

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Pennsylvania-American Water Company :
For Approval of Tariff Changes and Accounting : P-2017-2606100
and Rate Treatment Related to Replacement :
of Lead Customer-Owned Service Pipes :

RECOMMENDED DECISION

Before
Elizabeth H. Barnes
Administrative Law Judge

INTRODUCTION

This decision recommends granting in part and denying in part Pennsylvania-American Water Company's (PAWC) Petition for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes¹ (Petition).

Specifically, this decision recommends that PAWC should be granted permission to file a Tariff Supplement to Tariff No. 5, which authorizes the Company to replace under contract customer-owned lead service pipes during a projected removal and replacement of 18,000 PAWC-owned lead Service Lines (Part 1) and to replace other customer-owned lead service pipes as proposed under Part 2 over the next ten years at PAWC's sole cost, subject to the accounting and rate recovery treatment proposals advocated by the Office of Consumer

¹ Rules 2.15 and 2.16, respectively, set forth at page 43 of PAWC Tariff Water-Pa. P.U.C. No. 5 ("Tariff No. 5"), define a "Service Line" as "[t]he Company-owned piping and appurtenances which run between and are connected to the Company's main and its street service connection," and a "Service Pipe" as "[t]hat portion of a water line not owned by the Company which transmits water from the Company-owned water main to the Customer's premise. The water service pipe begins at the Company-owned street service connection and continues into the structure on the premise to be supplied."

Advocate (OCA), Office of Small Business Advocate (OSBA) and Bureau of Investigation and Enforcement (I&E) (collectively “statutory advocates”).

However, PAWC’s request to classify the cost of customer-owned service pipe replacement as either a “capitalized cost” or “eligible property” within the meaning of the statutory definitions at 66 Pa. C.S. §§ 1351 and 1351(3)(i) and its request to record those costs in Account No. 333 – Services (Services Account) for accounting purposes should be denied. PAWC’s request to treat the costs as “eligible property” for water utilities under Section 1351, a recoverable cost under its Distribution System Improvement Charge (DSIC) pursuant to 66 Pa. C.S. §§ 1351, 1353 and 1357 should be denied.

I recommend adopting OCA’s and I&E’s proposed modifications to the Petition and directing PAWC to treat the cost as a deferred regulatory asset to be amortized over a period to be established in PAWC’s next rate base proceeding. Ownership of replaced pipes should transfer to the customer-owner with a one-year warranty as per PAWC’s request. OCA’s proposal that the Company should compensate, on a graduated sliding scale, those customers who have replaced their lead service pipes within the past four years should be adopted. Finally, PAWC should be directed to collaborate with the statutory advocates to improve customer education and outreach regarding Parts 1 and 2 of the replacement project and it should annually report its efforts to obtain federal and state grants to lower the cost of the project to PAWC’s ratepayers.

HISTORY OF THE PROCEEDINGS

On May 22, 2017, PAWC filed the instant Petition seeking approval from the Commission to revise its tariff in order to: 1) replace customer-owned lead service lines at its sole cost, subject to accounting and rate recovery treatment proposals; 2) capitalize such costs incurred and to record those costs in Account No. 333 – Services (Services Account) for accounting purposes; and 3) affirm that the costs are “eligible property” for water utilities under Section 1351, a recoverable cost under its Distribution System Improvement Charge (DSIC) pursuant to 66 Pa. C.S. § 1357. PAWC is proactively planning to comply with drinking water

standards, including the Lead and Copper Rule ('LCR') at 25 Pa. Code §§ 109.1101 through 109.1108.

On June 12, 2017, I&E and the OCA filed Answers, respectively. On June 15, 2017, OSBA filed a Notice of Intervention. On August 8, 2017, a prehearing conference was held, and a procedural schedule was adopted scheduling an evidentiary hearing on January 17, 2018. Written testimony was pre-submitted by the parties and the hearing was cancelled upon request of the parties as they had no cross-examination for any of the witnesses. On January 22, 2018, the parties filed a joint Motion for Admission of Testimony and Exhibits, stipulating as to the authenticity of the statements and exhibits as well as waiving any cross examination of witnesses sponsoring their statements and exhibits. On January 25, 2018, an Order was issued granting the Motion and admitting testimony, exhibits and schedules into the record. The parties filed main briefs on March 1, 2018 and reply briefs on March 15, 2018. The record closed on March 15, 2018. This matter is ripe for a decision.

FINDINGS OF FACT

1. A "partial lead service line" replacement may not significantly reduce the lead level at the customer's tap but may temporarily increase lead at the customer's tap due to disturbing the customer-owned service line during the partial replacement. OCA Exhibit SJR-1 at 5.

2. Dislodging of particulate lead from the remaining service line and galvanic corrosion have been shown to be causes of elevated lead observed after partial replacement. OCA Exhibit SJR-1 at 5.

3. Galvanic corrosion will occur at the connection of the old lead service line (LSL) on the private side of the home and then newly installed copper service line on the public side. OCA Exhibit SJR-1 at 5.

4. A decrease in lead release can occur over time with both full and partial replacement. OCA Exhibit SJR-1 at 5.

5. PAWC has not failed any water sampling tests and is compliant with the LCR. PAWC R. B. at 6.

6. The one-time replacement cost of a customer-owned lead service pipe with ownership of the pipe transferring to the customer is akin to an extraordinary cost. OCA St. 1 at 20-25; I&E St. 1 at 6-11; OCA St. 1-SR at 7.

7. The average cost of lead service pipe replacement is approximately \$3,500 per service line. PAWC St. Nos. 1, p. 14 & 1-R, pp. 12-13.

8. Regulatory assets are incurred costs recovered over a period through rates, a compromise between immediately expensing a cost and an immediate charge to ratepayers. NRRI 94-7: National Regulatory Research Institute: Generally Accepted Accounting Principles for Regulated Utilities: Evolution and Impacts at 6.

9. A one-year limited workmanship warranty on replacement pipes is consistent with other routine utility work and is reasonable. PAWC St. 1-R at 11.

10. PAWC has a customer education program. PAWC St. 1-R at 12; OCA St. 1 at 24.

11. PAWC has not sought state or federal grant monies to lower the cost of replacement of lead service pipes. Petition, PAWC Sts. 1 and 2.

DISCUSSION

Burden of Proof

Section 332 of the Public Utility Code states:

(a) Burden of proof. — Except as may be otherwise provided in section 315 (relating to burden of proof) or other provisions of this part or other relevant statute, the proponent of a rule or order has the burden of proof.

66 Pa. C.S. § 332(a).

As the petitioner seeking Commission approval of a proposed Tariff Supplement regarding Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes, PAWC has the burden of proof in this proceeding.² It is well-established that the “degree of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of the evidence.” *Lansberry v. Pa. Pub. Util. Comm’n*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990) (*Lansberry*). PAWC’s evidence must be more convincing than the evidence presented by the other parties.³ Additionally, the Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. The evidence must be substantial and legally credible and cannot be mere “suspicion” or a “scintilla” of evidence. *Lansberry*, 578 A.2d at 602. Even where a party has established a prima facie case, the litigant must show that:

the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary.

Burleson v. Pa. Pub. Util. Comm’n, 461 A.2d 1234, 1236 (Pa. 1983).

² See *Petition of PPL Electric Utilities Corporation for Approval of a Competitive Bridge Plan*, Docket No. P-00062227, (Order May 17, 2007).

³ *Se-Ling Hosiery, Inc. v. Margulies*, 70 A.2d 854 (Pa. 1950) (holding that the term “burden of proof” means a duty to establish a fact by a preponderance of the evidence, which is satisfied when one party has presented evidence that is more convincing, even by the smallest degree, than the evidence presented by the other party).

The utility's burden of proof to establish the justness and reasonableness of every component of its Petition is an affirmative one and remains with PAWC throughout the course of the proceeding.⁴ Thus, PAWC has the burden of proof to show that every element of its proposal is just and reasonable.

PAWC's Petition

PAWC is a public utility engaged in the business of supplying water and wastewater services to approximately 655,632 customers in 36 of the 67 counties in Pennsylvania. The company also provides wastewater service to approximately 54,478 customers. 66 Pa. C.S. § 102. PAWC St. 1 at 3.

On April 28, 2017, PAWC filed tariffs requesting an increase in its total annual operating revenues using a calendar year 2018 projected test year at Docket No. R-2017-2595853. The Commission approved a Joint Petition for Settlement allowing an increase in annual operating revenues of \$61.85 million, or approximately a 9.41% increase, in lieu of the \$107.9 million, or approximately 16.4%, increase originally requested. *Pa. Pub. Util. Comm'n, et al. v. Pennsylvania American Water Company*, R-2017-2595853 (Final Order entered December 7, 2017). PAWC did not include costs associated with the replacement of customer-owned service pipes in its rate-case projections.

On January 20, 2017, PAWC filed a Petition seeking approval of its Water Long-Term Infrastructure Improvement Plan (LTIP). On May 18, 2017, the Commission held PAWC's LTIP to be compliant with Act 11 and the Commission's Final Implementation Order and approved an infrastructure replacement schedule. *Petition of Pennsylvania American Water Company for Approval of their Long-Term Infrastructure Improvement Plan*, P-2017-2585707 (Opinion and Order entered May 18, 2017). This plan prioritized removal of an estimated

⁴ See, *Pa. Pub. Util. Comm'n v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2014-2407345, 2014 Pa. PUC LEXIS 691, at *11 (Oct. 23, 2014) ("The burden of proof does not shift to a statutory party or individual party (whether an entity or an individual) which challenged the requested Rider. Instead, the utility's burden, to establish the justness and reasonableness of every component of its request, is an affirmative one and remains with the public utility throughout the course of the proceeding.").

18,000 company-owned lead service lines over the next 10 years in combination with the ongoing main replacement program. *Id.* at 9. PAWC noted that if it discovered a customer-owned lead service pipe during main or service line replacement, it would also replace the customer-owned pipe.

PAWC's instant Petition is prompted by recent events in Flint, Michigan and heightened customer concern about lead levels in water. PAWC St. No. 1, p. 5. The Company claims it ceased installing lead Service Lines by the 1950's; however, some remain in service that predate that change or were acquired from other water utilities. The Company is not currently in violation of federal or state regulatory standards established by the United States Environmental Protection Agency ("EPA") or the Pennsylvania Department of Environmental Protection ("DEP"), including the LCR. The Company has implemented a variety of proactive measures, including: 1) corrosion control treatment and research; 2) customer education; and 3) elimination of lead Service Lines. PAWC has not triggered the LCR action level requirements in any portion of its system, which is a testament to the effectiveness of the Company's corrosion control measures and management of its distribution system. PAWC St. No. 1, pp. 5-7.

The current LCR requires utilities, among other things, to test drinking water inside older homes for lead and take additional action if more than 10% of tap water samples exceed the lead concentration limit (i.e., 15 parts per billion),⁵ including replacement of utility-owned and customer-owned lead piping. Consequently, remaining in compliance with applicable drinking water regulations necessarily requires taking steps to address possible sources of lead contamination from customer-owned property. However, PAWC can only replace the segment it owns. If a customer is unable or unwilling to pay for replacing the portion of the service piping for which the customer is responsible, the Company cannot replace the customer's pipe and capitalize the cost of replacement. PAWC St. No. 1, p. 6.

⁵ See 40 C.F.R. § 141.80 *et seq.*; 25 Pa. Code § 109.1101 *et seq.*

PAWC claims its options are further limited by Rule 4.9 of Tariff No. 4, which does not authorize the Company to replace a customer's Service Pipe.⁶ Under Rules 2.15 and 2.16 of Tariff No. 5, the Service Line extends from the water main to the curb stop street service connection and the Service Pipe extends from the curb stop to the customer's premises. Rule 4.9 of Tariff No. 5 provides, in relevant part, as follows:

4.9 Customer Responsibility for Service Pipe

The Customer shall have full responsibility for the installation, repair, replacement, and maintenance of all Service Pipes . . .

PAWC St. No. 2, pp. 3-4. Supplement No. 2 to Tariff Water-PA PUC No. 5 at 43, Rules 2.15 and 2.16, effective January 1, 2018.

The Company's proposed Supplement to Tariff No. 5, if approved, will revise the Company's Rules and Regulations to authorize PAWC to replace lead customer-owned service pipes at its sole cost, within the parameters of the Replacement Plan summarized below, while leaving with the affected customers the ownership and responsibility to maintain, repair and replace the new Service Pipe after it is installed. *See* PAWC St. No. 2, pp. 4-5; PAWC Exhibit No. 1.

PAWC's Replacement Plan consists of two parts. First, PAWC will proactively remove and replace, with the customer's consent, lead Service Pipes ("LSPs") that are encountered when it replaces its mains and Service Lines (Part 1) over a ten-year period. Second, PAWC will remove and replace LSPs when requested to do so by a customer subject to verifying that the customer, in fact, has an LSP (Part 2).

Under Part 2, the Company will coordinate customer-requested replacements. Customer requests will be grouped by geographic location, and replacements will be undertaken

⁶ Tariff No. 4 was in effect at the time PAWC filed the instant Petition; however, Tariff No. 4 was later replaced with Tariff No. 5, effective January 1, 2018.

when the number of customer requests in a given location allows the Company to realize reasonable economies of scale by doing those replacements as a single project. PAWC St. No. 1, pp. 8-12. With full implementation of Part 2, the Company anticipates segmenting its service territory into at least five geographical regions and its contractor crews could have the capacity to perform fifty customer-owned LSP replacements per week. PAWC will also strive to maintain the wait-time following a customer request under Part 2 to less than one year after PAWC can evaluate the level of customer requests and address any program start-up issues. PAWC St. No. 1-R, pp. 7-9.

Under both Parts of the Replacement Plan, the customer will own and be responsible for the new Service Pipe after the replacement to minimize disparity among customers based on Service Pipe composition. Under the proposed tariff changes set forth in PAWC Exhibit No. 1, prior to the initiation of any LSP replacement work by the Company, the affected customer must also enter into an agreement with the Company that, among other things, authorizes PAWC to access the customer's property to undertake the replacement work. PAWC St. Nos. 1, p. 14 & 1-R, at 10-11; PAWC Exhibit DRK-2R. The proposed revisions to Rule 4.9 do not change the rules regarding a customer's obligation to replace or repair a leaking or otherwise defective Service Pipe, but the customer will not be required to repair a LSP prior to replacement by the Company. PAWC St. No. 1-R, at 11. In addition, the Company will provide a one-year limited workmanship warranty to the customer on the newly installed Service Pipe.

The Company claims its current public education efforts regarding lead service lines are consistent with the National Drinking Water Advisory Council's (NDWAC) recommendations. PAWC's communications plan for the Replacement Plan will include direct mailings to notify potentially affected customers of the Replacement Plan, press releases, bill inserts, information on the Company's website regarding the health effects of lead, and a lead information pamphlet to be distributed to all customers. In addition, PAWC plans to release an educational video about lead and notify customers when lead is encountered on the customer-owned segment of the service line. PAWC St. Nos. 1, p. 14 & 1-R, p. 12.

PAWC is also proposing to set a budget cap of \$6.0 million per year on the amounts expended to replace LSPs to mitigate the impact of the Replacement Plan on customer rates, which it estimates will be \$1.24 per year per average customer. PAWC Exhibit No. 2. LSP replacements under Part 1 will have priority on the use of the \$6.0 million annual budgetary allotment as they address conditions that pose relatively greater risks of raising lead levels for the affected customers. If the Company does not expend the entire budgetary allotment for any given year under the Replacement Plan, the excess budgetary allotment will carry forward to the subsequent year. If the Company does not use the excess budgetary allotment in the subsequent year, the excess budgetary allotment will not carry forward into the following year, i.e. excess budgetary allotments will not carry forward on a cumulative basis. PAWC St. No. 1, pp. 14-15 & 1-R, p. 17.

The actual cost of a customer-owned LSP replacement reflects several site-specific factors, including the length of the Service Pipe, the technique used to install the new Service Pipe, and the built environment where the Service Pipe is located. The Company has estimated an average cost per LSP replacement of \$3,500 based on discussions with its field personnel and sample contractor pricing for various Service Pipe lengths and diameters. However, the Company requests permission to proceed with replacements, regardless of the actual costs, up to the budget cap of \$6 million per year. PAWC St. Nos. 1, p. 14 & 1-R, pp. 12-13. PAWC proposes to capitalize LSP Replacement Costs and include such investment in the Company's rate base in a subsequent base rate case or the Company's existing DSIC for property placed in service between base rate cases. PAWC St. No. 2, pp. 6-8.

OCA'S Position

OCA argues that allowing the Company to capitalize LSP Replacement Costs and include such investment in the Company's rate base in a subsequent base rate case or the Company's existing DSIC for property placed in service between base rate cases, is tantamount to allowing PAWC to earn a return on these expenses in violation of fundamental ratemaking principles. OCA M.B. at 10-12; OCA Sch. SJR-5 at 5. OCA contends that PAWC should not be permitted to earn a return on property devoted to use by individual customers. This is because

the property is not used generally for the public; rather, for the sole benefit of individual customers who will then own the new service pipes. For these reasons, the Company cannot earn a return on these expenses. Alternatively, because they are extraordinary, non-recurring, one-time expenditures, the Company should be permitted to create a deferred regulatory asset through which it can track the expenses it incurs when replacing customer-owned lead service lines. OCA St. 1 at 21. OCA contends that the Company should be allowed to recover a return of the prudent and reasonable expenses over an amortization period to be determined in PAWC's next base rate proceeding. *Id.*

Additionally, the OCA recommends that the Company provide a five-year warranty on all customer-owned service lines it replaces during this program. OCA St. 1 at 23. OCA argues that the Company should also offer a partial compensation plan for customers that replaced their lead service line in the four years preceding this Petition, as well as undertake a robust consumer outreach and education program related to identifying lead service lines, instructing the customer to contact the Company regarding replacement, and informing the customer on how to adapt to using a lead service line until it is replaced. *Id.* at 23-25.

OSBA's Position

OSBA's concerns are with the Company's proposal to recover potentially excessive costs from ratepayers in connection with Part 2.

OSBA does not oppose replacing Part 2 service lines in cases where the average replacement cost would exceed \$3,500 per unit, but it contends that ratepayers should not be responsible for the excess replacement costs. OSBA contends that either the individually affected customers and/or the Company should bear the risk associated with any Part 2 cost overruns, not general ratepayers. Thus, the Commission should deny PAWC cost recovery for Part 2 expenditures that exceed \$3,500 per unit, or the average replacement cost associated with Part 1 projects conducted through the completion date of a given Part 2 project, whichever is greater.

Alternatively, in the event that the Commission decides not to impose a cost recovery cap on Part 2 projects, OSBA argues that the Commission should require a customer to provide a contribution in aid of construction (“CIAC”), as needed, equal to the difference between: a) the cost of replacing the customer’s specific Part 2 lead service line, and b) \$3,500, or the average replacement cost associated with Part 1 projects conducted through the completion date of a given customer’s Part 2 project, whichever is greater. By requiring this limited customer contribution, general ratepayers would not be forced to subsidize excessively costly Part 2 service line replacements. Currently, customers are responsible for the total cost of lead service line replacement. Although it may be in the public interest to now require ratepayers to subsidize the average cost of service line replacements, it would be inequitable to make them responsible for “excess” service line replacement costs associated with Part 2 projects. A limited CIAC mitigates this inequity.

I&E’s Position

I&E contends that customer-owned lead service lines do not have the relevant characteristics of a capital asset as they are owned by the customer rather than the Company. Therefore, I&E recommends that the replacement costs be recovered through a regulatory asset account, which would allow the Company to recover the full replacement cost but would not include a return on the asset. Therefore, only the burden of replacement costs and no profit will be on all PAWC customers.

I&E recommends that the costs associated with replacing customer-owned lead pipes be recovered through a regulatory asset and amortized over ten years. This regulatory asset treatment was recently approved by the Commission for the York Water Company (“York Water”) at Docket No. P-2016-2577404, which is the only jurisdictional utility that has received Commission approval to replace customer-owned lead service lines, and it should similarly be approved in this proceeding for PAWC. Accordingly, I&E requests that PAWC be permitted to modify its tariff to allow for customer-owned lead pipe replacements but that its proposed ratemaking methodology be rejected and I&E’s recommended recovery through a regulatory asset be approved.

Disposition

The Public Utility Code addresses water utility accounting in pertinent part as follows.

§ 1351. Definitions.

The following words and phrases when used in this subchapter shall have the meanings given to them in this section unless the context clearly indicates otherwise:

"Capitalized cost." Costs permitted to be capitalized pursuant to the Uniform System of Accounts and Generally Accepted Accounting Principles.

"Distribution system." A system owned or operated by a utility. The term includes a natural gas distribution company, a city natural gas distribution operation, an electric distribution company, a water utility and a collection system for a wastewater utility.

"Distribution system improvement charge." A charge imposed by a utility to recover the reasonable and prudent costs incurred to repair, improve or replace eligible property that is part of the utility's distribution system.

"Eligible property." Property that is part of a distribution system and eligible for repair, improvement and replacement of infrastructure under this subchapter. Included property shall be as follows:

* * *

(3) For water utilities, eligible property shall include:

(i) Utility service lines, meters and hydrants installed as in-kind replacements for customers.

* * *

66 Pa. C.S. § 1351(3)(i). (Emphasis added).

In general, utilities are entitled to earn a return only on property devoted to the public use. *Keystone Water Co. v. Pa. Pub. Util. Cmm'n*, 339 A.2d 873 (Pa. Cmwlt. 1975) citing *Scranton v. Scranton Steam Heat Co.*, 176 A.2d 86 (Pa. 1961). Expenditures for the exclusive benefit of one customer such as the improvement of service lines constitutes customer

specific costs not for the public use. *Klossman v. Duquesne Light Co.*, C-00945802 (Final Order entered July 24, 1996). In the instant case, the Service Pipe is owned by and is the responsibility of the customer. PAWC's tariff provides in pertinent part:

Service Pipe: That portion of a water line not owned by the Company which transmits water from the Company-owned water main to the Customer's premise. The water service pipe begins at the Company-owned street service connection and continues into the structure on the premise to be supplied.

PAWC Supplement No. 2 to Tariff No. 5 at 43, Rule 2.16 (Service Pipe).

This definition indicates replacement costs related to a service pipe should be treated as a deferred regulatory asset because the Company intends to contract with customers to transfer ownership of the pipe with a one-year warranty upon completion of the respective pipe replacements. See Petition at 10. The expenses are for the benefit of the pipe owner and not the general customer base. Although there is no dispute that full rather than partial lead-line replacement is preferred, it is the owner and end-user customer who benefits from the full rather than partial line replacement, as a partial lead-line replacement may result in a temporary spike in lead levels to that customer. PAWC St. 1 at 9-10; OCA St. 1 at 13; Schedule SJR-1 at 5. I am persuaded by the credible testimony of I&E Witness Wilson who testified,

PAWC's repeated attempts to analogize customer-owned pipe replacement with Company-owned pipe replacement is disingenuous because, in reality, PAWC's proposal to replace customer-owned pipe at the expense of its other ratepayers violates long-standing ratemaking principles.

I&E St. No. 1-SR at 7 and 12.

The instant case is comparable to *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account*, P-2016-2577404 (Opinion and Order entered March 8, 2017)

(*York Water*). In *York Water*, the Commission approved a Settlement whereby York Water could only treat replacement costs as deferred regulatory assets.

PAWC cites as authority for its position two cases wherein the Commission granted limited waivers relating to the replacement of customer-owned service lines in cases involving public safety. See *Petition of Peoples Natural Gas Co., LLC for Approval of Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement*, Docket Nos. P-2013-2346161, *et al.*, 2013 Pa. PUC LEXIS 543, at *95-97 (Order Entered May 23, 2013)(*Peoples*); *Petition of Columbia Gas of Pennsylvania, Inc. for Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement*, Docket No. P-00072337, 2008 Pa. PUC LEXIS 344, at *9 (Order Entered May 19, 2008)(*Columbia*).

In these cases, both Peoples Natural Gas Company (Peoples) and Columbia Gas of Pennsylvania, Inc. (Columbia) were permitted to replace customer-owned natural gas service lines without retaining ownership of the lines pursuant to a statute specific to natural and artificial gas services lines, 66 Pa. C.S. § 1510, which provides as follows.

§ 1510. Ownership and maintenance of natural and artificial gas service lines.

When connecting the premises of the customer with the gas utility distribution mains, the public utility shall furnish, install and maintain the service line or connection according to the rules and regulations of the filed tariff. A public utility shall not be authorized or required to acquire or assume ownership of any pipe or appurtenances installed after the effective date of this section between its main and the meter unless the utility would have been authorized or required to do so according to the rules and regulations of its filed tariff if the pipe or appurtenances had been installed on or before the effective date of this section. Maintenance of the service lines shall be the responsibility of the owner of the service line.

66 Pa. C.S. § 1510.

This statute specifically applies to natural gas distribution companies and does not mention water utilities or water service lines. In *Columbia* and *Peoples*, the Commission

observed safety concerns with customer-owned bare steel service lines. Peoples and Columbia were directed to replace customer-owned bare steel service lines as part of their respective infrastructure replacement programs. Although Section 1510 may not be applicable to the instant matter, as it is specific to natural gas distribution companies, the benefit of the statute is public safety, like the benefit of the instant Petition.

In the *Peoples* case, pursuant to Sections 4 and 19 of Peoples' tariff, the customer was responsible for installation, maintenance and replacement of the customer service line, except for customers in the cities of Johnstown and Altoona. By petition filed on February 1, 2013, Peoples sought a limited waiver of the tariff provision in Section 4, to allow the Company to replace customer-owned service lines in conjunction with the main replacements. The cost of the replacement service would be recorded as part of the associated mains replacement, like the accounting for the cost of repairing other customer-owned property, such as driveways, that may be necessary as part of a main replacement. By order entered May 23, 2013, the Commission granted the petition for the tariff waiver.⁷

Peoples proposed to recover the cost of such customer-owned service line replacements through its Distribution System Improvement Charge (DSIC). As the cost of replacement would be booked to the mains account, it qualified as part of the cost of piping or, alternatively, as other related capitalized costs, under 66 Pa. C.S. § 1351. Due to the unique circumstances and the efficiencies gained by replacing customer-owned service lines in coordination with the accelerated mains replacement program, none of the other parties opposed recovery of these costs and they agreed that recovery of these costs through DSIC was appropriate and in the public interest.

In the *Peoples* case, as Peoples implemented its replacement of mains program, it tested the bare steel customer-owned lines for integrity, and if a customer line failed a pressure test, it was replaced before service would be restored. If a customer refused to allow Peoples to

⁷ *Petition of Peoples Natural Gas Company, LLC for Approval of Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacements*, PUC Docket No. P-2013-2346161 (Opinion and Order entered May 23, 2013).

replace the line, then service would be shut off to the customer-owned line for safety reasons related to pressure concerns. Peoples persuaded the Commission to find that leaving the individual customers to bear financial responsibility for the cost of replacement of their lines would hamper Peoples' ability to coordinate replacement activities with customers and may negatively impact cost and time efficiencies. Therefore, Peoples proposed in its Long-term Infrastructure Improvement Plan (LTIIP) to repair or replace customer-owned service lines that failed the pressure test during main replacement and to include the associated costs as a recoverable item under Peoples' DSIC. Peoples would not take ownership of, or maintain in the future, the customer-owned service lines that were replaced. Peoples' Petition for a waiver of tariff regarding replacement of these customer-owned service lines was granted by Commission Order dated May 23, 2013 at Docket No. P-2013-2346161 *et seq.*

In the *Columbia* case, Columbia had different tariff rules for each set of customers; one tariff rule for those customers that own their own service lines and another tariff rule for those customers that do not own their own service lines. *See Columbia Tariff Gas – Pa. P.U.C. No. 9. Supplement No. 78, Rules 4.7, 4.8, 4.9, 4.10, 4.13, 5.3, 8.1(a), and 8.4.*

The new distribution system operating at higher pressures enabled Columbia to install new safety devices in areas to be upgraded. As part of the upgrade, Columbia installed excess flow valves on service lines connected to the replacement mains. Columbia stated that these excess flow valves would shut off gas to a residence or business in the event of a large pressure differential indicating a possible gas leak.

Columbia petitioned that it was necessary to replace bare steel customer service lines and any other lines incapable of handling the new system pressures, along with meter risers and other related facilities in conjunction with Columbia's main replacement program. Columbia asserted that it was reasonable for Columbia to pay for the cost of replacing customer-owned service lines when the customer service lines could not or potentially could not operate safely at the new pressures and were to be replaced in conjunction with the main replacement program.

In its Petition, Columbia proposed to replace all customer service lines at its cost where replacement was necessary for the main replacement and upgrade program. Columbia planned to capitalize these costs of replacing customer service lines. However, Columbia would not take ownership of, or maintain in the future, the customer-owned service lines in the areas as delineated as customer-owned lines in Columbia's tariff. Columbia would inform the customer that he or she would lose service if the upgrades were not timely implemented.

Pursuant to 66 Pa. C.S. § 1510, the Commission granted Columbia's request for limited waivers of the provisions of its tariff and found it was in the public interest for Columbia to replace at its expense certain customer-owned service lines during Columbia's main replacement and upgrade program. The Commission considered that the limited waivers were unopposed and appeared to serve a useful and beneficial purpose designed to improve the quality of service. Therefore, by Order entered May 19, 2008, the Commission granted Columbia's petition for limited waivers of tariff rules 4.7, 4.8, 4.9, 4.10, 4.13, 5.3, 8.1(a), and 8.4 related to customer service line replacement at Docket No. P-00072337.

Although the instant Petition does not claim that customers refusing to allow the Company to replace their service lines will have their lines shut off due to safety concerns such as with the natural gas pressure concerns, I am persuaded to find that similar to the *Peoples* and *Columbia* cases, the cost efficiencies and general public interest is benefited by PAWC's general proposal to replace customer-owned service pipes. PAWC is in a cost-efficient position to test customers' service lines for lead at the time they are replacing their own lead service lines over the next ten years and to inform the consumers of an opportunity to have their lead lines replaced at the company's initial cost expeditiously. There is a health and safety benefit to full lead line replacements rather than partial lead line replacements as a spike in lead levels may be realized initially in a partial line replacement, and the DEP measures lead levels at the end of the line - the customer's tap.

However, I disagree with PAWC that it should be entitled to treat its expenses as DSIC expenses as in *Columbia* or *People*. Although Columbia Gas and Peoples Gas did receive Commission approval to replace some customer-owned natural gas service lines and capitalize

these costs, these natural gas distribution companies did own some service lines up to customers' meters on dwellings; thus, customer-owned lines that were vulnerable were being treated the same as eligible property of other company-owned service lines that connected to the meter at the dwelling. Further, these two cases involved emergency replacement of vulnerable customer-owned bare steel service lines. I&E M.B. at 14. The instant case is distinguishable because no service lines from the curb to the dwellings are currently included in PAWC's rate base or for the water industry at large. I&E M.B. at 14. Additionally, a vulnerable natural gas line represents a clear and present danger to not only the consumer/customers but also to his/her neighbors; whereas, a lead customer-owned service pipe is less of an immediate threat to public health and safety as it affects only the consumers at the dwelling. I&E M.B. at 14. Unlike Columbia and Peoples, PAWC's customers are not facing termination of service for failure to replace a customer-owned lead service line.

PAWC is voluntarily and proactively submitting this Petition and is compliant with the LCR. PAWC requests a more advantageous accounting treatment than York Water currently has to its proposed replacement costs. Specifically, PAWC objects to bearing uncompensated carrying costs and argues it should be able to recover its real cost to implement its replacement program. PAWC St. 2-R at 5, 10-11.

PAWC advocates that under its plan, the Annual Cost Per Customer is only \$1.24 given its annual budget of \$6 million using an annual revenue requirement rate of 11.73%. PAWC Exhibit No. 2. This will enable the Company to recover its real cost to commit \$6 million per year over ten years. PAWC contends a ten-year amortization would not match cost-recovery with cost-incurrence. Instead, the Company would have to commit its funds with no recognition of capital costs of underlying financing that the amortization method of recovery would impose. PAWC St. 2-R at 13; Exhibit JRC-1R. PAWC Witness Cox testified that if a five or ten-year amortization were employed, given the annual budgeted amount of \$6 million, the time value losses would be approximately \$1.5 million and \$2.34 million respectively. The Company would experience a time value of money loss of those magnitudes for each year's investment over the 10-year duration of its proposed replacement program. PAWC St. 2-R at 14.

Therefore, the Company seeks to require all of its utility customers to pay a return of and return on 100% of all costs related to replacing customer-owned lead lines.

Conversely, OCA's and I&E's proposals save the ratepayers money when compared to rate base treatment because the Company's expenditures will not earn a return. OCA St. 1 at 22-23; I&E St. 1 at 6-8. I am unaware of any other State that requires the water utility's customers to pay a return of and return on 100% of the costs of replacing customer-owned lead service lines. If the program is still in existence over the projected 10-year period, then PAWC can propose to include its actual expenses related to replacement, and the Commission may reevaluate the cost recovery mechanism at that time. Thus, the deferral and amortization of costs might be limited to the period between the program start date and the test year in PAWC's next rate case. OCA St. 1-SR at 7.

There are many Distribution System Improvement Charge (DSIC) – eligible properties including planned water main and company-owned service line replacement projects as well as capital costs for water main breaks. Repairs, improvements and replacements of DSIC-eligible property are costs that the Company can capitalize. As PAWC offered no actual number of customer-owned lead-service lines within its service territory, it is difficult to assess the annual projected cost of replacement of these customer-owned lead service pipes. The company may have the “capacity to perform fifty customer-owned lead service pipe replacements per week” but it is unknown how many lead pipes are connected to the estimated 18,000 company-owned lead service lines and how many customers in Part 2 will request replacement. PAWC St. 1R at 8.

I&E witness Kline testified that approximately 18,000 out of 655,632 customers will request replacement of their service pipes, but there is not enough evidence before me to find a 1:1 ratio of lead service lines to service pipes. I&E St. 1 at 10-11. I&E's witness Kline's opinion differs from OCA's witness Rubin, who estimated, “The work will be performed at a few thousand properties.” OCA St. 1 at 20. As no party objects to PAWC budgeting \$6 million annually over a ten-year period, with a remainder to carry over to the following year, I also find the annual budget amount to be reasonable and recommend it not be modified at this time. If the

carry-over is only for one more year, then it will not ultimately be a needless cumulative budget. See OCA St. 1 at 25. However, because the Company may be over-estimating that it will spend \$6 million each year for 10 years or \$60 million on this project, I recommend that the Commission direct PAWC to include as part of its next Annual Asset Optimization Plan (AAOP) an accounting of budgeted versus actual customer-owned lead-service pipes replaced, and costs associated with the replacement.

I agree with OCA and I&E that the one-time replacement cost of a customer-owned lead service pipe and giving ownership of the replaced pipe to the customer is akin to an extraordinary cost normally classified as a regulatory asset as opposed to a capitalized cost recovered through PAWC's DSIC, which would allow a return of and return on investment in the pipes or assets that it would no longer own. I recommend classifying the incurred cost as a deferred regulatory asset to be amortized consistent with the Commission's decision at *York Water*. The amortization period should be established in the next base rate proceeding. *Id.* The Company should record expenses associated with the replacement of customer-owned lead service pipes and receive only a return of the reasonable and prudent expenses over the amortization period. I am persuaded by the credible testimony of OCA Witness Rubin who stated:

Given the extraordinary, one-time nature of the program, the public health benefits of the program and the likelihood that such program will be legally required, I recommend that the Commission authorize the Company to establish a regulatory asset to defer the expenses the Company incurs to replace customer-owned lead service lines. The ratemaking treatment of the deferred costs should be determined in the Company's next base rate case. I further recommend that, as provided in the York Water settlement, the Company should not be permitted to earn a return on the amount deferred. This will have the effect of sharing the costs of the extraordinary, public-health program between the utility's investors and customers.

OCA St. 1 at 21.

Additionally, the Commission has approved other petitions seeking deferred accounting treatment of extraordinary, non-recurring, one-time costs. *See Popowsky v. Pa. Pub.*

Util. Comm'n, 868 A.2d 606, 611 (Pa. Cmwlth. 2004). To obtain authorization for deferral accounting, the utility must establish based on Commission precedent that “the expense item appears to be within the scope of the type of items the commission has allowed as an exception to the rule against retroactive recovery of past expenses.” *Petition of West Penn Power Company for Authority to Defer for Regulatory Accounting and Reporting Purposes Certain Losses from Extraordinary Storm Damage*, P-2010-2216111, 2011 Pa. PUC LEXIS 1270, at *7-8 (Apr. 1, 2011). In the instant case, the cost of replacing customer-owned lead service pipes is an extraordinary, non-recurring, one-time expense applicable to a few thousand properties, a relatively small number of PAWC’s approximately 700,000 customers. Once work is complete, the health hazard will have been removed and it is not a recurring cost. OCA St. 1 at 20.

In *York Water*, the Commission approved a Settlement, which provided in pertinent part:

The Joint Petitioners agree that York Water shall be permitted to record the cost of all customer-owned service line replacements to a regulatory asset account. York Water will be permitted to amortize the amounts booked to the regulatory asset account in a base rate proceeding over a reasonable period to be not less than four years and not to exceed six years. No amortization will commence until the effective date of new rates in a base rate proceeding that establishes the amortization. The regulatory asset account will remain in place until all eligible costs are finally amortized. Because costs may be booked to the regulatory asset account for up to nine years, York Water will reconcile amounts amortized to amounts incurred, and the difference shall continue to be amortized in subsequent base rate proceedings. York Water agrees that it will not be permitted to recover interest or return on any unamortized balance.

The allocation among customer classes of the recovery of amortized costs will be determined in a base rate proceeding.

If the Commission subsequently permits any other water utility in Pennsylvania to capitalize for ratemaking purposes the costs of replacing customer-owned service lines made of lead, York Water shall be permitted to file a petition requesting that the Commission: (1) amend its Order approving this Settlement only as it pertains to the rate treatment of such costs to the extent not already collected in rates through the amortization; and (2) permit York Water to capitalize the Phase 1 replacement costs and/or Phase 2 replacement costs to its services account on a going-

forward basis to the extent not already collected in rates through the amortization. All parties reserve their rights to support or oppose such petition if filed. Such amendment of the Commission's Order approving this Settlement shall not enable any of the Joint Petitioners to withdraw from the Settlement, as provided in Paragraph 43 herein.

Id.

Unlike *York Water*, PAWC has neither failed any water sampling tests nor averred that it is facing disciplinary action or civil penalties by either the Environmental Protection Agency (EPA) or Pennsylvania Department of Environmental Protection (DEP). PAWC is proactive and admits a benefit to replacement includes "a multi-year assurance that it can continue to comply with important drinking water standards, including the LCR." PAWC R.B. at 6. 25 Pa. Code §109.1101 through 109.1108.

If the Commission were to approve PAWC's petition in its entirety without modification, it would impact not only PAWC, but all water companies contemplating similar filings. Further, York Water would then be permitted to file a petition requesting that the Commission: (1) amend its Order approving this Settlement only as it pertains to the rate treatment of such costs to the extent not already collected in rates through the amortization; and (2) permit York Water to capitalize the Phase 1 replacement costs and/or Phase 2 replacement costs to its services account on a going-forward basis to the extent not already collected in rates through the amortization. *York Water*.

PAWC argues, "At the outset, it is a stretch to characterize a program requiring regular annual expenditures of \$6 million for ten years as atypical and non-recurring." PAWC M.B. at 27. PAWC's Witness Cox testified as to the loss of capital expenses the company would incur if the expenditures were treated as deferred regulatory assets. His testimony assumed an annual investment of \$6 million over 5 and 10-year amortization periods and stated the time value losses are approximately \$1.5 million and \$2.34 million respectively. However, this argument assumes the Company will be replacing almost as many pipes as there are service lines or approximately 17,140 pipes at an average cost of \$3,500, close to the total number of service lines of 18,000. This may be an over-estimate as to capital expenditure and value loss

given the credible testimony of Mr. Rubin who testified that there may be a few thousand pipes replaced in the total project. Additionally, the Company has not provided the Commission with a breakdown of the \$3,500 cost per service pipe replacement.

It is unknown whether PAWC will be able to realize sufficient economies of scale to ensure that the average cost under Part 2 is reasonable. The total cost could be closer to ten percent of what is being advocated by PAWC, or \$6 million in its entirety. PAWC's costs are projected at this point. Accordingly, I find in favor of OCA and I&E on this issue and recommend that the Commission deny PAWC's request to capitalize the costs at issue. PAWC should still have a financial incentive to replace customer-owned lead pipes. Full recoupment of the cost of replacement of customer-owned pipes over an amortized period of approximately five years benefits the Company and consumers alike. It is foreseeable that PAWC may replace some leaking lead pipes and conserve water in its system as an added benefit to the reduction of lead levels in drinking water. Additionally, with no profit motive, if a less expensive technology like coating or lining proves workable, the Company has no disincentive to using those lower-cost approaches.

PAWC requests it be permitted to reflect investment in the replacement of customer-owned service pipes in the Company's DSIC as the Commission did *In Re: Petition of Peoples Natural Gas Co., LLC*, Docket Nos. P-2013-2344596 and C-2013-2348847 (Opinion and Order entered August 21, 2014), pp. 5-6 and 42-43. However, by denying PAWC this request, there would be no limitations of the Company's DSIC. In other words, there would be no cap on total spending or limit on time period in which the work could be performed. OCA St. 1 at 22-23. Additionally, these costs are not "eligible property" within the meaning of Section 1351 of the Public Utility Code. 66 Pa. C.S. §§ 1351-1357. OCA's proposal reduces costs for customers when compared to rate base treatment because the Company's expenditures will not earn a return. OCA St. 1 at 22-23.

A regulatory asset method provides incentive for PAWC to seek potential funding from the state or federal government that can be booked as an offset to the regulatory asset. OCA M.B. at 17. Regulatory assets are "recovered over a period of time through rates, and

therefore, represent a compromise between immediately expensing a cost (and an immediate loss to shareholders) and an immediate charge to ratepayers (and an immediate spike in rates),”⁸ which represents a fair balance of both interests. Regulatory assets directly tie the recovered amounts to the actual costs incurred by the utility without need for forward-looking speculation of costs,⁹ which removes any guesswork from the equation and promotes visibility and accountability of this process. Additionally, this methodology will eliminate any potential for unwarranted loading of assets¹⁰ and will, accordingly, provide substantial consumer safeguards not found in the original petition. Since this ratemaking treatment will allow PAWC to recover the costs of the replacement of lead customer owned service lines but not to earn a return on those lines, it promotes the Company’s minimization of pertinent costs. Conversely, this ratemaking treatment will still ensure that PAWC can earn full recovery of the costs and will be able to continue providing safe and reliable service to its customers.

Part 2 Excessive Costs

I am persuaded by the credible testimony of OSBA’s witness Kalcic to find that there ought to be a limit on excessive costs as there is no limit on total spending. OSBA St. 1 at 3-6, OSBA R.B. 2. In Part 2 where the average replacement cost exceeds \$3,500 per unit, ratepayers should not be responsible for the excess replacement costs. Individually affected customers and/or the Company should bear the risk associated with any Part 2 cost overruns, not general ratepayers. This will encourage the Company to minimize mobilization/demobilization costs and achieve the desired “economies of scale” in Part 2 service pipe replacements. Exhibit OSBA – I-1(b), OSBA M.B. 2-5. Thus, the Commission should deny PAWC cost recovery for Part 2 expenditures that exceed \$3,500 per unit, or the average replacement cost associated with

⁸ NRRI 94-7: National Regulatory Research Institute: Generally Accepted Accounting Principles for Regulated Utilities: Evolution and Impacts – P. 6.

⁹ Financial Accounting Standards Board, "FAS No. 71, Accounting for the Effects of Certain Types of Regulation," Original Pronouncements: Accounting Standards as of June 1, 1993, Volume I (Burr Ridge, IL: 1993), pars. 122-124.

¹⁰ NRRI 94-7: National Regulatory Research Institute: Generally Accepted Accounting Principles for Regulated Utilities: Evolution and Impacts – P. 72.

Part 1 projects conducted through the completion date of a given Part 2 project, whichever is greater.

Alternatively, in the event that the Commission decides not to impose a cost recovery cap on Part 2 projects, the Commission should require a customer to provide the difference between: a) the cost of replacing the customer's specific Part 2 lead service line, and b) \$3,500, or the average replacement cost associated with Part 1 projects conducted through the completion date of a given customer's Part 2 project, whichever is greater. By requiring this limited customer contribution, the contracting customer receives better value for its contribution and general ratepayers would not be forced to subsidize excessively costly Part 2 service line replacements. OSBA St. 1 at 4. This limit should not deter a customer, who needs only to pay the differential and should reduce excessive expenditures on Part 2. OSBA R.B. at 3. Currently, customers are responsible for the total cost of lead service line replacement. Although it may be in the public interest to now require ratepayers to subsidize the average cost of service line replacements, it would be inequitable to make them responsible for "excess" service line replacement costs associated with Part 2 projects.

Warranty

PAWC requests it be permitted to provide a one-year warranty. Conversely, OCA requests a five-year warranty. OCA St. 1 at 23. I have considered the testimony of OCA Witness Rubin that a five-year warranty would not cost the Company anything and would give the customer more assurance the work was properly performed. OCA St. 1SR at 3. However, I am more persuaded by PAWC Witness Kaufman's testimony that a one-year limited workmanship warranty would be consistent with other routine utility work performed by its contractors. PAWC St. No. 1-R, p. 11. Given this common practice, I recommend finding in favor of PAWC on this issue.

Partial Compensation Program

The Public Utility Code prohibits unreasonable discrimination in rates between customer classes of service. Specifically, Section 1304 provides in pertinent part:

66 Pa. C.S. § 1304. Discrimination in rates.

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service. . .

66 Pa. C.S. § 1304.

OCA recommends that the Company implement a partial compensation program for customers who have recently replaced a lead Service Pipe at the customer's expense. If a customer has replaced its customer-owned lead Service Pipe in the past four years, the customer should be entitled to some compensation for that expense (and the compensation should be included in the regulatory asset). OCA St. 1 at 23. The Compensation plan would work as follows:

Specifically, if a customer has replaced its customer-owned lead service line in the past four years, the customer should be entitled to some compensation for that expense (and the compensation should be included in the regulatory asset). I recommend that if a Company representative visits the customer's site and determines that the service line has been replaced, and the customer provides the Company with a paid invoice, a certification from a verified plumber, and other documentation as determined by the Company, the Company should offer a cash payment as follows: 20% of the customer's cost, but not more than \$700, for work performed during the calendar year 2014; 40% of the customer's cost, but not more than \$1,400, for work performed during calendar year 2015; 60% of the customer's cost, but not more than \$2,100, for work performed during calendar year 2016, and 80% of the customer's cost, but not more than \$2,800, for work performed during calendar year 2017 or the first quarter of 2018.

OCA St. 1 at 23-24.

The Company has opposed this recommendation on the basis that it would be administratively complex and that the proper focus of this proposal is on customer-owned Service Pipes that remain in service and pose a health risk. PAWC St. 1R at 17-18. PAWC cites no authority for its position. There is little evidence to suggest that this proposed reimbursement program that is similar to the one approved in *York Water* would be administratively complex. The Company stated that it “anticipates a small number of customers would qualify for reimbursement.” PAWC St. 1R at 18. Moreover, the OCA’s recommendation limits the reimbursement period to four years prior to the enactment of the Replacement Plan. This is consistent with the general limitation on refunds of customer bills under the Public Utility Code, 66 Pa. C.S. § 1312(a). OCA St. 1SR at 4. The administration of this program, therefore, should not impose an undue burden on PAWC. Additionally, the Company would verify the customer’s lead Service Pipe replacement by visiting the customer site to confirm, as well as require a paid invoice, a certification from a verified plumber, and other documentation as determined by the Company. OCA St. 1 at 23-24.

I agree with OCA that failure to include such a partial compensation program creates equitable concerns regarding discrimination within a class of customers. PAWC’s Petition expresses the importance of replacing lead Service Pipes and requests that all ratepayers subsidize the replacement of pipes exclusively benefitting individual consumers. It would be inequitable for customers that have recently replaced their lead Service Pipe at their sole cost to pay for future replacements on behalf of other customers. I find credible the testimony of OCA Witness Rubin who testified:

I agree that the focus of the program is on the removal of lead from the distribution system, but that must be done in a way that is fair to all customers. Reimbursing customers who recently replaced a lead service line is fair and will help avoid customers feeling that they are being disadvantaged by the new program -- they recently paid for their own service line replacement and they are now being asked to subsidize line replacements for other customers, too.

OCA St. 1SR at 3-4. If the Company expects all ratepayers to pay these expenses, ratepayers who have had a lead Service Pipe replaced in recent years should also have the opportunity to recover some of their costs. I recommend the Commission adopt the OCA’s proposal to institute

a partial reimbursement program for PAWC customers that replaced their lead Service Pipe within the past four years similar to the one done in *York Water*.

Communication and Education Program

PAWC states that it will undertake “appropriate customer education in areas that align with the scope of its Replacement Plan – Part 2 to inform customers in those areas that the Company is offering to replace their lead Service Pipes under the terms and on the timeline explained above.” Petition at 10. This includes “direct mailings to notify potentially affected customers of the Replacement Plan, press releases, bill inserts, information on the Company’s website regarding the health effects of lead, and a lead information pamphlet to be distributed to all customers.” PAWC St. 1R at 12. In addition, PAWC plans to release an educational video about lead and notify customers when lead is found on the customer-owned segment of the service line. *Id.*

OCA recommends that the Company also develop a comprehensive outreach and education program in conjunction with the statutory advocates. Specifically, OCA requests PAWC be directed to ensure that its public education program informs consumers about lead contamination and instructs consumers on how to identify whether their Service Pipe is made of lead. OCA St. 1 at 24. Further, the program should include “information about the Company’s project to replace lead service lines and who to contact to have the Company evaluate whether the customer should be placed on the service line replacement list.” *Id.* I recommend the Commission direct PAWC to collaborate with the statutory advocates in this proceeding to develop education and outreach efforts in conformity with the National Drinking Water Advisory Council’s (NDWAC) recommendations on consumer education and OCA’s recommendations.

Additional Reporting Requirements

The Company should additionally show as part of its annual line replacement report filed with the Commission and served on the parties to this proceeding evidence of attempts to seek and obtain state and federal grant monies to lower the cost of replacement of

lead service lines. Examples of documented evidence include but are not limited to letters of grants or denial.

CONCLUSION

Lead in drinking water presents health risks and the use of lead pipes has been prohibited by the EPA. Replacing a lead customer-owned service pipe at the same time as a lead Company-owned service line is replaced is in the public interest. The Company has access to determine the composition of the customer-owned line and will only realize an incremental cost to replace both lines. Replacing both parts of the service line at the same time makes economic sense and greatly simplifies the replacement process. There is a reduction in coordination requirements between customer and Company as well as an elimination of a costly financial burden to the customer.

For these above reasons, I recommend that the Commission grant in part and deny in part PAWC's Petition as follows. PAWC should be directed to resubmit a draft Tariff Supplement to its Tariff Water-PA PUC No. 5 regarding the replacement of lead service pipes in conformity with these recommended modifications. I agree the tariff provision should apply only to those customers affected by PAWC's lead Company-owned service Replacement Plan and should not change the rules regarding a customer's obligation to replace or repair leaking or otherwise defective customer-owned service lines unrelated to the Replacement Plan. I recommend the Commission approve PAWC's plan to budget \$6 million per year for up to ten years in order to replace all lead service pipes in its service territory disaggregated into two parts.

Part 1 will have priority on the use of funds under the annual budget allotment and consists of replacement of lead service pipes encountered when replacing its mains and or service lines up to \$6 million per year. Part 2 is the replacement of lead service pipes at customer request subject to 1) verification that the customer has a lead service pipe; 2) the time of replacement; 3) number of other replacements within a geographic area; and 4) availability of funds not used for Part 1. The Company should make a payment towards the replacement cost of the lead customer-owned service line up to an amount not to exceed the Company's average

contracted cost for replacing the customer-owned lead service in the year the replacement is made or \$3,500, whichever is greater. Either there should be a cap on the cost, or customers should be permitted to pay any difference as a lump sum, or as an amount added to the customer bill, to be paid over a reasonable period not to exceed one year. If the difference is included on the customer bill, the provisions of 52 Pa. Code § 56.23 will apply, and the Company should not terminate for non-payment of the amount included on the customer's bill. If the Company is unable to collect the difference from a customer and the difference or any portion is written off as uncollectible, PAWC should be permitted to include the uncollected amount in the regulatory asset account.

The Company should add a "partial compensation" portion to its tariff to compensate on a sliding scale only those customers who have already replaced their lead service line within the past 4 years. All replacement costs and partial compensation costs should be treated as a regulatory asset rather than a capitalized cost attributable to DSIC. Specifically, PAWC should be permitted to book such costs into a deferred regulatory asset in which it may recover the prudent and reasonable expenses over an amortization period to be decided in the Company's next base rate proceeding. PAWC should be directed to provide a one-year warranty for replaced pipes and should collaborate with the statutory advocate parties to this proceeding regarding the development of a comprehensive education and outreach program. Finally, I recommend that the Company be directed to report on an annual basis as to its progress and costs related to its service line and service pipe replacement project so historical data may be captured. This report could be included in its Annual Asset Optimization Plan (AAOP) showing the budgeted versus actual customer-owned lead service pipes replaced and costs associated with the replacements.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter and the parties to this proceeding. 66 Pa. C.S. § 1301 *et seq.*

2. An approved tariff is legally binding on both the utility and its customers. *Brockway Glass Company v. Pa. Pub. Util. Comm'n*, 437 A.2d 1067, 1070 (Pa.Cmwlth. 1981).

3. It is reasonable and non-discriminatory to replace customer-owned service lead lines in this case as the reduction of lead levels contributes to public safety and customers already replacing their lines within the past four years are entitled to a sliding-scale reimbursement. See *Petition of Peoples Natural Gas Co., LLC for Approval of Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement*, Docket Nos. P-2013-2346161, *et al.*, 2013 Pa. PUC LEXIS 543, at *95-97 (Order Entered May 23, 2013)(*Peoples*); *Petition of Columbia Gas of Pennsylvania, Inc. for Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement*, Docket No. P-00072337, 2008 Pa. PUC LEXIS 344, at *9 (Order Entered May 19, 2008) (*Columbia*).

4. PAWC should be granted permission to file a Tariff Supplement to Tariff No. 5, which permits PAWC to contract to replace customer-owned lead service pipes at PAWC's sole cost, subject to treating the cost as a deferred regulatory asset to be amortized over a period to be established in PAWC's next rate base proceeding. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account*, P-2016-2577404, (Opinion and Order entered March 8, 2017).

5. A customer service pipe replacement cost is neither a "capitalized cost" nor "eligible property." 66 Pa. C.S. §§ 1351 and 1351(3)(i).

6. The replacement costs should not be recorded in Account No. 333 – Services (Services Account) because they are not "eligible property" for water utilities under Section 1351, a recoverable cost under a Distribution System Improvement Charge (DSIC). 66 Pa. C.S. §§ 1351, 1353 and 1357.

7. Ownership of replaced pipes should transfer to the customer-owner with a one-year warranty and only those customers who have already replaced their lead service pipes within the past four years should be compensated on a graduated sliding scale by the Company. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account, P-2016-2577404* (Opinion and Order entered March 8, 2017).

8. PAWC should be directed to collaborate with the statutory advocates to improve customer education and outreach regarding Parts 1 and 2 of the replacement project. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account, P-2016-2577404* (Opinion and Order entered March 8, 2017).

9. There ought to be a limit on excessive costs over \$3,500 per service line as there is no limit on total spending in PAWC's Petition. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account, P-2016-2577404* (Opinion and Order entered March 8, 2017).

10. In Part 2, there should be a replacement cost cap of \$3,500 per unit so that ratepayers are not responsible for the excess replacement costs. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account, P-2016-2577404* (Opinion and Order entered March 8, 2017).

11. Alternatively, in Part 2, if there is no cost recovery cap, the customer should pay the difference between the cost of replacing the customer's lead service pipe and \$3,500 or the average replacement cost associated with Part 1 projects conducted through the

completion date of a given customer's Part 2 project, whichever is greater. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account*, P-2016-2577404 (Opinion and Order entered March 8, 2017).

12. A partial compensation program offering a graduated sliding scale compensation to those customers who have already replaced a lead service pipe within the past four years should be implemented. *In Re: Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account*, P-2016-2577404 (Opinion and Order entered March 8, 2017).

ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Petition of Pennsylvania-American Water Company filed on May 22, 2017 at P-2017-2606100 be granted in part and denied in part consistent with the body of this Recommended Decision and the Ordering Paragraphs below.

2. That Pennsylvania-American Water Company be directed to file a Tariff Supplement to Tariff Rule No. 5 consistent with the body of the Commission's final decision at Docket No. P-2017-2606100, within twenty (20) days of the date of entry of a final Order, and which will be effective upon three (3) days' notice.

3. That Pennsylvania-American Water Company be directed to serve its tariff supplement on the statutory advocates, who will have three (3) days to object.

4. That Pennsylvania-American Water Company be directed to replace Part 1 customer-owned lead service pipes at its initial expense and to record the incurred costs as a regulatory asset, to be recovered in future base rate proceedings.

5. That Pennsylvania-American Water Company make a payment towards the replacement cost of the Part 2 customer-owned lead service pipes up to an amount not to exceed Pennsylvania-American Water Company's average contracted cost for replacing the Part 1 customer-owned lead service pipes in the year the replacement is made or \$3,500, whichever is greater.

6. That customers be permitted to pay any difference between the replacement cost and Pennsylvania-American Water Company's contribution under Part 2 of the Replacement Plan as a lump sum, or as an amount added to the customer bill, to be paid over a reasonable period not to exceed one year.

7. That if the difference is included on the customer bill, the provisions of 52 Pa. Code § 56.23 shall apply, and Pennsylvania-American Water Company shall not terminate for non-payment of the amount included on the customer's bill.

8. That Pennsylvania-American Water Company be directed to not charge interest on any payment period for the difference, other than interest for late payment.

9. That if Pennsylvania-American Water Company is unable to collect the difference from a customer and the difference or any portion, is written off as uncollectible, Pennsylvania-American Water Company be permitted to include the uncollected amount in the regulatory asset account.

10. That if a lead customer-owned service pipe that qualifies as a replacement is leaking or otherwise defective at the time it is discovered, the customer should not be required to repair the line prior to it being replaced by Pennsylvania-American Water Company.

11. That after replacing the customer-owned service pipes, the customers' ownership of and duty to maintain the service pipes will remain unchanged.

12. That Pennsylvania-American Water Company be given leave to offer a 12-month warranty on the replaced pipes and the customer be required to sign an agreement authorizing Pennsylvania-American Water Company or its contractors to enter the customer's property to replace the service pipe.

13. That Pennsylvania-American Water Company be directed to restore the customers' properties as nearly as practicable to their former conditions after replacements.

14. That if a customer has replaced their customer-owned lead service pipe in the past 4 years from the effective date of the Tariff Supplement to Tariff No. 5, subject to verification by Pennsylvania-American Water Company in the form of customer paid invoices, certifications from certified plumbers and other documentation as may be requested by Pennsylvania-American Water Company, Pennsylvania-American Water Company will offer a cash payment as follows: between 3 and 4 years from date of this agreement 20% of Pennsylvania-American Water Company's current contractor lump sum rate; between 2 and 3 years 40%; between 1 and 2 years 60%; and in the past year 80%. The cash payment is not to exceed the actual cost on the customer paid invoice.

15. That no amortization will commence until the effective date of new rates in a base rate proceeding that establishes the amortization. The regulatory asset account will remain in place until all eligible costs are finally amortized.

16. That the allocation among customer classes of the recovery of amortized costs will be determined in a base rate proceeding.

