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Initiated Measure:
Lifeline Rate Reform

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As utility rates have increased to reflect increasing energy costs, there has been a mounting concern that the cost of utilities is causing undue hardship for people with low incomes and the elderly who must live on fixed incomes. The initiated Lifeline measure is designed to alleviate some of this concern.

The initiated law seeks to price the amount of gas and electricity deemed necessary for survival (the Lifeline) below cost, with successive amounts priced at higher rates to cover the losses incurred from selling the initial amounts of gas and electricity below cost. Users of large amounts of natural gas and electricity, mostly commercial and industrial users, will subsidize residential users of such energy.

The proposed act directly affects only customers of investor owned utility companies. Customers of municipal systems and rural electric cooperatives are not included.

Utility rates have traditionally been based upon the declining block rate structure. This pricing system charges a higher rate for the first units of service purchased each month (the minimum in your gas and electricity bill), with successive units of service priced at lower rates. The "Lifeline Rate Reform and Energy Conservation" measure would replace the declining block rate structure with an inverted rate structure; a low rate would be charged on the minimum portion, with increasingly higher rates on successive amounts of gas and electricity consumed.

Lifeline Proposal in Detail

The proponents of the Lifeline measure base it upon five "findings" which are included in the proposed act. These are:

1. "Light and heat are necessities of life, and must be made available to all people at low cost for basic minimum quantities."
2. "At present, the prices residential customers have to pay for basic minimum quantities of energy are unjustifiably high."
3. "Present rate structures for gas and electricity, which provide volume discounts for large commercial and industrial users, encourage wastefulness and overconsumption of energy."
4. "Wastefulness and overconsumption by large commercial and industrial users unduly drive up the cost of energy to all and deplete resources essential to humanity."
5. "Customers who use large quantities of energy have the greatest opportunity for the conservation of such energy."

The proposed act provides the following minimum quantities of gas and electricity to be sold at reduced rates to residential users per month, per customer, or per residential unit where more than one user is served by a single meter or account (these are the quantities the proponents of the act consider "lifeline" amounts):

(1) At least 500 kWh of electricity; (2) At least 200 ccf of natural gas (20 thousand cubic feet).

It further provides "that the Commission may set special seasonal amounts (of natural gas) for usage during the non-peak usage months of March through October." The proposed measure requires the Public Utilities Commission to adopt a rate structure within which lifeline rates are:

1. "sufficiently low so as to require only minimal financial outlay on the part of low use customers,"
2. "significantly lower than the rates (presently) being charged for the lifeline amount," and
3. not modified for any reason to residential customers in a proportion greater than to any other customers.

Utility company revenues which may be lost from low residential users are to be recovered by instituting rates structured so that:

1. the declining block rate structure for electricity and natural gas is eliminated across all customer classes, and
2. only large commercial and industrial users can have rate increases of a percentage greater than the average percentage increase imposed on any other class of user. (Their percentage increase may be higher but not lower.)

Economic Impacts of the Proposed Law

The declining block rate structure for utility charges has evolved because of the nature of the utility business.

One of the economic characteristics of the utility industry is the large proportion of total costs which is fixed. Much of a utility company's cost in any period represents the recovery of past investment in plant and equipment to produce, transmit, and distribute the service.
It is also true that larger plants can produce the service at a lower per unit cost than can a smaller plant. Thus, to the extent that large users of utility service cause the utility to build and use the larger, more efficient plant the cost per unit of service will benefit all customers. The declining block rate structure benefits all customers using the service.

This situation has changed somewhat in recent years as the cost of producing the product of the utility has increased relative to the other costs of providing the service. Rates for the large user have increased faster than the rates of the low user, even though the rates for all users have increased significantly.

Some costs of providing utility service are nearly the same for all customers regardless of the amount of the service consumed by any of the customers. These include the cost of connecting to the service, metering, billing, collection, and maintaining the distribution system. If these costs are allocated equally to all customers, then the cost per unit of service will be higher for the low use customer. This is another economic justification for the declining block rate structure.

Large consumers of gas and electricity have responded to the increase in utility rates by slowing their increase in consumption rate, but there is evidence that residential users have not. This bears out one of the "findings" of the Lifeline measure proponents that large users of energy have the greatest opportunity for the conservation of such energy.

By the same token, we might assume that if low users of energy suddenly paid lower energy costs, they might also respond by increasing their energy consumption. If so, the increased consumption by the many thousands of homes might be greater than the reduction in usage by the relatively few businesses and industries. The end result could be a greater consumption in energy overall.

Utility firms are granted monopoly privileges within their service territories. In exchange for this privilege they must provide "adequate, efficient, and reasonable service" without granting any "unreasonable preference or advantage" or imposing any "unreasonable prejudice or disadvantage" on any person within their service territories. The rates charged must be "just and reasonable," must not discriminate between any users within a given class of users and must not, in total, provide the firm with profits in excess of a "fair and reasonable return upon the value of its property." (SDCL 39-34A)

The rates and profits as well as the quantity and quality of service provided by investor owned utilities are regulated by the South Dakota Public Utilities Commission. Other utilities such as rural electric cooperatives and municipal utility systems are not regulated by the state. For this reason the proposed Lifeline law will not apply to them.

The Public Utilities Commission is charged with the duty of regulating the investor owned utilities in accordance with the standards outlined above. The Commission and its staff must therefore concentrate on such issues as the costs of producing, transmitting, and distributing utility services. Their functions are to assure utility consumers an adequate supply of utility services at a reasonable cost and to ensure investors in public utilities receive a fair return on their investment. The Commission's decisions are based upon data submitted by the utility companies. By law, before there can be any rate changes, the Commission must hold public hearings. If, after the Commission has reached its decision and the utility company is dissatisfied with the decision, the matter is usually settled in the courts.

The initiated Lifeline inverted rate proposal, if passed, would add another dimension to the decisions of the Public Utilities Commission. By definition, the highest rates in an inverted rate structure would be charged for the last units of the utility consumed. It is on these units that the losses incurred from selling the first residential units of gas or electricity below cost are to be recovered.

If the large users cut their consumption and do not use the higher priced units, the utility company will be faced with revenue losses and will be forced to apply for across-the-board rate increases which would include the low use customers as well. The further increase at the tail end of the rate structure might trigger further cuts in utility use by the high use customers and the rate increase process might begin again.

Eventually, extremely high rates for the last units used might make it economical for high use customers to produce some of their own electricity and supplement their natural gas use with other forms of energy. The utility company could be faced with unused plant capacity, the cost of which would have to be passed on to users.

It is conceivable that in the long run all consumers of gas and electricity will pay higher rates because of the inefficient resource use brought on by the inverted rate structure.

Welfare Impacts of the Proposed Law

The proposed Lifeline law is an income redistribution measure. Large users of gas and electricity, whether they be residential, commercial, or industrial users, will subsidize nearly all residential gas and electricity consumers of investor owned utilities. Such users may, or may not be, low income persons.

The usefulness of Lifeline rates in supporting low income families depends upon the relationship between income and utility use. If every low income family uses small amounts of utility services and every higher income family uses larger amounts, the Lifeline rate structure would, in effect, levy a tax on each higher income family in proportion to the service used and provide a subsidy to each low income family in proportion to how much service it used.

The question is, can each family's income be identified by its use of utility services? The answer would have to be no.

It is true that, on the average, higher income families consume more utilities, but that is all it is, an
average. We cannot conclude that the highest income people use the most utility service or the lowest income people use the least. Many low income families use relatively large amounts of gas and electricity, especially if they are large families who live in poorly insulated and larger, older homes. They spend most of their time at home in the evenings watching television because they cannot afford more costly entertainment. Elderly people, as a whole, require warmer homes than their incomes would indicate. Many low income and elderly would be required to pay the higher rates.

On the other hand, there may be numerous higher income families who are low use utility customers. A well-to-do retired couple may live in a small, well insulated apartment. They might spend the winter in the south, summer months at the lake, and go out often in the evenings. Such affluent families would be subsidized under a Lifeline rate structure.

Some of the larger consumers of gas and electricity are state and local units of government. Office buildings, schools, and service facilities must be well lighted and heated. The higher utility rates under the inverted Lifeline rate structure can only be paid from higher taxes. Low income customers will experience a proportionate increase in their taxes to pay these bills. Commercial businesses faced with higher utility bills can only pass these increased costs on to their customers. To the extent that low income people patronize these establishments they will help to pay their own subsidy.

As noted earlier, the initiated Lifeline rate reform measure applies only to those areas served by investor owned utility companies regulated by the Public Utilities Commission. It does not apply in those areas served by rural electric cooperatives and municipal electric systems. Rural low income and those low income families living in towns served by municipal electric systems will not benefit by the lower Lifeline electric rates, and of course, the proposed Lifeline gas rates can only apply to those cities and towns served by natural gas utilities.

In spite of the limitations of the service areas and the exceptions noted above, there can be no question but what there will be many residential gas and electric utility customers who will benefit from the inverted Lifeline rate structure, at least initially. A high proportion of these will be low income people. We might ask, is this an efficient and equitable means of redistributing income?

To the extent that some low income families would pay higher rates and higher income families would pay lower rates along with those families not affected at all, the Lifeline inverted rate structure would fail as a mechanism for achieving the purpose of income redistribution.

The proposed measure imposes a welfare function upon the Public Utilities Commission, a function which is the primary purpose of other agencies.

The fundamental problem of low income people is not that their utility bills are too high but that their income is too low. It would appear that a more efficient means of dealing with the fundamental problem is through programs which increase incomes directly, rather than to price essential utilities at artificially low prices which will benefit some, but not all, who need it and some who do not.

Energy Conservation Impacts of the Proposed Law

The concept of raising prices to reduce use is known as price rationing. That is, only those who are willing and able to pay the higher price or have no alternative but to pay the higher price will purchase the product. Obviously many will not choose to purchase the product at the higher price, and thus less of the product will be consumed.

Whether such conservation is desirable or beneficial depends upon the purpose or purposes for which it is conserved and at what economic and social cost.

If price rationing of gas and electricity in South Dakota will result in more adequate supplies at lower cost and at a later date, the conservation of such energy may be a worthy goal. If, on the other hand, the reduction in electricity and natural gas use through price rationing only results in greater use at a lower cost elsewhere, such conservation would not be in the best interests of the people of South Dakota. In the same manner, if reduction in electricity use results in higher costs for the remaining electricity consumed the price of the electrical energy conserved might be quite high.

Just as important as the total amount of electricity consumed is the problem of peaks and valleys in the rate of consumption in a 24-hour period. The highest residential use is during the peak periods of electricity consumption. In fact, it is residential use which creates the peaks and valleys.

Under an inverted rate structure residential use can be expected to increase if the cost is lower. A utility plant must operate to supply sufficient energy to meet peak period demands. Conserving such energy during the low use periods only makes the cost higher for peak period use and at very little saving in the energy used to generate the electricity.

Conservation of energy may be costly in terms of industrial jobs and industrial development. Certainly higher priced gas and electricity, a significant input for almost all industries, would make South Dakota less attractive to industry and might make lower cost energy states more attractive to our South Dakota industries. It might also cause some industrial relocation within the state as industries move to those areas not under public utility regulation or where there are fewer residential rate customers.

In recent years many new homes have been designed and built to be heated electrically and some older homes have been converted to electric heat. As the price of petroleum based fuels increases the trend will continue. Under an inverted rate structure the trend will reverse, and such homes will probably be heated
by the more critically short petroleum based fuels. Electricity conservation which results in increased oil consumption might prove to be counter-productive.

Summary

The Lifeline utility rate structure has some advantages. It would shift some of the costs of utility service from the low use residential customers to the higher use customers. It would be an easily administered system of income redistribution, although the initial adjustments in the regulating system might be quite painful.

The redistribution, in all probability, could be more effectively and efficiently accomplished by other mechanisms. Lifeline may or may not reduce total utility use. Some customers might use more and others less. To the extent that use is curtailed it will affect working conditions and increase the costs of goods and services. Lifeline could influence industrial location decisions and industrial growth, and to the extent that it raises utility charges for state and local governments it will increase taxes.

Do the benefits outweigh the disadvantages? That is the question to be decided by the voters in the general election on November 7.