure regarding the collection of unpaid utility bills.

- I find that Plaintiffs had a reasonable expectation that the following customer service terms and provisions would be in force and effect:

  - A deferred payment plan procedure allowing for customers claiming an inability to pay to retire their arrears over time;

  - A written statement of procedures articulating how to challenge a proposed termination of service as unjustified;

  - A process for obtaining a delay in service termination when such a termination would create or exacerbate a medical emergency as determined by a qualified health professional;

  - A prohibition on service terminations for reasons collateral to the provision of water service;

  - A written pretermination notice of the existence of a mechanism to challenge a termination as unjustified;

  - A written pretermination notice of the means by which to access the complaint procedure; and

  - A set of written standards to be applied in any appeal of an adverse decision regarding a customer service term or condition of service.

- I find further that the following actions of Easton Water vis a vis Plaintiffs were in contravention of the commercially reasonable standards of conduct observed in the utility industry:

  - The refusal to enter into deferred payment plans allowing persons in arrears to retire their arrears over time, with the payment plan taking into consideration factors including, but not limited to, ability to pay, payment history, the time the bills have remained outstanding, the reasons why the bills have remained outstanding;

  - The refusal to honor existing payment plans when customers are not in default on such plans;

  - The failure to provide written procedures outlining how to challenge a proposed termination of service as unjustified;

  - The refusal to provide for delays in service termination when the termination would create or exacerbate a medical emergency as documented by a qualified health professional;

- The termination of service for reasons collateral to the provision of water service, including but not limited to, the nonpayment of trash collection charges;
- The failure to provide written pretermination notice of the existence of a mechanism to challenge a service termination as unjustified;
- The failure to provide written pretermination notice of the means to access a complaint procedure;
- The failure to provide written standards to apply in resolving appeals of disputes; and
- The refusal to reconnect water service pending a code inspection and remedy of any code violations.

THE REASONABLENESS OF THE PROCESS LEADING TO SERVICE TERMINATION

Aside from the issues of commercial reasonableness that I discuss above, there are specific actions taken by Easton Water that do not comport with generally accepted utility standards of reasonable practice and procedure.

Collateral matters.

Trash collection: Disconnecting water service for nonpayment of a trash collection (sometimes referred to as solid waste collection) is unreasonable. The basic rule is that utility service may not be disconnected for a collateral matter. Within the City of Easton, there is no connection between trash collection and the municipal water department. Trash collection is undertaken through a contract between the City and Grand Central Sanitation, Inc (hereafter Grand Central). The Water Department has no staff assigned to trash collection duty, no office assigned trash collection responsibilities, and no expenditures devoted to trash collection (outside its trash collection contract payments.

A review of the contract between Grand Central and the City of Easton reveals that the City explicitly provided that "the contractor shall be regarded as an independent contractor, and not as an agent, servant or employee of the City. . ." No work regarding or affecting water service is included in the contract with Grand Central.

In contrast, the Water Department's finances are segregated into the City's water department fund. While the Water Department makes a contribution to the City's general fund each year, the revenues collected through the water rates flow into the water fund, and the expenditures made are disbursed from the water fund. In contrast, payment of the trash collection obligations are made from the general fund. There is no functional or financial overlap between the provision of water service in Easton and the provision of trash collection.

There is no fee imposed by Grand Central on residential customers for trash collection. Instead, the financial payment is a sum, set by the contract, to be paid by the City to Grand Central on a monthly basis. There is no "customer" relationship between Grand Central and individual residential water customers. Not all residential water users even have to use the City's trash collection services under the City's ordinance.

Public utilities are not allowed to use their state-sanctioned monopoly status as a mechanism to leverage their ability to collect non-utility bills. Many utilities, for example, engage in the provision of non-utility services or goods. The sale of appliances, for example, might well occur through a public utility. While such a sale may, for purposes of administrative convenience, be billed with the corresponding utility bill, customer payments must be posted to utility bills first (whenever there is a bill due for utility service) and utility service may not be disconnected for nonpayment of the non-utility bill.

Providing billing and collection for another commercial entity is considered an administrative service, not a utility service. It is akin to local exchange telephone companies selling billing and collection service to inter-exchange carriers. No reason exists why local exchange companies could not also sell similar billing and collection services to Visa or American Express or Sears as well. Nonetheless, while a utility might engage in such billing and collection, it may not use the termination of service as a collection tool for nonpayment of those bills. A utility may not disconnect for a collateral matter and may not sell its right to disconnect its monopoly service to a non-utility.

Two models are available to assist in an empirical determination of whether trash collection is "collateral" to the provision of water service. The Process Model of analysis, as well as the Utility Model of service, are both described in detail below. My application of both models to an analysis of trash collection service and water service in Easton leads to the conclusion that trash collection and the provision of water service are collateral matters.

Aside from the collateral nature of trash collection, the prohibition on disconnecting water service for nonpayment for collateral matters extends to all contracts outside the contract for which utility service is being rendered. If a person has business service and residential service, for example, the person may not have service for one service disconnected for nonpayment of the other.

In sum, trash collection is collateral to the provision of water service. Trash collection is not a public utility service. And it is not a part of the contract for water service. Billing trash collection along with water service may be an administrative convenience to the city. Nothing more. The collection efficacy associated with the right to disconnect an essential utility service may not be used as a collection tool for trash collection. I set aside any statutory constraints in this discussion.

Sewer service: The combined billing for water and sewer service in Easton presents a more involved inquiry. Water and sewer service, unlike water and trash collection, have sometimes been considered to be inextricably related. If provided by the same utility, and if authorized by

statute, the water utility may be allowed to disconnect water service for nonpayment of a sewer charge billed in tandem with water charges.

If service, however, is provided by different entities, as is done in Easton, the issue is not quite so straightforward. Easton Water does not provide sewer (sometimes known as wastewater) service to residents of Easton. The Easton Suburban Sewer Authority provides sewer service. Within Easton, the sewer system is operated under a management contract between the Authority and Easton Water.

Outside this management contract, the Sewer Authority and Easton Water are entirely separate entities. They have independent governance. They have independent financing. They have independent ratesetting.

In such circumstances, I would look to see whether the Sewer Authority has: (1) made a formal request to the City of Easton for the use of water service disconnection as a sewer charge collection device; (2) made any payment to the City from the Authority for the administrative costs of effecting such service terminations; or (3) made any payment from the Authority to Easton Water for lost water sales resulting from such disconnections. I find no evidence that any of these three actions have occurred.

Denying Deferred Payment Arrangements

When Easton Water began its aggressive process of bill collection vis a vis Plaintiffs, one of its collection steps was to refuse to negotiate deferred payment plans allowing a customer to retire his or her arrears over time. I discussed above why I conclude that this refusal is contrary to the reasonable expectations of Easton Water customers as well as why the refusal is contrary to the commercially reasonable standards of conduct extent in the utility industry. What I discuss below is why the refusal to enter into a deferred payment agreement is substantively unreasonable.

The refusal to enter into deferred payment plans is unreasonable from the perspective of the customer. Requiring immediate payment of a bill irrespective of the impact on the customer's ability to retain service has never been considered a reasonable standard of conduct in the utility industry. Levelized monthly budget billing plans are universally allowed to take the peak off of high seasonal bills. One accepted payment practice is to allow a customer to pick the date in the month on which to receive a bill, in order to better match the bill issuance with the receipt of household income. Moratoria on the disconnection of service during cold weather (and increasingly during hot weather as well) is considered reasonable industry practice. As I discuss above, the offer of deferred payment plans for arrears is universal.

Deferring payments when the utility by its own actin or inaction has contributed to high outstanding bill is universal as well. Errors in meter readings, incorrect meter recording, errors in billing, and prolonged use of estimated bills all lead to the reasonable deferral of payment.

From the Company's perspective, these payment plans make economic sense. Deferred payment plans often prevent the disconnection of service with attendant credit and collection costs. The failure to enter into a deferred payment plan often places the entire bill at risk of moving into uncollectible status rather than being collected over time. The disconnection of service generates an opportunity cost, where a utility loses future sale revenue. It makes sound business sense for a utility to enter into deferred payment arrangements.

Finally, deferred payment arrangements are the established commercially reasonable way for a utility to fulfill its obligation to serve while still making reasonable provisions to ensure payments.

Clear and Believable Warnings

In order to assess the notice provided by Easton Water to Plaintiffs, one should consider the purposes and functions of a notice. Through a shutoff notice, a consumer should be provided with the information she needs to quickly and intelligently take available steps to prevent the threatened termination of service. The notice should meet sufficiently stringent standards so as to protect all customers, given that customers are of various levels of education, experience and resources. The notice should be made at a meaningful time and in a meaningful manner. It should present truthful information.

To meet these standards, the notice should contain specific information and meet specific standards. For example:

- The notice should state the reasons for having the utility seek the termination of service.
- To fulfill the standard that the notice be "meaningful," it should give a clear and believable warning that termination is about to occur.
- The notice must inform the consumer of the required procedure by which the proposed termination can be avoided. It should, for example, mention the available procedure by which a disputed termination can be challenged.

In sum, through a shutoff notice, the customer should be informed clearly of the pending shutoff along with the means to avoid it. For all the reasons I discuss below, Easton Water did not meet these standards.

Repeated notices destructive of notice purpose: To meet the requirement that the notice be "meaningful," it must give a clear and believable warning that termination is about to occur. The key word in this formulation is that the notice be "believable." Note, for example, the case of *Palmer v. Columbia Gas Co.*, where the utility's notice was invalidated when the utility sent out 120,000 to 140,000 shutoff notices each year while actually disconnecting only 6,000 households.[1]

\1\ 342 F.Supp. 241, 242 - 243 (N.D.Ohio 1972)

By sending repeated disconnect notices, with no collection follow-up, Easton Water has destroyed the message contained by the notice. As a result, the basis for its claimed compliance with notice requirements collapses.

<u>Retraction of waiver</u>: The Easton Water action is a course of performance that is inconsistent with the specific terms of the various shutoff notices provided by the Department and its subsequent inaction. I do not assert that Easton Water has acted inconsistently with its right to receive payment for the service it has provided. What Easton Water *has* acted inconsistently with is its right to receive payment within a time certain after its bill, as well as inconsistently with its right to receive payment within a time certain after the Department sends a disconnect notice.

From the perspective of Easton Water's claim that it has provided more than sufficient "notice" is the concept of retracting the waiver implied within its inconsistent course of performance. By failing to provide a clear notice of its change in collection practices, Easton Water provided *no* notification (let alone *reasonable* notification) that strict performance in accord with the disconnect notices would be required in the future. Indeed, even after its change in policy, the Department's personnel concede that Easton Water would send disconnection notices to far more customers than it physically had the ability to implement.

Plaintiffs had no notice, in other words, of Easton Water's intent to enforce the actual terms of the contract *in the future*. Plaintiffs were never informed in any fashion that despite Easton Water's habitually ignoring its prior shutoff warnings presented in termination notices, and despite habitually issuing disconnect notices without really meaning to follow up with a disconnection, and despite continuing to issue far more disconnect notices than the Department was physically capable of implementing, *henceforth*, the Department really *did* mean it and customers must respond in a specified manner to avoid the disconnection of service.

Applying the concept of retracting a "waiver" is not done in a vacuum. UCC Section 2-209(5) allows a party to retract its waiver by reasonable notification received by the other party that strict performance will be required of any term waived. This UCC subdivision permits a retraction of such a waiver if reasonable notice is given that strict performance will be required and the retraction is not unjust in view of a party's material change of position.

In this case, even though Easton had the contractual right to discontinue service upon late payment, the Department repeatedly accepted late payments without implementing that remedy. The Department, over the course of several years, established a pattern of accepting late payments rather than insisting on timely payments. After having established this pattern, the Department provided no clear and specific notice of its intent to change its collection practices. Given these facts, Plaintiffs justifiably relied on a course of conduct established by the Department, a course of conduct inconsistent with an intention to insist rigorously on the prompt payment and disconnection provisions of the terms of service.

Easton Water simply did not provide its customers with a clear warning that strict compliance with payment terms would be required in the future. It is true that each time Easton Water sent a disconnection notice to its customers, it warned of the need for strict compliance and said it would terminate service in the absence of payment. But it is also true that most times the Department sent such a notice, it thereafter did *not* insist on strict compliance, nor did it discontinue service. In my opinion, the Department's retraction of waiver was not given by the reasonable notice required by UCC section 2-209(5). Moreover, in my opinion, the retraction notice that was given, in the absence of deferred payment plans and medical emergency provisions, was unjust within the meaning of that section. The retraction notice is made even more unjust by the procedures that result in nonpayment of water, trash or sewer bills resulting in the customer's immediate eviction from his or her home and the required compliance with code inspections prior to reoccupancy.

These observations about notice are particularly important with respect to the termination of utility service because shutoff notices serve a number of different functions. One function is to permit the customer to contact the utility, make payment, or arrange an affordable deferred payment arrangement. However, other functions can be served as well. For example, one *different* function of a shutoff notice is to permit the customer to make alternative plans after service is, in fact, terminated. Consider, for example, that the right to receive notice does not depend upon the right to contest the disconnection of service. Regardless of whether the plaintiffs had a right to contest the discontinuance of service, they certainly had a right to know that service was being discontinued to enable them to protect themselves from damages that might occur.

THE REASONABLENESS OF THE PROCESS LEADING TO SERVICE RECONNECTION

Maintaining a reasonable process for reconnecting service after service is disconnected is as important to preserving customer rights as maintaining a reasonable process of service termination with which to begin. My discussion below examines the issues regarding the reasonableness of the reconnection process.

Billing in Tandem with Non-Utility Service

For all the reasons I discuss above, it is inappropriate to use the disconnection of water service as a collection device for trash collection charges. Just as it is inappropriate to disconnect service for collateral matters (such as trash collection), it is equally inappropriate to refuse to reconnect service for nonpayment of trash charges. These collateral trash collection charges include reconnect fees and deposits. (The issue of the reasonableness of the *level* of those charges is independent and is separately discussed below.)

Similarly, in the absence of statutory authorization, the requirement that sewer charges be paid as a prerequisite to reconnect water service is an inappropriate collateral billing. (As with trash charges, the reasonableness of the sewer reconnect charge and deposit is independent and is discussed separately below.)

Reconnect Fees

The City cannot provide a cost justification for any of its reconnect fees (water, sewer, and trash). When asked for such a justification, the most that could be said was that the fees are what they are because that's what the municipal ordinance says. The following analysis is presented in light of that inability to provide *any* cost justification or to document *any* relationship between the fee charged and the costs incurred.

<u>Water reconnect fees</u>: Easton Water imposes a fee of $100 to be reconnected to the water system after a service termination. The purpose of the $100 fee is "to cover the costs of discontinuing and reinstating service. . ."

The reconnect fee imposed by Easton water is thus an administrative charge imposed for cost recovery purposes. In this sense, it is like any other municipal administrative fee (such as a dog license, a permit application fee, or a franchise fee). It is to be sufficient to recover costs, but it is not to be a revenue raising measure. To the extent that the fee substantively exceeds costs, it becomes a revenue raising tax.

The $100 reconnect fee significantly exceeds the cost of discontinuing and reinstating service. Establishing the cost of discontinuing and reinstating service is a reasonably straightforward process. The costs to be included are governed by the principle of cost causation. What costs are incurred by Easton Water as a result of the need to discontinue and reinstate service? If the costs are paid by some other revenue stream, or if the costs would be incurred by Easton Water even if there was no need to discontinue and reinstate service, then the link of cost causation is broken and the costs are not to be included in a reconnect fee.

No part of the collection process prior to the disconnection activities is to be included in the reconnect fee. The collection process involving the issuance of reminder notices, the servicing of customer calls, and the issuance of disconnect notices, are all costs that are recouped through Easton Water's late fee and interest charges.

Nor do overhead costs associated with personnel and/or vehicles involved with the disconnect process go into the reconnect fee. The acquisition of office space and/or vehicles does not occur because of service terminations and reinstatements.

After considering the reasonable costs involved with the disconnect and reconnect process, a maximum reasonable water reconnect fee for Easton Water would thus be less than $30. While this fee includes salary and benefits for personnel involved with the disconnect process, in fact, the fee should probably exclude such salary since Easton Water does not hire additional personnel to perform the disconnect and reinstatement activities. The costs of personnel are not "caused" by the disconnect process. The $100 water reconnect fee is 300% above costs, even when the costs are over-inclusive.

My conclusion that a $100 reconnect fee is unreasonable is bolstered by my review of the reconnect charges of other Pennsylvania water utilities. I have reviewed the tariffs of more than

40 Pennsylvania water companies. Those tariffs show that, of the water companies charging a reconnect fee, the reconnect fee generally ranges from $10 to $35.

Sewer Reconnect Fee: The City of Easton's imposition of a $100 sewer reconnect fee bears no relationship to the costs incurred by the City purportedly to be reimbursed through the reconnect charge. The City's sewer ordinance states that the $100 reconnect fee is to compensate the City for "the costs of discontinuing and reinstating service."

There is, however, no separate termination or reconnection of sewer service. There is no separate activity, in other words, that occurs independent of the termination and reinstatement of water service. No separate vehicle is dispatched. No separate personnel are involved. No separate process is invoked. If no water is coming into a home, there is no sewage going out of the home. That is the extent of a sewer "service disconnection."

Moreover, even if there were independent costs incurred as a result of "disconnecting" sewer service, the City of Easton will be paid those costs by the regional sewer authority. Pennsylvania's statutes provides that:

> The authority imposing such sewer, sewerage or sewer treatment rentals, rates or charges *shall pay* (emphasis added) to every such water utility the reasonable additional clerical and other expenses incurred by it in providing such billing and collecting services. The authority (etc.) which shall request and direct the shutoff of water *shall also pay to the water utility* (emphasis added) the cost of such shutoff services and the estimated loss of water revenues resulting from such shutoff.

(53 PS §2264).

The statute uses mandatory language. I can find no evidence of payments made to the City from the regional sewer authority to compensate the City for the administrative costs of disconnecting and reinstating sewer service. There is no booking of additional revenue with respect to sewer service attributable to sewer reconnect fees.

Given the mandatory statutory language, along with the absence of any cost-causing factors attributable to sewer service, I conclude that there is an absence of costs assignable to the disconnection and reinstatement of sewer service.

Trash collection reconnect fee: The $100 fee imposed as a "reconnect fee" for trash service is unrelated to costs incurred by the City. Indeed, even when municipal water service is discontinued, there is no corresponding discontinuance of trash collection.

The trash collection ordinance makes clear that the suspension or termination of trash collection is not automatic when an account is delinquent. A delinquent account is only "subject to" suspension or termination. Suspension or termination can occur only upon the direction of *both*

"the Director of Public Service *and* the City Treasurer." (emphasis added). The $100 charge applies only "*if* the service shall have been discontinued or terminated." (emphasis added).

No disconnection of trash service occurs by the City upon the disconnection of water service. In addition, there are no additional charges billed to the City by Grand Central as a result of water service disconnection procedures. No additional payments are made to Grand Central as a result of the collection of trash collection "reconnect" fees.

The $100 fee is purportedly designed "to cover the costs of discontinuing and reinstating service." Since there is no process of discontinuing and reinstating trash collection service when water bills go unpaid, there are no costs to be covered by the fee. There are certainly no costs incremental to the costs covered by the water reconnect fee. Any collection activities, to the extent that they are attributable to unpaid trash collection, are covered by the late fee and interest charge.

Unified reconnect fee: While on paper, the reconnection fee for Easton Water Department customers is split into three parts ($100 each for water, sewer, and trash collection), in fact, it is applied as a single unified $300 fee. To the extent that the $100 fee discussed above is excessive in relation to costs, the fee becomes even more unreasonable and excessive when viewed as a unified $300 reconnect fee. This $300 reconnect fee covers costs of less than $30.

Deposits

The size of deposits: The City of Easton requires –for water, sewer and trash collection—a customer whose service has been disconnected for nonpayment to post a one-year deposit with the City Treasurer prior to reinstituting service. For all three services, in the absence of new or changed usage, the deposit shall reflect the actual cost of the service (or actual usage) for the immediately preceding twelve months.

A one-year deposit is unreasonable when viewed in light of the commercially reasonable standards of behavior in the industry. The function of cash deposits required of utility customers is generally defined within the context of bad debt. Bad debt is an expense to the utility just like any other expense. As such, it is an expense that a utility can and should seek to reduce where possible. The collection of a cash deposit is one means to gain protection against the potential loss of revenue through bad debt. The deposit serves the function of security to protect against the risk of default.

Deposits should be reasonably designed to result in a reduction in uncollectibles at least equal to the cost of obtaining and servicing the deposits. In order for this reduction to occur, the customers from whom deposits are demanded must represent a risk of loss to the utility. If, in other words, the customer does not represent a potential situation where the utility will experience a permanent loss of arrears, any deposit collected from that customer has no relation to the risk of loss due to uncollectibles.

This risk, it should be noted, is only a significant problem to the extent that it is not "set right" after the fact. A default on payments is not, in other words, necessarily a risk of permanent loss

of the entire remaining balance of payments. Either a complete, albeit late, payment or a partial payment reduces the risk of loss. A utility's deposit must be adequate, but no more than adequate, to offset the losses on that fraction of bills which are involved in default and on which losses are accrued.

Standard deposit terms involve requiring a deposit of one billing period plus one month. For accounts billed on a monthly basis, this would involve a maximum deposit of two months of usage/bills. For quarterly bills, this would involve a maximum deposit of four months usage/bills. Water service is billed in arrears. After receipt of a bill, a customer is provided a reasonable time within which to pay the bill (generally from 15 to 20 days). If a bill is not paid within that time period (i.e., by the due date), the utility begins its collection process. The collection process ultimately leads to the termination of service if bills continue to go unpaid. To the extent that the utility enforces its own collection processes, therefore, a maximum security deposit of one billing period plus one month provides adequate protection against the loss of revenue due to bad debt. A one year security deposit, irrespective of the service for which it is sought (water, sewer or trash collection) is clearly excessive when viewed from the perspective of the need for protection against reasonably expected bad debt loss.

Services for which deposits are taken: For all the reasons I have previously stated, trash collection is a matter collateral to the provision of water service. Water service may not be disconnected (or denied) for nonpayment of a trash collection security deposit, irrespective of the size of the deposit requirement.

POST-DISCONNECT POLICIES AND PROCEDURES

Code Inspection and Enforcement

When an Easton Water customer has his or her service disconnected for nonpayment, the City requires the water customer to have a full housing inspection prior to having water service reinstated. All housing code violations found in the inspection must be cured prior to the reinstatement of water service. Both of these requirements (housing inspection, code compliance) are unreasonable.

Requiring a housing inspection as a prerequisite to renewing occupancy of a house, and restoring water service, is an unreasonable action on the part of Easton Water. Inspecting homes for housing code compliance is not a utility service provided by the Easton Water Department. Nor is it related to, let alone an essential element of, the provision of water service. Water service may not be denied for matters collateral to that water service.

I reach the conclusion that housing code inspection is collateral to water service first by applying the Process Model of organizational behavior. Consistent use of Process Model terminology is key to the analysis. The Process Model holds that any organizational endeavor can be characterized in process terms as follows:

- **Suppliers** provide **inputs** to an organizational process. Suppliers may reside within the organization or be external to it. Inputs are the *raw material* that is transformed by the organizational process.

- The **process** itself is a combination of people, technology, supplies, methods and environment that **converts** inputs into **outputs**.

- **Resources** (such as people costs, technology costs and the costs of supplies) are **consumed** in the conversion process.

- Process outputs are **delivered** to a **customer**, either (1) delivered to an internal customer where they become inputs to a downstream organizational process; or (2) delivered to an external customer. Customers are identified by their act of accepting delivery of process outputs.

In general, these process model terms are used to describe a hierarchy: A process consists of multiple activities. An activity, in turn, consists of multiple tasks. In this analysis, however, the terms "process" and "activity" are used interchangeably unless the context clearly dictates otherwise. Tasks are defined to be units of work that are aggregated into activities and processes. Information developed through process modeling and analysis can yield insight into whether two activities are sufficiently unrelated to be "collateral."

Activities are considered related if any one of the conditions listed below is true:

- **The two activities share a common input.** For example, the processes of burning coal to produce steam heat and burning coal to generate electricity would be considered related because they share the common input of coal. The processes of making paper and producing plywood could likewise be considered related because they share the common input of raw timber.

- **The two activities share a common process task**. As defined in this analysis, activities can be subdivided into a sequence of work steps called ***tasks***. Tasks need not be uniquely identified with one activity. They can be shared. For example, the process of billing customers and the process of communicating with shareholders could share the common task of sealing envelopes and applying postage within the mailroom. In this scenario, the two processes are related.

- **The two activities share a common resource.** Resources are consumed as a process converts inputs into process outputs but resources are seldom uniquely identified with one activity. They can be shared. The co-location of two processes is often an indicator that resources may be shared. The resource of floorspace (a facility) may be shared. Supervision and management may be shared. Technology infrastructure may be shared. For example, if one accountant supervises both the process of preparing check for vendors and the process of preparing customer statements then the two processes are related due to the shared resource.

- **The two processes share a common customer.** Two activities may appear totally different. They may employ different process inputs, have different process tasks and

consume different resource. Yet, if they deliver process outputs to a common customer, they are related. For example, the process of selling automobiles and the process of selling groceries are related because they share a common customer, the retail consumer.

Being related, however, is not synonymous with being "not collateral." Processes can have secondary relationships and still be collateral. For example, processes sharing support activities can be related but nonetheless still be collateral.

It is thus necessary to apply the above model to the provision of water service by Easton Water and the provision of housing code inspection services by the City of Easton. A useful discipline when building process-based models is to characterize each organizational process using a verb/noun combination; the verb describes the process of conversion and the noun identifies the process output. An extension of this technique is to append the process inputs onto the verb/noun phrase using the word *from* and to include output quality attributes as adjectives.

Water utility: Using this syntax, the water utility process becomes: *provide fresh water from ground water. Fresh water* is the process output. The adjective *fresh* is a quality attribute of the output *water* that indicates the water is suitable for human consumption. The phrase *from ground water* denotes a generic source of un-processed, un-purified water.

The process itself is encapsulated in the verb *provide.* The process of *providing water* includes all of the tasks necessary to find water, purify water, store water and transport water to the end customer. Note that the utility's process of *providing water* begins at a well (generically speaking) and ends at the curb stop valve of a customer. At the curb stop interface the customer takes delivery of the *fresh water* and distributes it throughout the property-using infrastructure of the property.

In general, the customer of the utility's "*provide water"* process is the property owner. If the owner is the resident of the property then he or she is also the end consumer of the *fresh water.* If the property owner rents the property to tenants, he or she has a stand-alone *provide water* process that takes delivery of *fresh water* from the municipal utility at the curb stop and delivers it to the tenant at the tap.

Code inspection: Using the verb/noun syntax, the housing code enforcement process is stated *make housing code compliance determination from inspection observations.* The analysis of this process is more difficult since the inputs and outputs, while captured in tangible form, are themselves intangible

Clearly, a determination of housing code compliance is the output of this process. This determination is a decision, a chunk of information. A "certificate of occupancy" or an "inspection seal" is the tangible product, but these pieces of paper both simply document the underlying determination of compliance.

The inputs into the process are also intangible chunks of information, *inspection observations.* The inputs are all of the things a housing code inspector looks for and finds (or doesn't find) as an inspection is conducted. An inspection report or checklist is the tangible form of these inputs.

The process itself is defined in the verb *make.* The *housing code compliance determination* is a decision and one *makes* a decision. In this case, the housing code inspector makes a decision as to whether a property complies with the housing code.

Note that *compliance* with the housing code is NOT an output of this process. *Compliance* is an outcome supported by the process of *make compliance determination*, but there is no direct link between making a compliance determination and achieving compliance.

The realization that code compliance is an outcome, not a process output is related to the identification of the customer of this process. Although the property owner takes delivery of the piece of paper documenting code compliance (or not), different parties take delivery of the *compliance determination.* In this case, the customer is best determined by looking at what triggered the *make determination* process. For example, if a transfer of property triggered the process, then the pending mortgage holder is likely the primary customer of the *compliance determination.* They have an interest in assuring that the property they are financing is in good shape. If construction or remodeling triggered the *determination,* the municipality is likely the customer, fulfilling its role of assuring safe and healthy housing.

Based on this analysis, I conclude the following:

- The two processes do not share a common input. The input of the "*provide water* process" is raw water, a tangible commodity. The input of the *make compliance determination* process is inspection observations, an intangible collection of information.

- There are no common tasks shared between the two processes. The key to this analysis is that the *make compliance determination* process effectively takes place within the mind of one individual. Making a decision is totally different from providing water.

- The two processes do not share resources. The training and experience needed by individuals participating in the *provide water* process is different from the training and experience needed by housing code inspectors who *make compliance determinations.* The technology and infrastructure needed to *provide water* is different from that needed to *make compliance determinations.* (The two processes do share common *support* processes --called *secondary activities* in process-model terms. For example, since both are municipal processes, it is likely that both are supported by a common accounting department, a common human resources department, a common legal department, even common general management. These secondary activities are insufficient to destroy the collateral nature of the relationship between the water and code inspection processes for purposes of our analysis here.)

- Clearly, the customer of the *provide water* process is the property owner who takes delivery of *fresh water* at the property curb stop. It is less clear who is the customer of the *make compliance determination* process. It depends on who or what event triggered that specific iteration of the process. In the case at bar, the City of Easton is the customer of the *make compliance determination* process. The City is making a

decision as to whether to allow a household to reoccupy a house (or not) based on the *compliance determination.* Despite the fact that the event of water disconnection is the inspection-triggering-event (such as property transfer or construction), it is clear that neither the property owner nor the water utility is the customer of the *make compliance determination* process in this case. Therefore, the two processes (provide water, make compliance determination) do not share a common customer.

This conclusion (that code inspections and the provision of water service are collateral to each other) is corroborated by a utility model of service as well. I developed for the Massachusetts attorney general's office a model for determining what represents the "service" provided by a public utility. There is no question but that the service of Easton Water extends beyond the mere provision of gallons (or ccf) of water. Just as a manufacturer might provided warranties as part of its service, or as an appliance/computer retailer might provide on-site installation or set-up assistance, the service of a water utility extends beyond the commodity being supplied. Easton Water, for example, provides billing and collection service; it provides inquiry service; it provides credit approval service.

Within this utility model, three tests can be applied to determine whether the activity of a public utility is a "utility" service by that company: (1) the inextricable relationship test; (2) the "product acquisition cycle" test; and (3) the revenue requirement test.

- The revenue requirement test is readily satisfied. The "revenue requirement" of a public utility involves all the operating expenses of the utility which the rates paid by consumers are intended to cover. If Easton Water were a regulated utility, we would speak of "jurisdictional revenue requirement." Since I refer to Easton Water as an unregulated company, however, I simply refer to revenue requirement as those costs that are paid through Water Department rates. Water Department revenue is not used to pay for code inspection and enforcement. Since it is an extra-departmental activity, code inspection and enforcement is not a utility service of the Easton Water Department.

- The inextricable relationship test is equally readily satisfied. This test is applied using a "but for" approach. This test asks whether the code inspection and enforcement would disappear "but for" the provision of water service. The answer is clearly "no." Most water customers have no connection with, or need for, code inspection and/or enforcement. Conversely, most code inspection and/or enforcement activities have no connection with the provision of water service. There is clearly no "but for" connection between the provision of code inspection services and the provision of water utility service.

- The product acquisition cycle test is readily satisfied as well. The product acquisition cycle test encompasses the entire process of providing water service to residential customers from beginning to end. The product acquisition cycle begins with an application for service, continues through the provision of the commodity or good (in this case, water), and ends with a final billed account (either voluntarily or

involuntarily). If an activity is part of this product acquisition cycle, it is part of the utility service being rendered by the water company. I have compared the provision of housing code inspections to the product acquisition cycle. Since housing code inspection and enforcement activities are not part of the product acquisition cycle, they are not a service of the Easton Water Department.

Based on the above discussion, I conclude that the provision of code inspection and enforcement service by the City of Easton is a matter that is collateral to the provision of water service by Easton Water. By extension, providing the housing inspection cannot be a prerequisite to the reconnection of service after a disconnection of water service for nonpayment.

Other matters found to be "collateral" to the provision of utility service, and held to be an inappropriate precondition of service, have included matters with much tighter connections to the provision of utility service than code inspection and enforcement.

Eviction and Nonpayment of Water Bills

When an Easton Water customer has his or her water service disconnected for nonpayment, the City simultaneously placards the house as uninhabitable and requires the occupants to vacate the home. The City argues that the decision to declare a house uninhabitable is simply the necessary consequence of the customer having water service terminated. Under the municipal building code, City officials argue, a home lacking water/sewer service is deemed, by that fact, to be uninhabitable. Easton has adopted the local building code developed by the association of Building Officials and Code Administrators (BOCA).

Evicting a customer from her home is not a necessary consequence of the disconnection of water service. It is instead a policy choice to leverage the control over the monopoly supply of water (as an essential public service) to coerce payments from customers.

Before providing a more detailed analysis, I note several aspects of the eviction and bill payment process that make the process and result unreasonable:

- First, a customer does not have the right to apportion payments to pay the service that would prevent the eviction. No one argues that being without trash collection service makes a house uninhabitable. Yet a customer is not provided the right to designate his or her payment for water service, thus paying the water bill and maintaining the habitability of the home.

- Second, the order in which payments are posted to a customer's account (with trash collection bills paid first) is contrary to established utility principles. When a utility service is billed in tandem with a non-utility service, payments are to be credited against outstanding utility bills first. To have any other rule creates a transparent mechanism to avoid the rule that utility service may not be disconnected or denied for a matter collateral to the provision of utility service.

Evictions are not a necessary part of the disconnection of utility service to a home. Other municipalities do not automatically and immediately placard a home as uninhabitable upon the disconnection of water service. This is true for both municipal governments where water is provided through a municipal utility and for municipal governments where water is provided through a private investor-owned utility. I have had no experience in my 20 years of work in public utility regulation in which the disconnection of water service leads to the municipal government automatically and immediately placarding a home as uninhabitable.

Declaring a house uninhabitable as a result of the loss of water service does not necessarily flow form the observation that water is an essential public good either. Other public utilities also provide essential public goods. Natural gas and electricity, like water, are essential to the health and safety of a household. The termination of service by natural gas or electric utilities does not result in local governments, including Easton, automatically and immediately placarding a home as uninhabitable.

Nor does every loss of water service result in a home being automatically and immediately declared to be uninhabitable. Water utility tariffs universally reserve the right to temporarily disconnect service for maintenance work. In addition, customers, themselves, have the right to voluntarily disconnect service, without having their homes automatically and immediately being declared uninhabitable. Water service is often disconnected upon a transfer of rental occupancy without having the home declared uninhabitable during the vacancy.

Finally, the practice within the utility industry is to distinguish between a home that is without utility service and a home to which utility service has been temporarily interrupted due to nonpayment. A customer whose service has been disconnected for nonpayment does not lose his or her customer status for periods of time ranging up to 90 to 180 days. In these situations, the home is still considered to be connected to the utility system, with access to utility service maintained, but the contractual and legal obligation of the utility to continue to supply the service having been temporarily suspended due to nonpayment. Once the time period has expired, the contractual obligation to supply the customer also expires and the housing unit is considered to be without service. This principle of utility supply has multiple ramifications in the utility industry. Its application to Easton's uninhabitability declaration is but one. In short, however, a house is not without water service (or other utility service) immediately upon suspension or discontinuance of supply due to nonpayment. Only after a period of time (in Pennsylvania going up to six months) expires does the service to a continuing resident expire and the house become "without" utility service.

In this respect, a distinction needs to be made between several things:

- There is a distinction between the physical access to water supply (as evidenced by the physical facilities that are the connection to the water system) and the economic seller-buyer relationship (as evidenced by the contract calling for the city to supply the water commodity). A temporary suspension of the contractual obligation to supply the commodity does not mean the house does not have the physical access to the municipal water system.

- There is a distinction between the loss of water service to a home and a temporary interruption in the supply of the commodity. A temporary interruption in the supply of the commodity, which can occur for any number of reasons, does not make a home uninhabitable.

It must be kept in mind, also, that the termination of service for nonpayment is a voluntary or discretionary action on the part of Easton Water as a public utility. It is well-established that while utilities may be *authorized* to disconnect service for nonpayment, nothing and no one *requires* a utility to disconnect service for nonpayment. If, therefore, a utility such as Easton Water chooses to disconnect service (and render a home uninhabitable), it is, by its choice, commandeering the right of the occupant to occupy the home as part of the bill collection process. Setting aside legal issues of the need for a pretermination hearing in these circumstances, the occupant of the home has had taken from him or her the value of the occupancy right that has been confiscated by the collection process.

Finally, the nature of Easton Water's water bills renders the practice of declaring a house automatically and immediately uninhabitable fundamentally unfair. Even assuming, solely for the sake of analysis, that the disconnection of water service renders a house uninhabitable, the nonpayment of property taxes (and any ensuing tax collection activity) does not. No part of the tax collection process allows the City of Easton to use an immediate, summary, procedure to evict homeowners for nonpayment of local property taxes. The water bills of Easton Water, however, have been structured to include a substantial contribution to the City's general fund. In addition, sewer rates are simply set at 200% of water rates.

Allowing Easton to automatically and immediately declare a home uninhabitable due to the disconnection of service for nonpayment of water and sewer bills thus allows Easton to do indirectly what it cannot do directly (summarily evict for nonpayment of general tax revenues). The process adopted by Easton is a backdoor effort to achieve a tax collection tool that is otherwise prohibited to it.

LATE FEES AND INTEREST CHARGES

Easton Water imposes both an interest rate and a penalty charge on unpaid water, sewer and trash bills. According to Easton Water officials, for bills rendered on or after April 2000, the penalty charge is applied 30 days after a bill is rendered. In addition, every thirty days a bill continues to be unpaid, Easton Water imposes an interest charge on the unpaid usage. Interest is not compounded. In no month does Easton Water impose *both* the penalty and the interest on the same unpaid usage charges.

I reach the following conclusions with respect to the combined penalty and interest charges:

- The penalty and interest charges are unrelated to, and substantially exceed, the costs imposed upon the system by unpaid bills;

- The penalty and interest charges result in a composite interest rate that reached 19% for post-April 2000 bills and reached 27% for pre-April 2000 bills;

- The interest charge is unrelated to, and substantially exceeds, the costs imposed upon the system by unpaid bills.

The Penalty and Interest Charges Relative to Costs

The primary purpose of a utility late payment charge is to compensate the utility for expenses associated with delinquent payments. A customer's delinquent payment of her utility bill can result in two types of expenses to the company. The utility may first experience out-of-pocket collection expenses. A second expense involves the carrying charge associated with delinquent payments. A utility is entitled to compensation for each.

Late payments by utility customers can create out-of-pocket collection expenses for the utility. These expenses might include, for example, the postage associated with delivering reminder notices or shutoff notices, the costs of telephone calls to make "personal contact" prior to a shutoff, and the cost of fuel used in making a premise visit to disconnect service.

A late payment charge designed to compensate a utility for out-of-pocket collection expenses should be based on the decremental cost of collection to the utility. In this fashion, the utility will be compensated for those costs, but only for those costs, that are incurred as a result of the late payment. A decremental cost is the cost that the utility would save should one late payment instead be made in a timely fashion. Use of a decremental cost analysis is necessary to prevent a double compensation to the utility. Without a decremental cost analysis, Easton Water would collect its costs first through its base rates and then again through the penalty and/or late payment charge.

In this case, since Easton Water uses existing staff for collection, the late payment imposes no decremental cost to the Department. Paying the staff salary in this instance is not caused by the need to engage in collection activity. As a result, the late payment charge should include only the truly decremental expenses: items such as postage, envelopes and the like.

Easton Water overcharges its late payment charges, also, by imposing such charges prematurely. Given the fact that late payment charges are intended only to compensate for out-of-pocket expenses, the imposition of such a charge must be triggered by some event that also triggers the incurrence of the expenses. Easton Water has set a past due date of the 30th day after a bill is rendered, with a penalty and interest charge levied for all unpaid amounts outstanding after that date. With Easton Water, however, no collection activity begins at the time the bill first becomes overdue. Customers making payments during that interim period (between the time a bill becomes past due and the time collection activities begin) are paying compensation for collection expenses that were never incurred.

This realization --that payments must be overdue by some time before the utility begins its collection process and thus before the utility begins to incur expenses --is particularly important to ensure that households who pay late, but who do not have collection activities directed against

them, are not discriminated against. Discrimination would exist if a customer were charged for a cost that she did not cause the utility to incur. Discrimination would exist if a late payment fee were imposed on the day after the due date, failing to recognize that collection activity is not initiated until some later date.

In addition to timing, Easton Water effectively has a minimum arrears below which it will not begin any collection activity. Easton Water officials have referred to the fact that the Department begins its collection process with the largest bills first. The smaller bills are not made subject to collection interventions. In such an instance, charging the penalty and interest charges immediately after the bill payment due date charges the customer for expenses the Water Department has not yet incurred.

Finally, charging an interest rate sufficient to compensate the City for collection charges when collection activities have been suspended charges customers for costs that were not incurred. One example of where the Water Department does precisely this is when Easton Water charges an interest on deferred payment plans on which payments are current. No collection activities are directed against customers with current payments on deferred payment plans. No collection expenses have thus been incurred to be offset by the interest charge.

The Interest Charge Relative to Costs

A second cost component that a utility is entitled to collect through its late payment fee is the carrying cost of money. There will be a carrying cost irrespective of whether the City has to borrow money as a result of the unpaid bills. If the City borrows money, the interest charge will be necessary to generate dollars to pay the interest expense. Even if there is no borrowing, the failure to pay will generate an opportunity cost for the City. If the City *had* collected the money and not needed to use it immediately to pay expenses, it would have invested that money and received a return on it. The nonpayment thus generates a foregone return.

There are several items that are *not* appropriate to place into an interest rate charged on unpaid bills, however. Administrative overhead costs do not go into the late payment charge. These costs are not caused by the late payment; in addition, they have already been collected through base rates. The late payment charge is not to be a profit center or revenue-raising measure. Like other municipal administrative fees, it is to compensate the City for actual costs and not to be a de facto tax.

In this respect, a comparison of the interest rate to consumer credit interest rates is inappropriate. It is important to recognize that a late payment fee is ***not*** the equivalent of interest charged in consumer credit transactions. A consumer credit interest rate has cost components that may not be included in a late payment interest rate. Overhead and depreciation costs, for example, would be included in a commercial interest rate. Those Easton Water costs, on the other hand, are already included in base rates. While an interest rate for consumer credit transactions will include a component for uncollectibles, to the extent that Easton Water has uncollectibles, those expenses are already included in the bill subject to collection.

The maximum carrying cost of money for a municipal utility will be the short-term borrowing rate incurred by the city. The City of Easton has not incurred long-term debt to cover unpaid bills by municipal water customers. A long-term interest rate would thus be an inappropriate measure for an interest charge.

The cost of short-term borrowing for Easton has ranged from 2.16% to 2.57% in 2002. This figure represents the interest rate charged on short-term Treasury bills as reported in the Federal Reserve Board's H15 report. The addition of 250 basis points would provide adequate compensation for out-of-pocket credit and collection expenses. Easton Water interest charges above 5% are thus excessive under these circumstances.

The Penalty and Interest Charge Relative to Statutorily-Prescribed Maximum Rates

I have computed the effective rates of interest by Easton Water given two different scenarios:

- An 18% interest rate (pre-April 2000 practice); and
- A 10% interest rate (post-April 2000 practice).

I have assumed that the only change between pre-April 2000 and post-April 2000 practice was a scaling down of the interest rate to 10%. I have assumed, in other words, that there was not change in the *structure* or application of the interest and penalty charges. If there was a change in the structure or application of interest and penalties, my conclusions may be different.

Application of the post-April 2000 interest and penalties yields an effective annual interest rate of 19.2%. Application of the pre-April 2000 interest and penalties yields an effective annual interest rate of 26.5%. Whether these effective interest rates violate the statutory maximum is a legal conclusion on which I offer no opinion.

UNFAIR AND DECEPTIVE ACTS AND PRACTICES (UDAP) IN COLLECTIONS

The discussion above has focused on the utility aspects of the collection activities in which Easton Water has engaged. Not all of my conclusions as to the unreasonableness of Easton Water actions, however, are based exclusively on this utility-related analysis. Collection actions can be unfair and/or deceptive irrespective of whether the entity undertaking the actions happens to be a public utility generally (or a municipal water utility in particular).

Having said that, however, a utility analysis is not entirely unrelated to a UDAP analysis. I conclude that actions found to be unfair and/or deceptive under a UDAP analysis cannot be "just and reasonable" under a utility's obligation to serve. Actions found to be UDAP violations are, ipso facto, also violations of the utility obligation to provide just and reasonable rates and services.

For the case at bar, my inquiry considers that under state Unfair and Deceptive Acts and Practices (UDAP) statutes, a creditor is restricted on the types of collection activities the creditor may undertake. A creditor's misrepresentation of the imminence of threatened credit and collection actions constitutes a UDAP violation. A creditor, for example, may not misrepresent the urgency and importance of collection correspondence. Nor can the creditor misrepresent the imminence or probability of particular collection action. For example, debt collectors may not threaten that nonpayment "will" result in legal action unless suit is filed in all cases, and may not threaten that nonpayment "may" result in litigation unless suit is the ordinary response to nonpayment. Finally, a creditor may not threaten that if payment is not made immediately or within a specified number of days, specified action will be initiated, if the determination to take that action at that time has not been made.

Consider the implications for a utility such as Easton Water. Easton Water may not automatically issue disconnect notices during the holiday season if it does not disconnect during the holiday season. It may not issue a disconnect notice to a household owing $100 if it does not disconnect for arrears less than $300. It may not issue a disconnect notice to someone 30-days in arrears if it does not disconnect until a customer is 60-days behind. Moreover, Easton Water may not issue a disconnect notice saying a customer's service will be disconnected if payment is not received in ten days if the determination to take that collection action at that time has not been made when the notice was issued. Easton Water may not issue a notice that disconnection "may" occur within ten days unless disconnection generally occurs if payment is not made within that designated time.

Statements and actions by Easton Water may be deceptive in other respects as well. More specifically, I find that the actions identified below involved Easton Water making false representations of fact upon which Plaintiffs relied to their detriment. I find further that Easton Water knew of the falsity of the statements when made. I find finally that, whether or not Easton Water knew of the false nature of the representations, Easton Water statements had the tendency to mislead a substantial number of the customers to which the statements were made.

Actions undertaken by Easton Water that I find to be unfair and/or deceptive include:

- The repeated issuance of disconnect notices with no follow-up on the threatened collection activity;

- The issuance of disconnect notices with a date certain when no disconnect had been scheduled at the time the notice was issued (and when disconnects did not typically follow);

- Issuance of disconnect notices to customers with balances less than that balance which Easton Water knew at the time of the issuance of the notice were not sufficiently large to trigger the disconnection of service;

- Issuance of disconnect notices to a number of customers that Easton Water knew, at the time it issued the notices, was so large that it would be physically impossible to implement all of the noticed service disconnections.

- Issuance of a disconnect notice falsely stating that the entire bill must be paid to avoid a disconnect, knowing that a partial payment reducing the balance to less than that balance which triggered disconnect activity would also avoid the disconnection of service;

- Charging a fee for the reinstitution of trash collection service when trash collection service had never been halted;

- Charging a fee to compensate the city for the costs of halting and reinstituting trash collection service when no costs had been incurred;

- Charging a fee to compensate the city for the costs of disconnecting and reinstituting sewer service when no costs had been incurred;

- Charging late fees on payments made in-person on or before the stated due date for bill payment, but which payments were dated "received" and posted on a date subsequent to the due date;

- Charging late fees on payments by mail that were mailed with a U.S. Postal Service postmark on or before the stated due date for bill payment, but which payments were dated "received" and/or posted on a date subsequent to the due date;

- Telling delinquent customers that nonpayment of bills would result in a notice being sent to state social service staff that children were living in an uninhabitable home, with the stated prospect that such notification would result in a subsequent removal of the children from the home, when service disconnections were not yet scheduled, were not likely to be scheduled, and such notices to social service staff were not typically generated if and when the terminations were scheduled.

- Stating that medical emergency exemptions could be obtained for service terminations when no written process existed to obtain such an exemption, no written standards existed governing when and/or whether such an exemption could be obtained, and such exemptions were rarely granted.

NON-DISCRIMINATORY TREATMENT OF WATER CUSTOMERS

One of the established rules in public utility regulation is that rates and services are to be offered on a nondiscriminatory basis. Most states have codified a prohibition against unjust or unreasonable discrimination in the rendition of utility service. Those jurisdictions that do not have statutes setting forth-such a proscription have judicially incorporated the prohibition. Not

all discrimination is banned, however. Rather, only unreasonable differences and undue preferences fall afoul of the limitation.

While the claim of "discrimination" has often been confined to "rates"—it is defined as "cost-based" in this context, the same principles that are used to evaluate claims of discrimination in ratemaking are used to evaluate claims of service discrimination as well.

The features which at common law distinguished those engaged in public or common callings (the original public utility companies) from those who were not so engaged, were the peculiar general duties laid upon the persons engaged in common callings to serve all applicants for their services, and to perform such services with care without a special assumpsit to that effect. To these primary duties there are certain corollaries, namely, that the service must be reasonably adequate and rendered upon reasonable terms, and that it must be impartial.

The genesis of the proscription on discrimination lies in the utility's common law duty to serve. The common law predicated the obligation to provide non-discriminatory rates and services on three grounds. First the monopolistic character of the services was considered important. Whether it was a ferrier, common carrier, or an innkeeper, the common law recognized that consumers had no choice among vendors and that a law was needed to stand between the provider of services and the abuse that unfettered monopoly power might portend.

Second, the common law included an implicit agreement in a general assumpsit in the holding out to serve the general public. This holding out was the factor that created a quasi-contract with the public to serve all who came on just and reasonable terms and on equal terms.

Third, the acceptance of public benefits required recipients to serve all who came on equal terms. While the acceptance did not by its terms mandate such activity by the recipient, it necessarily implied it. According to the reasoning, government largess would not be provided to an institution that unreasonably excluded some part of the populace. A company of this kind is invested with important prerogative franchises among which are the rights to build and use an infrastructure using public streets, alleys and public ways, and to charge government-prescribed rates. These prerogatives are grants from the government, and the public utility status is the consideration for them.

For a rate or service to be discriminatory, it must have two essential elements:

- a benefit or preference to a discrete class of customers generating a harm to or burden upon a different class arising as a direct result, or a burden or duty uniquely imposed upon a particular class; and

- a lack of any utility-related basis for making the distinction at issue.

Several subsidiary principles regarding utility-related bases for distinctions flow from this general concept. First, non-utility characteristics are irrelevant. Characteristics that are not rationally related to the service itself will not support distinctions. Second the over-inclusive and

under-inclusive characteristics of proposals lead to disapproval. Classification of customers must necessarily be accomplished by reference to general characteristics having some rational nexus with the criteria used for determining just and reasonable, and nondiscriminatory, rates and services.

Given this discussion, and based on the narrative in the preceding sections, I find that the following rate and service discrimination issues are extent with Easton Water Company:

- Those water customers who are charged a $100 reconnect fee for water service and those customers who are not. There is no cost-basis for the distinction between these two classes of customers;

- Those water customers who are charged a reconnect fee for trash collection and those customers who are not. There is no utility-related distinction between these two classes of customers. In addition, there is no cost-basis for the distinction between these two classes of customers.

- Those water customers who are charged a reconnect fee for sewer service and those customers who are not. There is no utility-related distinction between these two classes of customers. In addition, there is no cost-basis for the distinction between these two classes of customers.

- Those water customers who are charged a cash security deposit equal to one-year of water bills as a pre-condition of continuing water service and those who are not. There is no cost-basis for the distinction between these two classes of customers.

- Those water customers who are charged a cash security deposit equal to one-year of sewer bills as a pre-condition of continuing water service and those who are not. There is no utility-related distinction between these two classes of customers. In addition, there is no cost-basis for the distinction between these two classes of customers.

- Those water customers who are charged a cash security deposit equal to one-year of trash collection bills as a pre-condition of continuing water service and those who are not. There is no utility-related distinction between these two classes of customers. In addition, there is no cost-basis for the distinction between these two classes of customers.

- Those water customers who have their water service denied (or disconnected) for a failure to pay trash collection bills and those who do not. There is no utility-related distinction between these two classes of customers.

- Those water customers who have their water service denied (or disconnected) pending a housing code inspection and those who do not. There is no utility-related distinction between these two classes of customers.