

Legally (Relevant



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Late Payment, Shut Off and Reconnection Fees

All water and wastewater systems have some type of fees that are assessed for late payments, shut off and/or reconnection. There is a surprising lack of uniformity in Kansas on how these fees are assessed and their amounts. The question is: Are these fees legal?

A quick survey of Kansas cities' and rural water districts' policies reflect widely divergent philosophies in assessing these fees. A recent

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article in the *Lawrence Journal – World* demonstrated these differences. It compared the policies, practices and results between Lawrence and Manhattan. These two cities, both college towns with relatively similar demographics, approach late payment fees very differently, with very different results. Lawrence charges a penalty of 2% of the total account balance not paid within twenty-one days of billing. This amounts to \$0.80 on a \$40 bill. Manhattan has no late payment penalty but instead charges a flat fee of \$25 only after water is shut off for non-payment. According to the *Journal – World*, about 30% of all Lawrence utility bills have a late fee, but only about 10% of the Manhattan customers pay the late (in effect, shut off) fee. Other examples include Wichita, that charges a 1.5% late payment fee; Pittsburg charges a 10% late payment fee; and Hays, Salina and Garden City all charge a 5% late payment fee. A

sampling of Kansas rural water districts revealed policies that set late payment fees in the range of 6% to 10% of the unpaid balance, with disconnect/reconnect fees ranging from \$20 to \$100. While these percentage based fees do not seem significant on their face (10% of a \$40 bill is still only \$4), if the utility adds this late payment fee every month, charges the late payment fee on all amounts due including previously assessed late payment fees, and allows the bill to accumulate for a number of months before taking action (almost an inevitability for rural water districts whose by-laws frequently prohibit forfeiture or other action until the bill is more than six months past due), these late payment fees can become substantial. It has been reported that in some extreme cases, where the utility cannot or would not terminate service for years, late payment penalties were added to the account until they amounted to several hundred thousand dollars!

The short answer to the question is that assessment of late payment, disconnect and reconnect fees is legal, but the authority to assess these fees is not without limitations. Some of these limitations are discussed below.

Are Late Payment Fees Actually “Finance Charges” Subject to Limitations and Disclosures?

Everyone is familiar with the “fine print” required on credit card, bank and similar statements and the legal limitations that go along with them. Are utility bills subject to these same rules? Somewhat surprisingly, that question has been presented many times in Kansas. Utilities usually do not intend to be creditors of their customers, as they expect to be paid promptly after billing for monthly

Listen Mayor, I understand the city's ordinance requires us to add a late charge that is 10% of the balance due even if the water is shut off and the house has sat empty for years, like this guy. The problem I'm having is that he has just passed the million dollar mark and our software won't display that many numbers!



service. However, utilities often become involuntary creditors when those customers do not timely pay their bills.

Utilities should avoid doing anything that might cause their dealings with their customers to be considered “credit transactions”. By entering into “credit transactions” the utility can subject itself to interest rate caps as well as the extensive notice

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requirements that lead to the kinds of “fine print” seen on credit card statements. If applicable, compliance with these requirements can be very burdensome and violations can be severe, including civil penalties and payment of a customer’s attorneys’ fees.

While this might seem highly unlikely over a \$4 “finance charge”, multiplied over a number of months or years and thousands of customers in a class action lawsuit can be an exceedingly expensive problem.

For water and wastewater utilities, most of these limitations and requirements for disclosure would come about if the utilities’ charges to their customers were regulated by the Uniform Consumer Credit Code (UCCC, K.S.A. 16a-1-101 et seq.), or the Federal Truth In Lending Act (TILA, 15 U.S.C. § 1601 et seq.). In a 1977 Kansas Court of Appeals case, *Jones v. KG&E*, the Court concluded that a late payment penalty of 5% was not in the nature of a finance charge that made the charge subject to the UCCC or the TILA. Although the case involved electric, not water or wastewater services, that case is different mostly because unlike most water and wastewater systems, KG&E was regulated by the Kansas Corporation Commission. However, the Kansas Attorney General in 1988 concluded that the same principals stated in the *Jones v. KG&E* case were applicable to municipal utilities. The Attorney General was asked about the City of Clearwater’s code that imposed a 10% late payment penalty on unpaid bills, plus a separate interest charge of 8% on the late bill until it was paid in full. The Attorney General concluded that as long as the purpose for the charges was to recover costs of collection and amounts designed to encourage prompt payment of bills, the charge is not improper. The Attorney General ruled that this combination of charges by Clearwater did not constitute excessive finance charges under state or federal law and did not require extensive disclosure like other regulated consumer credit transactions.

This was true despite the facts in the *Jones v. KG&E* case, there was no KCC oversight of the fees and charges by this municipal utility.

Is There a Limit on How Much is Too Much?

The short answer to this question is “yes”. Like virtually all charges made by water and wastewater utilities to their customers, these late payment, disconnect and reconnect fees are subject to a reasonableness standard. Stated differently, these charges may not be unreasonable or unjustly discriminatory.

“Reasonable” charges would include those that have some connection to the cost being incurred by the utility in providing the service of collecting late payments, plus some reasonable amount intended to encourage prompt payment. Costs incurred by a utility would include paper, envelopes, postage and other materials involved in managing delinquent payments, and could include a component designed to represent the lost use of the money, that being interest that could be earned on the payment if promptly received, or conversely the cost of borrowing money that is incurred as a result of not having the use of customers’ money. However, by far the largest component to this cost is for the time office staff, or in the case of disconnect/reconnect fees, office staff and field personnel spend in performing these services necessary to collect on delinquent accounts. These costs may be difficult to measure with precision, but some average costs may be determined, and these costs may be considerably different from one utility to another.

As to the discriminatory or the unjustly discriminatory component, this is very difficult to

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determine. The courts and the Attorney General have noted that it is unfair for customers who consistently pay their bills on time to effectively subsidize those who do not so that it is reasonable to charge late payment, disconnect and reconnect fees to those late paying customers who cause those services to have to be performed. The *Lawrence Journal – World* article quoted officials who concluded that Lawrence’s 2% late payment fee might not be enough to encourage prompt payment as approximately 30% of its customers were late, suggesting that the fee was not enough to encourage timely payment. On the other hand, such fees should not be set in order to punish customers who pay late, many of whom through mere oversight, but in other instances the result of true hardship. It is difficult to draw any specific conclusions about how a particular fee or charge would be viewed, except that it is clear that a fee that is based on demonstrable costs incurred by the utility in collecting the late payment will be acceptable.

Conclusion: Some Suggestions

- ❑ There is no “right” or “wrong” way to assess late payment fees. What is best for a given utility may vary from one to the next. There are advantages and disadvantages to both the percentage based and flat fee based late payment fees. Many utilities have become very aggressive in their collection policies, so that service is almost always disconnected before even a second consecutive bill can be late. For these utilities, having no real late payment fee, but a disconnect/reconnect flat fee may make the most sense. This may not work so well for those utilities like rural water districts who typically run much longer before reaching service termination/forfeiture.
- ❑ If possible, avoid terms like “finance charge” and “interest” in assessing fees. These just serve as red flags to anyone who may try to characterize these as being UCCC and TILA regulated charges.
- ❑ Utilities should be vigilant in complying with their bylaws or ordinances regarding collection of late accounts and/or termination of services due to nonpayment. Not only is this good business, but particularly in the case of percentage based late payment fees that are charged on the unpaid balance monthly, if allowed to run for an extended period of time these late payment charges may become excessive to the point of unreasonableness. Additionally, such practice may contribute to the view that the utility really is making the collection of finance charges a part of its business so that it has subjected itself to UCCC and TILA regulations.
- ❑ Utilities would be well advised to perform a study of their costs incurred in handling late payments and disconnection/reconnections. These will include postage and other materials related to late notices, but most importantly an estimate of the amount of labor, and the cost of that labor, wages and benefits included, for staff to handle late payment noticing, shut off notices, shut off and disconnect services.