**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105-3265**

 Public Meeting held December 6, 2018

Commissioners Present:

Gladys M. Brown, Chairman

Andrew G. Place, Vice Chairman

Norman J. Kennard, Statement

David W. Sweet

John F. Coleman, Jr., Statement

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

**OPINION AND ORDER**

**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition are the Exceptions of Pennsylvania-American Water Company (PAWC or the Company), filed on June 4, 2018, to the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Elizabeth H. Barnes, issued on May 15, 2018, in the above-captioned proceeding. Replies to Exceptions were filed by the Commission’s Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA) and the Office of Small Business Advocate (OSBA). For the reasons stated below, we shall set aside the ALJ’s Recommended Decision and remand this matter to the Office of Administrative Law Judge (OALJ) for such further proceedings as may be necessary for the express purpose of evaluating the above-captioned Petition under *Act 120*[[1]](#footnote-2) and the issuance of a Recommended Decision on remand, consistent with this Opinion and Order. Alternatively, if PAWC deems it is more appropriate or efficient, it may file to withdraw the pending Petition in this proceeding and file a revised Petition at a new docket consistent with *Act 120*.

# I. History of the Proceeding

 As noted, on May 22, 2017, PAWC filed its Petition for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes (Petition). PAWC requested that it be permitted revise its tariff in order to: (1) replace customer-owned lead service pipes (LSPs) 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 DSIC pursuant to 66 Pa. C.S. § 1357. PAWC indicated that it is proactively planning to comply with drinking water standards, including the LCR at 25 Pa. Code §§ 109.1101 through 109.11108.

On June 12, 2017, I&E and the OCA filed Answers to PAWC’s Petition. The OSBA filed a Notice of Intervention on June 15, 2017. On August 8, 2017, a prehearing conference was held, and a procedural schedule was adopted that scheduled an evidentiary hearing on January 17, 2018.

Written testimony was pre-submitted by the parties and the hearing scheduled for January 17, 2018, was cancelled upon request of the parties because 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, an Order was issued that granted the Motion and admitted the testimony and exhibits into the record.

On March 1, 2018, Main Briefs were filed by PAWC, I&E, the OCA, and the OSBA, and Reply Briefs were filed by the parties on March 15, 2018. The record was closed on March 15, 2018.

On May 15, 2018, the Commission issued the Recommended Decision of ALJ Barnes, which recommended granting, in part, and denying, in part, PAWC’s Petition. R.D. at 1.

As noted, Exceptions were filed by PAWC on June 4, 2018. Replies to Exceptions were filed by I&E, the OCA and the OSBA on June 14, 2018.

# II. Discussion

# A. Background

 PAWC filed the instant Petition to modify its tariff to permit it to replace customer-owned lead service pipes at the Company’s expense. As explained *infra*, under PAWC’s existing tariff rules, the Company owns and is responsible for the service line which extends from the water main to the curb stop, and the customer owns and is responsible for the service pipe that extends from the curb stop to the premises. PAWC is asking for approval to capitalize the costs associated with the customer-owned pipe replacement and to include the amount in Account 333 – Services. The Company also asks that the amount booked to Account 333 be depreciated in the same manner as other investments in that account and seeks permission to make the amount expended for customer-owned pipe replacements eligible for inclusion in the Distribution System Improvement Charge (DSIC).

PAWC is a water utility in the Commonwealth of Pennsylvania and subject to regulation by the United States Environmental Protection Agency (EPA) and the Pennsylvania Department of Environmental Protection (DEP). As such, the Company must comply with drinking water, environmental and other operational standards established by the EPA and DEP, including the Lead and Copper Rule.

Lead is a neurotoxin that is classified as a persistent, bioaccumulative, and toxic (PBT) chemical. PBT chemicals are a class of chemicals that resist degradation and persist in the environment for an extensive period, and when inhaled, ingested, or consumed, they bioaccumulate in the fat tissues, bones and brains of organisms. Exposure to lead can have severe health impacts on humans and can lead to death at high doses. Lead primarily targets the nervous system, but cardiovascular, kidney, digestive and reproductive impacts have also been noted with high exposure. There is no conclusive proof that lead causes cancer, but the EPA has determined that lead is a probable human carcinogen.[[2]](#footnote-3) Children are more sensitive to the health effects of lead than adults, and no safe level in children has been determined. They have more severe symptoms at lower exposure than adults, and even exposure at less severe levels may slow mental development and cause lower intelligence later in childhood. These effects may persist beyond childhood.[[3]](#footnote-4)

While water utilities must treat and meet standards for lead before water is sent from the drinking water treatment facility, one of the greatest risks of lead exposure to customers occurs from sending the water through the distribution system. Lead can enter drinking water when service pipes or household plumbing that contain lead corrode. Homes built before 1986, the year the Federal Safe Drinking Water Act (SDWA) was enacted, as discussed *infra*, are more likely to have lead pipes, fixtures and solder.

For water utility systems, the use of lead pipe ended in the 1950s or 1960s for most utilities. However, the use of lead solder, faucets, and other plumbing fixtures was not banned until the enactment of the SDWA in 1986.[[4]](#footnote-5) Even this law did not eliminate all lead from water systems, as piping and certain plumbing fixtures were still allowed to have up to 8% lead. Similar to the SDWA, Pennsylvania’s Plumbing System Lead Ban and Notification Act was enacted in 1991, the same year that the EPA promulgated the Lead and Copper Rule (LCR), addressing lead exposure by requiring drinking water providers to collect and test tap water from a certain number of households likely to have lead piping. EPA amended the LCR in 2000 and 2007 to improve the effectiveness of the rule. Provisions of the current rule include:

* An action level of 15 parts per billion (ppb) or micrograms per liter (µg/L) for lead and 1.3 parts per million (ppm) or 1.3 milligrams per liter (mg/L) for copper;
* Lead and copper tap sampling in homes meeting high risk criteria (older homes with a lead service line or copper pipe with lead solder);
* If the lead or copper action level is exceeded in more than 10% of tap water samples collected during a monitoring period, the water system must take specific follow-up or corrective actions, including the following: [[5]](#footnote-6)
1. Issue public education materials.
2. Monitor source water quality.
3. Conduct a corrosion control treatment feasibility study.
4. Install and maintain optimized corrosion control treatment.
5. If the system later exceeds the lead action level following installation of treatment, the company must implement a lead service line replacement program (replace 7% per year).

Congress enacted amendments to the SDWA, tightening requirements concerning lead in drinking water in 1996 and 2011.[[6]](#footnote-7), [[7]](#footnote-8)

While the use of lead service lines ended by the 1960s, there are still lead service lines in public water systems, and while corrosion control has been used as an effective means of reducing the leaching of lead from old service lines, lead solder and other plumbing fixtures, it may not be 100% effective. Beyond corrosion control, physical replacement of the entire lead service line, all the way to the meter, is the current best practice in the water utility industry. When reviewing possible revisions for the LCR, the EPA National Drinking Water Advisory Council (NDWAC) stated that the most proactive way to improve public health protection from lead in drinking water is to remove full lead service lines from contact with drinking water to the fullest extent possible, and that the reduction of lead exposure via drinking water could not be achieved by the LCR alone. The NDWAC also noted that partial lead service line replacements were not preferable treatment methods for reducing lead, as they may increase lead levels in household drinking water and recommended that stronger corrosion control methods be implemented in cases where full lead service line replacement was not possible.[[8]](#footnote-9)

Therefore, with this backdrop, when addressing the remediation of lead in utility service lines, there are two components that must be considered. The first component is the direct connection to the water main that runs from the main in the street to the curb stop. This component is owned by the utility. The second component is the pipe that runs from the curb stop to the customer meter. This pipe is owned by the customer in the water utility industry and referred to as the “customer-owned service line.” In general, the customer is responsible for maintaining and replacing the customer-owned portion of the service line.

In order to achieve continuity throughout the record in this proceeding and this Opinion and Order, within the remainder of this document the terms “service line” and “service pipe” are employed in the manner they are defined in Rules 2.15 and 2.16 of Supplement No. 2 to Tariff Water – Pa. P.U.C. No. 5 (Tariff No. 5).[[9]](#footnote-10) As set forth on First Revised Page 43 of Tariff No. 5, Rules 2.15 and 2.16, respectively, the tariff provisions 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.” A “service pipe” is defined as “[t]hat portion of the water line not owned by the Company” that “begins at the Company-owned street service connection and continues into the structure on the premise[s] to be supplied.” Additionally, Tariff No. 5 does not authorize the Company to replace a customer’s service pipe. 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 . . .

On April 28, 2017, PAWC filed tariffs requesting an increase in its total annual operating revenues, based on a fully projected future test year (FPFTY) ending December 31, 2018, in which the costs associated with the replacement of customer-owned service pipes were not included*. Pa. PUC, et al. v. Pennsylvania American Water Company*, R-2017-2595853 (Final Order entered December 7, 2017).[[10]](#footnote-11)

On January 20, 2017, PAWC filed a Petition seeking approval of its Water Long-Term Infrastructure Improvement Plan (LTIIP). The Commission approved its LTIIP on May 18, 2017, affirming compliance with Act 11 and the Commission’s Final Implementation Order. *Petition of PAWC for Approval of its LTIIP*, P-2017-2585707 (Opinion and Order entered May 18, 2017). This plan prioritized removal of an estimated 18,000 Company-owned lead service lines over the next ten 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.

As discussed *infra*, through the instant Petition, PAWC is seeking Commission approval to revise its tariff to permit the Company to replace customer-owned lead service pipes, to capitalize those costs and to affirm that its lead line replacements constitute “eligible property” to which it is entitled to recover a return on, and a return of, through its DSIC.

**B. PAWC’s Petition**

On May 22, 2017, PAWC petitioned the Commission to approve its plan to replace customer-owned, lead service pipes and to recover the associated costs. In its Petition, PAWC requests Commission approval to modify its Tariff No. 5 to enable it to replace customer-owned LSPs pursuant to its proposed LSP replacement plan (Replacement Plan). Petition at ¶ 7.

As discussed *supra*, under PAWC’s existing tariff rules, the Company owns and is responsible for the service line which extends from the water main to the curb stop, and the customer owns and is responsible for the service pipe that extends from the curb stop to the premises. Specifically, PAWC’s Tariff Rule 4.9 mandates that customers own and are responsible for the installation, repair, and replacement of all service pipes which run from the Company-owned service connection to the structure receiving service. Through its Petition, the Company is requesting, *inter alia*, that Rule 4.9.1, shown on PAWC Exhibit No. 1, be added to Tariff No. 5, to provide the Company the ability to, at its sole cost and with the agreement of the customer, replace LSPs on a customer’s premises pursuant to its proposed two-part Replacement Plan. The customer then would retain ownership of the service pipe and the responsibility to maintain, repair, and replace the service pipe after it is replaced by the Company. PAWC St. No. 2 at 4-5.

As described above and by PAWC witness Kaufman on page 6 of PAWC Statement No. 1, prior to 1950 it was common practice to install lead service lines (LSLs) that run from the mains to the structure receiving service. The Company has ongoing efforts to replace all LSLs owned by the Company, from the main to the Company-owned service connection and recognizes that customers have not previously replaced LSPs on their own due to economic constraints. PAWC St. No. 2 at 3; PAWC St. No. 1 at 13. Therefore, in order to take advantage of economies of scale and other efficiencies in order to make the replacements more cost-effective, PAWC has proposed Tariff Rule 4.9.1 that would allow it to perform the replacement work, based on PAWC’s Replacement Plan, on the customers’ premises and spread the costs over all of PAWC water customer base.

### Replacement Plan

PAWC’s Replacement Plan consists of two parts. First, PAWC proposes to proactively remove and replace, with the customer’s consent, LSPs that are encountered during the process of the Company’s regular main and/or service line replacements (Part 1). PAWC St. No. 1 at 11. Second, PAWC proposes to remove and replace LSPs when requested to do so by a customer, subject to certain conditions and verifying that the customer, in fact, has an LSP (Part 2).

During the ten-year period under Part 1 of its Replacement Plan, PAWC expects to identify and replace approximately 18,000 LSLs, which it estimates remain on its system. The Company, however, indicates that it does not have records regarding the composition of the service pipes that are installed and owned by the customer, but estimates that it is reasonable to assume that the majority of the same customer premises served by the Company’s LSLs will also have LSPs. PAWC St. No. 1 at 10-11.

Part 2 of the Replacement Plan accounts for those customers who may not be within the scope of Part 1 by allowing these customers to request a replacement of their LSPs. Under Part 2, the Company will coordinate customer-requested replacements, grouping them by geographic location and undertaking replacements 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 M.B. at 4.

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. Additionally, under both parts of the Replacement Plan, the customer will own and be responsible for the new service pipe after the replacement, and PAWC’s proposed revisions to Tariff Rule 4.9 would not change the rules regarding a customer’s obligation to replace or repair leaking or otherwise defective service pipe. The Company proposes to provide a one-year limited workmanship warranty to the customer on the newly installed service pipe. *Id*. at 5.

### Replacement Plan Budget

PAWC estimates that the average cost per LSP replacement would be approximately $3,500 whether the replacement is done under Part 1 or 2 of its proposed Replacement Plan. However, the Company has indicated that it will establish a budget cap of $6.0 million per year to replace LSPs under its Replacement Plan. Petition at ¶¶ 19-20. The budget cap of $6.0 million is intended to mitigate the impact of the Replacement Plan on customer rates, attributable to the Company’s proposed rate treatment of the LSP replacement costs, as discussed *infra*. PAWC indicates that Part 1 of its Replacement Plan will have priority on the use of the annual budget allotment as they address conditions that pose relatively greater risks of raising lead levels for the affected customers. Subject to the parameters for allowing replacement work to commence under Part 2, any funds available in the annual budgetary allotment not used for Part 1 will be applied to LSP replacements under Part 2 in that year. 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 at 14-15; PAWC St. 1-R at 17.

### Accounting and Ratemaking Treatment

In addition to approval of its Replacement Plan and budget, PAWC requests that any costs incurred as a result be subject to its accounting and ratemaking proposals. Specifically, the Company is requesting that the LSP replacement costs be capitalized and recorded in Account 333 – Services under the Uniform System of Accounts (USOA) for Water Utilities and the return of, and return on, the investment be recovered through rate base, even though the Company will not own or maintain the service pipes after the replacement work is completed. PAWC St. No. 2 at 7-8. PAWC is also requesting that the “Commission affirm that its investment in capitalized lead service pipe replacements represents ‘eligible property’ as defined in Section 1351 and, therefore, under Section 1357, the fixed costs (pretax return and depreciation) of such investment placed in service between base rate cases may be recovered through the Company’s [DSIC].” PAWC St. No. 2 at 8.

# Disposition

The OCA, the OSBA and I&E participated in this evidentiary adjudication proceeding and took the position that they did not oppose the replacement of customer-owned lead service pipes. However, they did disagree with aspects of PAWC’s proposed accounting and cost-recovery methodologies. Specifically, the OCA and I&E opposed the capitalization of replacement costs and recommend that these costs be treated as a one-time expense and recovered through a deferred regulatory asset.

The ALJ recommended that PAWC be allowed to amend its tariff, and to replace customer-owned lead service pipes. However, the ALJ agreed with the OCA and I&E that PAWC should not be allowed to capitalize its LSP replacement costs, and thereby recover a return of, and return on, the investment through rate base. Instead, the ALJ recommended that the Commission adopt the OCA and I&E proposal for accounting and cost-recovery.

After the filing of Exceptions and Reply Exceptions, Governor Tom Wolf signed into law, *Act 120* which addresses the accounting and cost-recovery questions at issue in this case, effective December 23, 2018. Relevantly, the new law provides that an investor-owned water utility may include the replacement costs for customer-owned lead service lines in rate base when they are replaced as part of a Commission approved program. The legislation also addressed other issues raised in this proceeding, including utility access to customer premises and warranties for the work performed.

While *Act 120* has not yet taken effect, the General Assembly has adopted a clear mandate for the accounting and cost-recovery for expenses related to the replacement of customer-owned lead service pipes. Based on the foregoing, we believe it appropriate, and expected, that the program of our state’s largest, investor-owned water utility be reviewed under the provisions of *Act 120*. Accordingly, we shall set aside the Recommended Decision and remand this case to the OALJ for the express purpose of evaluating the PAWC Petition under *Act 120*. We direct the ALJ to conduct such proceedings as may be necessary to supplement the record with evidence and legal argument culminating a new Recommended Decision.[[11]](#footnote-12)

Accordingly, if PAWC wishes to proceed at this docket, they are directed to supplement the record, as may be necessary, to conform its Petition to all the provisions of *Act 120*. If PAWC chooses to do so, our expectation is that the parties to this proceeding would thoroughly address all relevant issues so that this case may be used as a model for the implementation of *Act 120* by other water utilities. In the alternative, if PAWC concludes that it would be more appropriate or efficient to file a revised Petition at a new docket, it is free to propose the withdrawal of this Petition.

# III. Conclusion

Based on our review of the record, and consistent with the foregoing discussion, we shall set aside the ALJ’s Recommended Decision and remand this matter to the OALJ for such further proceedings, as deemed necessary, for the express purpose of evaluating the above-captioned Petition under *Act 120* and the issuance of a Recommended Decision on remand, consistent with this Opinion and Order. Alternatively, if PAWC deems it is more appropriate or efficient, it may file to withdraw the pending Petition in this proceeding and file a revised Petition at a new docket consistent with *Act 120*; **THEREFORE,**

 **IT IS ORDERED:**

1. That the Recommended Decision of Administrative Law Judge Elizabeth H. Barnes, issued on May 15, 2018, be set aside, consistent with this Opinion and Order.
2. That this proceeding is remanded to the Office of Administrative Law Judge for such further proceedings, as may be necessary, and for the issuance of a Recommended Decision on remand.

**BY THE COMMISSION,**



Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: December 6, 2018

ORDER ENTERED: January 4, 2019

1. House Bill 2075 of 2018 (*Act 120*) was signed in the House and Senate on October 17, 2018, and approved by Governor Tom Wolf on October 24, 2018. *Act 120* takes effect on December 23, 2018. It amends Section 1311(b) of the Public Utility Code, Pa. C.S. §1311(b). [↑](#footnote-ref-2)
2. Agency for Toxic Substances and Disease Registry (ATSDR) (August 2007). Toxicology Profile for Lead. <https://www.atsdr.cdc.gov/toxprofiles/tp13.pdf>. [↑](#footnote-ref-3)
3. *Id.* [↑](#footnote-ref-4)
4. Section 1417 of the SDWA, 42 U.S.C. § 300g–6, banned the “use of any pipe, any pipe or plumbing fitting or fixture, any solder, or any flux, after June 1986, in the installation or repair of (i) any public water system; or (ii) any plumbing in a residential or non residential facility providing water for human consumption, that is not lead free.” At that time, “lead free” was defined as solder that contains less than 0.2% lead and pipes that contain less than 8.0% lead. See U.S. Environmental Protection Agency, Use of Lead Free Pipes, Fittings, Fixtures, Solder and Flux for Drinking Water, <https://www.epa.gov/dwstandardsregulations/use-lead-free-pipes-fittings-fixtures-solder-and-flux-drinking-water>. [↑](#footnote-ref-5)
5. <https://www.epa.gov/dwreginfo/lead-and-copper-rule>. [↑](#footnote-ref-6)
6. The 1996 amendments expanded the prohibition on lead to include the use of any plumbing fitting and fixtures that are not lead-free and prohibited their introduction into commerce. [↑](#footnote-ref-7)
7. In 2011, the Reduction of Lead in Drinking Water Act was enacted, reducing the permissible percentage of lead to its current level of 0.25%. Reduction of Lead in Drinking Water Act, P.L. 111-380, 124 Stat. 4131 (enacted January 4, 2011), amending the definition of “lead free” in Section 1417(d) of the SDWA. [↑](#footnote-ref-8)
8. NDWAC Recommendations to the Administrator for the Long Term Revisions to the LCR (December 15, 2015). <https://www.epa.gov/sites/production/files/2016-01/documents/ndwacrecommtoadmin121515.pdf>. *See also*, Final Report of the LCR Working Group to the NDWAC (August 24, 2015). <https://www.epa.gov/sites/production/files/2016-01/documents/ndwaclcrwgfinalreportaug2015.pdf>. [↑](#footnote-ref-9)
9. Tariff Water – Pa. P.U.C. No. 4 (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. [↑](#footnote-ref-10)
10. 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. [↑](#footnote-ref-11)
11. The ALJ also recommended that PAWC collaborate with the parties on consumer education for the program, implement certain annual reporting requirements, and make reasonable efforts to obtain grants or loans to offset program costs. PAWC did not file Exceptions to these requirements, and *Act 120* does not address them. These may be reasonable elements of a replacements plan, and we would encourage the parties to consider their inclusion in any revised proposal. [↑](#footnote-ref-12)