

**CREDIT AND COLLECTION FEES**

**AND**

**LOW-INCOME HOUSEHOLDS:**

**Ensuring Effectiveness and Cost-Effectiveness**

**PREPARED FOR:**

Missouri Office of Public Counsel  
Jefferson City, Missouri

**PREPARED BY:**

Roger D. Colton  
Fisher, Sheehan and Colton  
Public Finance and General Economics  
34 Warwick Road  
Belmont, MA 02178

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It is popular today for a utility to introduce particularly onerous credit and collection charges as a means to "encourage" households to pay on time. The theory is that given the size of the credit and collection charges, a household will make every effort to pay in an effort to avoid those charges.

The purpose of the discussion below is to examine whether the imposition of certain credit and collection charges on residential customers can *a priori* be assumed to serve the purpose of accelerating timely payments. The discussion is presented in four parts. *Part 1* examines why customers do not pay. This Part concludes that the population of nonpaying customers is not monolithic and the assumption that additional charges will address all reasons why customers do not make timely payments is unreasonable. *Part 2* examines the impact of imposing additional charges on customers who do not pay because they have insufficient funds to pay. *Part 3* proposes a specific means of testing whether the imposition of credit and collection charges accelerate payment and proposes a sunset provision for the charges absent a clear showing that the fees are effective in obtaining such accelerated payments. Finally, *Part 4* produces figures on low-income utility customers in Missouri and Kansas City, and suggests that additional credit and collection charges will not be effective in addressing their inability to make full and timely payments.

## **UNDERSTANDING WHY CUSTOMERS DON'T PAY**

Unfortunately, most utilities who propose credit and collection charges on the reasoning that such charges accelerate payments have no idea of *why* their customers do not pay on time with which to begin. As a result, these companies have no basis upon which to conclude that the imposition of additional charges will be either effective or cost-effective from a credit and collection perspective.

There is some literature which exists, however, that would indicate that there are a variety of reasons why customers do not pay on time, only a small portion of which reasons would be addressed by increased credit and collection charges.

### ***The Pennsylvania Report***

A late 1985 Pennsylvania State University (Penn State) study looking at payment-troubled households in Pennsylvania<sup>1)</sup> debunked the myth that nonpaying households are characterized 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)

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<sup>1)</sup>Hyman, et al., "Optimizing the Public and Private Effects of Utility Service Terminations," *Public Utilities Fortnightly*, at 29 (December 29, 1985).

customer sample."<sup>2\</sup> 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.

Ultimately, the study concluded: "thus, with regard to their socio-economic and demographic characteristics, the groups that encounter payment problems have higher proportions of the type of customers intended for protection by public policy."<sup>3\</sup> The data reported in the study are laid out in Table A.

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. 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).<sup>4\</sup> 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."<sup>5\</sup> Moreover, 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 Table B.

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<sup>2\</sup>The statewide study examined representative samples of four groups of households involving over 1,800 interviews. The four groups included: (1) general residential utility customers; (2) customers who received a termination notice; (3) households whose service was actually terminated; and (4) households who sought to have a proposed termination mediated by the Public Utility Commission Bureau of Consumer Services. *Id.*, at 30, n. 1.

<sup>3\</sup>*Id.*, at 30.

<sup>4\</sup>*Id.*, at 32, Table 2.

<sup>5\</sup>*Id.*, at 32.

**TABLE A**  
**COMPARISON OF FOUR SURVEY GROUPS**  
**ON SELECTED SOCIOECONOMIC**  
**AND DEMOGRAPHIC CHARACTERISTICS**

| <b>Characteristic</b>                         | <b>General</b> | <b>Notice</b> | <b>Termination</b> | <b>PUC-BCS</b> |
|---|----------------|---------------|--------------------|----------------|
| <b>Female heads of household</b>              | 22%            | 23%           | 31%                | 43%            |
| <b>Aged heads of household</b>                | 24%            | 5%            | 8%                 | 5%             |
| <b>Unmarried heads of household</b>           | 24%            | 24%           | 31%                | 43%            |
| <b>Median per capita income</b>               | \$6,403        | \$4,500       | \$4,035            | \$2,282        |
| <b>Home ownership</b>                         | 83%            | 71%           | 67%                | 57%            |
| <b>Unemployment during study year</b>         | 17%            | 29%           | 32%                | 66%            |
| <b>Major source of income is welfare</b>      | 2%             | 3%            | 8%                 | 17%            |
| <b>Disabled members in household</b>          | 21%            | 20%           | 23%                | 37%            |
| <b>Average family size</b>                    | 3.0            | 3.9           | 3.9                | 4.2            |
| <b>Education -- lacks high school diploma</b> | 21%            | 18%           | 31%                | 26%            |
| <b>N=</b>                                     | 559            | 532           | 265                | 271            |

**TABLE B**  
**COMPARISON OF THREE STUDY GROUPS ON CIRCUMSTANCES**  
**SURROUNDING THE OVERDUE BILL**

| <b>Unusual Condition for Overdue Bill</b>     | <b>NOTICE</b> | <b>TERMINATED</b> |
|---|---------------|-------------------|
| <b>No income. No money</b>                    | 18%           | 18%               |
| <b>Illness. Medical</b>                       | 15%           | 19%               |
| <b>Extra high utility or other large bill</b> | 22%           | 18%               |
| <b>Laid off. Less work</b>                    | 21%           | 21%               |
| <b>Other</b>                                  | 14%           | 16%               |
| <b>No unusual condition</b>                   | 10%           | 8%                |

Finally, the Penn State study found that payment-troubled customers "made changes in their spending or lifestyle (or both) to deal with inflation and the high cost of energy." In general, the study found that "payment-troubled groups report cutting back more on essentials such as food, clothing and medical care than the general sample, and they also cut back more in other areas such as recreation, vacations, and gasoline for automobiles."<sup>6</sup> Indeed, the Penn State study reported that:

the payment-troubled groups, which may be living near or below the margin of adequacy for necessities, exhibit greater propensity to cut these items than the average residential consumer. Furthermore, the more serious the degree of utility payment problems, the higher the rate of reported cutbacks.<sup>7</sup>

In sum, the Penn State study concluded that looking at the "microdynamics of behavior and needs of the different utility consumers" suggests that "a uniform response to nonpayment may be inappropriate from both company economic and broader social perspectives. In fact, a monolithic response may be suboptimal from the point of view of utility company profit maximization."<sup>8</sup>

### ***The Wisconsin Report***

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."<sup>9</sup> The Wisconsin research broke the study population into five basic groups:<sup>10</sup>

Group 1. The poor and the helpless who blame themselves for their status (19%).

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<sup>6</sup>*Id.*, at 32.

<sup>7</sup>*Id.*, at 32.

<sup>8</sup>*Id.*, at 34. The utility's profit is implicated because, by not automatically seeking to disconnect households who do not pay, "utility companies continued to receive payments, many of which might otherwise have been written off as bad debts had the customers' service been terminated." *Id.*, at 34.

<sup>9</sup>Michael Kiefer & Ronald Grosse, "Why Utility Customers Don't Pay Their Bills," *Public Utilities Fortnightly*, at 41 (June 21, 1984).

<sup>10</sup>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, 200 door-to-door interviews were completed. The questionnaire took thirty to forty-five minutes to complete and did not identify the utility as the sponsor of the survey.

- 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%).
- Group 5. People who can pay their bills but do not (12%).<sup>11\</sup>

The Wisconsin study found that roughly half (47%) of all customers who had a history of bill payment problems "did not have enough money to pay their bills."<sup>12\</sup>

Wisconsin Public Service described Group 1 (poor who blame selves) as being "very poor. They seem to be standing still economically."<sup>13\</sup> 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."<sup>14\</sup> Looking at their income versus family size and expenses, the utility concluded, "it appears they really do not have enough to live on."<sup>15\</sup>

These households tend to be "primarily young women." One-third (32%) are high school dropouts and one-half (47%) have spouses who are high school dropouts.<sup>16\</sup> Eight of ten (79%) have annual income less than \$10,000 and nine of ten (90%) have annual income less than \$15,000.<sup>17\</sup>

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."<sup>18\</sup> 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."<sup>19\</sup>

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<sup>11\</sup>*Id.*, at 42.

<sup>12\</sup>*Id.*

<sup>13\</sup>*Id.*

<sup>14\</sup>*Id.*

<sup>15\</sup>*Id.*

<sup>16\</sup>In contrast, the general dropout rate for Green Bay was 15 percent.

<sup>17\</sup>The mean income for Brown County, in which Green Bay is located, is \$24,000.

<sup>18\</sup>*Id.*

<sup>19\</sup>*Id.*, at 43.

This group, too, is primarily young and female. While half the Group 2 households have an employed person, only one-quarter (28%) have a full time employed person; none have two people working full time. Sixty-five percent of the Group 2 households are high school dropouts. More than nine of ten (94%) have incomes less than \$10,000.

Group 3 (poor in transition) was described by Wisconsin Public Service as being "somewhat of a mixture."<sup>20\</sup> 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."<sup>21\</sup>

Most Group 3 customers are women. They are better educated with only 17 percent being high school dropouts. They tend to be employed, with more than seven of ten (71%) having an employed person and nearly four of ten (38%) having at least one full time employed person. The income level is somewhat higher, with only 54 percent making less than \$10,000 and only 12 percent making less than \$5,000 per year.

Group 4 (poor money managers), Wisconsin Public Service concluded, "is the most diverse group in terms of demographics, attitudes, and life-styles."<sup>22\</sup> 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." While education is lower in this group (with 26 percent being high school dropouts), employment is higher, with 75 percent having someone employed and 18 percent having two members employed full time.

The income of Group 4 is higher than any other group except Group 5, the most affluent group. Only 30 percent of Group 4 makes less than \$10,000 per year. According to the utility, for the households in this group, "their income level and family composition is such that they should be able to pay their bills if they manage their income carefully. They appear to be in financial difficulty because they have not learned to budget properly."<sup>23\</sup>

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."<sup>24\</sup> The utility, according to the study, "is

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<sup>20\</sup> *Id.*, at 43.

<sup>21\</sup> *Id.*

<sup>22\</sup> *Id.*

<sup>23\</sup> *Id.*, at 43.

<sup>24\</sup> *Id.*

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."

This group is well-educated. Only 12 percent of the persons interviewed had less than a high school education. More than nine of ten (92%) have someone employed in these households and 20 percent have two people employed full time. None of these households make less than \$10,000 per year and 72 percent make more than \$20,000 per year. According to the utility, "this group can pay their utility bill when they are threatened with a cutoff.\* \* \*They have discretionary money and generally do not care to worry too much about money."<sup>25\</sup> The utility concluded that this last group of households "appear to be savvy people who know how to make the system work for them."

In addition to looking at the 1984 article by Wisconsin Public Service Corporation, the detailed study which underlies the article provides much useful information.

"Overall," Wisconsin Public Service concluded in this study, "it appears that about half the sample is quite hopeless, but half can learn to pay their bills with a little coaxing and coaching."<sup>26\</sup> 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.

All households in Group 1 had been late in making a utility payment within the prior twelve months.<sup>27\</sup> Nearly half (45%) had been late four or more times. The late payments, according to Wisconsin Public Service, were not surprising. Four of ten of those households had an average

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<sup>25\</sup>*Id.*, at 44.

<sup>26\</sup>*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.*

<sup>27\</sup>*Id.*, at G-4.

monthly utility bill in excess of \$100.<sup>128\</sup> This is to be added to rent/home mortgage payments<sup>129\</sup> of \$200 - \$300 per month.<sup>130\</sup>

The combination of home payments and utility bills often makes housing unaffordable.<sup>131\</sup> As a result, 24 percent of these households had moved within the past year.<sup>132\</sup> An additional 26 percent plan to move in the next year. Wisconsin Public Service reported that "the main reason they are moving is because they can't afford to live where they do."<sup>133\</sup>

If this group had to choose which bills to pay first, they would pay the bills in the following order:

1. Pay the utility bill first ..... 79%
2. Pay the telephone bill second..... 74%
3. Pay the gas credit card third..... 68%
4. Pay the charge account last ..... 76%

The reason the utility bill is paid first is because it represents an essential service and is subject to disconnection for nonpayment.<sup>134\</sup>

Wisconsin Public Service ultimately concluded with regard to Group 1 that: "there is probably very little that can be done with these people. Most likely, they will continue to pile up unpaid bills and do the best they can."<sup>135\</sup>

All households in Group 2 had been late in making a utility payment within the prior twelve months.<sup>136\</sup> More than half (54%) had missed four or more payments and roughly four of ten (36%) had missed more than five payments. The utility bills for these households are somewhat

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<sup>128\</sup> *Id.*, at G-5.

<sup>129\</sup> 34% of these households own their homes; 66% rent.

<sup>130\</sup> 47% of these households pay \$200 - \$300 per month. An additional 16% pay more than \$300 per month.

<sup>131\</sup> Remember, 80 percent of these households have incomes of less than \$10,000 per year.

<sup>132\</sup> *Id.*, at G-4.

<sup>133\</sup> *Id.*

<sup>134\</sup> *Id.*, at G-7.

<sup>135\</sup> *Id.*, at G-7.

<sup>136\</sup> *Id.*, at G-13.

lower than Group 1, with only one-third (33%) having an average monthly bill in excess of \$100.<sup>137</sup> Again, this utility bill is to be added to rent or mortgage payments<sup>138</sup> of \$200 - \$300 per month.<sup>139</sup>

Like the households in Group 1, these payments tend to force households into a pattern of mobility. More than one-third of Group 2 households (36%) have lived in their current home for less than six months. In addition, more than four of ten (42%) plan to move in the next year, citing the unaffordability of their current housing as the reason for the move.<sup>140</sup>

If Group 2 households had to choose which bills to pay first, they would pay bills in the following order:

- 1. Pay the utility bill first ..... 77%
- 2. Pay the telephone bill second..... 71%
- 3. Pay the gas credit card third..... 74%
- 4. Pay the charge account last ..... 81%

As with Group 1, the reason the utility bill is paid first is because it represents an essential service and is subject to disconnection for nonpayment.<sup>141</sup>

Wisconsin Public Service ultimately concluded that the Group 2 households "offer() little opportunity for (the company) to work with."<sup>142</sup>

All households in Group 3 had been late paying a bill within the past 12 months. More than six of ten (62%) had been late over four times in the past year.<sup>143</sup> The utility bills for these households are somewhat higher. Exactly half have average monthly bills in excess of \$100.<sup>144</sup> Unlike

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<sup>137</sup> *Id.*, at G-13.

<sup>138</sup> Only 13% of Group 2 households own their own homes.

<sup>139</sup> 61% of Group 2 households make rental payments of \$200 - \$300 per month.

<sup>140</sup> *Id.*, at G-12.

<sup>141</sup> *Id.*, at G-15.

<sup>142</sup> *Id.*, at G-16.

<sup>143</sup> *Id.*, at G-21.

<sup>144</sup> *Id.*, at G-22.

Groups 1 and 2, Group 3 households tend to own their own homes (46%).<sup>\45\</sup> Nearly nine of ten (88%) pay \$100 - \$300 in house payments each month; roughly half (46%) pay \$200 - \$300 per month.

This group of households is quite stable. Nearly all (88%) have lived at the same address for more than one year.<sup>\46\</sup> While none has moved more than once in the past year, six in ten have moved more than once in the past five years.

If Group 3 households had to choose which bills to pay first, they would pay bills in the following order:<sup>\47\</sup>

- 1. Pay the utility bill first ..... 79%
- 2. Pay the telephone bill second..... 71%
- 3. Pay the gas credit card third..... 67%
- 4. Pay the charge account last ..... 71%

Several items need attention in this discussion of the households that Wisconsin Public Service found to be "quite hopeless." First, these households generally try very hard to cut household expenses. Group 1 households, for example, spend less than \$10 per month on recreation. Moreover, 66 percent spend less than \$50 a week on groceries (for an average family size of more than 4).<sup>\48\</sup> More than half (60%) own a car, but half of those own a car that is at least ten years old.<sup>\49\</sup> Similar findings were made for Group 2 and Group 3 households as well.<sup>\50\</sup>

Despite these cost-cutting measures, these households are forced into a mode of constant mobility. As a result, one expense they cannot avoid is the expense of moving: the actual cost of moving; connect fees for telephone and utilities; rental deposits; and the like. Stabilizing the living situation for these households would go a long way toward extending their budgets.

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<sup>\45\</sup>*Id.*, at G-21. "This may reflect that this is a more stable, settled group." *Id.*

<sup>\46\</sup>*Id.*, at G-21.

<sup>\47\</sup>*Id.*, at G-24.

<sup>\48\</sup>"Most" of these families have 3 or more people. 50% have 4 or more members and 40% have 5 or more people. Most have small children. *Id.*, at G-1. Note, however, that the date of the study is 1983.

<sup>\49\</sup>*Id.*, at G-1.

<sup>\50\</sup>See, *Id.*, at pp. G-11 (Group 2) and G-19 - G-20 (Group 3).

The bill paying priorities should be noted also. For each group, nearly eight of ten households said that, if a choice were forced between which bills to pay, they would pay their utility bill first. This is because, these households said, utility service is essential and is subject to disconnection. (Remember, too, these households did *not* know the survey was being sponsored by the local utility company.) These households went on to say that payment of credit card bills would come last. As a result, it should be clear that consumer credit reports involving bills other than utility bills should be rejected as a basis for making utility credit and collection decisions. For example, deposit demands should not be based upon nonpayment of a non-utility bill that households consistently ranked as "last" in their order of priorities.

The futility in deferred payment plans should be recognized. For Group 1 households, for example, while 88 percent of the households said that someone from the utility talked to them, made arrangements to let them pay what they could, and put them on a budget, nevertheless, nearly six in ten (56%) missed 2 - 3 payments and nearly half (45%) missed 4 or more payments.<sup>151</sup> Again, similar observations were made for Group 2 and Group 3 households.<sup>152</sup>

Finally, the futility (as well as the counterproductiveness) of utility late fees for these households should be noted. In all three groups, eight of ten households have already decided that the utility would be the first bill to be paid with the limited income available. To add a late fee, therefore, would be to add no incentive to pay and, indeed, would simply make the utility bills that much more unaffordable. Moreover, nonpayment, according to the utility, is due to the unaffordability of the bills, not to a lack of incentive. While eight of ten households in Group 1 had incomes less than \$10,000, for example, (and 94% of households in Group 2 had incomes of less than \$10,000), none of the households in the can-pay-but-don't group (Group 5) had incomes that low (with three-quarters [72%] making in excess of \$20,000).

### ***The Washington State Study***

A 1989 Washington Natural Gas study was based upon a survey undertaken for the Washington Utility Group.<sup>153</sup> 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\* \*

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<sup>151</sup>*Id.*, at G-4.

<sup>152</sup>*Id.*, at G-13 (Group 2) and G-21 - G-22 (Group 3).

<sup>153</sup>This group consists of Washington Natural Gas, Pacific Power and Light, Washington Water Power, Northwest Natural Gas, Cascade, and Puget Power.

\*?"<sup>54</sup> 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."<sup>55</sup> These include the new poor (22%), the survivors (9%) and the chronic poor (6%).

### **Summary**

These empirical reports are significant in several regards. For example, on the one hand, the Washington report identifies (as discussed above) payment-troubled households by reason of nonpayment. Based on the Washington report, however, it is possible to work "backwards" as well: to characterize households with certain characteristics as particular types of nonpayers. For example, if a household at 90 percent of poverty does not pay, it is possible to conclude from this report that this household is not likely a poor money manager (household incomes above poverty level),<sup>56</sup> a temporary downer (income above poverty level),<sup>57</sup> or a won't pay (most incomes above poverty level).<sup>58</sup> (It is unfortunate, however, that the Washington study categorized only households at or below 100% of the Poverty Level as "poor." It would be useful to know how many households in the "poor money managers" category would have been recategorized as "chronic poor" if the more typical definition of "poor" [150% of the Poverty Level] would have instead been used.)

Other significant policy conclusions can be reached for that portion of the populations (in all three reports: Wisconsin, Washington, Pennsylvania) that these utilities found "do not have the means to pay."

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<sup>54</sup>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).

<sup>55</sup>*Id.*, at 25.

<sup>56</sup>*Id.*, at 19.

<sup>57</sup>*Id.*, at 21.

<sup>58</sup>*Id.*, at 23.

- oFirst, to impose late charges on these households makes little sense. If these households do not pay their bills because they cannot afford to pay their utility bills, to respond by *increasing* their bills through late charges makes little sense.
- oSecond, deferred payment plans are not likely to succeed in retiring accrued arrears. Again, if these households have not paid their bills in the past because they cannot afford them, to expect the households to pay their current bills in the future *plus* some additional increment to retire arrears is unreasonable.
- oFinally, credit counseling and budget billing is not the answer to the payment problems of these households. If credit counseling or budget billing would have resolved the payment problems of these households, the households would already have been placed into the "poor money managers" group and categorized as a "can pay" household. By instead placing these households into the "can't pay" category, (defined as households that "do not have the means to pay"), the utilities have acknowledged the inapplicability of credit counseling and budget billing as a solution.

One observation can be made about the "can pay" population as well. This involves the use of late payment charges. Of the 64 percent of the Wisconsin payment-troubled population that "can pay," for example, late payment charges are inapplicable, unnecessary and likely counterproductive in 55 percent of the cases. A late charge will not make a poor money manager (39%) a better money manager nor will a late charge give the temporary downer (16%) a job or eliminate her temporary disability. The only population to which the late payment charge is applicable as an effective collection tool is the "won't pay" (8%).

Finally, these reports demonstrate the lack of any basis to demand deposits from low-income households who have poor credit histories with non-utility vendors. In both Wisconsin and Washington, the utilities found that consumer utility bill payment came before any and all other credit payments. Ironically, therefore, to base the demand for a utility deposit based on a bad non-utility credit report may well penalize a poor person who paid the utility bill on time to the detriment of other outstanding consumer credit. In any event, these studies demonstrate that bad credit reports regarding payments consumers said they would pay "last" provide no basis to demand a deposit for payments that consumers said they would pay "first."

#### **ADDING FEES WHEN CUSTOMERS HAVE INSUFFICIENT FUNDS**

Utility credit and collection charges are sometimes justified not as a means to gain compensation for expenses, but rather as a means to induce prompt payments on the part of customers. If this rationale is proffered, it is a legitimate inquiry as to whether the level of the charge bears any relation to an acceleration in payment dates. Moreover, it is a legitimate inquiry as to whether a charge designed to induce prompt payment is rational in those instances where nonpayment occurs

in households who are unable to pay either because of chronic poverty or because of a mismatch between their receipt of utility bills and public benefits checks.

For that population of customers who do not pay because they cannot pay, the effectiveness of encouraging prompt payments by adding fees is questionable. A financial inducement to make prompt payments is effective when the customer's reason for nonpayment is to gain financial advantage from devoting the funds to other uses to gain the difference between the substitute return and the utility late charge. Clearly, however, low-income households do not withhold payments toward their utility bills in order to gain a higher return by devoting their resources to alternative uses.

Low-income households do not pay because they cannot afford to pay. Increasing their bill will thus provide no inducement to make prompter payments. The issue has been studied in at least two states.

Like late payment charges, the imposition of credit and collection fees only serve to push households further into debt, thus diverting scarce household resources away from current payments to these extrinsic payments. Accordingly, such charges would not redound to the benefit of all remaining households. One cannot simply add new charges on to a household that has an inability to pay current bills with the expectation that these new charges will be paid in full.

The Pennsylvania Public Utilities Commission considered these impacts within the context of a request by Columbia Gas to begin imposing a late payment fee and reconnection charge on its residential customers. In rejecting the proposal, the PUC adopted the reasoning of the state Office of Consumer Advocate, whose testimony found:

Let's assume that a Budget Plus monthly payment accurately reflects the limit of the participating customer's ability to pay. Let's also assume a late payment charge is set at the Company's weighted cost of capital (12 percent). Let me look only at the impact of such a charge on Budget Plus plans entered into in 1989. For the 3,907 customers in our sample, this late payment charge would up to more than \$200 per year to the cost of the arrears subject to the payment plan. It is not the dollar amount, however, which is so important, as it is the strain that the added late payment charge will add to the Budget Plus plan.

\* \* \* a late payment charge would add the equivalent of up to more than 20 more payments per year to the plan. Remember, that these equivalent additional payments are above and beyond the level of payment which has already been determined to be the limit of the participating customer's ability to pay.

The fallacy in any belief that a late payment charge will accomplish any constructive task is seen with a sub-sample of the 3,907 Budget Plus plans studied. A late payment charge would

add a monthly cost of \$5 or more to 751 households who are charged the minimum \$5 "Plus" amount because they already have an acknowledged *negative ability to pay*.

The Office of Consumer Advocate found:

Let's look at our sample of 3,907 Budget Plus customers. Of those households, 1,636 reported that they had more expenses than income. Moreover, 2,400 of the 3,907 paid the minimum five dollars (indicating that some households, while with positive income, had almost zero positive income and thus paid the minimum \$5). As one can see, therefore, every time Columbia Gas imposes a \$20 reconnect fee, it diverts four months of payments away from the household's "Plus" payments toward its arrears.

Similarly, a late charge would double (or more) the required "Plus" payment for 849 households of the 3,907 sample. As mentioned above, 751 of those 849 households are households who are charged the minimum \$5 because of their calculated negative ability to pay anything.

The PUC, quite rightfully, found that such results made no sense. The late fee and reconnection would not encourage payments under these circumstances and, in fact, would likely divert the funds of low-income households away from current payments to making the payments on these additional charges instead.

A related issue was studied in a 1988 study for the Maine Public Utilities Commission. The Maine report considered the impacts of imposing uniform payment plan terms on all payment troubled customers. Like the issue in Missouri, and in Pennsylvania as discussed above, the Maine research considered the wisdom of responding to inability to pay by *increasing* the payment responsibilities of the payment troubled customer.

The Maine report found that payment plans that require households to make an equal monthly payment toward their arrears, while maintaining payments on total current bills, most often pose no win situations for low-income households. The two components which go into any deferred payment plan are (1) the installment payment toward the arrears; and (2) the current payment toward the current monthly bill.<sup>159)</sup> As a result, the combination of equal monthly payments toward arrears plus current bills creates an inescapable dilemma for the low-income households, NCLC found.

If (the low-income households) enter into a payment plan early in the winter, they not only commit themselves to pay their installments each month, but they commit themselves, as well, to paying their entire current winter bills in full as they come

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<sup>159)</sup>National Consumer Law Center, *An Evaluation of Low-Income Utility Protections in Maine: Payment Arrangements for Maine's Electric Utilities*, at 39 - 49, 55 - 59 (July 1988).

due. If, on the other hand, the household waits until the end of the winter before entering into a payment plan, it will have higher arrears and a shorter payback time with which to cope.<sup>\60\</sup> Either strategy, therefore, poses serious problems. A failure to make any given payment in full will be considered to be a default on the payment plan.<sup>\61\</sup>

The high payments required in payment plans, the research found in Maine, pose "at least three problems."

oFirst, the payment plans were generally entered into during the winter months. "The higher payments are thus required at the same time customers are *also* seeking to pay winter heating bills, whether or not those heating bills are made to the same energy vendor (as the payment plan is made with)."<sup>\62\</sup>

oSecond, the higher payment plan payments are required almost immediately after the person enters the plan. "The household was, however, presumably forced into the plan by an inability to pay in the first instance. A response to that inability which immediately *increases* (emphasis in original) the payment obligation has little to commend itself."<sup>\63\</sup>

oFinally, under the regular payment arrangement process in Maine,<sup>\64\</sup> the household is required to pay its entire current winter monthly bill in addition to the installment payments in order to comply with the plan. No benefit arises from making partial payments during the winter, the time that payment troubles are likely to be the greatest.<sup>\65\</sup>

#### **SHOULD THE FINANCIAL INDUCEMENT TO ACCELERATE PAYMENTS BE ADOPTED**

Should the Public Utilities Commission (PUC) adopt the proposal to allow the Company to impose certain credit and collection fees as an inducement to accelerate payments, the PUC should impose

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<sup>\60\</sup>In Maine, the arrears must be paid before the start of the next winter heating season.

<sup>\61\</sup>*Id.*, at 55.

<sup>\62\</sup>*Id.*, at 58. Simply because the heating bills are owed to a fuel oil dealer rather to the utility, in other words, "does not make them cease to be a drain on winter incomes." *Id.*

<sup>\63\</sup>*Id.*, at 58.

<sup>\64\</sup>Maine also has a "special payment arrangement" process whereby winter bills are billed at below cost with the shortfall being made up during the summer.

<sup>\65\</sup>*Id.*

a sunset provision on the charge. At the end of 12 months, unless the Company can demonstrate that the fees have been effective in accelerating payments, the charge should be dropped.

The means for the Company to make such a demonstration are reasonably available. It would involve the Company preparing and submitting a "payment pattern" analysis for one group of households subject to the fee and another who are not.

A payment pattern analysis provides useful insight into the effectiveness --and cost-effectiveness-- of utility credit and collection practices precisely like those being proposed as a means to accelerate payments. Payment pattern analysis looks at the "collection experience" of a business enterprise that sells to its customers on credit ("credit sales"). The originators of the payment pattern analysis define "collection experience" simply as "the rate at which remittances for credit sales are received over time; that is, the chronological pattern according to which the receivables created during a given interval are converted into cash."

Taking a month to be the standard unit of account, Lewellen and Johnson state:

the issue is the liquidation rate for each month's new credit sales. A *constant* collection experience\* \* \*denotes a situation wherein the fractions of credit sales still uncollected as time passes follow a stable and predictable pattern from month to month. (emphasis in original)

The concept of collection experience, Lewellen and Johnson conclude, "refers to nothing more than this standard notion of the rate of accounts conversion into cash." Other analysts agree. One refers to a "payment pattern" as "the time distribution of cash flows that arise from credit sales at a point in time." Stone states that "a monthly payment pattern can be characterized by the proportion of credit sales in a given month that become cashflows in that month and a series of subsequent months."

A payment pattern analysis creates a receivables status report that follows from this definition of the term "collection experience." Such a report provides:

balances outstanding as a percentage of the respective *original* sales that gave rise to those balance. In this fashion, customer payment rates are automatically traced to their source, and the appraisal of collection success is rendered independent of sales patterns and of the impact of changes in relative account composition. (emphasis in original)

The use of payment pattern analysis allows the credit manager to perform a number of functions that are not possible using other traditional credit and collection measurement techniques. The manager can, for example, distinguish between seasonal payment patterns, and disaggregate the impacts of changes in payment behavior from the seasonal changes in sales. (Stone). Such a

distinction can be ascertained merely by comparing the different rates of conversion into cash as betwixt different months of the year. If, in Attachment A, for example, the January "same month" data was 50 percent while the July "same month" data was 86 percent, the credit manager would determine a seasonal variation in payment patterns. Use of payment pattern analysis, Stone says, will allow accurate monitoring of credit policy decisions such as relaxing or tightening credit granting decisions, changing discount terms, or eliminating discounts altogether. In short, Stone asserts:

Meaningful measures of the performance of a company's collection effort must be based on measures of behavior that do not depend on factors beyond the control of those responsible for collections, *e.g.*, the sales pattern, the level of interest rates, and the quality of the accounts, the latter being determined by the company's credit granting decisions.

Underlying basic payment proportions represents such a measure, he concludes.

Pursuing a payment pattern analysis recognizes the reality that charging a rate and collecting a rate are two separate actions. Simply because a utility charges a particular rate does not mean that the utility will ever collect that money from a low-income household. A payment pattern analysis, in other words, reveals the rate at which *billed* revenue is turned into *collected* revenue over time. Payment pattern analysis allows a utility to track how quickly billed revenues are converted into cash for any particular period. If the Company is correct in its assertion that the proposed credit and collection fees will accelerate payments, the acceleration will show up in a payment pattern analysis.

The payment pattern analysis is reasonably easy to prepare. An illustrative payment pattern analysis is presented in Attachment A below.

## **THE LOW-INCOME OF MISSOURI**

That low-income households often have, quite literally, more expenses than income from which to pay their utility bills is beyond dispute. The income for these poor households simply does not provide sufficient dollars for a household to pay all of its necessary expenses.

### ***1988 Income and Expenses***

The National Consumer Law Center does periodic studies of the status of low-income households. The most recent study, *The Forgotten Crisis: A State-by-State Analysis of the Energy Situation Facing the Poor, Including the Elderly, the Unemployed and Households with Children*,<sup>66)</sup> is discussed in detail below. *The Forgotten Crisis* is based on a variety of federally-supplied

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<sup>66)</sup>National Consumer Law Center (May 1989).

statistics, as cited in the report. The earlier figures are taken from the NCLC report *Cold--Not by Choice*.<sup>167)</sup>

These income problems directly translate into energy payment problems. *The Forgotten Crisis* found that Missouri residents had an average 1988 energy cost of \$1,051, including an average monthly winter energy cost of \$129. This data is particularly troubling for recipients of AFDC benefits, for recipients of SSI benefits, and for recipients of unemployment benefits.

In Missouri, an *AFDC* household of three receiving the maximum monthly benefit in 1988 (\$282) would have spent 31 percent of its annual income on home energy bills. That household would have had a weekly income left, after paying its winter energy bills, of only \$36 for all other living expenses, including housing, food, medical attention, transportation and communication. These figures assume *maximum* benefits.

An elderly couple receiving the maximum *SSI* grant in January 1988 (\$532) would have spent 17 percent of their income on annual home energy bills. That household would have \$94 per week left for all other living expenses after paying its winter energy bills. The individual receiving *SSI* is in much worse shape. An elderly individual receiving the maximum *SSI* benefit in January 1988 (\$354) would have spent 25 percent of her income on her annual home energy bill. That individual would have had \$52 left per week for all other living expenses after paying her winter home energy bill. As with *AFDC*, these figures assume *maximum* benefits.

A household receiving the average *unemployment* benefit in Missouri in 1988 (\$518) would have spent 117percent of its income on its annual home energy bill. It would have had \$90 left per week to spend on all other living expenses after paying its winter energy bill.

Finally, the average monthly *Social Security* benefit in Missouri for a retired worker and spouse was \$749 in 1988. That household would have spent 12 percent of its income on its annual home energy bill. That household would have had \$144 left per week for all other living expenses after paying its winter energy bill. This data is particularly disturbing. According to the U.S. Administration on Aging, unlike the average household, elderly households spend fifteen percent of their income on medical bills alone, thus further pinching elderly budgets.

### ***1992 Winter Heating Bills and Burdens in Missouri***

The data presented here is taken primarily from the February 1994 report titled *On the Brink of Disaster: A State-by-State Analysis of Low-Income Natural Gas Winter Heating Bills*, prepared by an Oregon-based consultant Michael Sheehan. According to this report, Missouri recipients of the benefits through the Low-Income Home Energy Assistance Program (LIHEAP) had, *on*

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<sup>167)</sup>National Consumer Law Center (1984).

average, a "winter" income --winter was defined to include the three months of December, January and February--<sup>168)</sup> of \$1,537 with a winter gas heating bill of \$210.94. LIHEAP recipients, therefore, were billed, *on average*, roughly 14 percent of their income toward their gas heating bills. The extent to which these bills were actually paid is an entirely different question.

As the *Sheehan* report notes, however, the use of averages masks the real problems which Missouri LIHEAP recipients face. If one disaggregates the LIHEAP population into income ranges, winter natural gas bills impose the percentage of income burden set forth in Table C below.

The *Sheehan* report looked also at AFDC recipients, Supplemental Security Income (SSI) recipients, unemployment recipients, Social Security recipients, and minimum wage employees. The burdens which natural gas winter home heating bills impose on each of those respective populations is set forth in Table D below.

Moreover, the report found, the average winter natural gas heating burden as a percent of income for all households with incomes of \$15,000 or less was 10.5 percent. Even worse, the 13,931 households receiving public assistance in Kansas City experienced a winter natural gas heating burden of 24.5 percent. A comparison of LIHEAP households, all low-income (*i.e.*, below \$15,000) households, and public assistance households, specifically in Kansas City, is set forth in Table E below.

### ***Summary and Conclusions***

The conclusion from the discussion above is *not* simply that the proposed credit and collection fees should be opposed because low-income households cannot afford to pay them. The conclusion instead relates to the Company's assertion that the proposed credit and collection fees are justified as a means to accelerate payment of the Company's bills by nonpayers. Based on the data and discussion above, it seems unreasonable at best, and totally fabricated at worst, to assert that these fees will accelerate payment from low-income households.

Low-income households face an absolute mismatch between household income and household expenses. To impose *additional* credit and collection charges is simply to impose a tax on being poor. Moreover, not only will such charges not likely accelerate payments from the poor, they will likely be counterproductive in obtaining full payments at all.

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<sup>168)</sup>Because NARUC reported winter bills only for the three months of December, January and February, the *Osterberg & Sheehan* report limited its definition of "winter" to those three months. The limit represents a data limitation, in other words, and *not* an endorsement of that definition of "winter."

**TABLE C: MISSOURI LIHEAP NATURAL GAS WINTER HEATING BURDENS**

| <b>INCOME RANGE</b>      | <b>WINTER NATURAL GAS HEATING BURDEN AS INCOME PERCENT</b> | <b>TOTAL NO. OF HH'S IN EACH INCOME RANGE</b> |
|--------------------------|--|---|
| <b>\$0-\$1,999</b>       | 84.4%  | 8,083   |
| <b>\$2,000-\$3,999</b>   | 28.1%  | 19,276  |
| <b>\$4,000-\$5,999</b>   | 16.9%  | 43,899  |
| <b>\$6,000-\$7,999</b>   | 12.1%  | 24,775  |
| <b>\$8,000-\$9,999</b>   | 9.4%   | 14,674  |
| <b>\$10,000-\$11,999</b> | 7.7%   | 7,213   |
| <b>\$12,000-\$14,999</b> | 6.3%   | 4,874   |
| <b>\$15,000</b>          | 5.6%   | 1,990   |

**TABLE D: MISSOURI NATURAL GAS WINTER HEATING BURDENS  
FOR VARIOUS LOW-INCOME POPULATIONS**

|   | <b>WINTER INCOME</b> | <b>WINTER GAS BILL</b> | <b>WINTER GAS BURDEN</b> |
|---|----------------------|------------------------|--------------------------|
| <b>AFDC</b>   | \$876                | \$210.94               | 24.1%                    |
| <b>SSI</b>  | \$1,221              | \$210.94               | 17.3%                    |
| <b>UNEMPLOYMENT</b>                                       | \$1,620              | \$210.94               | 13.0%                    |
| <b>SOCIAL SECURITY (elderly<br/>non-disabled retired)</b> | \$1,767              | \$210.94               | 11.9%                    |
| <b>SOCIAL SECURITY (elderly<br/>widows and widowers)</b>  | \$1,645              | \$210.94               | 12.0%                    |
| <b>MINIMUM WAGE</b>                                       | \$2,040              | \$210.94               | 10.3%                    |

**TABLE E: WINTER HEATING BURDENS FOR  
LOW-INCOME, LIHEAP AND PUBLIC ASSISTANCE HOUSEHOLDS  
IN KANSAS CITY**

| <b>PROGRAM</b>                              | <b>AVERAGE WINTER HEATING BURDEN</b> |
|---|--------------------------------------|
| <b>HH'S WITH INCOMES LESS THAN \$15,000</b> | 10.5%                                |
| <b>LIHEAP RECIPIENTS</b>                    | 13.1%                                |
| <b>PUBLIC ASSISTANCE RECIPIENTS</b>         | 24.5%                                |

**ATTACHMENT A**

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**STATUS REPORT ON RECEIVABLES OUTSTANDING  
AS A PERCENT OF ORIGINAL SALES**

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|  | MONTH |     |     |     |     |     |     |     |     |     |     |     |
|--|-------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
|  | J     | F   | M   | A   | M   | J   | J   | A   | S   | O   | N   | D   |
| <b>Percentages outstanding for 1970 from sales of:</b> |       |     |     |     |     |     |     |     |     |     |     |     |
| <b>Same month</b>                                      | 90%   | 89% | 91% | 95% | 97% | 93% | 86% | 92% | 91% | 90% | 91% | 90% |
| <b>One month before</b>                                | 60    | 62  | 59  | 68  | 73  | 69  | 59  | 54  | 62  | 63  | 61  | 60  |
| <b>Two months before</b>                               | 20    | 19  | 18  | 35  | 37  | 33  | 23  | 20  | 17  | 21  | 22  | 20  |

**NOTE**

To ascertain the payment figures for one month's original sales, see the numbers in a descending left-to-right diagonal pattern. Thus, the sequence 86%-54%-17%, singled out for July-August-September of 1970, refers to balances originating in July's sales as they remain outstanding as of the end of three consecutive months.

**SOURCE:**

Wilber Lewellen and Robert Johnson, "Better way to monitor accounts receivable," *Harvard Business Review*, at 101, 107 (May-June 1972).