MOUNTAIN STATES LEGAL FOUNDATION
V.
COLORADO PUBLIC UTILITIES COMMISSION

Leading Light or Flickering Flame?

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In 1979, the Colorado supreme court issued a decision that has stalled the implementation of discount utility rates for the poor ever since. In *Mountain States Legal Foundation v. Public Utilities Commission*,[1] the state supreme court overturned the PUC's approval of discount rates for low-income elderly and low-income disabled customers. Such discounts, the court held, violated the statutory prohibition against preferential rates.

The Colorado court recognized the economic difficulties of the target populations, observing "the fact that many of our state's elderly live on fixed incomes which are severely strained by today's inflationary economy, as are low-income disabled persons who are often shut out of the employment market."[2] The court held, however:

> While efforts to provide economic relief to such needy persons are laudatory, the PUC has limited authority to implement a rate structure which is designed to provide financial assistance as a social policy to a narrow group of utility customers, especially where that low rate is financed by its remaining customers. . .It is clear in the case before us that the PUC's authority to order preferential rates has, in fact, been restricted by the legislature's enactment of [the no undue preference statute].[3]

\1\ 197 Colo. 56, 590 P.2d 495 (1979).

\2\ 590 P.2d at 496.

\3\ *Id.*, at 497.

The court ultimately concluded that:

> In this instance, the discount rate benefits an unquestionably deserving group, the low-income elderly and the low-income disabled. This, unfortunately, does not make the rate less preferential. . .[A]lthough the PUC has been granted broad rate making powers. . .the PUC's power to effect social policy through preferential rate making is restricted by statute no matter how deserving the group benefiting from the preferential rates may be.[4]

While the *Mountain States* decision has been read to prohibit *per se* low-income discount rates in Colorado, when studied more closely, it stands for no such broad proposition. It is instead necessary to look at *precisely* what the Colorado supreme court proscribes.

PROHIBITION OF LOW-INCOME RATES BASED ON "SOCIAL POLICY"

First, in *Mountain States*, the Colorado PUC was prohibited from implementing "a rate structure which is designed to provide financial assistance *as a matter of social policy*. . ." (emphasis added). This notion that the state supreme court disapproved the PUC's social policymaking is reinforced by the language that "the PUC's power *to effect social policy* through preferential rates is restricted. . ." (emphasis added).

In recent years, however, state utility regulators have found that affordable rate structures are not justified simply on social policy grounds, but on sound financial grounds as well. The Pennsylvania Public Utilities Commission (PUC), for example, approved a low-income discount rate on the grounds that it generated benefits for all consumers. In 1991, one Pennsylvania utility, National Fuel Gas Distribution Corporation, proposed an explicit marginal-cost-based rate for its payment-troubled customers. In support of this rate, which the commission approved, the Pennsylvania utility explained to the Commission:

> National Fuel has a number of programs designed to aid low-income consumers. Uncollectible balances remain, nevertheless, a significant concern. National Fuel's proposed discount rate is an additional attempt to address the growing problem of uncollectibles among its low-income residential customers.* * *A premise that repeatedly surfaces in discussions on this matter is that payment-troubled low-income customers are discouraged from making payments for their use of National Fuel's services by the apparent unaffordability of such services. The hypothesis therein is that if National Fuel's services were made more affordable for these customers, they would

[4] *Id.*, at 498.

> make a greater effort to pay for all or part of the services which they consume. The result, therefore, would be a greater dollar contribution by these customers to the cost of their service and thereby a reduction in the rate of growth of uncollectible balances. The net consequence of which would be a reduction in the subsidy exacted from remaining customers. The proposed Low-Income Residential Assistance Rate is an experiment which is designed to test that hypothesis.\5\

Similarly, the reasoning of the Pennsylvania Commission in September, 1990, was sound when it directed Columbia Gas of Pennsylvania to implement a pilot Energy Assurance Program (EAP), stating:

> * * *for the poorest households with income considerably below the poverty line, existing initiatives do not enable these customers to pay their bills in full and to keep their service.* * *Consequently, to address realistically these customers' problem and to stop repeating a wasteful cycle of consecutive, unrealistic payment agreements that cannot be kept, despite the best of intentions, followed by service termination, then restoration, and then more unrealistic agreements, we believe that new approaches like* * *the [Office of Consumer Advocate's] proposed EAP program should be tried.

So, too, has the New York commission approved a low-income discount, not on social policy but on economic grounds. In 1994, the New York Public Service Commission approved a low-income rate for Niagara Mohawk Power Corporation. Two utilities in particular (Consolidated Edison and Long Island Lighting) objected to the arrears forgiveness component of the low-income program. Con Edison claimed that there are no studies which show that a negotiated payment plan encourages payment. "In fact," the commission said in rejecting this opposition, "evaluation of Niagara Mohawk's Power Partnership Pilot, completed in 1990, revealed that following the implementation of a negotiated payment arrangement strategy, participants increased both the amount of dollars paid to the utility and the frequency with which payments were made." The New York commission rejected arguments by other utilities commenting on the program that the commission lacked the legal authority to approve such a program. "This program is aimed primarily at customers who have a demonstrated inability to pay their bills," the commission said, "and who, because of increased collection activities, cause additional collection expenses to be borne, in various proportions, by Niagara Mohawk's entire body of ratepayers. It is thus reasonable to consider these circumstances in designing a program with the potential for increased customer bill

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\5\ Direct Testimony and Exhibits of Vincent Esposito, at 3 - 4, ***Pennsylvania Public Utility Commission v. National Fuel Gas Distribution Corp.***, Docket No. R-9111912 (1991).

payments and for easing the company's uncollectible expenses."

While the state-of-the-art in 1978 might have been that low-income discounts were merely good social policy, the state-of-the-art has advanced in the ensuing 20 years. Regulatory commissions now realize the financial benefits. Thus, if discounts are adopted not "as a social policy" but rather as a "financial policy," they would fall outside the *Mountain States* prohibition.

DISCOUNTS FINANCED BY REMAINING CUSTOMERS

In addition to considering the purpose of the low-income rate, *Mountain States* considered the operation as well. The *Mountain States* decision disapproved of low-income rates "especially where that low rate *is financed by. . .remaining customers.*" (emphasis added). Recent regulatory analysis has found, however, that low-income discounts need not be "financed by remaining customers." Instead, commissions have found, such discounts can be financed out of the expense savings generated by the discount itself. In July 1992, the Pennsylvania PUC directed each of Pennsylvania's electric and gas companies to develop an income-based Percentage of Bill Program.\6\ The PUC decision was based on an 18-month study of how to control uncollectibles in that state. One finding made in the resulting report was that:\7\

> In 1985, Wisconsin Gas Company (WGC) implemented an Early Identification Program (EIP), similar to a CAP,\8\ as an alternative to traditional budget plans. Prior to implementation of EIP, WGC experienced an 80% default rate on payment arrangements. From 1981 - 1985, only 1.73% of revenues were written off as uncollectible compared to 2.79% in 1985. In 1986, the first year after EIP began, write-offs increased to 3.10% of total revenues. However, uncollectibles decreased consistently each year beginning in 1987 from 2.66% to 2.02% in 1990. As of March 1991, the level of write-offs at 1.6% was below the 1981 rate of 1.73%. Wisconsin Gas Company's experience lends support to Mr. Colton's proposal that an EAP\9\ is an effective collection device.

\6\ For a detailed description of an income-based percentage of bill rate, *see generally*, Roger Colton (1995). ***Models of Low-Income Utility Rates***, Fisher, Sheehan & Colton, Public Finance and General Economics: Belmont, MA.

\7\ ***Report on the Investigation of Uncollectible Balances, Report to the Pennsylvania Public Utility Commission*** (August 1991); *see also*, ***Report on the Investigation of Uncollectible Balances, Report to the Pennsylvania Public Utility Commission: Comments and BCS Response*** (Feb. 1992).

\8\ The Pennsylvania PUC's term for its proposed income-based Percentage of Bill Plan was Customer Assistance Program, or CAP.

\9\ The proposal I advanced to the PUC on behalf of the Office of Consumer Advocate, Office of Attorney

Moreover, the PUC report said:

> In 1990, Wisconsin Gas Company's EIP participants experienced an 80% success rate in maintaining payment arrangements. The Wisconsin experience shows that over time participants improve payment behavior and remain on the program longer. Defaults were higher when the program first began, however, history has shown that failures occur early in the program and that customers remained in the program longer each time they reentered it.

In addition, as was discussed in more detail above, experience with a similar Niagara Mohawk Power Corporation project led the New York Commission to approve a low-income rate for that Company, stating: "evaluation of Niagara Mohawk's Power Partnership Pilot, completed in 1990, revealed that following the implementation of a negotiated payment arrangement strategy, participants increased both the amount of dollars paid to the utility and the frequency with which payments were made."

Given the ability of properly-designed[10] low-income rates to pay for themselves today, such a rate design would seem to fall outside the *Mountain States* prohibition of low-income discounts which are "financed by. . .remaining ratepayers."

A NOTE: "PAY FOR THEMSELVES"

"Pay for themselves" has a technical meaning. The rates should be found to be "cost-effective" by using a "net back" analysis. "Net back" measures how a utility can maximize net income after taking into consideration the percentage of outstanding arrears actually collected along with the expenses associated with such collection. The "net back" concept was introduced as a means to evaluate low-income rates at a 1995 Hydro-Quebec symposium in Montreal:

> "Net back" is the preferred measure of the effectiveness and cost-effectiveness of utility credit and collection practices. "Net back," a term coined by the credit management industry in the early 1980s, is the ratio of the *net* dollars returned to a company (the total amount collected minus the total expenses involved with the collection technique) to the gross amount of receivables

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General, was called an Energy Assurance Program (EAP).

\10\ Not all low-income discounts are appropriately designed to generate offsetting savings. *See generally*, Roger Colton (1995). ***Models of Low-Income Utility Rates***, Fisher, Sheehan & Colton, Public Finance and General Economics: Belmont, MA.

> assigned to the collection technique. The contribution made by the "net back" analysis is that it forces a creditor to take into account the expense of collection, as well as the effectiveness of collection, in considering the cost-effectiveness of collection practices.[11]

The concept was recently applied by H.Gil Peach in his evaluation of the Equitable Gas low-income rate program.[12] Peach concluded that:

> Does EAP work as designed? As shown [by the evaluation data], EAP is working perfectly in accord with its design, or at least as perfectly as can be desired in actual practice. The [Net Back Ratio--NBR] for the modeled 1989 Reference Group is 0.91, while the NBR for the "EAP: One Full Year" is 1.41, and for "EAP: Two Full Years" is 1.37. This means that EAP is not only revenue neutral, but revenue positive in relation to the comparison situation for which it was designed. For those who remain in the program for one year, the amount of *additional* revenue collected is $262 per customer, and in the second year, an additional $206 per customer.[13]

Given these findings, it is possible to conclude that, unlike the situation which *Mountain States* posits, where discount rates are "financed by remaining ratepayers," the low-income affordable rate programs designed in compliance with the new regulatory philosophy will pay for themselves, and thus not run afoul of the *Mountain States* directive.

SUMMARY

In sum, while the 1979 *Mountain States Foundation* decision is frequently viewed as a barrier to low-income discount rates in Colorado *per se*, that need not be the case. A low-income discount rate designed to implement sound financial and economic policy rather than strictly social policy, as well as rate discounts that do not shift costs to remaining customers, can be crafted without running afoul of the *Mountain States* dictates.

\11\ Roger Colton (July 1995). *Credit and Collection Strategies in a Competitive Electric Utility Industry*, Fisher, Sheehan & Colton, Public Finance and General Economics: Belmont, MA.

\12\ H.Gil Peach. ***Impact Assessment of Equitable Gas Energy Assistance Program: An Independent Analysis of the Energy Assistance Program (EAP), An Account Management Pilot Designed to Make Energy Affordable***. (September 1996).

\13\ ***Peach***, at 116.