



**OAK RIDGE
NATIONAL
LABORATORY**

LOCKHEED MARTIN



**THE "OBLIGATION TO SERVE" AND A
COMPETITIVE ELECTRIC INDUSTRY**

Roger D. Colton
Fisher, Sheehan & Colton
Public Finance and General Economics

November 1997

MANAGED AND OPERATED BY
LOCKHEED MARTIN ENERGY RESEARCH CORPORATION
FOR THE UNITED STATES
DEPARTMENT OF ENERGY

ORNL-27 (3-96)

DISTRIBUTION OF THIS DOCUMENT IS UNLIMITED

This report has been reproduced directly from the best available copy.

Available to DOE and DOE contractors from the Office of Scientific and Technical Information, P.O. Box 62, Oak Ridge, TN 37831; prices available from (615) 576-8401, FTS 626-8401.

Available to the public from the National Technical Information Service, U.S. Department of Commerce, 5285 Port Royal Rd., Springfield, VA 22161.

This report was prepared as an account of work sponsored by an agency of the United States Government. Neither the United States Government nor any agency thereof, nor any of their employees, makes any warranty, express or implied, or assumes any legal liability or responsibility for the accuracy, completeness, or usefulness of any information, apparatus, product, or process disclosed, or represents that its use would not infringe privately owned rights. Reference herein to any specific commercial product, process, or service by trade name, trademark, manufacturer, or otherwise, does not necessarily constitute or imply its endorsement, recommendation, or favoring by the United States Government or any agency thereof. The views and opinions of authors expressed herein do not necessarily state or reflect those of the United States Government or any agency thereof.

ENERGY DIVISION

THE "OBLIGATION TO SERVE" AND A
COMPETITIVE ELECTRIC INDUSTRY

Roger D. Colton
Fisher, Sheehan & Colton
Public Finance and General Economics

November 1997

Sponsored by
Office of Economic Electricity and Natural Gas Analysis
U.S. Department of Energy

OAK RIDGE NATIONAL LABORATORY
Oak Ridge, Tennessee 37831
managed by
LOCKHEED MARTIN ENERGY RESEARCH CORPORATION
for the
U.S. DEPARTMENT OF ENERGY
under contract No. DE-AC05-96OR22464

DISTRIBUTION OF THIS DOCUMENT IS UNLIMITED

MASTER

DISCLAIMER

**Portions of this document may be illegible
electronic image products. Images are
produced from the best available original
document.**

CONTENTS

EXECUTIVE SUMMARY	ES-1
INTRODUCTION	1
PART 1: HISTORICAL VIEW OF AN ELECTRIC UTILITY'S "OBLIGATION TO SERVE"	2
The Traditional Obligation to Serve Rule	2
Source of the Traditional Obligation	4
Summary	4
PART 2: A "SOCIETAL" OBLIGATION TO SERVE OUTSIDE THE UTILITY INDUSTRY ..	5
The Doctrinal Basis for a "Societal" Obligation to Serve	6
Health Care Industries	7
Insurance: Property, Liability, Automobile	8
Telecommunications	10
Lessons Learned for Competitive Electric Utilities	11
Whether a Societal Obligation to Serve Provides a Sufficient Basis to Achieve Universal Service	11
Health Care	11
Health Insurance	13
Insurance: Property, Liability, Automobile	14
Telecommunications	15
Lessons Learned for Competitive Electric Utilities	17
Competition and its Impact on Universal Service	18
Health Care	18
Health Insurance	20
Insurance: Property, Liability, Automobile	21
Telecommunications	24
Lessons Learned for Competitive Electric Utilities	26
PART 3: IMPOSING A LEGAL OBLIGATION TO SERVE ON NON-UTILITIES	26
Hospitals	27
The Public Payments	27
The Industry Compensation	28
The Nature of the Obligation	29
The Explicit Exchange	33
Enforcing the Obligation	34

CONTENTS (Cont'd)

Insurance: Workers Compensation, Automobile, Property	36
Workers Compensation.....	37
Automobile	38
Property	40
Telecommunications	41
Lessons Learned for Competitive Electric Utilities.....	44
PART 4: COMPONENTS OF A RESTRUCTURED ELECTRIC INDUSTRY'S "DUTY TO SERVE".....	45
The Policy Declarations.....	46
Statement of Purpose	46
No Deterioration in Universal Service	47
Definition of Universal Service.....	49
The Specific Enforceable Components of the Obligation.....	50
The Obligation to Connect.....	51
Dedication to a Public Use	51
The Legal Basis for Imposing an Obligation to Connect	52
The Right to Revoke a Dedication to a Public Use	55
Irrevocable Dedications by Non-Utilities.....	56
The Obligation to Provide Service to Residual Classes.....	59
The Obligation to Make a Standard Offer.....	63
The Obligation to Provide Non-Discriminatory Service	66
The Obligation to Fund Residual Markets.....	70
CONCLUSION	72
GLOSSARY OF TERMS	75
APPENDIX A: SUMMARY OF "LESSONS LEARNED" FROM NON-ELECTRIC INDUSTRIES.....	78
APPENDIX B: SUMMARY OF OBLIGATION TO SERVE POLICY RECOMMENDATIONS.....	81

EXECUTIVE SUMMARY

Historically, the social compact to which electric utilities have been held involves a common law "duty to serve." Permitting a move to a restructured competitive electric industry provides the opportunity to explicitly rewrite this social compact. This report presents an assessment of what the "obligation to serve" might look like in a competitive electric industry. Broadly, this research has three objectives:

- o To define the "duty to serve" of a competitive electric industry;
- o To identify those companies to whom that duty applies; and
- o To explain how that duty protects residual classes.^{vi}

The development of an obligation to serve for a competitive electric industry can find its roots in three different inquiries:

- o What has the obligation to serve traditionally been for electric utilities?
- o What types of a societal obligation to serve have been imposed, why, and with what success, on various non-electric industries? and
- o What legal obligations to serve have been imposed, why, and with what success, on non-electric industries?

These three inquiries are summarized below and the synthesis of their lessons presented in the form of a proposed obligation to serve for competitive electric utilities.

THE TRADITIONAL ELECTRIC UTILITY OBLIGATION TO SERVE

Historically, electric utility companies have had imposed upon them by common law an "obligation to serve." The fundamental common law rule requires a utility to serve on reasonable terms all those who desire the service it renders. If a member of the public has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty

^{vi} For purposes of this paper, a "residual class" is any class of consumers that the private market would not voluntarily seek to serve on substantially equivalent terms and conditions.

of a utility to render adequate and reasonably efficient service impartially, without unjust discrimination, and at reasonable rates.

This obligation to serve arises from an electric utility's dedication of its property to a public use. Declarations in the corporate charter and other words or actions which represent a dedication to the public use would result in the creation of an obligation to serve. So, too, would actions such as accepting franchises from state and local governments or making a commitment by contract (such as by accepting public funds).

A "SOCIETAL" OBLIGATION TO SERVE OUTSIDE THE ELECTRIC INDUSTRY

Aside from the legal obligation to serve imposed on electric utilities, some industries are argued to shoulder a "societal" obligation to serve. A societal obligation to serve is often equated with the pursuit of universal service. A number of services in today's world have been found to be essential for persons to engage in a meaningful and productive life. One result of this necessity has been an argument that the industries providing those services should pursue the goal of universal service. Industries fitting this mold include those providing health care (including health insurance), property insurance, automobile insurance and telecommunications.

The common themes argued to support the nexus between universal service and a societal obligation to serve include the assertion that universal service is both necessary for the individual and beneficial to society as a whole. For example, good health (and thus health care) is both necessary for individual achievement and for the proper functioning of society. Insurance both protects individuals against unacceptable risks of loss and ensures compensation for innocent victims. Telecommunications service is necessary for individuals to engage in a range of social and economic activities as well as necessary for the proper functioning of various political and economic institutions.

Despite the conclusions that industries such as health care, telecommunications, and various personal lines of insurance are essential to individuals and beneficial to society, these industries have failed to achieve the stated goal of achieving universal service. Consider that:

- o 56% of the population relying on public assistance goes without telephone service;
- o 18% of the population (37 *million* persons) goes without health insurance coverage;

- o Hospitals, both for-profit and non-profit alike, engage in the process of "dumping" inability-to-pay customers into public institutions;
- o The population served in residual markets for auto and property insurance receive less coverage and worse customer service, even though paying substantially higher rates.

The fact that any one of these industries has failed to achieve universal service is disturbing. Even more important for purposes of this report, however, is the fact that across-the-board, industries argued to shoulder a societal obligation to maintain universal service have failed to do so. It would appear that a societal obligation to serve fails to provide a sufficient basis to achieve universal service.

Given this shortcoming, it is important to determine whether there are inherent structural barriers that prevent such performance in a competitive market. Does the failure to achieve universal service, in other words, occur in spite of or because of competitive forces. If a competitive industry can *not* be expected to meet universal service goals in light of a societal obligation to serve standing alone, there may be a need for some form of an obligation to serve enforceable by law to be crafted and implemented.

COMPETITION AND UNIVERSAL SERVICE

Persons who seek universal service can not rely upon a competitive market to deliver such results. By its nature, a competitive market tends not only to exclude those most in need, but tends to increase prices to those least able to pay. The essential characteristic of the marketplace is that it allocates goods and services on the basis of the ability to pay rather than on the basis of the need for the service. The market, therefore, excludes those who are unable to afford the service being sold. By the nature of markets, those who are unable or unwilling to pay the price of the commodity are left out.

The harm arises not from a market that does not work, but rather from a market that *does*. Inclusiveness of customers through the pursuit of universal service is not a goal which a competitive market recognizes. Conversely, exclusion is not necessarily considered a market failure.

This is not to indicate that industry participants in a competitive market harbor ill will or caprice toward consumers unable to pay. Instead, the failure to pursue universal service is based on decisionmaking considered to be not only rational by the industry, but dictated by the economics of the industry and its consumers.

A LEGAL OBLIGATION TO SERVE FOR NON-ELECTRIC INDUSTRIES

Despite the societal obligation to serve expressed for the various industries explored above, there has also been recognized a need for an obligation to serve imposed by law in some instances. A "legal" obligation to serve gives rise to enforceable obligations on the part of an industry on the one hand and to enforceable rights on the part of individuals on the other hand.

The doctrinal basis for imposing a legal obligation in some industries is helpful to understanding how and why an obligation to serve might be imposed on competitive electric companies. In the nonprofit health care industry, there are definable legal duties to provide services even to non-paying indigent patients, particularly in emergency situations. The obligations are imposed as the *quid pro quo* for the extensive federal, state and local tax subsidies provided to nonprofit hospitals. These subsidies are provided in consideration for the commitment by such hospitals to provide recuperative care without charge to those unable to pay. The touchstone of charitable hospital status was a willingness to treat patients without regard to their ability to pay. Excessive attention to paying patients and zealous billing and collection efforts were evidence of unwillingness to treat the poor. So too were low percentages of low-income patients. The hospital that provided little or no charity care stood to lose its exemption.

In sum, the legal obligation to serve in the health care industry has been based on an exchange of consideration. For nonprofit hospitals, a tax-exempt status at the federal, state and local levels has been "exchanged" for a two-fold commitment: (1) to provide medical care to the indigent up to some minimum level of health care resources; and (2) to provide emergency care irrespective of ability to pay.

In contrast, the obligation to serve within the insurance industry is largely directed toward ensuring that there are public markets to provide insurance to high risk residual classes that would not otherwise be served by the private market. In general, for workers compensation, automobile and property insurance, public markets have been statutorily created to serve residual risks unable to obtain coverage otherwise.

Even when served through these residual market mechanisms, however, those persons brought into the market are unlikely to obtain equivalent products at equivalent prices and on equivalent terms. They are likely, instead, to pay more for less. In the case of residual market automobile insurance, almost all state plans limit coverage in both dollar amount and type of coverage. Typically, the coverage was limited to the minimum requirements of compulsory insurance and financial responsibility. Despite this, rates in such plans

averaged 45% higher than rates for similar drivers in the voluntary market. In the case of property insurance, the coverages available under FAIR plans are likely to be more restricted and the cost higher than the private market. Property insurance coverage provided under FAIR plans is limited generally to fire and extended coverage, and vandalism and malicious mischief coverage. Upper limits on lines of coverage exist in order to spare the FAIR program single large losses. FAIR plan insureds often receive slower claims service and are usually denied a premium payment plan.

In brief, legal obligations to serve in non-electric industries teach that the "exchange" of an obligation to serve for public support for the industry bearing the obligation is appropriate public policy. The obligation to serve imposed in exchange for public perquisites provided in support of the industry should be in furtherance of the goal of universal service. Making such an explicit exchange of the provision of universal service in consideration of the provision of public benefits is appropriate whether or not there is a dollar-for-dollar accounting of the relative value of the consideration exchanged.

Moreover, it is possible to mandate participation in residual market "pools" as a mechanism to fulfill a legal obligation to serve. The adequacy of public markets as a mechanism for meeting an industry's obligation to serve depends on the form the public market takes and the way in which it operates. A sharing of the costs of serving residual markets in proportion to the share of the voluntary market is the most common method of pursuing universal service. If profits or benefits arise from the residual markets, those profits or benefits are assigned in proportion to market share as well. Without effective regulation of the prices, service levels and terms offered the residual markets, however, those markets are likely to be offered less service, for higher prices, on less favorable terms.

COMPONENTS OF A RESTRUCTURED ELECTRIC INDUSTRY'S "DUTY TO SERVE"

The lessons learned from the three-fold inquiry above can be synthesized into an obligation to serve for a restructured competitive electric industry. The specific components of the obligation to serve discussed below need not represent a unified program. While some components are identified as being essential, generally, rather than presenting a package to be accepted or rejected as a unified whole, the discussion presents a menu from which decisionmakers can choose.

"The" obligation to serve in a restructured electric industry cannot be defined by reference to the industry as a whole. Instead, the extent to which an obligation to serve attaches, as well as the definition of what precisely that obligation entails, will depend upon which part

of the industry --distribution or generation-- is being discussed. Affirmative obligations should attach to each part of the industry. However, the obligations that attach to distribution companies may differ in kind, not simply degree, from those that attach to providers of the actual commodity of electricity.

The recommended obligation to serve consists of two policy declarations, a definition, and five enforceable components.

Principle No. 1: The purpose of the obligation to serve is to attain and maintain universal service within the electric industry. The foundation of imposing an obligation to serve lies in the fact that the service in question is not merely important, but essential, to persons in today's world. Universal service cannot be measured by reference to customers as a whole. As has consistently been seen, universal service breaks down in the sub-markets. For there to be universal service, there must be universal service in each sub-market as well as for consumers as a whole.

Principle No. 2: The purpose of the "obligation to serve" is to prevent involuntary deterioration in current penetrations of electric service amongst those seeking service. A move to a restructured and competitive electric industry creates the potential that many households now receiving service will lose service in the future. As has been seen, a competitive market is not necessarily supportive of the pursuit of universal service. Moreover, as has been found in other industries, imposing an obligation to serve based exclusively on a moral and ethical foundation in a competitive market does not result in the provision of universal service. The electric industry stands alone in its achievement of complete success in service penetration levels. Penetration of electric service approaches 100 percent. Given this achievement, public policy should declare that any deterioration in universal service will be unacceptable.

Definition: For purposes of the obligation to serve, "universal service" means that all persons desiring to take electric service, and paying or agreeing to pay the reasonable price for such service, and abide by the reasonable rules, shall have the opportunity to take such service on a nondiscriminatory basis. The "opportunity to take service" is defined to include an affirmative obligation by service providers to engage in best efforts to make affordable service available to all customers. The definition of "universal service" has several key components. First, "universal service" does not seek to *guarantee* that every person has electric service. What it does instead is to guarantee that every person has *access* to electric service. In this sense, "access" means that every person has the opportunity to take electric service.

While there can be no guarantee that all persons will find service to be both available *and* affordable, the obligation to serve involves a responsibility to take specific actions to bring about that result. This duty is not merely one of proscriptions (*e.g.*, prohibitions on discriminatory exclusion), but instead involves a requirement for market participants to make specific efforts in furtherance of universal service. The passive offer of service to any person who wants it is insufficient compliance with the obligation if the price or terms of the offering would represent a functional denial of service to a substantial subpopulation of persons.

Component No. 1: The "obligation to serve" should include a distribution utility's obligation to connect. This obligation to connect is consistent with the historical legal obligations within the electric industry as well as with the various obligation-to-serve requirements in non-electric industries.

The obligation to connect is not an obligation that has been imposed upon a utility by the government. Instead, it is an obligation to which utilities have submitted themselves, one they have voluntarily taken upon. The obligation is an explicit *quid pro quo* that was exacted in exchange for substantial --and continuing-- public benefits. So long as the local distribution companies enjoy the fruits of that exchange, they must abide by the obligations that were bargained for as part of the exchange.

In particular, electric utilities have been granted two sets of public perquisites: (1) the right to exercise eminent domain; and (2) the right to use the public's streets, alleys and public ways as transportation corridors. In accepting these public perquisites, electric utilities have dedicated their property so supported to a public use. The "bargain" that has been made in consideration of these two public perquisites is both explicit and continuing.

Public rights-of-way are acquired and paid for through government action, usually the exercise of a jurisdiction's eminent domain powers. Thus, the public rights of way are the most valuable property rights in the hands of government. Local governments must receive fair compensation for granting use of the rights-of-way. Electric utilities were deemed to provide public compensation in the form of universal service and regulated rates. For utilities, in other words, compensation for use of the public rights-of-way was passed onto the end consumer through dedication of the utility land in support of universal service, rather than being paid directly to the governments, the actual owner of the public rights-of-way.

The dedication of electric utility property to a public use is complete upon the exercise of eminent domain or the use of public streets. The dedication of utility property to a public

use is irrevocable. The fundamental law of dedications provides that a dedicator cannot resume control of or convey the land free from the public easement, nor can he or his successor reclaim the use of the property unless the object and purposes of making the dedication has completely failed.

Component No. 2: The "obligation to serve" should include an electric service provider's obligation to participate in providing service to residual classes not served by the voluntary market. In a competitive retail environment, in other words, the state would impose an obligation to serve on all companies selling power at retail. The specific means through which this obligation is met, however, can involve various options.

Imposing an obligation to serve on service providers can be informed by mechanisms ensuring access to residual classes within the insurance industries. In the insurance industries, four basic approaches are available to serve the residual classes:

1. **Model 1:** Members of the residual class are assigned to service providers in proportion to their market share. The member is then served in the same fashion as any other customer, with the service provider either bearing the cost or pocketing the profit.
2. **Model 2:** Service providers have an obligation to serve all. However, while service is actually provided by each market participant, the providers may cede back to a public market the "risk" of any individual customer that the provider does not wish to shoulder itself. The expenses and/or profits from this public market are then allocated back to all providers in proportion to the market share of those providers. Through this mechanism, in other words, an individual consumer's service is provided through each company, with the profit or loss associated with that consumer being allocated back to the pool.
3. **Model 3:** The residual class is served by a single public market, generally administered by one (or just a few) service provider[s]. The costs and profits of that public market are allocated to all service providers in proportion to market share.
4. **Model 4:** Members of the residual class are assured of access to service through a pool mechanism. Rather than allocating the pool costs back to all market participants, however, to the extent that the members of the class

represent higher risks, the provider of such service may place the additional cost of serving the class on the members of the class. Rates to the residual class, therefore, may be much higher than rates in the private markets. In addition, the level of services offered may be lower.

Each model has its advantages and disadvantages.

Component No. 3: The "obligation to serve" should include the obligation of an electric service provider to make available at least a minimum standard offer of service. In the event that local regulators do not adopt the pro rationing mechanism from Model 1 for serving members of the public market, regulations will be necessary to ensure that members of the residual class are, at the least, made available a minimum standard offer at regulated rates.

The requirement for a minimum standard offer serves three functions. First, it helps to ensure that the goal of universal service has been fulfilled by ensuring a threshold offer of service. Recommendations in the health insurance industry, for example, have included the need to guarantee the "availability of a specified minimum benefit package." In the health care industry, the recommendation has been for "an adequate minimum standard of coverage" including "access to 'primary,' as well as 'catastrophic,' care."

Second, it ensures that the residual classes are not unduly discriminated against in the provision of service. As noted above with respect to the insurance industries, the residual markets are often offered significantly reduced coverages at significantly increased prices. In response, statutes have mandated minimum coverages.

Finally, it ensures that the goal of universal service is truly met. As the Federal Communication Commission (FCC) recently held with respect to its universal service obligations: "We find that the overarching universal service goals may not be accomplished if low-income universal service support is provided for service inferior to those supported for other subscribers."

Component No. 4: An electric service provider should have the obligation to make service available on a non-discriminatory basis. This duty of "non-discrimination" has two elements to it. First, the duty should adopt principles in line with traditional notions of consumer protection. Actions that have the *effect* of imposing adverse impacts on a residual class should be unlawful unless they are dictated by a business necessity. Second, the duty of non-discrimination must extend beyond those decisions by electric service providers that may be economically irrational. Reference to public policies prohibiting

"redlining" in the housing, home lending, and insurance industries are helpful in defining the obligation to serve in this regard. In these industries, just because a decision to redline may be "rational" does not mean that it is lawful.

Component No. 5: The obligation to serve should include an obligation by all electric service providers to help fund the cost of serving residual classes via a charge on all end use. It is frequently accepted that electric restructuring will involve the imposition of a wires charge to help fund assistance for these customers. All service providers and all end users should help fund this wires charge as part of the obligation to serve.

Four factors go into this determination. First, as discussed in detail above, utilities are unique in that they are granted the right to use city streets as well as the right to exercise the power of eminent domain. Second, those public benefits have a distinct value, which is positive; indeed, the right to eminent domain is not only *valuable*, but is essential to public utilities. This value inures to the benefit of all ratepayers. If a utility could not use eminent domain, in other words, the increased costs that would arise as a result would be borne by all ratepayers. All end users gain the benefit. Third, a commitment to universal service is simply the compensation to the public for having provided these public benefits. There has been an exchange of consideration. On the one hand, electric utilities are provided the right to use public streets and to exercise eminent domain. On the other hand, the utilities "pay" for these grants through a commitment to universal service. Finally, offering unaffordable service is the functional equivalent of denying service altogether. Accordingly, a commitment to universal service implies a commitment to affordable service.

In sum, having obtained the benefits of the bargain, all service providers and all end users should be required to help fulfill the responsibility part of the bargain. To allow otherwise would be to grant the benefit while forgiving the costs.

CONCLUSION

Given the historical basis for imposing a legal obligation to serve on the electric industry and its continuing validity, the failure of non-electric industries to achieve universal service based exclusively upon a societal obligation to serve, the inherent structural barriers that a competitive market presents to achievement of universal service, and the existence of readily available non-electric obligation-to-serve models applicable to competitive markets, an electric utility obligation to serve consisting of the elements provided above is necessary, reasonable, and appropriate.

INTRODUCTION

Historically, the social compact to which electric utilities have been held involves a common law "duty to serve." Permitting a move to a restructured competitive electric industry provides the opportunity to explicitly rewrite this social compact. This report presents an assessment of what the "obligation to serve" might look like in a competitive electric industry.¹²¹ Broadly, this research has three objectives:

- o To define the "duty to serve"¹³¹ of a competitive electric industry;
- o To identify those companies to whom that duty applies; and
- o To explain how that duty protects residual classes.¹⁴¹

In pursuit of these objectives, the discussion below is laid out in four parts. *Part 1* presents an historical view of an electric utility's obligation to serve. *Part 2* describes the basis for and justification of a "societal" obligation to serve within the context of non-electric industries where such a societal obligation has been found (or argued) to exist. *Part 3* describes the "obligation to serve" imposed by law on non-electric industries. Finally, *Part 4* synthesizes the results of these three inquiries into a new "obligation to serve" applicable to a restructured competitive electric industry.¹⁵¹

¹²¹ This analysis applies with equal force to a competitive natural gas industry.

¹³¹ The phrases "duty to serve" and "obligation to serve" are synonymous.

¹⁴¹ For purposes of this paper, a "residual class" is any class of consumers that the private market would not voluntarily seek to serve on substantially equivalent terms and conditions.

¹⁵¹ See generally, Harmeet Sawhney, "Universal Service: Prosaic Motives and Great Ideals," 38 *Journal of Broadcasting and Electronic Media* 375 (1994).

The main thesis of this paper is that the development of universal service is primarily a function of politics, economics, and social values. The specific characteristics of a particular technology or service are of secondary importance. The problem is fundamentally the same whether the service under consideration is education, electricity, or telecommunications. Therefore, there is a great deal of consistency in the way society resolves the question of providing a service on a universal basis. In other words, although the specifics of each individual situation are different, there is a pattern which underlies the development of universal service within society. An understanding of this pattern can aid the formation of a conceptual framework that would be most appropriate for analyzing universal service issues in the telecommunications arena.

Id. The same can be said for the development of an "obligation to serve" within a competitive electric industry.

Two appendices are then attached. *Appendix A* summarizes the lessons learned from a consideration of the obligation to serve in a variety of industries. *Appendix B* summarizes the menu policy to implement an obligation to serve in a competitive electric industry.

PART 1: HISTORICAL VIEW OF AN ELECTRIC UTILITY'S "OBLIGATION TO SERVE"

An assessment of to what extent an obligation to serve attaches to a competitive provider of electric services should take into account the extent to which such an obligation has attached to "public utilities" in the past and why. The following discussion will look at the obligation to serve for retail utilities. The purpose of the inquiry is to determine whether past treatment of the issue can help guide a transition to a more competitive electric industry today.

The Traditional Obligation to Serve Rule

Historically, electric utility companies have had imposed upon them by common law a "duty to serve." The fundamental common law rule requires a utility to serve on reasonable terms all those who desire the service it renders.¹⁶¹ If a member of the public has applied for and made the necessary arrangements to receive service, and has paid for or offered to pay the price and abide by the reasonable rules of the company, it is the duty of a utility to provide the service.¹⁷¹ An electric utility is under a legal obligation to render adequate and reasonably efficient service impartially, without unjust discrimination, and at reasonable rates.¹⁸¹ In short, under the common law, a utility must make its service available to all members of the public to whom its public use and scope of operation extend, who apply for such service, and who comply with its reasonable rules and regulations.¹⁹¹

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

¹⁷¹ Annotation, *Liability of gas, electric or water company for delay in commencing service*, 97 *A.L.R.* 838, 839 (1935); see also, 26 *Am.Jur.2d*, *Electricity, Gas and Steam*, §110 (1966) (delay in commencing electric service); 26 *Am.Jur.2d*, *Electricity, Gas and Steam*, §216 (1966) (delay in commencing gas service).

¹⁸¹ See e.g., *Arizona Corp. Comm'n v. Nicholson*, 497 P.2d 815, 817 (Az. 1972) (citations omitted).

¹⁹¹ For excellent discussions of the scope and ramifications of this duty, see generally, Comment, "Liability of Public Utility for Temporary Interruption of Service," 1974 *Wash. L. Qtrly* 344, 346, n. 10 (1974); Gustavus Robinson, "The Public Utility Concept in American Law," 41 *Harv. L.Rev.* 277 (1928); Norman Arterburn, "The Origin and First Test of Public Callings," 75 *U.Penn. L.Rev.* 411 (1927); Charles Burdick, "The Origin of the Peculiar Duties of Public Service Companies," 11 *Columbia L.Rev.* 514 (1911).

One key element of a utility's common law duty to serve is its total independence from any statutory basis.¹¹⁰ The duty of an electric utility "is one implied at common law and need not be expressed by statute, or contract, or in the charter of the public utility."¹¹¹ The Indiana supreme court has noted:

when the state fails, or does not see fit, to regulate the rates and charges or services by legislation or by creating a commission for the purpose, the public, nevertheless, still has the basic right under the common law to be served in all particulars, without discrimination, and at a reasonable price .¹¹²

The duty to serve "is an integral aspect of public utility status. American courts imposed such a duty long before the establishment of comprehensive regulation of utilities pursuant to statutes."¹¹³

¹¹⁰ See e.g., *Snell v. Clinton Electric Light, Heat and Power Company*, 196 Ill. 626, 58 L.R.A. 284, 63 N.E. 1082 (1902). "There is no statute regulating the manner under which electric light companies shall do business in this state. They are, therefore, subject only to the common law and such regulations as may be imposed by the municipality which grants them privileges." *Id.*, at 1083; see also, *Morehouse Natural Gas Company v. Louisiana Public Service Commission*, 140 So.2d 646 (La. 1962); *Messer v. Southern Airways Sales Co.*, 17 So.2d 679, 681 (Ala. 1944); *Birmingham Railway, Light and Power Company v. Littleton*, 77 So. 565, 569 (Ala. 1917); *Snell v. Clinton Electric Light Company*, 196 Ill. 626, 58 L.R.A. 284 63 N.E. 1082 (1902); *Gibbs v. Baltimore Gas Company*, 130 U.S. 396 (1888); *Southwest Gas Corp. v. Public Service Commission*, 474 P.2d 379 (Nev. 1970).

¹¹¹ 64 *Am.Jur.2d, Public Utilities*, §16 (1972) (citations omitted). The duty may well be incorporated into state statutes for regulated utilities, see, Comment, "Liability of Public Utility for Temporary Interruption of Service," 1974 *Wash. U.L.Q.* 344, 345 - 46, n.9 (1974), but it exists at common law for those public utilities not covered by statute.

¹¹² *Foltz v. Indianapolis*, 130 N.E.2d 650 (1955); see also, *Montgomery Ward & Co. v. Northern Pacific Terminal Co.*, 128 F.Supp. 475 (D.Ore. 1953); accord, *Messer v. Southern Airways Sales Co.*, 17 So.2d 679 (Ala. 1944). So, too, have the Missouri courts held with regard to the common law duty to serve, "such duties arise from the public nature of a utility, and statutes providing affirmatively therefore are merely declaratory of the common law." *Overman v. Southwestern Bell Tele. Co.*, 675 S.W.2d 419, 424 (Mo. App. 1984). According to the Missouri courts, "a public utility is obligated by the nature of its business to furnish service or commodity to the general public, or that part of the public which it has undertaken to serve, without arbitrary discrimination." *Id.*, quoting, 73B C.J.S., *Public Utilities*, §8 (1983). (emphasis added).

¹¹³ Floyd Norton and Mark Spivak, "The Wholesale Service Obligation of Electric Utilities," 6 *Energy Law Journal* 179, 182 (1985).

Source of the Traditional Obligation

This obligation to serve arises from an electric utility's dedication of its property to a public use. This dedication may take one of several forms.¹¹⁴ The utility may, for example, make self-declarations (through actions or deeds) of its intent to dedicate its property to a public use and thus accept the imposition of an obligation to serve. Declarations in the corporate charter and other words or actions which represent a dedication to the public use¹¹⁵ would result in the creation of an obligation to serve.

In contrast, the utility may evidence its dedication of property to a public use (and acceptance of the obligation to serve) through particular transactions. Accepting franchises from state and local governments,¹¹⁶ as well as making a commitment by contract,¹¹⁷ involve such situations.

Summary

In sum, several lessons can be learned from the traditional obligation to serve imposed upon electric utilities:

- o The obligation is intended primarily to ensure that electric service is extended to all who desire service and express a willingness to pay for the service rendered and to abide by the reasonable regulations of the utility.

¹¹⁴ One commentator, notes that "where utility status exists, a particular service obligation may arise from several sources, separately or in combination." *Norton and Spivak, supra* note 13, at 182.

¹¹⁵ This "holding out" can be evidenced in any one of numerous ways. *See generally*, Roger Colton (1993). *The Regulation of Rural Electric Cooperatives*, at §1.1 (Factors Showing Public Utility Status), National Consumer Law Center: Boston (identifying six manifestations of "holding out" recognized by the courts).

¹¹⁶ The Ohio courts have held that the acceptance of public perquisites is, unto itself, an acceptance of public utility status. "Ohio," one state appellate court held:

does not allow the granting of a franchise permitting the use of the public ways for a private purpose. When (the company) actually accepts the franchise from the village it will then be committed, if not theretofore committed, to serving the public. At that time, if not before, (the company) will fulfill the principal determinative character of a public utility.'

Ohio Power Co. v. Village of Attica, 250 N.E.2d 111, 117 (Oh. App. 1969).

¹¹⁷ For example, an REC's acceptance of REA funds would be acknowledgement that the co-op is a "public utility." One court noted that in accepting REA loan funds, a co-op makes a contractual commitment to the federal government in its loan agreement with REA to "make diligent effort to extend electric service to all unserved persons" within its area. *Dairyland Power Cooperative v. Brennan*, 82 N.W.2d 56, 61 (Minn. 1957).

- o While this commitment does not ensure that customers will retain service if they do not or can not pay for it, it does involve an element of ensuring that all customers (and potential customers) have the opportunity to take service.
- o The obligation to serve includes a requirement of non-discrimination. Discrimination historically has involved a commitment to refrain from making unreasonable distinctions.¹¹⁸¹
- o The obligation has traditionally derived from the common law, imposed as a result of the nature of the electric industry. Specific regulations or pieces of legislation setting forth the obligation were merely restatements of that common law.

To avoid doing violence to any of these principles, each should be incorporated into the obligation to serve in a restructured competitive electric industry.

PART 2: A "SOCIETAL" OBLIGATION TO SERVE OUTSIDE THE UTILITY INDUSTRY

Even though the electric utility industry is often cited as *the* example of an industry bearing an "obligation to serve," imposing such an obligation is not unique to electric utilities. Industries ranging from health care to various types of insurance are argued, at the least, to bear a "societal" obligation to serve to one extent or another.

A societal obligation to serve is often equated with the need to provide universal service. A number of services in today's world have been found to be essential for persons to engage in a meaningful and productive life. One result of this necessity has been an argument that the industries providing these services pursue the universal provision of such services. Industries fitting this mold include those providing health care (including health insurance), property insurance, automobile insurance and telecommunications.

A societal obligation to serve, however, often falls short of the broad goal of achieving universal service. Given this shortcoming, the discussion below defines and provides the doctrinal foundation for a societal obligation to serve, assesses whether that obligation is being met, and considers whether, if not, there are inherent structural issues that prevent

¹¹⁸¹

See generally, Roger Colton "Discrimination as a Sword for the Poor: Use of an 'Effects Test' in Utility Litigation." 37 *Washington University Journal of Urban and Contemporary Law* 97 (1990), reprinted, XIII *Public Utilities Anthology* 813.

such performance. Finally, the implications of these non-electric industries are assessed in light of their application to a competitive electric industry.

The Doctrinal Basis for a "Societal" Obligation to Serve

Arguments for a "societal obligation to serve" are generally based on the asserted ethical or moral obligation on the part of an industry to make service universally available to all who seek it. The societal obligation to serve primarily arises from the over-arching necessity for the service in question. The argument and analysis spans industries as well as generations. Discussions of education in the mid-19th Century mirror quite closely discussions of electricity as the 21st Century approaches. As noted in one context:

We find similar appeals for the provision of education, electricity, and medical coverage on a universal basis. In the mid-1800s the masthead of the *Working Man's Advocate* read, "all children are entitled to equal education; all adults to equal privileges." The argument here was that universal education is a necessary requirement for modern life. In 1925 this sentiment reappeared in a speech by L.J. Taber, master of National Grange, who saw electricity as a basic right and therefore implored the electric utilities "to render conspicuous service to humanity and to bring Electrical Sunshine to all American homes, and with it the confidence that the rights of the humblest citizens are being protected." Today, the concern about universal medical coverage is generating similar pleas. The individual rights argument was well articulated by Pope John XXIII, who wrote, in his 1963 encyclical, that all humans had "the right to bodily integrity and the means necessary for the proper development of life."¹¹⁹

Discussions frequently equate a societal obligation to serve with the need to achieve universal service. The common themes which lead to this connection include the arguments that universal service is both necessary for the individual and beneficial to society as a whole.¹²⁰ The breadth and reach of a societal obligation to serve based on these premises can be seen in their application to various non-electric industries.

¹¹⁹ *Sawhney, supra note 5, at 378.*

¹²⁰ As one commentator said, "it became the interest of the whole to provide the necessary [service] for its parts." Sidney Ditzion (1947). *Arsenals of a Democratic Culture, A Social History of the American Public Library Movement in New England and the Middle States from 1850 to 1900*. Chicago: American Library Association, as quoted in *Sawhney, supra note 5, at 380.*

Health Care Industries

The assertion that there is a societal obligation to provide persons with health care in the United States is typical of the arguments raised throughout other industries. "Universal access to health care," one commentator states, "is justified not only by greater vitality among the currently uninsured, but also by social and economic benefits for all of society."¹²¹ In addition, good health is not simply beneficial, but "a necessary condition for just about all aspects of human endeavor."¹²²

Because of the connection between health care and health insurance, many argue that there is not only an obligation to serve on the part of the direct provider of health care services, but on the part of the industry that *enables* persons to obtain those direct services as well, the health insurance industry. "Health insurance coverage must be universal. Only if everyone is adequately covered can we assure all Americans access to care when they need it and bring an end to . . . underservice to the uninsured."¹²³

There is little dispute about the profound impact that the access to health insurance has on the access to, and effectiveness of, health care.¹²⁴ ". . . virtually every study on the use of medical services reports that lack of health insurance represents a major barrier to medical care."¹²⁵ This analyst concludes that "financial barriers to health care. . . may restrict

¹²¹ Lawrence O. Gostin, "Securing Health or Just Health Care? The Effect of the Health Care System on the Health of America," 39 *St. Louis U. L.J.* 7, 10 (1994).

¹²² *Id.*, at 13. According to this analysis, "health is necessary for the pursuit of livelihood. Without a certain level of health, a person cannot train, develop skills, or employ existing qualifications and skills in income-producing activities." This impedes individuals from obtaining basic necessities such as food, shelter and clothing. Moreover, "a certain level of health is a necessary condition for the exercise of fundamental rights and privileges." Persons with acute and chronic diseases may not be able to exercise their right to travel or their autonomy of decision-making in personal and financial affairs. Finally, health is important to achieve personal satisfaction, happiness, and better personal relationships. "Human fulfillment is much more difficult to achieve when human beings experience unremitting pain and suffering, when they cannot meet their basic self-care needs, or when they lose mental and physical functioning." *Id.*

¹²³ Carlo V. DiFlorio, "Assessing Universal Access to Health Care: An Analysis of Legal Principle and Economic Feasibility," 11 *Dick. J. Int'l L.* 139, 154 (1992).

¹²⁴ Commission on Monitoring Access to Personal Health Care Services, Institute of Medicine, *Access to Health Care in America* 3, 17 (Michael Millman ed., 1993) (indicators that measure health outcomes suggest that low income persons with no health insurance experience profoundly different health outcomes).

¹²⁵ *Gostin, supra* note 21, at 21. "Compared with the insured, [persons without health insurance] have significantly fewer ambulatory visits, are less likely to have contact with a medical provider, and are more (continued...)

access either by impeding the person's ability to pay for services or by discouraging health care providers from treating patients with limited means."^{126\}

In sum, the health care industry introduces the dual basis for arguing the existence of a societal obligation to serve: (1) the necessity for individuals; and (2) the benefits for society.

Insurance: Property, Liability, Automobile

This dual basis is seen also in the substantial argument in support of a societal obligation to serve for insurance coverage involving property, liability and automobiles. The reasoning urges that insurance is a necessity since it protects individuals against risks that they could not reasonably be expected to bear. "Insurance is essential in a way different from most other privately provided goods and services."^{127\}

Families need protection from the death and disability of breadwinners. Houses and cars are not financed without insurance. There is strong social pressure to compensate the innocent victims of accidents. More than half of the states require liability coverage or some other approved form of security before a car can be registered.^{128\}

One common theme running through discussions of the necessity of insurance is the use of insurance as a prerequisite to the grant of credit.^{129\} "For a family with even modest

^{125\}(...continued)

likely to receive their care in a hospital outpatient clinic or emergency department. The under-utilization of health services among the uninsured is particularly pronounced among those with chronic and serious illness, precisely those individuals who most need health care. Children without health insurance are particularly at risk of not receiving care. Further, the uninsured are significantly more likely to report needing but not receiving medical care, primarily for economic reasons." *Id.*

^{126\} *Id.*, at 22.

^{127\} Leah Wortham, "The Economics of Insurance Classification: The Sound of One Invisible Hand Clapping," 47 *Ohio St. L.J.* 835, 874 (1986).

^{128\} *Wortham*, *supra* note 27, at 852.

^{129\} Leah Wortham, "Insurance Classification: Too Important to be Left to the Actuaries," 19 *U.Mich. J.L. Reform* 349, 351-52, 395, 396 (1986).

assets to protect, the personal lines of insurance are necessities."¹³⁰ Moreover, even persons who own their homes free of debt "often would lack personal savings sufficient to repair extensive fire or storm damage."¹³¹

Insurance provides a societal benefit as well. For example, imposing an obligation to serve on the property insurance industry helps to protect the urban core. In discussing the harms of insurance "redlining," one analyst finds:

That [redlining] is commonplace in an industry which provides a service as vital as property insurance has devastating implications for the housing opportunities of minorities. Disinvestment and building abandonment in redlined areas is accelerated by skyrocketing maintenance and operating costs. Families with the means to do so flee redlined areas, leaving behind the higher insurance costs and the stigma of the residual market. Hard-pressed owners who have foregone property insurance coverage lack the capacity to rebuild after a fire. White flight, which accompanies disinvestment, almost invariably leads to accelerated racial and economic segregation.¹³²

As can be seen, arguments for an obligation to serve within the insurance industry track arguments within the health care industry. Imposing an obligation to serve assists consumers individually as well as society as a whole. The availability of property insurance helps to maintain communities. The availability of automobile insurance helps to compensate victims.¹³³

¹³⁰ *Id.* "Personal lines are those that individuals usually carry: automobile, homeowner's or renters, health, life, and disability insurance." *Id.*

¹³¹ *Id.*

¹³² David Badain, "Insurance Redlining and the Future of the Urban Core," 16 *Columbia J.L. & Soc. Probs.* 1, 35 (1980). "The unavailability of insurance coverage stemming from redlining has contributed to the deterioration of American urban centers and has effectively frustrated attempts at urban revitalization." Comment, "Application of Title VIII to Insurance Redlining," 75 *NW.U.L.Rev.* 472, 472 (1980) (footnote omitted).

¹³³ Jon Hanson, *et al.* (1974). *Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business*, at 124 - 125, National Association of Insurance Commissioners: Milwaukee.

Telecommunications

The telephone has become one of life's necessities and, as a result, that industry is increasingly viewed as imbued with at least a societal obligation to serve.

[T]elecommunications services have now become so important that an individual without access to them is not equipped for everyday life. The telephone is no longer a luxury. Rather, it is a necessity in a modern society. Therefore, no one, including even the poorest individuals, "should be denied the opportunity to phone for help in an emergency or be denied the participation in the life of the community that the telephone provides."^{134\}

In addition, the lack of a telephone can adversely affect households in all of their economic and social aspects of being. The Montana Supreme Court found in a 1987 case, for example, that the lack of a telephone is a significant "barrier to employment."^{135\} Moreover, a study for the Maine public utilities commission found that the lack of a telephone in the home interfered with a household's ability to maintain home heating service because it impeded the ability to contact the utility to arrange payment plans and to contact social service agencies for public assistance.^{136\}

In addition, increasing the penetration of telecommunications service generates added value to the system as a whole. This "system benefit" argument finds that each additional telephone subscriber increases the value of the entire network, because not only can that subscriber call out, but all other subscribers can call in as well. In addition, various retail establishments are more accessible to a person who has telecommunications service in the home. In general, both the social and economic systems of the nation function more effectively and efficiently if telephone service is universally available.^{137\} Stated

^{134\} *Sawhney*, *supra* note 5, at 378. (citations omitted).

^{135\} *Butte Community Union v. Lewis*, 745 P.2d 1128, 1131 (Mont. 1987).

^{136\} Roger Colton (1994). *Universal Residential Telephone Service: Needs and Strategies*, in *Proceedings of the 105th NARUC Annual Conference*, at 247, 249, National Association of Regulatory Utility Commissioners: Washington D.C.

^{137\} *Sawhney*, *supra* note 5, at 379 - 380.

conversely, the *unavailability* of universal telephone service is postulated to have significant adverse impacts on society.¹³⁸¹

Lessons Learned for Competitive Electric Utilities

The experiences outlined above are closely related to the experiences in the electric utility industry. No one questions the essential nature of electricity in today's world. The lessons learned from the discussion above, however, are more specific than simply "electricity is important in today's world." The lessons learned can be summarized easily. A societal obligation to serve has been urged to exist when three conditions are present:

1. the services affected are essential to individual persons;
2. providing universal service offers tangible benefits to all parts of society; and
3. a failure to provide universal service results in dysfunctions in critical elements of society, including social, economic, and political institutions.

Given these strong bases for an obligation to serve, it is necessary then to determine whether that obligation, founded on moral or ethical grounds rather than on legal principle, is sufficient to ensure universal service.

Whether a Societal Obligation to Serve Provides a Sufficient Basis to Achieve Universal Service

In light of these findings of the need to serve on the part of various industries, this section considers whether a societal obligation to serve provides a sufficient basis to achieve universal service. If the universal service goal is *not* being fulfilled, it is reasonable to consider whether structural barriers exist in a competitive market that impede or prevent its achievement despite the identified societal "obligations."

Health Care

Health care is not an industry that has reached the goal of universal service. The lack of access to health care is particularly acute within low-income and minority populations.

¹³⁸¹

See generally, Heather Hudson and Edwin Parker, "Information Gaps in Rural America: Telecommunications Policies for Rural Development," 14 *Telecommunications Policy* 193 (1990); Larry Pressler and Kevin Schieffer, "A Proposal for Universal Telecommunications Service," 40 *Federal Communications Law Journal* 351 (1988).

The failure to achieve universal service in health care has been documented through measuring the use of health services, the quality of those services, and health outcomes.¹³⁹

"The disparities in access to care are particularly sharp and enduring for persons with low socioeconomic status (the poor or near poor, the uninsured, and those in public programs such as Medicaid) and persons in minority racial and ethnic groups."¹⁴⁰

Not all poor health outcomes can be attributed to inadequate access to health care. Instead, much can be attributed to environment, housing, behavior, and nutrition. Nonetheless:

most thoughtful observers conclude that barriers to access to health services, measured by utilization of services and health outcomes for equivalent conditions, remain a significant contributing factor explaining the increased morbidity and mortality among the poor and minorities.¹⁴¹ For example, the Institute of Medicine estimates that one-third to one-half of the gaps in mortality rates are attributable to difficulties in obtaining access to health care.¹⁴²

¹³⁹ Institute of Medicine, Committee on Monitoring Access to Personal Health Care Services *Access to Health Care in America* 4-5, 32-34 (Michael Millman ed., 1993), National Academy Press: Washington D.C.

¹⁴⁰ See e.g., Nancy E. Adler, *et al.*, "Socioeconomic Inequalities in Health: No Easy Solution," 269 *J.Am.Med.Ass'n* 3140, 3143-44 (1993); Helen R. Burstin, *et al.*, "Socioeconomic Status and Risk for Substandard Medical Care," 268 *J.Am.Med.Ass'n* 2383, 2383 (1992); Paul H. Wise, "Racial and Socioeconomic Disparities in Childhood Mortality in Boston," 313 *New Eng. J. Med.* 360 (1985); Council on Ethical and Judicial Affairs, "Black-White Disparities in Health Care," 263 *J.Am.Med.Ass'n* 2344 (1990).

Health disparities between poor people and those with higher incomes are almost universal for all dimensions of health. For virtually all of the chronic diseases that are the leading causes of mortality, low income is a special risk factor. Thus, the incidence of heart disease and most all forms of cancer (lung, esophageal, oral, stomach, cervical, prostate) are significantly higher for persons in poverty than for the rest of the population. The poor also suffer disproportionately from infectious diseases such as HIV and respiratory diseases such as tuberculosis. Similar vulnerability is found among the poor for traumatic injuries and death. . . Low-income people have death rates that are twice the rates for people with incomes above the poverty level.

Gostin, supra note 21, at 31 - 32.

¹⁴¹ See, *Access to Health Care, supra* note 39, at 3-4, 17-18, 32-34.

¹⁴² *Gostin, supra* note 21, at 33.

In short, the health care industry falls significantly short of achieving universal service despite its societal obligation to serve.¹⁴³¹

Health Insurance

Health *insurance*, also, has fallen short of achieving universal service. At any given time during the last year, approximately 37 to 40 million people were without health insurance.¹⁴⁴¹ Not only are substantial numbers of persons without insurance, but the number of uninsured persons is rising.¹⁴⁵¹

The lack of health insurance is significantly related to low-income and minority racial/ethnic status. The uninsured population is disproportionately poor or near-poor, African-American or Hispanic, young, and unemployed.¹⁴⁶¹

In 1991, some 36% of the uninsured population were African-American (17%) or Hispanic (greater than 18%), representing approximately 30% of the African-American population, and over 40% of the Hispanic population. .38% of the uninsured population were unemployed, and 55% had family incomes below \$10,000.¹⁴⁷¹

As can be seen, as with health care services generally, the failure to achieve universal service does not fall equally on all consumers. Instead, those households in lower socio-

¹⁴³¹ See generally, Randall R. Bovbjerg & William G. Kopit, "Coverage and Care for the Medically Indigent: Public and Private Options," 19 *Ind. L. Rev.* 857 (1986). One study found a ten-fold or greater differential in the proportion of physicians to population between more affluent areas and low-income, minority neighborhoods. Eli Ginzberg, *Parallels, Differences, and Prospects*, in *Changing U.S. Health Care: A Study of Four Metropolitan Areas* 200 (Eli Ginzberg, et al. eds., 1992), Westview Press: Boulder, CO.

¹⁴⁴¹ *Gostin*, supra note 21, at 18 - 19. This represents about 15-18% of all children and adults. "[W]hile the census reported 33.5 million uninsured in 1992 based on monthly averages, others calculated that 50 to 58 million lacked health insurance for at least one month in that year." *Id.*

¹⁴⁵¹ "Primary reasons for the rising number of the non-elderly uninsured persons are the decline in health coverage among individuals (and their families) working for small firms, the increase in the overall poverty rate, and the increase in the costs of medical services." *Gostin*, supra note 21, at 20.

¹⁴⁶¹ Howard E. Freeman et al., "Abstract, Uninsured Working-age Adults: Characteristics and Consequences," 265 *J.Am.Med.Ass'n* 2474, 2474 (1991) (noting that "the uninsured are most likely to be poor or near poor, Hispanic, young, unmarried, and unemployed.").

¹⁴⁷¹ *Gostin*, supra note 21, at 20.

economic strata, as well as non-white households, disproportionately bear the burden of the lack of access.

Insurance: Property, Casualty, Automobile

The failure to achieve universal service does not necessarily represent a failure to have an industry which reaches penetration levels of at or close to 100 percent. Most states today, for example, have enacted "financial responsibility" laws that require persons to have automobile insurance as a condition of having a driver's license (and as a *de facto* condition for financing a car). Nonetheless, there is considerable opinion that "universal service" has not yet been reached because of the vast differences in prices and terms offered to various populations.

The auto insurance industry has long been criticized for its process of "territorial rating." Territorial rating bases the prices paid for insurance policies on the residence of the policyholder. The impact is dramatic. One analysis of territorial rating in California reports:

Territorial rating imposes a substantial economic burden on drivers who choose to, or must, live in low income, predominantly minority, communities. The system has led to an inherently unfair economic result: those residents of urban areas of California with the lowest median income levels are charged the highest rates in the state for automobile insurance.¹⁴⁸¹

The disparities in insurance pricing place hundreds of dollars of increased automobile insurance burdens on low-income and minority insurance customers. In 1986, for example, the California Department of Insurance published a comprehensive study of the financial consequences of territorial rating. That study examined liability insurance rates for automobiles using a standard policy type and automobile model.¹⁴⁹¹ It revealed that in almost every instance, residents of areas of the Los Angeles Basin and San Francisco Bay Area that are identifiably African-American, Latino, Asian, and/or poor pay the highest rates for automobile insurance in California.

¹⁴⁸¹ Gary Williams, "The Wrong Side of the Tracks: Territorial Rating and the Setting of Automobile Liability Insurance Rates in California," 19 *Hastings Const. L.Q.* 845, 847 (1992).

¹⁴⁹¹ The study was entitled *Comparative Premium Survey of Automobile Insurance for California*. The *Comparative Premium Survey* listed the rates charged by ten major insurers for every county in California, for every zip code in the state. Comparison of the data from the *Comparative Premium Survey* with demographic and economic data compiled by the Census Bureau and other organizations documented the racial and economic impact of that distribution.

Similar rate disparities affect Inglewood, another predominantly Black and Latino area of Los Angeles County. The Insurance Department Study's hypothetical driver, living in Inglewood, would have paid an average premium of \$703.00. If that driver moved to El Segundo or Manhattan Beach, predominantly Anglo communities located adjacent to Inglewood, the driver's average premium cost would plunge to \$345.00. Again, the racial impact of the disparity in rates is indisputable. Inglewood's population was 102% people of color.¹⁵⁰¹ Racial minorities made up a mere 11% of the population of El Segundo in 1990 and they comprised 10% of the population of Manhattan Beach in 1990.¹⁵¹¹

The economic burden that falls on low-income neighborhoods is both substantial and avoidable. For example, Inglewood, with an average premium of \$745, the median community income was \$25,720. In nearby El Segundo, the median household income was \$41,763, while the median income in Manhattan Beach, was \$58,403. Both communities paid an average liability insurance premium of \$345, less than half the rate paid by Inglewood residents. According to the automobile insurance industry, these results do not reveal a pattern of discrimination. They merely reflect actual differences in risks (and therefore of costs) that arise on a geographic basis.

Telecommunications

The most commonly used measure of the success in reaching universal telephone service in the United States is "telephone penetration" --the percentage of all U.S. households that have a telephone on-premises.¹⁵²¹ Using this standard, most people would believe that universal telephone service is the standard in the United States. Yet large portions of the low income population cannot afford telephone service in their homes. In 1991, while fewer than one out of 100 upper income families did not have a telephone, roughly 25 out of 100 low income families did not.¹⁵³¹

¹⁵⁰¹ Figures can add up to more than 100% because under Census definitions, a person of Hispanic ethnicity can be of any race.

¹⁵¹¹ *Williams, supra* note 48, at 848 - 849.

¹⁵²¹ Jim McConaughy, Cynthia Ann Nila and Tim Sloan (1995). *Falling through the Net: A Survey of the 'Have Nots' in Rural and Urban America*, at 1, U.S. Department of Commerce, National Telephone Information Administration: Washington D.C.

¹⁵³¹ This sets aside the question of whether it is appropriate to measure "universal service" simply by reference to the "telephone." As one commentator puts it: "There are legitimate questions about linking universal
(continued...)

Amongst low-income households, telephone penetration rates are dramatically low:

- o Of households on public assistance, 35 percent lack telephones;
- o Of households receiving food stamps, 31 percent lack telephones;
- o Of households receiving energy assistance, 21 percent lack telephones.¹⁵⁴¹

Indeed, of those households completely dependent on public assistance, the penetration rate of telephone service is only 43.5 percent (leaving more than 56 percent without service).¹⁵⁵¹

Telephone penetration patterns are not racially neutral either.¹⁵⁶¹ While the national average penetration rate for telephone service is 94 percent,¹⁵⁷¹ the penetration rate for black households (regardless of income) is only 86 percent.¹⁵⁸¹ The racial inequality is a particular problem for the poor. While 75 percent of all households with incomes less than

¹⁵³¹(...continued)

service solely to telephone service in a society where individuals' economic and social well-being increasingly depends on their ability to access, accumulate, and assimilate information. While a standard telephone line can be an individual's pathway to the riches of the Information Age, a personal computer and modem are rapidly becoming the keys to the vault." *McConnaughey*, *supra* note 52.

¹⁵⁴¹ Alexander Belinfante (1989). *Telephone Penetration and Household Family Characteristics*, Federal Communications Commission Docket No. CC 87-339. Washington D.C.

¹⁵⁵¹ *Id.*

¹⁵⁶¹ See generally, Common Carrier Bureau, Federal Communications Commission, *Preparation for Addressing Universal Service Issues: A Review of Current Interstate Support Mechanisms*, at 14 (February 1996) ("Despite the high overall rates and the apparent progress among minorities, recent studies indicate that subscribership among African-American and Hispanic households continues to lag that of White households by about 10 percent.")

¹⁵⁷¹ Jorge Reina Schement (1996). *Beyond Universal Service: Characteristics of Americans without Telephones, 1980-1993*, *Communications Policy Working Paper #1*, at 1, Benton Foundation: Washington D.C.

¹⁵⁸¹ "Blacks and Hispanics experience lower telephone penetration than whites, not surprising since blacks and Hispanics have average lower incomes than whites. But such thinking is misleading. . . [E]ven when they share the same level of income, blacks and Hispanics have lower telephone penetration levels than whites. That is, at all levels of income below \$40,000, whites have higher levels of telephone penetration."

Schement, *supra* note 57, at 3. "Why shouldn't blacks, Hispanics and whites at the same income level, also share the same level of telephone penetration? We acknowledge that racism insinuates itself throughout American society, but telecommunications is supposed to be a neutral technology, so this finding is especially troubling. No hypothesis exists, yet we must pursue an answer with determination." *Id.*

\$5,000 had telephones, only 64 percent of black households and 65 percent of Hispanic households with incomes less than \$5,000 have telephone service.

This data shows that "affordability" is one key component to "universal service" in the telecommunications arena. As with other services, it is generally recognized that if rates are too high, consumers will effectively be excluded from the telecommunications system, even if no structural access problems exist.^{159\} Moreover, in response to the Telecommunications Act of 1996,^{160\} the Federal Communications Commission has said that its "goal should be to ensure the consumers in all regions of the Nation and at all income levels, including low-income consumers, enjoy *affordable* access to the range of services available to urban consumers generally."^{161\}

Lessons Learned for Competitive Electric Utilities

It is evident from the above discussion that a societal obligation to serve standing alone has been an insufficient tool to attain or maintain universal service in these industries. Even though in each instance above the service at issue has been identified as being not merely important, but *essential* to life in today's world, as well as beneficial to society as a whole, substantial segments of the population nonetheless still lacked access to such service.

Four additional lessons also emerge from the discussion of these non-electric industries. These lessons include:

- o "Universal service" may not be assessed simply for the population as a whole. Consistently, the populations identified as lacking access to essential services are the least powerful in society. The poor and dispossessed minority populations are those that are left out.
- o "Universal service" may not be measured at a single point in time. The population lacking essential service for intermittent periods of time is likely to be substantially greater than the population lacking service for extended periods.

^{159\} See generally, Canada Information Highway Advisory Council, (1995). *Access, Affordability and Universal Service on the Canadian Information Highway, Building Canada's Information and Communications Infrastructure*, at 16 - 17, Information Highway Advisory Council Secretariat: Ottawa, Ontario, Canada.

^{160\} Telecommunications Act of 1996, P.L. 104-104, 48 Stat. 1064, 47 U.S.C. §§ 151 *et seq.*

^{161\} Benton Foundation (1996). *Public Interest Advocates, Universal Service, and the Telecommunications Act of 1996*, at 3, Benton Foundation: Washington D.C. (<http://www.benton.org>).

- o "Universal service" has an affordability component to it. Consistently, the unaffordability of service effectively yields a lack of access to service.
- o "Universal service" may not be measured strictly by access to service, however. Service may impose unaffordable and unreasonable costs, even if reduced penetration rates do not reflect such unaffordability.

In short, this discussion tends to support "the simple observation that a wide variety of social goals are not achievable in an unregulated marketplace. This is true for a variety of reasons. . . Private markets. . . may not serve some individuals whom society would like to have served."¹⁶²¹

Competition and its Impact on Universal Service

Given the failure to achieve universal service despite the existence of a societal obligation to serve, this section considers whether there is some structural aspect of a competitive industry that serves to impede or prevent achievement of such a goal. If a competitive industry can *not* be expected to meet universal service goals in light of a societal obligation to serve standing alone, there may be a need for some form of an obligation to serve enforceable by law to be crafted and implemented.

The discussion below considers the impacts of competition on reaching universal service objectives that have been explicitly set forth in other industries. The inquiry is into whether the failure to achieve universal service occurs in spite of, or because of, competitive forces.

Health Care

It is often argued that, for a variety of reasons, a competitive health care industry will not adequately address the health care needs of all segments of the population. First, as explained below, health care involves a "product" that is not conducive to delivery through a competitive market. In addition, due to the social necessity of health care, even a properly functioning market --perhaps *particularly* a properly functioning market-- serves to impede rather than promote the goal of universal service sought through imposing an obligation to serve.

¹⁶²¹

Barbara Cherry and Steven Wildman (1995). *Managing Telecommunications Deregulation: A Framework for Managing Telecommunications Deregulation While Meeting Universal Service Goals*, paper presented at the *Twenty Third Annual Telecommunications Policy Research Conference*, Solomons, MD.

A competitive health care market is not well-designed to accommodate the needs and demands of all sectors of the population including, particularly, those unable to pay. "Whatever vision of health care that the public may prefer, the system itself has become market-oriented. By the nature of markets, those who are unable or unwilling to pay the price of the commodity are left out. . . ."¹⁶³

Even if it were accurately assumed that the market would behave as theorized when buying and selling health services, the result of a well functioning market would be the opposite of that which is desirable. The essential characteristic of the marketplace is that it allocates goods and services on the basis of the ability to pay rather than on the basis of the need for the service. The market, therefore, excludes those who are unable to afford the service being sold.¹⁶⁴

Indeed, according to many, health care competition is antithetical to a commitment to universal health care services. In addition to excluding those unable to pay, a competitive market can be expected to exclude, rather than to *include*, those most in need of health care services. Such a market might be expected to price health care services at rates that would be unaffordable to many poor households.

If it is true that health care is a precious and sought after commodity, the demand for services would be expected to rise. As demand increases, so should price. It would be similarly expected that individuals in poorer income groups would have a decreasing ability to purchase the product as the price rises. Since poverty is often associated with poorer health for a variety of environmental, nutritional and behavioral reasons, those who need the service most would be least likely to afford access.¹⁶⁵

As can be seen, competition thus has different impacts on different customer classes, precisely as it is designed to do. The differentiation, however, tends to thwart rather than to advance any move toward universal service.

Market solutions appear ill-suited to the vexing problems associated with allocation of health care resources. If seen from the perspective of insurers

¹⁶³ *Gostin, supra* note 21, at 18, 37.

¹⁶⁴ *Id.*, at 37.

¹⁶⁵ *Id.*, at 37.

(who are freed from government regulation), health care providers (whose services are paid by third party payers), or younger and healthier individuals in the work-force (who gain access to generous benefits at reasonable, tax advantaged prices), competition appears attractive. However, if seen from the perspective of poorer, older, and sicker individuals, competition exacerbates the dual problems of inaccessibility and inequity.¹⁶⁶¹

In short, persons who seek universal service in health care can not rely upon a competitive market to deliver such results. By its nature, a competitive market would not only exclude those most in need, but would increase prices to those least able to pay. The harm arises not from a market that does not work, but rather from a market that *does*.

Health Insurance

The health insurance industry, which as discussed above is inextricably tied to the provision of health care, does not offer a stronger commitment to universal service if left strictly to competitive forces. The failure to achieve universal service in these two industries --health care delivery and health care insurance-- are closely connected. One reason "insurance is becoming less affordable [is] simply because the cost of the services it covers is doubling every few years."¹⁶⁷¹

As with health care generally, competition does not promote, and is likely to impede, the goal of reaching universal health insurance coverage. One analysis states:

If the health insurance industry is regarded strictly as a business, it is difficult to question the ability to discriminate on the basis of sound actuarial data. The very essence of underwriting is to classify people according to risk, treating those with higher risks differently. . .The activity of underwriting in the health insurance industry has indeed tended to exclude those who most need services. Health insurers have increasingly adopted principles of experience rating. Under experience rating, premiums are based on a particular group's historical costs, not on the expected costs for all persons in the community (a practice known as community rating). As a result, groups with the best health risks (by definition, those with the least needs for services) will receive lower priced services in the market than

¹⁶⁶¹ *Gostin, supra* note 21, at 42.

¹⁶⁷¹ *DiFlorio, supra* note 23, at 149.

those with the worst health risks (by definition, those with the greatest needs for services). The predictable outcome is that the poorest, who can least afford health services, and the sickest, who most need services, are the least likely to have access. As the group becomes increasingly less attractive to the industry because of the health risks of its members, the more likely it is that private insurance simply will not be offered at any price. . . ¹⁶⁸¹

Some parallels to the electric utility industry can be found. The customers least likely to be served are those in payment-trouble and with limited resources. When they are served, if these customers exhibit a higher need for expensive collection services, impose higher working capital costs (through higher and older arrears), and yield higher bad debt, a "cost-based" response might well be to raise rates. Since, however, these customers are payment troubled in the first place because of their inability to pay, this seemingly rational economic response will lead to the exclusion of these customers altogether. Access to some will be denied outright. Access to others will be denied because of affordability constraints.

Insurance: Property, Liability, Automobile

Competition has served to hinder, rather than to facilitate, reaching universal service goals in the various insurance industries. The property insurance industry is one such example. In the mid-1960s, the property insurance industry reacted to the extensive urban rioting by denying insurance to inner city property owners. The reason for the denial was simple: the insurance companies feared the payouts that would be necessary from the violence and property destruction that arose as a result. Congress reacted to this abandonment of the inner city market by enacting the FAIR laws in 1968. "Since the Panel had found the main cause of insurance unavailability to be fear of catastrophic losses due to rioting, it felt that a government guarantee would allow insurance companies to continue to provide basic property insurance." ¹⁶⁹¹

The new federal statute, however, did not accomplish what it was intended to accomplish. Rather than encouraging the insurance industry to become involved with the urban

¹⁶⁸¹ *Gostin, supra* note 21, at 38 - 39. ". . . [F]or those left out (i.e., individuals with higher risks, small employers, and larger groups with higher aggregate risks) the health care system has failed because price rises and accessibility decreases. Furthermore, experience rating expands existing gaps between poorer and richer and between sicker and healthier, thus making the system more inequitable." *Id.*

¹⁶⁹¹ John Hugh Gilmore, "Insurance Redlining & the Fair Housing Act: The Lost Opportunity of *Mackey v. Nationwide Insurance Companies*," 34 *Cath. U.L.Rev.* 563, 579 (1985).

communities, instead, the competitive insurance companies sought to insure the "best" risks while dumping the remaining risks into the public market.¹⁷⁰ Because the FAIR plans offered less insurance coverage at higher rates and with less supportive service, the markets were subject to *de facto* abandonment notwithstanding FAIR.

It was widely believed the FAIR plans would make insurance available to all "insurable risks." Regrettably, this did not come to pass. The single most devastating factor upon the effectiveness of FAIR was the higher rate it offered as compared to the voluntary market. Denied coverage in the voluntary market for whatever reasons, rejected applicants found themselves paying appreciably higher premiums for less coverage. Some of the plan's rates were over three times those of the voluntary market with the result that "risks often were 'written-out' by the voluntary market and then 'rated-out' by FAIR plans." This combination of inadequate service and even higher prices was devastating for communities.¹⁷¹

The consequence of the FAIR structure, therefore, was not to protect the residual market, but to segregate it out for less service at higher prices. In one case challenging the property insurance industry's action in this regard, the court held that these impacts were not prohibited by state or federal insurance laws.¹⁷²

FAIR, the court found, allowed insurance companies to "dump" their ghetto area policies. This resulted in two separate insurance markets: a "normal" market, served by private insurers, and a market consisting of the urban

¹⁷⁰ Similar results have occurred in other insurance markets. One analysis of the workers comp residual market, for example, reported:

Agents and brokers see a crisis in the growing unwillingness of private carriers to write workers' compensation insurance for certain types of companies in certain states, and in the vast numbers of employers who, as a result, are forced to seek the mandatory coverage in the residual market. That means assigned risk pools in which policies are parceled out and losses split according to market share among all private carriers operating within a state. Originally conceived as a last-ditch option for high-risk or accident-plagued businesses, the residual market has now become the nation's largest single provider of workers' compensation coverage. It accounts for almost 22 percent of premiums written in the 33 states where the [National Commission on Compensation Insurance] administers the pools.

David Weber, "The Comp Crisis," 51 *Insurance Review* 28 (1990).

¹⁷¹ *Gilmore*, *supra* note 69, at 579.

¹⁷² *Mackey v. Nationwide Insurance Companies*, 724 F.2d 419 (4th Cir.1984).

inner core, served by FAIR. With discriminatory denial of access to the normal insurance market and the relegation of minorities to the state FAIR plans, a pervasive pattern of segregated housing developed and continued.¹⁷³⁾

The effect is the same as an outright refusal to write the policy in the first instance. "Excessive cost is a significant factor in insurance unavailability."¹⁷⁴⁾

Similar results have arisen in the automobile insurance industry. Supporters of territorial ratings in the automobile insurance industry argue, quite simply, that they involve economically rational decisionmaking.

The defenders of territorial rating concede that neighborhoods do not cause accidents. In making their case, proponents of territorial rating have never denied that the practice adversely affects racial minorities and the poor. Instead, they have based their defense exclusively on the premise that territory is an accurate predictor of expected losses. . . A study issued by the Rate Regulation Division of the California Department of Insurance in 1979 concluded that driving performance "appears to vary significantly by geographic area."

Pursuant to the initial trial court ruling requiring exhaustion of administrative remedies in *County of Los Angeles v. Farmers Insurance*, the County of Los Angeles filed a petition with the Insurance Commissioner seeking relief from territorial rating. Insurance Commissioner Wesley Kinder held administrative hearings in response to that petition. Following those hearings, Commissioner Kinder concluded: "If territorial distinctions can be found to have predictive value, then the use of such a standard must be

¹⁷³⁾ *Gilmore, supra* note 69, at 584 - 585. This same process of "dumping" has occurred as the hospital and health care industries have become more businesslike. Charles J. Milligan, Jr., "Provisions of Uncompensated Care in American Hospitals: The Role of the Tax Code, The Federal Courts, Catholic Health Care Facilities, and Local Governments in Defining the Problem of Access for the Poor, 31 *Cath. Law.* 7, 16, 22 and 25 (1987). "In addition, nonprofit hospitals have transferred record numbers of indigent patients to public hospitals, a practice known as "dumping." In a recent study of 467 consecutive adult transfers to Cook County Hospital in Chicago, Illinois, researchers concluded that eighty-seven percent were transferred because of lack of insurance. . . the current health care market places enormous financial stress on public hospitals, by permitting leading proprietaries and nonprofits to dump record numbers of patients on public facilities, and simultaneously forcing public hospitals to pay escalating prices for goods and services with decreasing surplus revenue." *See generally*, Geraldine Dallek and Judith Waxman, "'Patient Dumping': A Crisis in Emergency Medical Care for the Indigent," 19 *Clearinghouse Rev.* 1413, 1414 (1986).

¹⁷⁴⁾ *Gilmore, supra* note 69, at 580, n. 126.

deemed 'fair' and reasonable." . . . In line with these observations and the conclusions of the Study of Driving Performance, the commissioner found that territorial rating was "actuarially valid."^{175\}

Indeed, during hearings on initiative proposals to reform automobile insurance in California, "one industry representative claimed that the elimination of territorial rating would usurp the economic process in the interest of 'socially based pricing.'"^{176\}

Telecommunications

Competition may well have adverse universal service impacts that stretch beyond limited access and decreased affordability. In the telecommunications industry, for example, the process of marketing and delineation of a customer base has also interfered with the maintenance of universal service. For example, a recent study of the investment practices by the Regional Bell Operating Companies (RBOCs), those holding companies which own the local Bell telephone companies, found a distinct pattern of geographic redlining. According to the United Church of Christ Office of Communications:

Over the years, the RBOCs have come to believe that households with the greatest disposable income are the most receptive and reliable customers for advanced communication services. Even when confronted with evidence to the contrary, this rule of thumb significantly influences marketing strategy. . . . Despite facts that confirm the existence of market demand for advanced communication services among minority and low-income customers, RBOC test marketing and deployment plans are designed to capitalize on the high-income customer.^{177\}

These marketing and deployment plans, can significantly affect the services offered to consumers. For example, in a study of the deployment of video dialtone (VDT), the United Church of Christ found that:

^{175\} Williams, *supra* note 48, at 869 - 870.

^{176\} Williams, *supra* note 48, at 871.

^{177\} *In Re.: A Notice of Inquiry Concerning Universal Service and Open Access*, Comments of the Office of the Office of Communications, United Church of Christ, at 4, 6, in National Telecommunications and Information Administration Docket No. 940955-4255 (December 14, 1994).

- o Bell Atlantic's Maryland VDT test trial focused on consumers with a median household income of \$54,809. The percent of minorities in Montgomery County (where VDT was test marketed) is 11.6 percent compared to 25.9 percent throughout all of Maryland.
- o Consumers test trialed in Falls Church, Virginia have a median income of \$51,011 and are 7.5 percent minority compared to \$33,328 and 19.8 percent for statewide data.
- o Richardson, Texas in Southwestern Bell's region has a median income of \$50,240 compared to \$27,016 statewide. The percentage of minorities in Richardson is 10.7 versus 20.6 percent for the state of Texas.

The redlining found by the United Church of Christ did not involve a few isolated incidents. The investigation looked also, for example, at the Ameritech deployment of video dialtone in 28 Illinois communities.

"...of the 28 municipalities that Ameritech proposes to serve in Illinois. . .over 90 percent of them significantly exceed the median household income of the state. . .Racial minorities account for less than the state average in 22 of the 28 municipalities. . .In many instances, the proposed deployment area exactly borders communities with high concentrations of low-income and/or minority people."¹⁷⁸

The lesson to be learned here does not involve an argument that all high tech services must be offered as part of a universal service regimen. The lessons are several-fold. First, in the telecommunications industry, we find again that that failure to pursue universal service is based on decisionmaking considered to be not only rational by the industry, but dictated by the economics of the industry and its consumers. Second, a "refusal to serve" need not involve a refusal to serve altogether. The RBOCs did not refuse to provide service entirely, but instead simply failed to provide the same *level* of service to low-income and historically Black communities. Third, as a result of this last conclusion, looking at penetration rates standing alone may not fully reveal the extent to which low-income communities are being served. The impact in telecommunications has been to deny low-income households, as well as households of color, the benefits of a full range of service based on their status.

¹⁷⁸

Id., at 9.

Lessons Learned for Competitive Electric Utilities

The impact of competition on the offer of services in those industries argued to have a societal obligation to serve offers several lessons for a move to a more competitive electric industry:

- o A competitive market may frequently serve to exclude rather than to include those who are either unwilling or unable to pay. Inclusiveness of customers through the pursuit of universal service is not a goal which a competitive market recognizes. Exclusion is not necessarily considered a market failure.
- o A competitive market will frequently choose to raise prices to those least able to pay. Exclusion by design, or exclusion by inability to pay, is still exclusion for these consumers.
- o Even when included in response to some external force, those persons brought into the market through such means are unlikely to obtain equivalent products at equivalent prices and on equivalent terms. They are likely, instead, to pay more for less.
- o Failure to pursue universal service is based on decisionmaking considered to be not only rational by the industry, but dictated by the economics of the industry and its consumers.
- o The gradations in service access must be considered in reviewing the extent to which residual markets are being served. The failure to achieve universal service may come as a result of denying a full range of services as much as by denying service altogether.

PART 3: IMPOSING A LEGAL OBLIGATION TO SERVE ON NON-UTILITIES

Despite the societal obligation to serve expressed for the various industries explored above, there has also been recognized a need for an obligation to serve imposed by law. A "legal" obligation to serve gives rise to enforceable obligations on the part of an industry on the one hand and to enforceable rights on the part of individuals on the other hand.

Imposing an "obligation to serve," however, has many different levels. While not all legal responsibilities include a broad-based obligation to serve all who come without regard to ability to pay, some do. In other situations, the general obligation (as well as the over-

arching commitment to "universal service") is operationalized through a series of narrower requirements imposed upon specific institutions. Under such circumstances, the "obligation to serve" informs rather than defines what the specific duties of the institutions are. The meaning of these summary statements will become clearer within the operational context of the legal obligations to serve discussed below.

Hospitals

The obligation to serve within the health care industry can best be considered within the context of nonprofit hospitals. The obligation to serve by nonprofit hospitals rises above a mere societal obligation to serve. Instead, there are definable legal duties to provide services even to non-paying indigent patients, particularly in emergency situations.¹⁷⁹ The discussion below considers the obligation to serve imposed on nonprofit institutions and the rationale for those obligations.

The Public Payments

This country maintains a system of nonprofit "charitable" hospitals today. Indeed, in 1996, nonprofit hospitals encompassed between 85 and 90 percent of all hospitals that existed. For many years these hospitals have been extended federal income tax exemptions.¹⁸⁰ These tax breaks bring other public benefits as well:

Donations and bequests to the organization are deductible by individual contributors, the United States Post Office offers its preferred second and third class mailing rates, and many states follow the federal lead and exempt hospitals from property, sales, and use taxes. This package of waived

¹⁷⁹ This obligation has been referred to as an "obligation to rescue." See generally, Barry Furrow, "Forcing Rescue: The Landscape of Health Care Provider Obligations to Treat Patients," 3 *Health Matrix* 31 (1993).

¹⁸⁰ James Simpson and Sarah Strum, "How Good a Samaritan? Federal Income Tax Exemption for Charitable Hospitals Reconsidered," 14 *U. Puget Sound L. Rev.* 633 (1991).

Estimates of the amount of the tax subsidy for charitable hospitals vary. There are difficult methodological problems in estimating taxes that would have been paid by an exempt organization had it been taxable. The estimates are least for *ad valorem* taxes and greatest for income-related taxation. A recent estimate that includes all the major subsidies (federal and state income tax exemption, state and local property and sales tax, issuance of tax-exempt bonds and deductibility of charitable contributions) but unfortunately does not specify estimation methods is contained in John Copeland and Gabriel Rudney, "Federal Tax Subsidies of Not-for-Profit Hospitals," 3 *Exempt Org. Tax Rev.* 161, 167 (1990).

governmental taxes is a form of subsidy, similar to a cash grant in the amount of taxes the organization would otherwise have paid.^{181\}

The annual subsidy in the mid-1980's was estimated to have been \$8.5 billion.

The Industry Compensation

These subsidies, however, are not provided without strings. Instead, the subsidies are provided in consideration for the commitment by such hospitals "to provide recuperative care without charge to the indigent and the destitute."^{182\} Tax-exempt status was granted "largely because [the nonprofit institutions] cared for the poor and unwanted members of society."^{183\}

The connection between the obligation to serve the indigent and the grant of federal, state and local tax subsidies is not merely implicit. When subsidies were challenged in court, judicial decisions:

were reached in the context of reviewing the validity of charitable trusts for hospital purposes, or the entitlement of charitable hospitals to exemption from various state and local taxes. The decisions rejected the idea that charity demanded exclusive attention to the indigent, but made the accessibility of the hospital to all without regard to ability to pay an important consideration.^{184\}

As technology and medical knowledge advanced, hospitalization became increasingly a true process of healing.

Hospitals began to attract paying patients for the services they could provide. They charged fees to cover rising costs and to subsidize continued treatment of the poor. When confronted with this trend, courts across the country ruled

^{181\} Milligan, *supra* note 73, at 15.

^{182\} Simpson, *supra* note 80, at 633.

^{183\} Milligan, *supra* note 73, at 15.

^{184\} Simpson, *supra* note 80, at 642.

that hospitals could admit paying patients and still qualify as charitable institutions.¹⁸⁵¹

Nonetheless, a continuing tax exemption was dependent upon the provision of something more in services:

the same courts repeatedly affirmed that the touchstone of charitable hospital status was a willingness to treat patients without regard to their ability to pay. Excessive attention to paying patients and zealous billing and collection efforts were evidence of unwillingness to treat the poor. So too were low percentages of indigent patients. Courts often emphasized that revenues derived from paying patients would enable hospitals to extend their capacity to provide free care. It was acknowledged that revenues from paying patients enabled the hospital to maintain its physical plant and equipment. *However, the hospital that provided little or no charity care stood to lose its exemption.*¹⁸⁶¹

The Nature of the Obligation

The obligation of nonprofit hospitals, however, is more specific than simply "to provide care to the poor." The obligation that nonprofit hospitals take upon themselves because of their tax exempt status has two identifiable components. First, there is an obligation to offer care, even if uncompensated, to low-income persons up to some minimum level of the institution's total resources. Second, there is an obligation to provide access in emergency situations irrespective of ability-to-pay considerations.

The first obligation on the part of nonprofit hospitals is to provide care to the poor even if the lack of compensation places some minimum level of demand on the hospital's resources. Even as hospitals entered into a new era of higher costs and more "businesslike" operations, the duty to provide care to the poor remained.

In the last fifty years, state courts, and occasionally legislatures, have continued to examine the free care obligations of charitable organizations, generally in the context of challenges to their property tax exemptions. In the majority of jurisdictions where the question of free care has been raised in

¹⁸⁵¹ *Simpson, supra* note 80, at 643.

¹⁸⁶¹ *Simpson, supra* note 80, at 643 - 644 (citations omitted) (emphasis added).

the hospital context, the provision of charity care and the accessibility of the hospital to indigent patients continue to be determinative, or at least important, criteria for entitlement to tax exemption.

The cases do suggest an increasing recognition that hospitals operate like businesses. The proposition that paying patients may be admitted and fees charged continues to be accepted. In addition, there is greater acceptance of the practice of billing all patients and attempting to collect on all bills. A reduced emphasis on target levels or percentages of free care is evident. Nevertheless, the prevailing view is that tax exempt charitable hospitals must not refuse to serve patients on account of an inability to pay.¹⁸⁷

In a 1969 Revenue Ruling, the IRS set forth language explaining the rationale for this requirement of a minimum level of indigent care:

Revenue Ruling 69-545 contains a limitation on its relaxed standards. At common law, a trust for charitable purposes must not benefit such a narrow class that it may not be said to benefit the community as a whole. The inclusion of this limitation on the ability of hospitals to exclude persons unable to pay for care is significant. In effect, the exclusion of the indigent from the hospital's benefits could, at some point, narrow the class of charitable beneficiaries to the point where the hospital would no longer benefit the community as a whole.¹⁸⁸

¹⁸⁷ *Simpson, supra* note 80, at 647 - 648.

¹⁸⁸ *Simpson, supra* note 80, at 652, *citing*, George Bogert, *Trusts*, 201-207 (6th ed. 1987), West Publishing: St. Paul. The 1969 IRS ruling, however, was based in large measure on factual assumptions about the hospital market and the accessibility of hospital services to the indigent that turned out to be in error.

Revenue Ruling 69-545 was issued shortly after the passage of landmark legislation establishing Medicare, Medicaid, and other "Great Society" programs intended to eliminate poverty. It came shortly before the enormous inflation in medical care costs occasioned by those programs became apparent. Many in the health policy community and in government believed at the time that these programs would do away with medical indigency. It seems likely that the IRS assumed in 1969 that the problem of access to hospital care for persons unable to pay had been, if not solved, converted from a tax policy matter to a health and social services budgetary question. As a result, the IRS appears to have concluded that to require hospitals to continue to provide free care would be meaningless and redundant. Thus, when the IRS indicated that the hypothetical qualifying hospital need not offer services without charge to poor patients, it did so on the stated assumption that the hospital would service the same formerly-indigent patients through Medicare and Medicaid. In addition, there appears to have been an assumed presence of another hospital in the community

(continued...)

At the state level, various levels of commitment to indigent care have been articulated as the basis for continuing tax exempt status.¹⁸⁹¹

¹⁸⁸⁹(...continued)

serving indigent patients to whom the minimally qualifying exempt hospital could refer the poor.

Id.

¹⁸⁹¹

Simpson, *supra* note 80, at 647, *citing*, Alabama: *ALA. CODE*, s 40-9-1(2) (1990 Supp.) (hospital property exempt if at least 15% of business is charity); Arkansas: *Burgess v. Four States Mem. Hosp.*, 250 Ark. 485, 465 S.W.2d 693 (1971) (hospital open to public, not refusing service on account of inability to pay, and applying profits to maintaining hospital and extending and enlarging its charity entitled to property tax exemption); *see also*, *Sebastian County Equalization Board v. W. Ark. Counseling and Guidance Center*, 296 Ark. 207, 752 S.W.2d 755 (1988) (community mental health clinic; similar holding); Delaware: *Durney v. St. Francis Hosp.*, 46 Del. 350, 83 A.2d 753 (1951) (hospital open to public regardless of financial ability entitled to tax exemption); Illinois: *Highland Park Hosp. v. Department of Revenue*, 155 Ill. App. 3d 272, 507 N.E.2d 1331 (1987) (hospital's immediate care facility billed all patients and did not advertise availability of free care, not entitled to property tax exemption); Minnesota: *Mayo Found. v. Comm'r of Revenue*, 306 Minn. 25, 236 N.W.2d 767 (1975) (hospital open to all without regard to ability to pay and which provided substantial free care entitled to sales and use tax exemption); Mississippi: *MISS. CODE ANN.*, s 27-31-1(f) (1972) (property of Hospitals which maintain one or more charity wards for charity patients exempt from taxation); *City of Natchez v. Natchez Sanatorium Benev. Ass'n*, 191 Miss. 91, 2 So.2d 798 (1941) (hospital providing charity care entitled to property tax exemption even though it did not set aside specific charity beds); Missouri: *Community Memorial Hosp. v. City of Moberly*, 422 S.W.2d 290 (Mo. 1967) (hospital extending service to usual and ordinary number of indigent patients entitled to property tax exemption); *Callaway Community Hosp. v. Craighead*, 759 S.W.2d 253 (Mo. App. 1988) (City of Moberly applied; hospital which did not encourage charity patients but which had never refused admission for inability to pay entitled to property tax exemption); Ohio: *Cleveland Osteopathic Hosp. v. Zangerle*, 153 Ohio St. 222, 91 N.E.2d 261 (1950) (hospital exempt from property tax should have as important objective care of poor, needy, and distressed who are unable to pay, although admitting some paying patients will not necessarily destroy its charitable character); Pennsylvania: *West Allegheny Hosp. v. Board of Property Assessment*, 500 Pa. 236, 455 A.2d 1170 (1982) (hospital with policy of open admission without regard to patient's ability to pay entitled to property tax exemption); *see also*, *Hospital Utilization Project v. Commonwealth*, 507 Pa. 1, 487 A.2d 1306 (1985) (multi-hospital shared data system not providing free services denied sales and use tax exemption); Tennessee: *Baptist Hosp. v. City of Nashville*, 156 Tenn. 589, 3 S.W.2d 1059 (1928) (hospital rendering free services to 10-15% of patients entitled to property tax exemption notwithstanding charging of fees to those able to pay, since fees enabled institution to care for more poor patients); *but see*, *Downtown Hosp. Ass'n v. Bd. of Equalization*, 760 S.W.2d 954 (Tenn. App. 1988) (under Baptist Hospital, hospital does not lose exemption because it receives substantial payment for the services it renders to patients); Texas: *Aransas Hosp. v. Aransas Pass Indep. School Dist.*, 521 S.W.2d 685 (Tex. App. 1975) (hospital providing less than 1% of gross revenues in free care not entitled to property tax exemption); *Lamb County Appraisal v. South Plains Hosp.*, 688 S.W.2d 896 (Tex. App. 1985) (hospital providing charity care to a small percentage of patients entitled to property tax exemption); Utah: *Utah County v. Intermountain Health Care*, 709 P.2d 265 (Utah 1985) (hospital providing less than 1% of gross revenues as charity not entitled to property tax exemption; charity is identified by either a substantial imbalance between value of services provided and payments received or the lessening of governmental burden through the charity's operations); West Virginia: *State ex rel. Cook v. Rose*, 299 S.E.2d 3 (W.Va. 1982) (charitable hospital must provide free and below cost services to those unable to pay under reasonable rules and regulations to be entitled to property tax exemption).

In addition to the commitments to providing a minimum level of indigent care irrespective of compensation, a second requirement is that nonprofit hospitals eschew a "refusal-to-admit" policy for nonpaying persons in emergency situations. Treating paying patients has been allowed, in other words, but it was the delivery of care to those unable to pay that constituted the "charity" that entitled a hospital to preferred trust or tax exempt status.^{190\} According to IRS Revenue Ruling 56-185,^{191\} there was an explicit obligation to provide universal service by these charitable institutions:

It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay. . . It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services.^{192\}

This prohibition on refusing to admit patients in need of urgent care is consistent with other legal obligations to serve imposed on hospitals irrespective of their nonprofit status. The Hill-Burton Act,^{193\} for example, is one of the primary federal initiatives which imposes an obligation to serve on hospitals in furtherance of the social goal of universal health care service for all persons. The goal of Hill-Burton is that no person be without care in time of urgent need. The Hill-Burton legislation ties the funding of hospital construction to a commitment by the new facility to provide uncompensated care to indigent citizens.^{194\} The statute allocates federal funds to states according to a formula based on relative population and per capita income. The program then attaches a twenty year requirement on recipient hospitals and mandates that they provide a reasonable amount of free care.^{195\}

Moreover, a variety of state and federal laws also provide limits on the circumstances under which treatment can be denied, even to those without the ability to pay. These limits

^{190\} *Id.*

^{191\} Rev. Rul. 56-185, 1956 C.B. 202.

^{192\} *Id.*

^{193\} 42 U.S.C. §291 (1996).

^{194\} 42 U.S.C. §§ 291d and 291c(e) (1996).

^{195\} Lawrence Schneider, "Provision of Free Medical Services by Hill-Burton Hospitals," 8 *Harv. C.R.-C.L. L. Rev.* 351 (1973); *Milligan*, *supra* note 73, at 12 - 13.

are included both in the common law and legislative enactments of various states.¹⁹⁶¹ In addition, a federal law adopted in 1986 requires most hospitals to examine and treat all emergency patients and women in labor.¹⁹⁷¹

The Explicit Exchange

There is merit to the analysis that posits that there is some exchange between the public perquisites provided to the hospital industry and the public responsibilities which that industry provides back to the public in exchange.¹⁹⁸¹ Consider that:

Congress expects charitable organizations that attain exemption from federal income tax to provide a public benefit commensurate with the revenue loss caused by their exemption. Exemption is a *quid pro quo* for the provision of services government would otherwise be obliged to deliver, or for services that augment existing governmental programs.

The concept of tax exemption as an exchange originated in the common law of charitable trusts and is frequently restated in contemporary court decisions considering charitable hospitals' exemption from various taxes. The cases do not indicate that charitable exemptions turn on an exact accounting of the costs of public services provided in comparison with tax revenues foregone. Exemption has not, at least historically, been conceived as a negotiated transaction between the tax authorities and the exempt organization. The task of such an accounting would be beyond the institutional capacities of the courts. Instead, the exchange concept appears to function as one of the underlying assumptions that lead (*sic*) a legislature to grant exempt status to a class of organizations.¹⁹⁹¹

As can be seen, while there is no requirement of a dollar-for-dollar return of the benefits provided to the industry, there is a specific exchange compliance with which is subject to public enforcement.

¹⁹⁶¹ See generally, George Annas, *et al.* (1990). *American Health Law* 43 - 90 Little, Brown Co.: Boston.

¹⁹⁷¹ 42 U.S.C. § 1395DD (1996).

¹⁹⁸¹ Marilyn Rose, "The Implication of the Charitable Deduction and Exemption Provisions of the Internal Revenue Code Upon the Service Required of a Voluntary Hospital to Treat the Poor," 4 *Clearinghouse Rev.* 183 (1970).

¹⁹⁹¹ Simpson, *supra* note 80, at 655 - 656.

Enforcing the Obligation

Despite the seeming exchange of consideration between the nonprofit hospital industry and government --tax benefits on the one hand for an obligation to serve on the other-- as the health care industry became more competitive, nonprofit institutions began to depart from their obligation to serve commitments.

In the latter half of the twentieth century charitable hospitals have changed dramatically. Today's charitable hospitals make available a technologically sophisticated setting in which physicians and other health personnel perform complex diagnostic and therapeutic procedures. Charitable hospitals have become wealthy institutions, with power and presence in the community far beyond their almshouse forebears. The indigent are seldom encouraged, and are sometimes shunned, from seeking treatment in many of these institutions. Instead, charitable hospitals compete with profit-making hospitals for a share of the privately and publicly insured patient market.¹¹⁰⁰

But these actions on the part of the nonprofit hospital industry brought government responses on at least two levels. At the federal level, questions began to be raised about whether it was appropriate to continue the tax exempt status of the industry. It was argued that standards might be developed to support the continued grant of public perquisites, but that such an exemption would depend on a more explicit individualized showing of compliance with the "bargain" identified above. As one analyst states:

The GAO Report concluded that an insufficient link existed between charitable tax status and service to the poor for the nation's charitable hospitals. This conclusion was based on the uneven distribution of uncompensated care among study hospitals, the lack of proactive policies for indigent care, and the lack of factors to differentiate community services other than charity care provided by charitable hospitals from those provided by investor-owned facilities. The GAO Report concluded that if Congress wished to encourage charitable activities for the poor, the current criteria for income tax exemption should be changed. If Congress wished to articulate an operational test for charitable hospitals focusing their activities on the poor, the GAO Report suggests three alternative standards directly linked to a minimum level of (1) care provided to Medicaid patients; (2) free care

¹¹⁰⁰

Simpson, supra note 80, at 633.

provided to the poor; or (3) efforts to improve the health status of underserved portions of the community.^{\101\}

This would stand in contrast to the current situation, where: "under the current exemption standards it appears to be possible for some, perhaps a large number, of charitable hospitals to enjoy a tax subsidy while ignoring the needs of the poor or passing responsibility to public, inner-city, and teaching hospitals."^{\102\}

Apart from the federal re-examination of the tax exempt status of nonprofit hospitals, so, too, has challenge arisen at the local level.^{\103\} Local government challenges to the tax exempt status of nonprofit hospitals are not a recent phenomenon.^{\104\} Still, as one analyst has observed: "it has been only recently that local governments have felt the fiscal bite of indigent transfers from nonprofits, combined with the escalating cost of medical care, to such a degree as to make *ad valorem* property tax exemption lawsuits a real threat to nonprofits."^{\105\} He notes:

For example, in 1984, the mayor of Austin, Texas, challenged the tax-exempt status of all nonprofit hospitals in Austin that transferred charity

^{\101\} Simpson, *supra* note 80, at 660 - 661, citing, U.S. General Accounting Office, *Nonprofit Hospitals: Better Standards Needed for Tax Exemption*, 1990, U.S. General Printing Office: Washington D.C.

^{\102\} *Id.*

^{\103\} See e.g., *Utah County v. Intermountain Health Care, Inc.*, 709 P.2d 265 (Utah 1985) (hospitals must prove entitlement to nonprofit status on annual basis); Note, "Nonprofit Hospitals and the State Tax Exemption: An Analysis of the Issues Since *Utah County v. Intermountain Health Care, Inc.*," 9 *Va. Tax Rev.* 599, 599 (1990); John O'Donnell & James Taylor, "The Bounds of Charity: The Current Status of the Hospital Property-Tax Exemption," 322 *New Eng. J.Med.* 65 (1990); Margaret Potter & Beaufort Longest, Jr., "The Divergence of Federal and State Policies on the Charitable Tax Exemption of Nonprofit Hospitals," 19 *J.Health Pol., Pol'y & Law* 393 (1994).

^{\104\} See, Robert Bromberg, "The Charitable Hospital," 20 *Cath. U.L.Rev.* 237 (1970).

^{\105\} Milligan, *supra* note 73, at 32; see also, *Id.*, at 27.

care patients to the city-owned public hospital.^{\106\} In other states,^{\107\} similar efforts are under way.^{\108\}

In sum, the legal obligation to serve in the health care industry is based on an exchange of consideration. For nonprofit hospitals, a tax-exempt status at the federal, state and local levels has been "exchanged" for a two-fold commitment: (1) to provide medical care to the indigent up to some minimum level of health care resources; and (2) to provide emergency care irrespective of ability to pay. Even outside the nonprofit sector, the principle of exchanging public perquisites for universal service has held. Hospitals receiving federal construction assistance were obligated as a result to provide emergency care for the indigent. As health care facilities have begun to abdicate their part of the bargain, the provision of public perquisites, also, has come under re-examination.

Insurance: Workers Compensation, Automobile, Property

The obligation to serve on the part of insurance companies will largely be treated together because of the similar institutions which have been developed in furtherance of that legal duty. The obligation to serve within the insurance industry is largely directed toward ensuring that there are methods of providing insurance to high risk residual classes that would not otherwise be served by the private market. The response has been to develop a series of public market alternatives.^{\109\}

^{\106\} Jane Perkins and Michael Dowell, "Developments Regarding the Charitable Tax Exemption for Hospitals," 19 *Clearinghouse Rev.* 472, 478 (1985).

^{\107\} See, *In re Doctor's Hosp.*, 51 Pa. Commw. 31, 414 A.2d 134 (1980). In *Doctor's Hospital*, the court denied a property tax exemption to a nonprofit hospital because all patients were billed, even if the patients were indigent, in order to match revenues with operating costs. The hospital considered itself to be involved in a commercial undertaking. Finding that *quid pro quo* permeated the entire operation, the court rejected contentions by the hospital that it was a charitable institution. See, 51 Pa. Commw. at 36-37, 414 A.2d at 137-38. In *Canyon County, Idaho Assessor v. Sunny Ridge Manor, Inc.*, 106 Idaho 98, 675 P.2d 813 (1984), the Supreme Court of Idaho removed the property tax exemption from a nursing home that charged its residents a substantial entry fee as well as an additional monthly fee to cover operating costs. In addition, the court emphasized that as only a small portion of the community was benefitted, the nursing home did not qualify for special tax treatment. *Id.*, at 102 - 103, 675 P.2d at 817.

^{\108\} *Milligan*, *supra* note 73, at 32 - 33.

^{\109\} A few states have assigned risk arrangements for individual health insurance, but such plans are not nearly so widespread as in automobile and property insurance. Leah Wortham, "Insurance Classification: Too Important to be Left to the Actuaries," 19 *U.Mich. J.L.Reform* 349, at 398-99, nn.292-93 (1986). There are generally no guarantees of access to any coverage in life or disability insurance. Leah Wortham, "The Economics of Insurance Classification: The Sound of One Invisible Hand Clapping," 47 *Ohio St. L.J.* 835, (continued...)

In general, for workers compensation, automobile and property insurance, public markets have been created to serve residual risks:

To meet the demand that is therefore not satisfied by the private or voluntary market, both automobile and property insurance are sold in a public or residual market. The public market for each is a statutorily created mechanism conceived in response to political pressures generated by the unavailability of coverage. These pressures were fueled, in the case of automobile insurance, by the enactment of financial responsibility laws and compulsory insurance requirements and, in the case of property insurance, by the insurance companies' near abandonment of urban markets (in favor of suburban markets) following the introduction of the package of coverages known as homeowners insurance.¹¹⁰

* * *

Insurance companies operate these public market mechanisms in that they supply the personnel and expertise that run them. Because they retain their right selectively to underwrite and reject risks presented in the private market, insurance companies determine which applicants will be required to purchase from the public mechanisms. The public markets provide less coverage at higher premiums and on worse terms than is generally provided by the private markets.¹¹¹

A more specific discussion of these mechanisms to meet the insurance industry's obligation to serve is presented below.

Workers Compensation

The public market institution through which the workers compensation insurance industry's obligation to serve is met involves an assigned risk pool. The assigned risk pool covers employers who are unable to purchase workers' compensation coverage in the private market because their claims experience is so high. An inability to purchase may involve

¹¹⁰(...continued)
853 (1986).

^{110A} Regina Austin, "The Insurance Classification Controversy," 131 *U.Pa. L.Rev.* 517, 521 (1983).

^{111A} *Id.*, at 522 - 523.

either an outright refusal to serve, or the pricing of premiums so high that the insurance is effectively unavailable.

As a general rule, a workers compensation assigned risk pool is funded by all insurers selling voluntary workers' compensation insurance in the state. The rates for workers' compensation insurance from the assigned risk pool are set by state regulators.^{\112\} Deficits in the assigned risk pool are then passed on to all insurance companies that issue workers' compensation coverage in the state. Each insurer's share of the deficit is based on its *pro rata* share of the voluntary market.^{\113\} This approach represents one potential equitable cost-sharing mechanism for a competitive electric industry.

Automobile

In contrast to workers compensation, automobile insurance residual mechanisms generally take one of three forms:

- o an assigned risk pool,
- o a reinsurance facility, or
- o a joint underwriting association.

Assigned risk pool: Under the assigned risk plans for automobile insurance, insured persons whose risks the private market will not cover are randomly allocated among insurers in proportion to the amount of voluntary business each does in the state.^{\114\} The individual insurer is totally responsible for the losses of the risks assigned to it.^{\115\}

^{\112\} Bruce D. Pengree and Felicia A. Finston, "Alternatives to Statutory Workers' Compensation Coverage," C724 ALI-ABA 331 (February 1992).

^{\113\} *Id.*

^{\114\} G. William Glendenning and Robert Holton, *Personal Lines Underwriting* 224-25 (1977), Insurance Institute of America: Malvern, PA.

^{\115\} Jon Sheldon & Ernest Sarason, "Auto Insurance Availability Issues—A Role for Legal Services," 15 *Clearinghouse Rev.* 825, 826 - 828 (1982).

Joint underwriting association: Under the joint underwriting association approach, a small number of insurers perform the marketing and servicing functions for all residual business, while the losses of the association are shared proportionately by all insurers.¹¹⁶

While the assigned risk pool and joint underwriting association will make automobile insurance available to the residual risks in the automobile insurance market, there is no pretense that *equivalent* insurance is available, let alone equivalent insurance on equivalent terms.¹¹⁷ One industry analyst observes that:

In the case of residual market automobile insurance, almost all state plans limit coverage in both dollar amount and type of coverage, although less so now than in the past. Typically, the coverage was limited to the minimum requirements of compulsory insurance and financial responsibility.¹¹⁸

Moreover, she observes, "residual market plans commonly charge higher rates than the voluntary markets. Indeed, at least one court has steadfastly ruled that residual market insureds are *supposed* to pay higher rates."¹¹⁹ According to a 1974 Federal Insurance Administration study, rates in such plans averaged 45% higher than rates for similar drivers in the voluntary market.¹²⁰ A few jurisdictions have enacted laws that limit the differential between private and public market premiums for automobile insurance. In other jurisdictions, legislators have statutorily restricted total automobile premium charges.¹²¹

¹¹⁶ J. Finley Lee and Roger Formisano, "Residual Markets in Automobile Insurance: The Service Center and the Joint Underwriting Association Approaches," 625 *Ins. L.J.* 92 (1975); *see generally*, J. Finley Lee and Roger Formisano, "Residual Markets in Automobile Insurance: A Comparative Analysis," 626 *Ins. L.J.* 143 (1975).

¹¹⁷ *Wortham*, *supra* note 109, at 852.

¹¹⁸ *Austin*, *supra* note 110, at 523, n.27.

¹¹⁹ *Id.*, *citing*, *State ex rel. Commissioner of Ins. v. North Carolina Rate Bureau*, 300 N.C. 381, 434, 269 S.E.2d 547, 580 (1980). (emphasis added).

¹²⁰ U.S. Dep't of Housing and Urban Development, Federal Insurance Administration, *Full Insurance Availability* 1-3 (1974), U.S. General Printing Office: Washington D.C.

¹²¹ *Austin*, *supra* note 110, at 527.

Reinsurance facility: In contrast to the two residual market mechanisms discussed above is the reinsurance facility.^{\122\} Under this approach, each insurer accepts all applicants that request coverage and then cedes those risks it does not wish to retain to a reinsurance pool. The insured whose risk is ceded is treated in every way like the insured whose risk is retained. The losses or profits attributable to the ceded risks are shared proportionately by all insurers.^{\123\}

Property

For property insurance, the statutory scheme for residual risks is referred to as a "FAIR plan." "FAIR" is the acronym for "Fair Access to Insurance Requirements."^{\124\} FAIR plans were created by Congress in 1968,^{\125\} after that year's urban riots threatened to leave significant numbers of urban property owners uninsurable.^{\126\}

It is generally agreed that like assigned risk automobile insurance, the coverages available under FAIR plans are likely to be more restricted and the cost higher than the private market.^{\127\} Property insurance coverage provided under FAIR plans is limited generally to fire and extended coverage, and vandalism and malicious mischief coverage.^{\128\} Upper limits on lines of coverage exist in order to spare the FAIR program single large losses. FAIR plan insureds often receive slower claims service and are usually denied a premium

^{\122\} See e.g., *N.C.Gen. Stat.* §§ 58-248.26 - 58-248.39 (1982).

^{\123\} J. Finley Lee and Roger Formisano, "Automobile Insurance Markets: Developments in the Reinsurance Facility Technique," 624 *Ins. L.J.* 9 (1975).

^{\124\} 12 *U.S.C.* § 1749bbb-3(a) (1982).

^{\125\} The FAIR plan program was created under the Urban Property Protection and Reinsurance Act of 1968. Pub.L. No. 90-448, 82 Stat. 555 (codified as amended in scattered sections of 5, 12, 15, & 42 *U.S.C.* (1976 & Supp. V 1981)).

^{\126\} See generally, Comment, "FAIR Plans: History, Holtzman and the Arson-for-Profit Hazard," 7 *Fordham Urb. L.J.* 616 (1979); see also, *Austin*, *supra* note 110, at 522, n.24.

^{\127\} *Wortham*, *supra* note 109, at 852- 853, citing, U.S. Dep't of Housing and Urban Development, Federal Insurance Administration, *Insurance Crisis in Urban America* at 20 - 22 (1978), U.S. General Printing Office: Washington D.C.; see also, *Badain*, *supra* note 32, at 9 (FAIR plan insureds generally pay higher premiums than do voluntary market insureds).

^{\128\} 44 *C.F.R.* § 55.3.

payment plan.¹²⁹ The differences between service provided under FAIR plans can be significant:

FAIR plan applicants, for example, can be subjected to inspections that may result in premium surcharges; voluntary market applicants whose properties pose similar risks are generally not surcharged, because their properties are not inspected. FAIR plan insureds are sometimes subjected to special procedural burdens, such as a condition that payment must be by certified check or coverage will become effective only after the check has cleared. Moreover, agency outlets are not conveniently located in areas where public market insureds are concentrated.¹³⁰

In most states, the FAIR plan is an association of companies writing insurance. All profits, losses, and expenses are divided based on market share in a particular line of insurance. "For example, a company writing 10% of fire insurance in the voluntary market would pay 10% of the losses and expenses accrued through fire insurance in the residual market and receive 10% of any profits."¹³¹

Telecommunications

In the telecommunications arena, the issue of "obligation to serve" is framed as a question of who bears common carrier responsibilities.¹³² Unlike the debate over *what* constitutes universal service, this question considers *who* bears a responsibility to provide service to all who seek it and agree to pay for it. Consider that:

¹²⁹ *Rights and Remedies of Insurance Policyholders--Discrimination by Property and Casualty Insurance Companies: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary, 95th Cong., 2d Sess. 91, 650-51 (1978) (statement of James Katz, Research Director, Mass. Fair Share).*

¹³⁰ *Austin, supra* note 110, at 524.

¹³¹ G. Keenan (1978). *Insurance Redlining: Profits vs. Policyholders*, at 10, National Training and Information Center: Chicago, IL.

¹³² "The Federal Communications Commission has traditionally regulated telephone service under Title II of the Communications Act of 1934, requiring, among other things, that telephone companies as 'common carriers' make their services available to the general public at reasonable rates." Peter Pitsch and Arthur Bresnahan, "Common Carrier Regulation of Telecommunications Contracts and the Private Carrier Alternative," 48 *Fed. Comm. L.J.* 447, 448 (1996). *See also*, Note, "Redefining 'Common Carrier': The FCC's Attempt at Deregulation by Definition," 1987 *Duke L.J.* 501 (1987).

It has been proposed that all facilities-based transmission service providers be required to offer common carrier services. This concept would broaden the universal service concept to another tier of service providers. Should such a requirement be put into force, presumably with open network rules similar to the FCC rules for [local exchange carriers], each customer would have access to the transmission capabilities of any vendor to which connection could be made.^{133\}

As discussed below with respect to electric utilities, the obligation to serve in the telecommunications industry (imposed by designation of common carrier status) is often imposed as a condition of being designated a "public utility" for gaining local public perquisites:

Cellular service providers and personal communications system providers are required to offer their services as common carriers. That condition is attached to the allocation of frequency spectrum. Spectrum allocation is a Federal responsibility. These carriers also need certification as utilities within the states so that they may exercise eminent domain rights for their location sensitive facilities. They also need local utility status for construction of commercial facilities in areas where local property use zoning otherwise prohibits such land use.^{134\}

It is important, however, to note the limits of common carrier status for telecommunications carriers. The terms "common carrier" and "universal service" do not mean the same thing.^{135\}

Within the context of telecommunications, common carriers have had the responsibility of charging just and reasonable rates and of providing service on a nondiscriminatory basis. Nothing in this context requires the common carrier to serve any specific area or any specific class of customers. Once an entity holds itself out to the public as offering specific services for hire, then the requirements of common carriage regarding just prices and

^{133\} John Borrows, Phyllis Bernt and Raymond Lawton (1994). *Universal Service in the United States: Dimensions of the Debate*, at 32, National Regulatory Research Institute: Columbus, OH.

^{134\} *Borrows, supra* note 133, at 32.

^{135\} Phyllis Bernt (1996). *The Eligible Telecommunications Carrier: A Strategy for Expanding Universal Service*, at 14 - 15, National Regulatory Research Institute: Columbus, OH.

nondiscriminatory service pertain. If the entity does not hold itself out as providing service in a specific area, or for specific services, there is no common carriage under this conceptualization.^{136\}

The actions of competitive long distance providers are cited as one example of how this common carriage limitation works.

While companies like Sprint and MCI may choose to offer originating long distance service in a geographical area, there are no requirements that these companies provide long distance service in any specific locations. In the move toward equal access in the latter half of the 1980's, long distance carrier chose the communities in which they would be placed on the presubscription ballots. Once these companies elected to provide service to any area, that is, held themselves out as offering services for hire, it was incumbent upon them to provide those services as a common carrier.^{137\}

"This same situation will pertain with local competition. The provisions of the [Telecommunications Act of 1996] suggest that telecommunications carriers who elect to be [local exchange carriers] may do so in areas of their own choosing."^{138\}

There has been a wrinkle in this common carrier analysis, however. Even if a telecommunications firm does not meet the "holding out" criterion for common carrier status, it can be *designated* a common carrier and *directed* to provide common carriage:

By itself, this [holding out] criterion could be insufficient because carriers with substantial market power might seek to price-discriminate among consumers to maximize their profits. [The D.C. Circuit Court in NARUC I] added a second criterion: a carrier may not choose to make individualized deals if the FCC, or other agency or legislation, compels it to behave as a common carrier. . . Thus, a carrier offering communications service is acting as a common carrier if it either (1) actually holds out its service

^{136\} *Bernt*, *supra* note 135, at 15.

^{137\} *Id.*, at 15.

^{138\} *Id.*

indiscriminately to the public or (2) is required to hold itself out because the public interest requires it.^{\139\}

This compelled common carriage, as well as the policy basis for it, is important to remember when considering the obligation to serve requirements in the 1996 federal telecommunications legislation. The Telecommunications Act of 1996 takes one step forward in providing an obligation to serve. In the 1996 statute, Congress created a federal funding mechanism to support universal service.^{\140\} Congress then created a class of telecommunications providers called "eligible telecommunications carriers" which would be allowed to receive funding through this universal service support mechanism. An eligible carrier includes any carrier, designated as such by the state utility commission, that provides the services supported by the universal services funding mechanism and, also, advertises the availability of such services through media of general distribution.^{\141\} A carrier may request that it be designated as an "eligible telecommunications carrier" or it may be assigned that status by the state utility commission.^{\142\} Moreover, the state utility commission may designate the service territory for each eligible carrier.^{\143\}

Lessons Learned for Competitive Electric Utilities

The lessons learned from this discussion of the legal obligation to serve in non-electric industries include:

- o The "exchange" of an obligation to serve for public support for the industry bearing the obligation is appropriate public policy.
- o The obligation to serve imposed in exchange for public perquisites provided in support of the industry should be in furtherance of the goal of universal service.
- o Creation of an obligation to serve simply for a term of years is an inappropriate and ineffective mechanism for promoting universal service.

^{\139\} *Pitsch and Bresnahan*, *supra* note 132, at 456.

^{\140\} 1996 Telecommunications Act, at § 254(c).

^{\141\} 47 U.S.C. § 214(e)(1) (1996).

^{\142\} 47 U.S.C. § 214(e)(2) (1996).

^{\143\} 47 U.S.C. § 214(e)(5).

- o Making an explicit exchange of the provision of universal service in consideration of the provision of public benefits is appropriate whether or not there is a dollar-for-dollar accounting of the relative value of the consideration exchanged.
- o The adequacy of public markets as a mechanism for meeting an industry's obligation to serve depends on the form the public market takes and the way in which it operates.
- o A sharing of the costs of serving residual markets in proportion to the share of the voluntary market is the most common method of pursuing universal service. If profits or benefits arise from the residual markets, those profits or benefits are assigned in proportion to market share as well.
- o Without effective regulation of the prices, service levels and terms offered the residual markets, those markets are likely to be offered less service, for higher prices, on less favorable terms.

PART 4: COMPONENTS OF A RESTRUCTURED ELECTRIC INDUSTRY'S "DUTY TO SERVE"

This section will synthesize the lessons in the discussion above into an obligation to serve for a restructured competitive electric industry. This obligation will build upon the common law duty to serve currently imposed on electric utilities. It will synthesize problem identification and response, "program"¹⁴⁴ structure, and policy rationales into a comprehensive obligation to serve in support of universal service. The obligation to serve components discussed below need not represent a unified program. While some components are essential, rather than presenting a package to be accepted or rejected as a unified whole, the discussion presents a menu from which decisionmakers can choose. In some sections, the menu presents multiple options from which to choose.

"The" obligation to serve in a restructured electric industry cannot be defined by reference to the industry as a whole. Instead, the extent to which an obligation to serve attaches, as well as the definition of what precisely that obligation entails, will depend upon which part of the industry --distribution or generation-- is being discussed. Affirmative obligations should attach to each part of the industry. However, the obligations that attach to

¹⁴⁴ This term is used recognizing that the recommendations do not constitute "programs" in a social service sense.

distribution companies may differ in kind, not simply degree, from those that attach to providers of the actual commodity of electricity. The discussion below first sets forth the general policy determinations. It then discusses the specific components which might comprise an obligation to serve in a competitive electric industry.

The Policy Declarations

Frequently, statutory schemes (in any substantive area of the law) begin with statements of principle or declarations of intent. When this occurs, the policy declarations do not impose, unto themselves, enforceable obligations. Instead, such policy declarations represent a broad touchstone of intent, consistency with which is used as a measurement of the appropriateness of other specific actions or requirements, rather than a self-enforcing, self-actuating, requirement of law unto itself. The purpose of policy statements generally is to serve as a touchstone of intent as well as a declaration of aspiration. When facing specific narrower decisions not covered by law, therefore, the choice between alternatives can be made by reference to whether it will advance or impede a movement toward the intent and aspiration.

Two statements of principle are presented below to represent a planning guide for an obligation to serve for competitive electric utilities. As has been appropriately stated in the telecommunications industry, "any plan for a more competitive telecommunications industry must have. . . a vision that matches policy goals with such regulatory instruments as are to be employed in the industry we are trying to create. . ." ¹⁴⁵ These statements set forth that vision.

Statement of Purpose

PRINCIPLE NO. 1:

The purpose of the obligation to serve is to attain and maintain universal service ¹⁴⁶ within the electric industry.

¹⁴⁵ *Cherry and Wildman, supra* note 62, at 4 - 5.

¹⁴⁶ The term "universal service" is defined below to mean: "For purposes of the 'obligation to serve,' 'universal service' means that all persons desiring to take electric service, and paying or agreeing to pay the reasonable price for such service, shall have the opportunity to take such service on a nondiscriminatory basis at reasonable rates and under reasonable terms. The 'opportunity to take service' is defined to include an affirmative obligation to engage in best efforts to make service available to all customers."

The purpose of imposing an obligation to serve within the electric industry is to attain and maintain universal service. The foundation of imposing an obligation to serve lies in the fact that the service in question is not merely important, but essential, to persons in today's world. The lack of access to the service will adversely affect persons in the entire range of their personal, economic and social wellbeing. In addition, the lack of access imposes significant harms on society as a whole. Finally, the obligation to serve is imposed because competitive markets have not, and by their nature cannot, fulfill the social goal of universal service.

Universal service cannot be measured by reference to customers as a whole. As has consistently been seen, universal service breaks down in the sub-markets. It is the poor and minorities that lack health care, telephones in the home, and access to insurance (be it automobile, health, property, or casualty). For there to be universal service, there must be universal service in each sub-market as well as for consumers as a whole.

No Deterioration in Universal Service

PRINCIPLE NO. 2:

The purpose of the "obligation to serve" is to prevent involuntary deterioration in current penetrations of electric service amongst those seeking service.

A move to a restructured and competitive electric industry creates the potential that many households now receiving service will lose service in the future. The discussion above presents a detailed overview of how and why a competitive market is not necessarily supportive of the pursuit of universal service. Moreover, as has been found in other industries, a move to competition can result in significant deterioration in service penetration levels. In 1982, for example, Congress largely deregulated the inter-city bus industry. Within ten years, the number of rural locations receiving regular route inter-city bus service had shrunk by more than 50 percent. A 1992 study by the U.S. General Accounting Office concluded that "the riders who have been losing service are those least able to afford and least likely to have access to alternative modes of transportation."¹⁴⁷

¹⁴⁷ U.S. General Accounting Office (1992). *Surface Transportation: Availability of Intercity Bus Service Continues to Decline*, at 2, 29, U.S. General Printing Office: Washington D.C.

(continued...)

The electric industry stands alone in its achievement of complete success in service penetration levels. Indeed, the Census Bureau has even stopped asking the question of whether homes are served by electric power. Penetration of electric service approaches 100 percent.

Given this achievement, public policy should declare that any deterioration in universal service will be unacceptable. Consider the impacts discussed above for other services that have been found to be not merely important but *essential* to living in today's world:

- o 56% of the population relying on public assistance goes without telephone service;
- o 18% of the population (37 million persons) goes without health insurance coverage;
- o Hospitals, both for-profit and non-profit alike, engage in the process of "dumping" inability-to-pay customers into public institutions;
- o The population served in residual markets for auto and property insurance receive less coverage and worse customer service, even though paying substantially higher rates.

Whether or not universal service is reached in any of these other industries is not the question here, however. The *electric* obligation to serve should incorporate a "no deterioration" policy.

¹⁴⁷(...continued)

Bus riders have low incomes and do not have access to personal motor vehicles. An April 1991 Greyhound passenger survey found that 46 percent of passengers had household incomes of \$15,000 or less per year. By comparison, only 24 percent of all households have incomes under \$15,000. . In addition, Greyhound found that 54 percent of its riders did not own an automobile or did not own an automobile they would feel comfortable taking on a trip of over 500 miles. While only 9 percent of all households did not own a motor vehicle in 1990, 22 percent of Greyhound riders reported that they took the bus because they did not own a motor vehicle.

Id., at 30.

Definition of Universal Service

DEFINITION

For purposes of the obligation to serve, "universal service" means that all persons desiring to take electric service, and paying or agreeing to pay the reasonable price for such service, and abide by the reasonable rules, shall have the opportunity to take such service on a nondiscriminatory basis. The "opportunity to take service" is defined to include an affirmative obligation by service providers to engage in best efforts to make service available to all customers.

The definition of "universal service" has several key components. First, "universal service" does not seek to *guarantee* that every person has electric service. What it does instead is to guarantee that every person has *access* to electric service.^{1148\} In this sense, "access" means that every person has the opportunity to take electric service. Providing the opportunity to take services, however, involves more than providing kWh. It incorporates an element of affordability as well.^{1149\} As one commentator noted as to insurance: "it is doubtful that the unsuccessful applicant takes any comfort from the fact that coverage is unavailable because it is unaffordable, rather than unobtainable at all."^{1150\} While the insurance industries discussed above do not explicitly incorporate this notion of affordability into rates set for residual markets, the Telecommunications Act of 1996 does.

^{1148\} Compare the efforts to promote universal service in the telecommunications industry. "Universal service has never implied an entitlement program under which U.S. residents would have a right to telephone service at government expense. Rather, the goal . . . is to ensure that the structure of the industry makes telephone service universally accessible and affordable." Edwin Parker *et al.* (1989). *Rural America in the Information Age: Telecommunications Policy for Rural Development*, Aspen Institute: Lanham, MD.

^{1149\} Compare the current efforts in promoting universal service in the telecommunications industry. "The 1996 Act makes explicit that Universal Service policies should promote affordability of quality telecommunications services. The Commission seeks comment proposing standards for evaluating the affordability of telecommunications services." *Universal Service and The Telecommunications Act of 1996*, *supra* note 61, at 5.

^{1150\} *Gilmore*, *supra* note 69, at 580, n.126.

While there can be no guarantee that all persons will find service to be both available and affordable, the obligation to serve involves a responsibility to take specific actions to bring about that result. This duty is not merely one of proscriptions (*e.g.*, prohibitions on discriminatory exclusion), but instead involves a requirement for market participants to take affirmative steps. The duty is to be measured against a specific legal standard, that of "best efforts."^{151\}

"Best efforts" is a concept out of the law of fiduciary relationships.^{152\} The standard is neither unusual nor onerous. For example, in the law of promotional and requirements contracts,^{153\} the concept of "best efforts" implies a duty to seek to discover exactly what contingencies may require adjustment, as well as a duty to act on information known or discovered. Broadly stated, the "best efforts" standard requires the provider of a product essential to public health and safety to use due care in attempting to discover alternative performances that would allow the customer to maintain service. Its application in the electric industry would be akin to its application in other contract law areas.^{154\}

The obligation to serve would also require market participants to make *specific* efforts in furtherance of universal service. The passive offer of service to any person who wants it is insufficient compliance with the obligation if the price or terms of the offering would represent a functional denial of service to a substantial subpopulation of persons.^{155\}

The Specific Enforceable Components of the Obligation

The following discussion is designed to identify what components might be made a part

^{151\} Charles Goetz and Robert Scott, "The Mitigation Principle: Toward a General Theory of Contractual Obligation," 69 *Virginia L.Rev.* 967, 985, 1015 - 1016, and n.126 (1984) (courts should impose a best efforts obligation whenever a single party controls the instrumentality necessary to achieve a cooperative goal).

^{152\} See, E. Allan Farnsworth, II *Farnsworth on Contracts*, 336 - 338 (1990), Little, Brown Co.: Boston; E. Allan Farnsworth, "On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law," 46 *U.Pitt. L.Rev.* 1 (1984).

^{153\} *Goetz and Scott, supra* note 151, at 1015 - 1016.

^{154\} *Trigg v. Tennessee Electrical Membership Corp.*, 533 S.W.2d 730, 734 (Tenn. App. 1975); *Carroll v. Local No. 269*, 31 A.2d 223 (N.J. Chanc. 1943); *McCreery Angus Farms v. American Angus Association*, 379 F.Supp. 1068 (D.Ill.), *aff'd*, 506 P.2d 1404 (7th Cir. 1974).

^{155\} See *e.g.*, *Universal Service and the Telecommunications Act of 1996, supra* note 61, at 6. "Public interest advocates should submit comments to the FCC that identify the needs of low-income people and the organizations that serve them. A policy which guarantees affordable rates for rural subscribers, but ignores the low subscription rates in America's inner cities, will fail a population most at risk of falling off important networks and will fall short of truly being universal."

of a utility's obligation to serve. The obligations are presented with greater specificity than the policy declarations. They are presented with a discussion of their rationale and a description of their anticipated operation where appropriate. As discussed above, with the exception of some which are considered essential (and are noted as such), they may be viewed as a package, but need not be. They might instead be viewed as a menu from which to select.

The Obligation to Connect

COMPONENT NO. 1:

The "obligation to serve" should include a distribution utility's obligation to connect.

An essential component to a distribution utility's obligation to serve involves the "obligation to connect" customers to the distribution system assuming that the provision of electric power eventually becomes competitive at the retail level. This obligation to connect is consistent with the historical legal obligations within the electric industry as well as with the various obligation-to-serve requirements discussed above in other non-electric industries. The discussion below undertakes to do two tasks:

- o To explain the rationale for the obligation to connect; and
- o To explain why electric utilities do not have the right to walk away from that obligation.

Dedication to a Public Use: The obligation to connect is not an obligation that has been imposed upon a utility by the government. Instead, it is an obligation to which utilities have submitted themselves, one they have voluntarily taken upon. One need only to look closely at the oft-quoted language of the U.S. Supreme Court in its seminal decision in *Munn v. Illinois*:¹¹⁵⁶

Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must

¹¹⁵⁶ 94 U.S. 113 (1876).

submit to be controlled by the public for the common good, to the extent of the interest he has thus created.¹¹⁵⁷

Utilities that have dedicated their property to a public use have granted the public an interest in the land. The process of dedication is examined next. The implications of that dedication follow.

The Legal Basis for Imposing an Obligation to Connect: The continuation of an obligation to serve is not strictly a public policy issue that can be freely decided one way or another. Instead, the obligation to serve is an explicit *quid pro quo* that was exacted in exchange for substantial --and continuing-- public benefits. So long as the local distribution companies enjoy the fruits of that exchange, they must abide by the obligations that were bargained for as part of the exchange.

In particular, electric utilities have been granted two sets of public perquisites:

- o The right to exercise eminent domain;¹¹⁵⁸ and
- o The right to use the public's streets, alleys and public ways as transportation corridors.¹¹⁵⁹

In accepting these public perquisites, electric utilities have dedicated their property so supported to a public use. The "bargain" that has been made in consideration of these two public perquisites is both explicit and continuing.¹¹⁶⁰ The Texas courts, for example, have

¹¹⁵⁷ *Id.*, at 126.

¹¹⁵⁸ See generally, "Progress of Regulation, Trends and Topics, Electric Utilities and Eminent Domain Laws," 106 *Pub. Util. Fort.* 49-51 (July 28, 1980).

¹¹⁵⁹ McQuillan, *The Law of Municipal Corporations*, §34.01 (3d ed. 1986). ("One thing should be kept constantly in mind, and that is that the rules of law governing franchises to use the streets do not depend, except to a very limited extent, on whether the grantee of the franchise is a gas company, or a water company, or an electric light company, or a telegraph or telephone company, or a street railway company, or any other public service company.")

¹¹⁶⁰ In addition to these two public perquisites, electric utilities have frequently been granted an exemption from local zoning ordinances. Annotation, *Applicability of Zoning Regulations to Projects of Nongovernmental Public Utility as Affected by Utility's Having Power of Eminent Domain*, 87 *A.L.R.3d* 1265 (1978) ("It has been held, especially where a utility is of statewide or national scope in its service, that if granted the power of eminent domain, the utility would be immune from local zoning regulations in exercising its reasonable discretion in choosing utility routes and location, it being reasoned that local control would cripple the function of state regulation, hamper the utility in serving the general welfare for the benefit of a local few, and weaken eminent domain.") See also, note 134, *supra*, and accompanying text.

recognized the exchange. A public utility, Texas statutes say, includes owning or operating or managing a pipeline "if any part of the right of way for said line has been acquired, or is hereafter acquired, by the exercise of the right of eminent domain." The court held:

If a corporation, acting within its corporate powers, acquires land for a pipeline to be owned by it for the transport of natural gas, through an exercise of the power of eminent domain (set forth) in (Texas statutes), it thereby submits to the regulatory provisions (of statute) so that its ownership of the pipeline, under regulation, is a "public use" by legislative declaration.

The court concluded:

In the present case, it is undisputed that (the natural gas company) was acting within its corporate powers under a resolution of its board of directors, that the easement across Loesch's land was necessary for the public interest and that it relies upon the power of eminent domain given in article 1436. *In acquiring the easement under authority of that statute, (the natural gas company) submits to regulation by the State of Texas and thereby becomes charged with numerous statutory duties to the public.*^{161\}

In a related vein, the Texas courts considered whether the pipeline of a natural gas company was a "public use." According to the Texas Courts:

When it is designated as a utility under (statute), an entity *submits itself* to regulation. *As a result*, ownership of a pipeline becomes a public use -- regardless of whether it is available for public use. By showing that the pipeline company here *submitted itself* to the regulation of the Commission and is considered to be affected with a public interest, it proved that the company is operating for a public use.^{162\}

In contrast to these Texas decisions is the decision of the Michigan supreme court in *City of Lansing v. Edward Rose Realty*.^{163\} In *Edward Rose Realty*, the court disapproved the use of eminent domain on behalf of a cable television operator. According to the court, the cable system was operated primarily for private gain. Specifically, the court of appeals

^{161\} *Loesch v. Oasis Pipeline Company*, 665 S.W.2d 595, 598 - 599 (Tx. App. 1984) (emphasis added).

^{162\} *Grimes v. Corpus Christi Transmission Company*, 829 S.W.2d 335 (Tx.App. 1992). (emphasis added).

^{163\} 502 N.W.2d 638 (1993).

concluded that "the primary beneficiary of the taking is not the public, but rather Continental Cablevision."¹⁶⁴ There was no obligation to serve and certainly no universal service obligation.

The dissent in *Edward Rose Realty* is as instructive as the majority opinion for illustrating the exchange referenced above.

Justice Mallett rejected the majority's position that the requirement of universal service was merely a restriction upon the franchisee. Justice Mallett preferred to regard the universal service requirement as one that would provide anyone notwithstanding their economic status, with cable television services. In light of the foregoing reasons, Justice Mallett contended that the condemnation was for the public benefit.¹⁶⁵

Given the dissent's finding that there was an obligation to serve, in other words, the use of eminent domain was appropriate. Without it, it was not.¹⁶⁶

Finally, the explicit exchange that has occurred has been recognized in the cable television context. According to the Practicing Law Institute within the context of cable television:

Local governments are realizing the unique value of public rights-of-way for which they act as trustee. Public rights-of-way are acquired and paid for through government action, usually the exercise of a jurisdiction's eminent domain powers. Thus, the public rights of way are the most valuable property rights in the hands of government. . . Local governments must receive fair compensation for granting use of the rights-of-way. Otherwise, government is merely subsidizing the businesses of private rights-of-way users. . . Traditional users of the public rights-of-way were deemed to provide public compensation in the form of universal service and regulated rates. . . With traditional users of public rights-of-way, compensation for use of the public rights-of-way was passed onto the end consumer through rate

¹⁶⁴ 481 N.W.2d 795, 797 (1992, *aff'd*, 502 N.W.2d 638 (1993).

¹⁶⁵ Note, "City of Lansing v. Edward Rose Realty: The Power of a Municipality," 1994 *Detroit College of Law Review* 211, 229 (1994).

¹⁶⁶ Similarly, the acquisition of less than fee interests to provide wind developers --who have no obligation to serve-- access has been held to be not a sufficient "public use" to support eminent domain. Kim York and Richard Settle, "Potential Legal Facilitation or Impediment of Wind Energy Conversion System Siting," 58 *Washington Law Review* 387, 396 (1983). In contrast, public utilities could acquire not only a site, but wind flow protection as well, via eminent domain. *Id.*

regulation and other public benefits like universal service, rather than being paid directly by the governments, the actual owner of the public rights-of-way.^{167\}

This principle has long been upheld. Indeed, the early regulation of cable television was based on the right of local government to control the use of public streets and ways.^{168\}

In sum, the obligation to serve flows from at least two different sources for electric utilities. First, the grant of the right to exercise the power of eminent domain has inherent within it the obligation to serve. Second, the grant of the right to use public streets, alleys and public ways has within it the obligation to serve. The obligation to serve is a type of "payment" for the grant of these powers. The obligation to serve is a type of public compensation. The mere fact that the electric industry may become competitive does not eliminate either the need for, or the justification for, obtaining this compensation.

The Right to Revoke a Dedication to a Public Use: Given the two foundations for the obligation to serve discussed above, the electric power industry does not have the right to walk away from that obligation. Instead, the dedication of utility property to a public use is irrevocable.

The dedication of utility right-of-way to a public use is a legal concept that has been recognized in a variety of circumstances. In one situation, for example the federal Cable Television Act of 1984^{169\} provided that cable systems have a right to use a right-of-way that has been dedicated to a compatible use.^{170\} Within that context, the courts have addressed when utilities have "dedicated" their property to a public use.^{171\}

"Dedication" is the intentional appropriation or donation of land, or an interest therein, by its owners for a proper public use. "In short, dedication is the setting aside of land for a

^{167\} Nicholas Miller and Kristen Nven, "What is the Emerging Role of Local Governments in This New World of Telecommunications," in *Cable Television Law 1996: Competition in Video and Telephony*, at 12 - 13 (1996: Practicing Law Institute).

^{168\} See e.g., *Group W. Cable Inc. v. City of Santa Cruz*, 669 F.Supp. 954, 963 - 964 (N.D.Cal. 1987); *Community Communications v. City of Boulder*, 660 F.2d 1370, 1379 (10th Cir. 1981), cert dismissed, 456 U.S. 1001 (1982).

^{169\} 47 U.S.C. §§ 521-611, Public Law 98-549).

^{170\} 47 U.S.C. §541(a)(1), (2).

^{171\} See generally, Jean Howard, "Real Property Issues in CATV, Use of Public Rights-of-Way and Easements Dedicated for Compatible Use," 25 *The Urban Lawyer* 413 (1991).

public use."^{172\} More importantly, "a dedication once completed is in its nature irrevocable."^{173\}

The dedicator cannot resume control of or convey the land free from the public easement, nor can he or his successor reclaim the use of the property unless the object and purposes of making the dedication has completely failed.^{174\}

The dedication of electric utility property to a public use is complete upon the exercise of eminent domain or the use of public streets. As described in detail above, the dedication which supports a utility's power to exercise eminent domain includes a commitment to an obligation to serve. Having made this dedication, as the *Munn* court so eloquently stated more than 100 years ago, the utility "devotes his property to a use *in which the public has an interest* (and), in effect, *grants the public an interest in that use*."^{175\}

Irrevocable Dedications for Non-Utilities: The concept that institutions built with substantial public perquisites become irrevocably dedicated to a public use is not a concept unique to public utilities. Perhaps the institutions involving the most frequent application of the principle are not-for-profit organizations. The discussion below will focus on application of the principle to non-profit hospitals and other medical facilities.^{176\} Conversions of non-profit hospitals to for-profit status raise the same essential issues as the conversion of the electric utility industry to a competitive industry. Compare the following formulation of the hospital conversion issue to the debates currently surrounding electric restructuring:

Conversions raise important public policy issues because non-profit corporations: 1) have a special legal status that obligates them to serve the public interest, 2) may provide unique services to local communities (such as access for vulnerable populations) that for-profit entities do not, and 3) often have received public subsidies via tax advantages that should benefit the public, rather than private investors or executives. State Attorneys

^{172\} 23 *Am.Jur.2d, Dedication*, §1 (1983).

^{173\} *Id.*, at §61.

^{174\} *Id.*

^{175\} 94 U.S. at 126.

^{176\} Hereafter, hospitals and other health care facilities will be referred to generically as "hospitals." This is done for ease of reference, despite the fact that not all health care facilities are hospitals.

General have long-standing legal authority to review changes in non-profit hospital ownership and require that the non-profit's assets be used to continue to serve the public interest.¹⁷⁷

When a non-profit hospital converts to for-profit status,¹⁷⁸ the value of the non-profit hospital must be retained in service of the charitable mission of the non-profit. "At common law, and by statute in most states, the doctrine of 'charitable trusts' imposes a *perpetual responsibility* on non-profit organizations to serve the community."¹⁷⁹ As one analyst finds:

At common law, the creation of a non-profit organization with charitable or other social welfare purposes results in a charitable trust that is *irrevocably dedicated* to the organization's original mission (determined by reference to the articles of incorporation and by-laws as well as how it has held itself out to the general public and prospective donors).¹⁸⁰

The doctrine is not limited to health care facilities. In recent years, the conversion of non-profit Health Maintenance Organizations (HMOs) to for-profit status has repeatedly raised the issue. In considering the significance of the conversion issue in California, one commentator starts with the proposition that "under California law, a nonprofit public benefit social welfare organization's assets must be *irrevocably dedicated* to exclusively charitable purposes. In exchange for this dedication, and as consideration for the public financial support of the nonprofit, the state exempts these organizations from certain taxes."¹⁸¹

¹⁷⁷ Patricia Butler (December 1996). *Profit and the Public Interest: A State Policymaker's Guide to Non-Profit Hospital and Health Plan Conversions*, at 6, National Academy for State Health Policy: Portland, Maine.

¹⁷⁸ Conversions may take any of multiple forms. The non-profit may merge with, or be acquired by, a for-profit entity. The non-profit may enter into a joint venture, with the conversion occurring when a sufficient proportion of the non-profit's assets or activities become controlled by the for-profit entity. Subsidiary corporations may be established which control the activities of the non-profit. The form of conversion is constrained only by the imagination of the corporate planner.

¹⁷⁹ *State Policymaker's Guide*, *supra* note 177, at 10, *citing*, Austin Scott and William Fratcher (1989). *The Law of Trusts*, Section 348.1, Little Brown and Company: Boston. (emphasis added).

¹⁸⁰ *Id.*, at 12 - 13, *citing*, *Greil Memorial Hospital v. First Alabama Bank*, 387 So.2d 778 (Ala. 1980); *Queen of Angels Hospital v. Younger*, 136 Cal. Rptr. 36 (Cal. App. 1977). (emphasis added).

¹⁸¹ Theresa McMahon, "Fair Value? The Conversion of Nonprofit HMOs," 30 *Univ. San Fran. L.Rev.* 355, 373 (Winter 1996); *see also*, Joane Stern, "The Conversion of Health Maintenance Organizations from Nonprofit to For Profit Status: Background, Methodology, and Problems," 26 *St. Louis Univ. L.J.* 711, 716 - 718 (1982).

There is no assertion here that public utilities are charitable organizations that have irrevocably dedicated their assets to charitable uses. The analogy does not stretch that far. What the nonprofit health care analogy *does* establish, however, is that institutions who have been supported through the grant of unique public perquisites may be held to have irrevocably dedicated their business so supported to the use for which the public support has been extended. Just as non-profit institutions have irrevocably dedicated their property to charitable purposes as compensation for the grant of tax exempt status, public utilities have irrevocably dedicated their property to the "public use," including the promotion of universal service and an obligation-to-serve as compensation for the grant of the public perquisites described in detail above.

Summary: The obligation to connect is an obligation that is imposed on other industries based on similar rationales. It does not differ markedly from the obligations imposed on nonprofit hospitals. In that situation, a particular industry was provided with public perquisites that were essential to the industry's development: tax exempt status (along with the miscellaneous perquisites that came along with that status). In exchange for those special public *benefits*, particular enforceable public obligations were imposed as well. The obligation to provide uncompensated care to the indigent was one such obligation.

While the obligation actually to provide service articulated below does not include a duty to provide service whether or not such service is paid for, the principle of exchanging public benefits (*e.g.*, use of city streets and public ways, right to exercise eminent domain) for a perpetual dedication to public responsibilities is one that has been long established in American law.

The obligation to connect is imposed on the distribution utility, which is the part of a restructured electric industry that carries forward the traditional electric utility obligations. As discussed below, the obligation to actually provide service is imposed on the competitive service providers.

The Obligation to Provide Service to Residual Classes

COMPONENT NO. 2:

The "obligation to serve" should include an electric service provider's obligation to participate in providing service to residual classes.

A second essential part of the obligation to serve would require a competitive service provider to participate in serving all members of the residual classes not served by the voluntary market. In a competitive retail environment, in other words, the state would impose an obligation to serve on all companies selling power at retail. The mechanism through which this obligation is met, however, presents a menu with various options.

Imposing an obligation to serve on service providers (in addition to the obligation to connect on the distribution company) is consistent with ensuring access to residual classes within the insurance industries. In the insurance industries, four basic approaches describe the universe of mechanisms available to serve the residual classes:¹⁸²¹

1. **Model 1:**¹⁸³¹ Members of the residual class are assigned to service providers in proportion to their market share. The member is then served in the same fashion as any other customer, with the service provider either bearing the cost or pocketing the profit.
2. **Model 2:** Service providers have an obligation to serve all. However, while service is actually provided by each market participant, the providers may cede back to a public market the "risk" of any individual customer that the

¹⁸²¹ Not surprisingly, different commentators categorize these various methods in a wide variety of ways. See e.g., *Insurance Classification*, *supra* note 29, at 401 - 402 ("Once a decision is made that a gap in availability should be closed, there are at least three approaches to doing so. Classification discretion can be limited by placing the additional cost of insuring those who would otherwise be uninsured on the pool of those buying insurance. In other words, the insurance pool is broadened. Another choice leaves insurance classification discretion unfettered but subsidizes the extra cost for some insureds from public funds. A third choice assures that all can purchase insurance but allows all or most of the cost of those perceived to be higher risks to fall on that group. In other words, classification is restricted in underwriting and coverage but not in rating. Many assigned risk pools take this approach and therefore have much higher rates than the private market.")

¹⁸³¹ These models are introduced in no order of priority or preference. The label is simply to facilitate future discussion and to allow the reader easily to refer back to the description of the model.

provider does not wish to shoulder itself. The expenses and/or profits from this public market are then allocated back to all providers in proportion to the market share of those providers. Through this mechanism, in other words, an individual consumer's service is provided through each company, with the profit or loss associated with that consumer being allocated back to the pool.

3. **Model 3:** The residual class is served by a single public market, generally administered by one (or just a few) service provider[s]. The costs and profits of that public market are allocated to all service providers in proportion to market share.
4. **Model 4:** Members of the residual class are assured of access to service through a pool mechanism. Rather than allocating the pool costs back to all market participants, however, to the extent that the members of the class represent higher risks, the provider of such service may place the additional cost of serving the class on the members of the class. Rates to the residual class, therefore, may be much higher than rates in the private markets. In addition, the level of services offered may be lower.

Each model has its advantages and disadvantages. Model 1 appears to have the most advantages. It is the model that provides the least opportunity for service providers to increase rates in the same fashion that occurs in the insurance residual markets. In many, if not most, of the residual insurance markets, rates substantially exceed those charged to participants in the private markets.¹¹⁸⁴ Model 1 is the only model that creates incentives for electric service providers to develop innovative approaches to inability-to-pay problems. If a service provider can develop effective ways to manage the risk of serving residual market members, the provider can minimize costs and maximize profits from such service. Finally, it is the only model that assures members of the residual classes the opportunity to obtain the same service treatment provided to private market participants. As with rates, in many if not most of the residual insurance markets, service levels differ sharply, to the detriment of the public market participant.¹¹⁸⁵

In contrast, Model 1 would require all service providers to take their fair share of the customers in the residual class. A service provider would not have the option of serving only selected industrial customers. This requirement would mandate that each provider

¹¹⁸⁴ See, notes 71 - 76 and 118 - 121, *supra*, and accompanying text.

¹¹⁸⁵ See, notes 111, 118, and 127 - 130, *supra*, and accompanying text.

either have the administrative procedures in place for billing and collection, or be willing and able to contract out for those activities.¹¹⁸⁶

Model 2 has the advantage of avoiding this billing and collection problem. Electric service providers who would choose to serve only a limited number of industrial customers could still be required to participate financially in serving the residual pool without changing the nature of their business or making potentially significant investments for serving a relatively small number of consumers.

Model 2, however, has several disadvantages as well. As discussed above with respect to assigned risk insurance pools, this model allows service providers --even those serving residential customers-- to engage in highly arbitrary customer selection. In the insurance industries, for example, the residual pool ends up serving all but the best risks, rather than representing a provider of last resort for the bad risks. As a result, the residual pool tends to become "over-populated" in this model. In addition, this model represents the same "cost recovery" approach to serving residual markets as current ratemaking does. Allowing the direct passthrough of expenses --such as working capital associated with arrears, bad debt, and collection expenses-- provides no reason for the administrator of a residual market to minimize those expenses, even though cost minimization mechanisms exist.¹¹⁸⁷

Model 3 has the same potential for over-populating the residual market that Model 2 has. It is an improvement over Model 2 in that the selection of the entity to administer the public market can use, as one selection criterion, the extent to which that institution will manage the risks of the market so as to reduce the total costs of serving the residual class. The approach is not quite as efficacious as Model 1, however, since it offers no economic

¹¹⁸⁶ It is conceivable, also, that a market would develop for this responsibility. Hence, a company not wishing to actually provide service to its assigned proportion of the residual class could sell its responsibility to another competitive service provider at whatever price the market would bear.

¹¹⁸⁷ See e.g., ICF Resources, *Program Evaluation: Weatherization Residential Assistance Partnership (WRAP) Program: Volume I, Final Report*, Northeast Utilities: Berlin, CT (1991); Harrigan, Merilee, *Evaluating the Benefits of Comprehensive Energy Management for Low-Income, Payment-Troubled Customers*, Alliance to Save Energy: Washington D.C. (1992); Synergic Resources Corporation, *Evaluation of the Cost-Effectiveness of a Bad Debt Conservation Program: Final Report*, Northeast Utilities Co.: Berlin, CT (1988); Energy Coordinating Agency of Philadelphia, *Philadelphia Water Department Conservation Pilot: Final Evaluation*, ECA: Philadelphia (1989); Monte de Ramos, Kevin, et al., "An Assessment of Energy and Non-Energy Impacts Resulting from the 1990 Columbia Gas Low-Income Usage-Reduction Program," *Proceedings of the 1993 Energy Program Evaluation Conference*, at 771, Energy Program Evaluation Conference: Chicago (1993); see generally, Roger Colton (1994). *Energy Efficiency and the Low-Income Consumer: Planning, Designing and Financing*, Chapter 7, Flying Pencil Publications: Scappoose, OR (review of evaluations of the impact of energy efficiency on low-income payment patterns).

incentive for the administrator to engage in risk and cost minimization strategies. Instead, this offer must be monitored and enforced through public oversight.

Some results are common to more than one model. Both Model 2 and Model 3, for example, create the situation where it is possible (if not likely) that either (a) the residual markets will be offered lesser service, or (b) the residual markets will be charged higher rates (or a combination of the two). To avoid these results, the Models create the potential for continuing public regulation of the rates and services offered to the residual classes.

In addition, to implement an obligation to serve through any of Models 1 through 3, regulators would be required to track the market shares enjoyed by each firm participating in a particular distribution company's service territory. For electric service providers serving multiple distribution company service territories, a separate market share would be computed for each separate territory. This effort, however, has not proved to be difficult in implementing assigned risk pools, reinsurance facilities, or joint underwriting associations. It does not appear that the electric industry would pose greater difficulties than the insurance industry.

Finally, none of the models discourage the aggregation of residential customers generally or low-income residential customers in particular. The obligation to serve residual markets is designed to ensure access to those who the private market will not voluntarily serve. If, through aggregation, residential consumers (or low-income consumers) can develop the mechanism and market power to attract the interest of a service provider, they will have taken themselves out of the residual markets.

In sum, companies selling electric power at retail will have imposed upon it an obligation to serve. This obligation would state that a utility is obligated to participate in the mechanism developed to serve residual classes.¹⁸⁸ The obligation can be operationalized through any one of four basic mechanisms. While each mechanism has its advantages and disadvantages, the model involving an allocation of residual market consumers to all service providers in proportion to the market share of each provider appears to offer the best approach.

¹⁸⁸ But see, note 186, *supra*, and accompanying text.

The Obligation to Make a Standard Offer

COMPONENT NO. 3:

The "obligation to serve" should include the obligation of an electric service provider to make available at least a minimum standard offer of service.

In the event that local regulators do not adopt the pro rationing mechanism from Model 1 for serving members of the public market, regulations will be necessary to ensure that members of the residual class are, at the least, made available a minimum standard offer at regulated rates.¹⁸⁹

The requirement for a minimum standard offer serves three functions. First, it helps to ensure that the goal of universal service has been fulfilled by ensuring a threshold offer of service. This need for a "standard offer" has been recognized in the health insurance field:

The problem lies with small businesses. The Commission recommends special measures to alleviate the barriers to the voluntary purchase of insurance which these smaller firms now face. This would be achieved by making reforms in the private insurance market that would guarantee the availability of a specified minimum benefit package.¹⁹⁰

The Pepper Commission concluded amongst other things:

Universal access to health care can only be effective if it, in no uncertain terms, establishes an adequate minimum standard of coverage. The commission recommends an adequate minimum standard that guarantees the uninsured, most of whom have low incomes, access to "primary," as well as "catastrophic," care. Such coverage includes: hospital care, surgical and other inpatient services, physician office visits, diagnostic tests, and limited

¹⁸⁹ If the model involving pro rationing of actual customers is adopted, treatment of these customers should be no different from treatment of private market customers.

¹⁹⁰ John D. Rockefeller IV, "A Call For Action: Final Report of the Pepper Commission," 265 *J. Am. Med. Ass'n* 2507 (1991). The "Pepper Commission" was the U.S. Bipartisan Commission on Comprehensive Health Care formed in 1990. The Commission, formed under President George Bush, was to examine the implementation of a system wide health care reform that would "guarantee all Americans health care coverage in an efficient, effective health care system." The bipartisan commission included 12 members of Congress and three presidential appointees.

mental health benefits. In addition, benefits would include preventive services. By placing emphasis on preventive services, the Commission embraces the view that early diagnosis and treatment may result in reduced mortality rates, increased quality of life, and increased savings. Thus, the need for expensive future treatment may be avoided.¹¹⁹¹

Second, it ensures that the residual classes are not unduly discriminated against in the provision of service. In this sense, the need for such a standard offer when dealing with a residual customer class served by a public market has been made evident from experience in the various insurance industries.¹¹⁹²

Finally, it ensures that the goal of universal service is truly met. As the Federal Communication Commission (FCC) recently held with respect to its universal service obligations: "We find that the overarching universal service goals may not be accomplished if low-income universal service support is provided for service inferior to those supported for other subscribers."

The concept of a "standard offer" for fulfillment of an obligation to serve can be informed by an examination of the debates over what services must be provided for there to be "universal service" in the telecommunications industry. Rather than listing particular technologies that would be part of the basic service package included in the standard offer, a standard offer would provide services that meet basic criteria of functionalities. The Telecommunications Act of 1996, for example, provides that services eligible for universal service support through that federal statute would include any services meeting one or more of the following criteria:

1. are essential to education, public health, or public safety;
2. have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;
3. are being deployed in public telecommunications networks by telecommunications carriers; and

¹¹⁹¹ Carlo V. DiFlorio, "Assessing Universal Access to Health Care: An Analysis of Legal Principle and Economic Feasibility," 11 *Dick. J. Int'l L.* 139, 157 (1992).

¹¹⁹² See, notes 69 - 74, 111, and 117 - 150, *supra*, and accompanying text.

4. are consistent with the public interest, convenience and necessity.^{193\}

In implementing these criteria, the FCC found that the definition of basic service should:

represent functionalities or applications associated with the provision of access to the public network, rather than tariffed services. . .[A] functionalities approach to defining universal service will be more flexible than a services-only approach, particularly with respect to anticipated technological and marketplace changes and evolutions. Second, a functionalities approach is consistent with the overarching goal of the 1996 Act of encouraging competition, since it is technology neutral. Thus, we recommend that for purposes of defining universal service, "telecommunications services" should not be limited to tariffed services, but instead also should include functionalities and applications associated with the provision of services.^{194\}

The adaptation of these criteria to define the electric service to be provided through a standard offer, while allowing for flexibility in the development of that offer, seems easy to conceptualize. State decisionmakers could decide what level of service is: (1) essential to education, public health, or public safety; (2) has, through the operation of market choices by customers, been utilized by a substantial majority of residential customers; (3) is being provided by existing electric utilities; and (4) is consistent with the public interest, convenience and necessity.

^{193\} 47 U.S.C. § 254(c)(1)(A)-(D).

^{194\} Federal Communications Commission, *In the Matter of the Federal-State Joint Board on Universal Service*, Docket No. 96-45, Recommended Decision, at para. 45 (November 8, 1996).

The Obligation to Provide Non-Discriminatory Service

COMPONENT NO. 4:

An electric service provider should have the obligation to make service available on a non-discriminatory basis.

One essential component of an obligation to serve is the obligation to make service available on a non-discriminatory basis. This duty of "non-discrimination" has two elements to it. First, the duty should adopt principles in line with traditional notions of consumer protection.¹⁹⁵ Actions that have the *effect* of imposing adverse impacts on a residual class¹⁹⁶ should be unlawful unless they are dictated by a business necessity.¹⁹⁷ This duty extends beyond the historic tenets of "non-discrimination" applied in the utility industry, which merely defined "discrimination" as charging rates that are "non-cost-based."¹⁹⁸

Second, the duty of non-discrimination must extend beyond those decisions by electric service providers that may be economically irrational. Reference to public policies prohibiting "redlining" in the housing, home lending, and insurance industries are helpful in defining the obligation to serve in this regard. In these industries, just because a decision to redline may be "rational" does not mean that it is *a priori* lawful. Moreover, a decision

¹⁹⁵ For a discussion of the significance of viewing a non-discrimination statute more as a consumer protection statute than as a civil rights statute, *see generally*, John Lyckman, "The 1976 Amendments to the Equal Credit Opportunity Act," 28 *Baylor L.Rev.* 633 (1976).

¹⁹⁶ For a discussion of the "effects test," *see generally*, Roger Colton, "Discrimination as a Sword for the Poor: Use of an 'Effects Test' in Public Utility Litigation," 37 *Journal of Urban and Contemporary Law* 97, at nn 80 - 128, and accompanying text (1990).

¹⁹⁷ *See generally*, Note "Business Necessity Under Title VIII of the Civil Rights Act of 1964: A No-Alternative Approach," 84 *Yale L.J.* 98 (1974); Note, "The Cost of Growing Old: Business Necessity and the Age Discrimination in Employment Act," 88 *Yale L.J.* 565, 587 - 595 (1979). *See e.g.*, *U.S. v. Bethlehem Steel*, 446 F.2d 652, 662 (2d Cir. 1971) ("the 'business necessity' doctrine must mean more than that transfer and seniority policies serve legitimate management functions. . . [N]ecessity connotes an irresistible demand. To be preserved, the seniority and transfer system must not only directly foster safety and efficiency of a plant, but also be essential to those goals."); *see also*, *Robinson v. Lorillard Corp.*, 444 F.2d 791, 799, n. 8 (4th Cir. 1970), *cert den'd*, 404 U.S. 1006 (1971) ("while considerations of economy and efficiency will often be relevant to determining the existence of business necessity, dollar cost alone is not determinative. ").

¹⁹⁸ *See, Discrimination as a Sword for the Poor*, *supra* note 196, at nn. 39 - 78 and accompanying text.

which is "economically rational" from a business perspective is not necessarily optimal from the community's perspective.

A decision to redline by participants in the home financing or insurance industries may well be an economically rational decision.^{1199\} One example may involve the decisions of the automobile insurance industry to engage in the practice of "territorial rating." Under such a system, auto insurers set policy premiums based in large part on the geographic location of the insured. Locations in large urban areas and inner cities are deemed to be more risky, and therefore more expensive to serve, than suburban areas. Accordingly, the rates charged to the predominantly low-income and minority auto owners in these areas are consistently higher than non-urban, non-poor, non-minority locations. The thing is, the conclusion that urban customers are more risky, and thus more expensive to serve than non-urban customers may be true. Thus, while the geography-based decisionmaking may be "redlining," it may nonetheless be economically rational.

Similarly, just because bank lending patterns are racially discriminatory does not *ipso facto* mean that they are economically irrational. It may well be that households in certain geographic areas of the city, as a class, do not have the financial resources to support home mortgages. Even more possible, as a class, households in certain geographic areas of a city may not, without further inquiry, satisfy the indices of "creditworthiness" which historically have supported a decision to grant a mortgage. No question exists but that if a bank or other financial institution would pursue a further inquiry, it may ultimately discover the creditworthiness of individual households in this area. Nonetheless, to pursue such an inquiry may be expensive and unmerited by the profit potential from that area.

In the alternative, a bank may simply decide that it can generate the same number of loans for an equal dollar value in a different geographic area of the city *without* engaging in the additional inquiry. In the absence of the additional expense of the further inquiry, the profit margin per loan may be higher and a profit-maximizing enterprise may rationally be drawn to the second geographic area. In short, ultimately, while the creditworthiness of the households in both areas of town may be equal, the transaction costs in making the creditworthiness decision may be vastly different, thus affecting the profit margin and the decision to serve. In this instance, even if unlawful, the decision of the financial institutional to redline is not economically irrational.^{1200\}

^{1199\} See generally, Stephen Trczinski, "The Economics of Redlining: A Classical Liberal Analysis," 44 *Syracuse Law Review* 1197 (1993).

^{1200\} As one commentator notes: "In summary, both neighborhood redlining and socially sensitive redlining are the result of rational lending behavior. Such behavior is illegal, it may well be immoral, but it is rational." *The Economics of Redlining*, *supra* note 199.

In contrast to these rational decisions to redline are the irrational decisions. The irrational decisions involve decisions not to make loans to creditworthy customers based solely on locational considerations. Creditworthy potential homeowners in the inner city, in this scenario, are denied home mortgages even though their risk and/or profit characteristics do not differ from their non-urban counterparts. In this scenario, given identical credit risks, all other things equal, the institution is not responding to its best economic interests but, indeed, is acting to the detriment of its best economic interests.

The imposition of an anti-discrimination obligation is important within the consideration of an obligation to serve. In commenting on the imposition of "common carrier" obligations, one commentator notes that telecommunications companies can be expected to engage in selective marketing.

it is hard to see how symmetry could be enforced between incumbents, whose identities are known to all customers, and entrants, which could select the potential customers they want to know of the options they offer. Furthermore, to the extent that symmetry of application is enforceable, it increases the incentive for entrants to offer service within carefully circumscribed geographic areas.

* * *

Under common carrier obligations, carriers must provide service to similarly situated customers on equivalent terms. . . While common carrier obligations may be relatively easy to enforce for franchised monopolists offering service to everyone, customers must be made aware of new entrants' service offerings and prices, and it would be difficult, if not impossible, to police marketing plans to ensure that information about competitive offerings is not selectively targeted.¹²⁰¹

According to this commentator, the discriminatory entrance into markets would not arise simply because of the obligation to serve requirements. Competitive service providers should also be expected to seek to avoid the imposition of financial requirements in support of universal service.¹²⁰² This has been true in industries other than telecommunications as

¹²⁰¹ *Cherry and Wildman, supra* note 62, at 7 - 8.

¹²⁰² "[C]ompetition has emerged through the entry of new providers targeting considerably narrower geographic areas than those served by incumbent LECs. There is no reason to expect this pattern to change. Sharing of support obligations within common geographic areas would encourage entrants to concentrate on areas in which the burden is least, leaving areas with more support recipients (or customers requiring more support) (continued...)

well.¹²⁰³ There is no reason that a competitive electric industry should be expected to react in any less discriminatory fashion when faced with an obligation to serve and universal service financial requirements.

Defining the type of discrimination that one seeks to prevent, if nothing else, is important for purposes of deciding upon the public policy responses establishing appropriate remedies for the objectionable behavior. If, on the one hand, the discrimination which one seeks to prevent involves irrational and uneconomic decisionmaking, the appropriate response might be simply to promote increased competition. This competition would increase the potential emergence of a firm that would serve this unserved, or under-served, yet profitable market. If, on the other hand, the discrimination which one seeks to prevent involves economically rational decisionmaking, promoting additional competition would *not* be the appropriate public policy response. It was the economics of the situation which created the discrimination in the first place and additional competition may exacerbate rather than alleviate the problem.

This situation presents an illustration of when the "statements of principle" articulated above become important. As stated above, the statements of principle represent the touchstone of intent, as well as an articulation of aspirations. To make unlawful only those discriminatory decisions that are economically irrational will not promote the goal of reaching universal service. Nor would it promote the principle that no degradation in service penetration levels be permitted. Accordingly, to be consistent with the statement of principles, the duty of non-discrimination imposed by the obligation to serve should incorporate the same duties imposed by statutes governing housing,¹²⁰⁴ consumer credit,¹²⁰⁵ employment.¹²⁰⁶

¹²⁰²(...continued)

to be served by incumbents." *Cherry and Wildman*, *supra* note 62, at 7.

¹²⁰³ See, notes 71 - 74, *supra*, and accompanying text.

¹²⁰⁴ 42 U.S.C. §§ 3601 to 3631 (1970), as amended, (Supp. 1975).

¹²⁰⁵ 15 U.S.C. §§ 1691 to 1691(f) (1976), Pub. L. 93-495, 88 Stat. 1521 (1974).

¹²⁰⁶ 42 U.S.C. §§ 2000e to 2000e-15 (1970) (hereinafter referred to as Title VII). Title VII was enacted in 1964, (*see*, Civil Rights Act of 1964, Pub. L. 88-359, 78 Stat. 253), and amended extensively in 1972, (*see*, Equal Employment Opportunity Act of 1972, Pub. L. No. 92-261, 86 Stat. 103).

The Obligation to Fund Residual Markets

COMPONENT NO. 5:

The obligation to serve should include an obligation by all electric service providers to help fund the cost of serving residual classes via a charge on all end use.

No one disputes the fact that low-income classes will represent a residual class in a restructured competitive electric industry. Moreover, it is frequently accepted that electric restructuring will involve the imposition of a wires charge to help fund assistance for these customers. A wires charge should fund three types of energy assistance:

- o **Crisis assistance:** Many households simply do not have sufficient funds to afford their electric bills at *any* cost. A household with an income of \$2,000, for example, will face likely payment troubles whether its bill is \$300 or \$1,300. As a result, it can reasonably be expected that these households will accrue arrears and eventually face a threat of service disconnection. Financial assistance to help meet emergency shutoff situations should be available.
- o **Cash fuel assistance:** In contrast, many other households will need non-crisis assistance. Even if not facing a shutoff, many households will face "unaffordable" home energy bills. Customers who face disproportionately high home energy burdens⁽²⁰⁷⁾ should be provided appropriate targeted energy assistance to help meet their home energy needs.
- o **Energy efficiency assistance:** Unlike cash assistance, energy efficiency provides long-term assistance to low-income households. Rather than needing a fresh influx of cash each year to obtain assistance, an energy efficient low-income household benefits from a reduced energy bill year-in and year-out. In addition, energy efficiency improvements help improve both the quality and the comfort of a low-income home.

⁽²⁰⁷⁾

A home energy burden is the home energy bill divided by household income. Hence, if a bill is \$1000 and annual income is \$4000, the home energy burden is 25 % ($\$1000 / \$4000 = 0.25$).

This analysis is not designed to present an appropriate wires charge plan.¹²⁰⁸ Instead, this analysis simply explains why all service providers and all end users should help fund this wires charge as part of the obligation to serve.¹²⁰⁹ Four factors go into this determination:

- o As discussed in detail above, utilities are unique in that they are granted the right to use city streets as well as the right to exercise the power of eminent domain.
- o Those public benefits have a distinct value, which is positive.¹²¹⁰ That value inures to the benefit of all ratepayers. If a utility could not use eminent domain, in other words, the increased costs that would arise as a result would be borne by all ratepayers. All end users gain the benefit.

¹²⁰⁸ Such a proposal has been detailed in various other documents. See e.g., Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for New Jersey*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Kentucky*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Iowa*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Montana*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Oklahoma*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Ohio*; Roger Colton (1996). *Structuring a Low-Income "Wires Charge" for Indiana*.

A "wires charge" mechanism is a common mechanism to use in support of universal service. Consider that in the telecommunications industry, a universal service fund is generally supported. "Strategies to seek funding for pilot projects and trials, targeted subsidies, and consumer education will also be needed. The industry itself should contribute to funding for these efforts. Commissions could mandate that a small percentage of revenues from each provider would be collected and pooled to provide a State Telecommunications Fund that would be allocated for these purposes. A board composed of industry, regulators, and consumer representatives could oversee disbursements from the fund." Heather Hudson (1996). *Universal Service: The Rural Challenge: Changing Requirements and Policy Options*, at 7, Benton Foundation: Washington D.C.

¹²⁰⁹ In other circumstances, other factors have been identified as important in the structure of a "wires charge." In the telecommunications arena, for example, one important component was identified to be "equitable and nondiscriminatory contributions by providers to the preservation and advancement of Universal Service. All providers of telecommunications services should make contributions to Universal Service." *Universal Service and the Telecommunications Act of 1996*. *supra* note 61, at 3. Moreover, another important consideration was that there be "specific and predictable support mechanisms. . .to preserve and advance Universal Service." *Id.*

¹²¹⁰ Indeed, the right to eminent domain is not only *valuable*, but is essential to public utilities. ". . .the specific right of the power of eminent domain has been given to most utilities. This right enables them to condemn private property and, with the payment of just compensation, to take it for 'public use' when necessary to the proper conduct of their business. This right is essential to resolve the complex property acquisitions required for powerline and pipeline right of way." Aspen Institute for Humanistic Studies, *Utility Obligations in Competitive Markets*, at 10, Aspen Institute for Humanistic Studies: Queenstown, MD.

- o A commitment to universal service is simply the compensation to the public for having provided these public benefits. As discussed in detail above,¹²¹¹ there has been an exchange of consideration. On the one hand, electric utilities are provided the right to use public streets and to exercise eminent domain. On the other hand, the utilities "pay" for these grants through a commitment to universal service.
- o As discussed in detail above,¹²¹² offering unaffordable service is the functional equivalent of denying service altogether. Accordingly, a commitment to universal service implies a commitment to affordable service.

In sum, having obtained the benefits of the bargain, all service providers and all end users should be required to help fulfill the responsibility part of the bargain. To allow otherwise would be to grant the benefit while forgiving the costs.¹²¹³

CONCLUSION

Permitting a move to a restructured competitive electric industry provides the opportunity to explicitly rewrite the social compact regarding that industry's commitment to universal service. This rewrite should include comprehensive, legally enforceable requirements. The need for, as well as the structure and operation of, an obligation to serve in a competitive electric industry can be informed by reference to other competitive industries.

There will exist a need within a competitive electric industry to have a legally-imposed comprehensive obligation to serve. It is evident from competitive non-electric industries such as those providing telecommunications, health care, health insurance and various personal lines of insurance that a societal obligation to serve is an insufficient tool to attain or maintain universal service. Even though in each of these non-electric industries, the service has been identified as not merely important but *essential* to life in today's world, substantial segments of the population nonetheless still lack access to them.

The impact of competition on the offer of services in those industries argued to have a societal obligation to serve offers several lessons for a move to a more competitive electric industry. Inclusiveness of customers through the pursuit of universal service is not a goal

¹²¹¹ See, notes 82 - 99, 103 - 108, 156 - 168, *supra*, and accompanying text.

¹²¹² See, notes 59 - 61, 63 - 68, 71 - 74, *supra*, and accompanying text.

¹²¹³ In this sense, some electric service providers have argued in the past that their competitors are not required to pay for universal service programs. While this may be true, neither have those competitors been provided the benefits of the use of public rights-of-way or the exercise of the governmental power of eminent domain.

which a competitive market recognizes. Indeed, a competitive market will often serve, by design, to exclude rather than to include those who are either unwilling or unable to pay. In addition, time after time, a competitive market will choose to raise prices to those least able to pay. These industry actions are based on decisionmaking considered to be not only rational by the industry, but dictated by the economics of the industry and its consumers.

Moreover, to consider "universal service" only for the population as a whole does not capture the full story. The populations consistently identified as lacking access to the essential services are the least powerful in society. The poor and dispossessed minority populations are those that are left out. A new social compact for electric utilities should thus state that only when universal service is extended to all subpopulations of society can it be said, more generally, that the goal of universal service has been attained.

The imposition of this obligation to serve does not represent an unreasonable regulatory burden. The obligation is instead simply the *quid pro quo* exacted in exchange for substantial --and continuing-- public benefits provided to the industry. So long as the electric industry enjoys the fruits of that exchange, it should abide by the obligations bargained for as part of the exchange. In particular, electric utilities have been granted two sets of public perquisites: (1) the right to exercise eminent domain; and (2) the right to use the public's streets, alleys and public ways as transportation corridors. In accepting these public perquisites, electric utilities have dedicated their property so supported to a public use. The bargain that has been made is both explicit and continuing. The obligation to serve is a type of compensation, the "payment" for the grant of certain public powers. The mere fact that the electric industry may become competitive does not eliminate either the need, or the justification, for obtaining this compensation.

Given the historical basis for imposing a legal obligation to serve on the electric industry and its continuing validity, the failure of non-electric industries to achieve universal service based exclusively upon a societal obligation to serve, the inherent structural barriers that a competitive market presents to achievement of universal service, and the existence of readily available non-electric obligation-to-serve models applicable to competitive markets, an obligation to serve consisting of the following elements is necessary, reasonable, and appropriate:

Statements of Principle

Principle No. 1: The purpose of the obligation to serve is to attain and maintain universal service within the electric industry.

Principle No. 2: The purpose of the "obligation to serve" is to prevent involuntary deterioration in current penetrations of electric service amongst those seeking service.

Enforceable Components

Component No. 1: The "obligation to serve" should include a distribution utility's obligation to connect.

Component No. 2: The "obligation to serve" should include an electric service provider's obligation to participate in providing service to residual classes not served by the voluntary market.

Component No. 3: The "obligation to serve" should include the obligation of an electric service provider to make available at least a minimum standard offer of service.

Component No. 4: An electric service provider should have the obligation to make service available on a non-discriminatory basis.

Component No. 5: The obligation to serve should include an obligation by all electric service providers to help fund the cost of serving residual classes via a charge on all end use.

GLOSSARY OF TERMS

Affordability: The federal Telecommunications Act of 1996 explicitly requires the Federal Communications Commission to adopt provisions to ensure the "affordability" of telecommunications services, "including to low-income consumers." The FCC decided that the concept of "affordability" includes both an "absolute" ("to have enough or the means for") and a "relative" ("to bear the cost of without serious detriment") component. According to the FCC, "both the absolute and relative components must be considered in making the affordability determination required under the statute."

Classification: In the insurance industry, treating an individual as a member of a class based on an individual trait. Common rating characteristics include gender, driving record, history of cancer, and the like.

Common carrier: A carrier that undertakes to carry for all people indifferently.^{1214\}

Coverage decisions: The process of setting policy conditions.

De facto discrimination: Facially neutral actions that have the effect of discriminating even if no discriminatory intent can be shown. (*see also*, "effects test").

Dumping: In the health care industry, the process of transferring poor or uninsured patients to public hospitals, admitting only those persons who are well insured or are affluent enough to pay the high cost of hospital care.^{1215\}

Effects test: The primary attribute of using an effects test is that the results of a practice urged to be discriminatory can be separated from the intention held by the defending party. The "effects test" relies not upon any improper intention by the challenged party, but rather upon the measurement of disparate impacts.^{1216\}

^{1214\} *National Association of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630, 641-42 (D.C. Cir. 1976), *cert. denied*, 425 U.S. 992 (1976) (*NARUC I*); *National Association of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) (*NARUC II*).

^{1215\} Geraldine Dallek & Judith Waxman, "'Patient Dumping': A Crisis in Emergency Medical Care for the Indigent," 19 *Clearinghouse Rev.* 1413, 1414 (1986).

^{1216\} David Hsia, "The Effects Test: New Directions," 17 *Santa Clara L.Rev.* 777 (1977); Comment, "Applying the Title VII Prima Facie Case to Title VIII Litigation," 11 *Harv. Civ. Rights - Civ. Liberties L.Rev.* 128 (1976); Note, "Credit Scoring and the ECOA: Applying the Effects Test," 88 *Yale L.J.* 1450 (1979).

Eminent domain: The right of a government to take, or to authorize the taking, of private property for a public use, just compensation generally being given to the owner.

Rating: The process of transforming classifications into prices for insurance.

Community rating: The process of basing rates on all insureds in an area rather than on separately defined groups.¹²¹⁷

Experience rating: The process of basing premiums on a particular group's historical costs, not on the expected costs for all persons in the community (a practice known as community rating).

Territorial rating: A process of setting insurance rates based upon where the policyholder lives. *See also*, "redlining."

Redlining: Within the home mortgage market, redlining has been defined as "the process of drawing or outlining a geographic area within which lending will be denied due to the composition or characteristics of the area."¹²¹⁸ Within the insurance industry, "redlining" has been defined to mean "canceling, refusing to insure or to renew, or varying the terms under which insurance is available to individuals because of the geographic location of a risk."¹²¹⁹ "Redlining" may be economically rational or economically irrational.

¹²¹⁷ Under community rating, insurers aggregate into one "community" individuals or groups for the purpose of providing insurance. A community rated plan generally charges the same rate for all members, spreading the costs for the entire group evenly over its members. Under experience rating, the past claims experience of a group is used to determine the premium. Congressional Research Service, Library of Congress, *Health Insurance and the Uninsured: Background Data and Analysis* 10-11 (1988).

¹²¹⁸ Joan Kane, "The Constitutionality of Redlining: The Potential for Holding Banks Liable as State Actors," 2 *William and Mary Bill of Rights Journal* 527, 527, n.8, citing, Warren Dennis and J. Stanley Pottinger, *Federal Regulation of Banking: Redlining and Community Reinvestment* (1980).

¹²¹⁹ Gary Williams, "'The Wrong Side of the Tracks': Territorial Rating and the Setting of Automobile Liability Insurance Rates in California," 19 *Hastings Constitutional Law Qrtly* 845, 861 (1992).

Residual class: A "residual class" is any class of consumers that the private market would not voluntarily seek to serve on substantially equivalent terms and conditions.

Underwriting: The decision whether to offer insurance to an individual at all. Underwriting criteria may be formal or informal.

APPENDIX A

SUMMARY OF "LESSONS LEARNED" FROM NON-ELECTRIC INDUSTRIES

HISTORICAL VIEW OF AN ELECTRIC UTILITY'S OBLIGATION TO SERVE	
	The obligation to serve is intended primarily to ensure that electric service is extended to all who desire service and either pay for service or express a willingness to pay for the service rendered.
	The obligation to serve involves a basic commitment to universal service. While this commitment does not ensure that customers will retain service if they do not or cannot pay for it, it does seek to ensure that all customers (and potential customers) have the opportunity to take service.
	The obligation to serve has a requirement of non-discrimination; discrimination historically has involved a commitment to refrain from making unreasonable distinctions. Non-discrimination implies the lack of unreasonable distinctions.
	The obligation to serve flows from the common law. Specific regulations or pieces of legislation setting forth the obligation are merely restatements of the common law.
A "SOCIETAL" OBLIGATION TO SERVE OUTSIDE THE UTILITY INDUSTRY	
	The purpose of an obligation to serve is to redress the harm of denying the availability of an essential service.
	Enforcing the obligation to serve benefits not only the person for whom access to the essential service is affected, but all of the various components of society.
	Failing to enforce an obligation to serve frequently has penumbra impacts: <i>e.g.</i> , the inability to finance a car due to the lack of automobile insurance, the inability to obtain a home due to the lack of property insurance, the inability to obtain employment due to the lack of a telephone.
	"Imposing" a "societal obligation to serve" on an industry providing essential services is an insufficient tool to use in securing universal service
	Only when universal service is extended to all subpopulations of society can it be said that the goal of universal service, more generally, has been reached.

	The implementation of an obligation to serve will involve making specific affirmative efforts to make available essential services to those who are difficult to serve, not merely making passive offerings to anyone who might come.
	Offering essential products and services to persons in residual markets at unaffordable prices and/or unreasonable terms is the effective equivalent of excluding those persons in the first instance.
	A competitive market will, by design, often serve to exclude rather than to include those who are either unwilling or unable to pay.
	Inclusiveness of customers through the pursuit of universal service is not a goal which a competitive market recognizes.
	A competitive market will likely exclude those persons who are the least able to respond by exercising any market influence over entities offering the essential service.
	Even when included in response to some external force, those persons brought into the market through such means are unlikely to obtain equivalent products at equivalent prices and on equivalent terms.
	A competitive market may frequently serve to exclude rather than to include those who are either unwilling or unable to pay. Inclusiveness of customers through the pursuit of universal service is not a goal which a competitive market recognizes. Exclusion is not necessarily considered a market failure.
	A competitive market will frequently choose to raise prices to those least able to pay. Exclusion by design, or exclusion by inability to pay, is still exclusion for these consumers.
	Failure to pursue universal service is based on decisionmaking considered to be not only rational by the industry, but dictated by the economics of the industry and its consumers.
IMPOSING A LEGAL OBLIGATION TO SERVE	The gradations in service access must be considered in reviewing the extent to which residual markets are being served. The failure to achieve universal service may come as a resulting of denying a full range of services as much as by denying service altogether.
	The "exchange" of an obligation to serve for public support for the industry bearing the obligation is appropriate public policy.

	<p>The obligation to serve imposed in exchange for public perquisites provided in support of the industry should be in furtherance of the goal of universal service.</p>
	<p>Creation of an obligation to serve simply for a term of years is an inappropriate and ineffective mechanism for promoting universal service.</p>
	<p>Making an explicit exchange of the provision of universal service in consideration of the provision of public benefits is appropriate whether or not there is a dollar-for-dollar accounting of the relative value of the consideration exchanged.</p>
	<p>The adequacy of public markets as a mechanism for meeting an industry's obligation to serve depends on the form the public market takes and the way in which it operates.</p>
	<p>A sharing of the costs of serving residual markets in proportion to the share of the voluntary market is the most common method of pursuing universal service. Assigned risk pools involve either assigning members of the residual markets, or the costs of the residual markets, in proportion to market share. Reinsurance facilities involve the assignment of the costs of serving the residual markets in proportion to market share. Joint underwriting associations involve assigning the cost of serving residual markets in proportion to market share.</p>
	<p>If profits or benefits arise from the residual markets, those profits or benefits are assigned in proportion to market share as well.</p>
	<p>Without effective regulation of the prices, service levels and terms offered the residual markets, those markets are likely to be offered less service, for higher prices, on less favorable terms.</p>

APPENDIX B **SUMMARY OF OBLIGATION TO SERVE** **POLICY RECOMMENDATIONS**

PRINCIPLE NO. 1:

The purpose of the obligation to serve is to attain and maintain universal service within the electric industry.

Universal service cannot be measured by reference to customers as a whole. For there to be universal service, there must be universal service in each sub-market as well as for consumers as a whole.

The obligation to serve is not narrowly focused on eliminating particular market failures. It is instead a broad-based policy determination that the service in question should be universally available.

PRINCIPLE NO. 2:

The purpose of the "obligation to serve" is to prevent involuntary deterioration in current penetrations of electric service amongst those seeking service.

Any deterioration in existing penetration levels of electric service will be unacceptable.

DEFINITION:

For purposes of the obligation to serve, "universal service" means that all persons desiring to take electric service, and paying or agreeing to pay the reasonable price for such service, and abide by the reasonable rules, shall have the opportunity to take such service on a nondiscriminatory basis. The "opportunity to take service" is defined to include an affirmative obligation to engage in best efforts to make service available to all customers.

"Universal service" does not seek to *guarantee* that every person has electric service.

What it does instead is to guarantee that every person has *access* to electric service. "Access" means that every person has the opportunity to take electric service by paying, or agreeing to pay, the reasonable price for such service.

"Universal service" incorporates an element of affordability within it. Pricing services at unaffordable levels is the functional equivalent of denying service altogether.

The obligation to serve imposes an affirmative duty to ensure that the opportunity to take electric service is made universally available.

The obligation to serve requires market participants to take *specific* efforts in furtherance of universal service. The passive offer of service to any person who wants it is insufficient compliance with the obligation.

The service which is provided must be provided on a nondiscriminatory basis.

While there is no guarantee that all persons will find service to be both available and affordable, the affirmative obligation to take specific actions to bring about that result is designed to make service available on a "best efforts" standard. Best efforts requires not minimum competence, but rather a calling of diligence.

COMPONENT NO. 1:

The "obligation to serve" should include a distribution utility's obligation to connect.

	<p>A distribution utility's obligation to serve should include the "obligation to connect" customers to the distribution system assuming that the provision of electric power eventually becomes competitive at the retail level.</p>
	<p>The obligation to serve is an explicit <i>quid pro quo</i> that was exacted in exchange for substantial --and continuing-- public benefits. So long as the local distribution companies enjoy the fruits of that exchange, they must abide by the obligations that were bargained for as part of the exchange. The benefits include the power to exercise eminent domain and the right to use public streets and ways.</p>
	<p>The obligation to serve flows from at least two different sources for electric utilities. First, the grant of the right to exercise the power of eminent domain has inherent within it the obligation to serve. Second, the grant of the right to use public streets, alleys and public ways has within it the obligation to serve. The obligation to serve is a type of "payment" for the grant of these powers. The obligation to serve is a type of public compensation.</p>
	<p>The imposition of a perpetual duty-to-serve on utility property in exchange for the grant of public perquisites is not different from the imposition of a perpetual duty to dedicate the assets of non-profit institutions to charitable purposes in exchange for tax exempt status.</p>
<p>COMPONENT NO. 2:</p>	
<p>The "obligation to serve" should include an electric service provider's obligation to participate in providing service to residual classes.</p>	
	<p>The obligation to serve requires a competitive service provider to participate in serving all members of the residual classes not served by the voluntary market.</p>
	<p>The obligation would state that each company providing retail service would be required to sell to members of the distribution company's "residual" customers in a proportion equal to the market share that the retail company has of the local distribution company's total distribution market.</p>
	<p>The "residual" classes would consist of at least the following two classes of customers: (1) low-income or other payment-troubled customers; and (2) customers who do not choose a competitive provider when given the option of leaving the local utility company at the commencement of direct retail access.</p>

COMPONENT NO. 3:

The "obligation to serve" should include the obligation of an electric service provider to make available at least a minimum standard offer of service.

In the event that local regulators do not adopt the pro rationing mechanism for serving members of the public market, regulations will be necessary to ensure that members of the residual class are, at the least, made available a minimum standard offer at regulated rates.

The standard offer shall include a minimum package of service offered at uniform prices and on uniform terms.

COMPONENT NO. 4:

An electric service provider shall have the obligation to make service available on a non-discriminatory basis.

The obligation to serve should include the obligation to make service available on a non-discriminatory basis. This duty of "non-discrimination" should have two elements to it.

First, actions that have the *effect* of imposing adverse impacts on a residual class should be unlawful unless they are dictated by a business necessity.

Second, the duty of non-discrimination must extend beyond those decisions by electric service providers that may be economically irrational.

COMPONENT NO. 5:

The obligation to serve shall include an obligation by all electric service providers to help fund the cost of serving residual classes via a charge on all end use.

The following discussion is designed to identify what components might be made a part The following discussion is designed to identify what components might be made a part

The funding shall generate dollars for distribution as: (1) crisis assistance; (2) cash fuel assistance; and (3) energy efficiency assistance.

All service providers and all end users should help fund this wires charge as part of the obligation to serve.

INTERNAL DISTRIBUTION

- | | |
|------------------------|--------------------------------|
| 1. V. D. Baxter | 16. M. Schweitzer |
| 2. L. Berry | 17. R. B. Shelton |
| 3. D. S. Bjornstad | 18. R. L. Shelton |
| 4. M. A. Brown | 19. J. Tomlinson |
| 5. J. Christian | 20. B. E. Tonn |
| 6. G. Courville | 21. J. Van Dyke |
| 7. T. R. Curlee | 22. J. Van Dyke |
| 8. M. Gettings | 23. J. VanCoevinger |
| 9. S. Hadley | 24. T. J. Wilbanks |
| 10. L. J. Hill | 25. ORNL Patent Office |
| 11. D. Jones | 26. Central Research Office |
| 12. B. Kirby | 27. Document Reference Section |
| 13. J. F. Munro | 28. Laboratory Records (RC) |
| 14. D. E. Reichle | 29-31 Laboratory Records Dept. |
| 15. A. C. Schaffhauser | |

EXTERNAL DISTRIBUTION

32. Lilia A. Abron, President, PEER Consultants, P.C., 1460 Gulf Blvd., 11th Floor, Clearwater, Florida, 34360.
33. Dr. Thomas E. Drabek, Professor, Department of Sociology, University of Denver, Denver, CO 80208-0209.
34. Dr. Stephen G. Hildebrand, Director, Environmental Sciences Division, Oak Ridge National Laboratory, P.O. Box 2008, Oak Ridge, TN 37831-6037.
35. Mr. P. Richard Rittelmann, FAIA, Executive Vice President, Burt Hill Kosar Rittelmann Associates, 400 Morgan Center, Butler, Pennsylvania 16001-5977.
36. Dr. Susan F. Tierney, The Economic Resource Group, Inc., One Mifflin Place, Cambridge, Massachusetts 02138.
37. Dr. C. Michael Walton, Ernest H. Cockrell Centennial Chair in Engineering and Chairman, Department of Civil Engineering, University of Texas at Austin, Austin, TX 78712-1076.
38. OSTI, U.S. Department of Energy, P.O. Box 62, Oak Ridge, TN 37831
39. Office of Assistant Manager for Energy Research and Development, DOE/ORO, P.O. Box 2001, Oak Ridge, TN 37831-8600.
- 40-700. Extra copies to Miranda Eady, Oak Ridge National Laboratory, Building 4500N, MS-6206.