

**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 ON REMAND

Before
Elizabeth H. Barnes
Administrative Law Judge

INTRODUCTION

This decision recommends granting a Petition of Pennsylvania-American Water Company (PAWC or “the Company”) for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes¹ (LSPs) at Docket No. P-2017-2606100 (Petition) as modified by a Joint Petition for Settlement on Remand (Settlement).

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

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.”

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, the Commission’s Bureau of Investigation and Enforcement (I&E) and the Office of Consumer Advocate (OCA) filed separate Answers. On June 15, 2017, the Office of Small Business Advocate (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.

On May 15, 2018, the Commission issued my Recommended Decision, which found that PAWC’s proposal to replace customer-owned LSPs is in the public interest² and, therefore, recommended that the Commission approve PAWC’s proposed Tariff revisions and authorize the Company to move forward with the replacement of customer-owned LSPs.³ However, I did not approve the Company’s proposal to capitalize its expenditures to replace LSPs; record those expenditures in a capital account; amortize or depreciate its LSP replacements costs over a reasonable estimated service life; and recover its weighted cost of debt and equity capital on those expenditures.⁴ I recommended accepting proposals made by witnesses for the OCA and I&E that would allow the Company to defer the costs it incurs to

² See, e.g., Recommended Decision dated May 15, 2018 (R.D.), p. 30.

³ *Id.*, p. 30.

⁴ *Id.*, pp. 21-25.

replace LSP, amortize those costs over a period of up to ten years beginning in its next base rate case,⁵ and not recover a return on the unamortized balance during the recovery period.⁶

PAWC filed Exceptions to the Recommended Decision on June 4, 2018. I&E, the OCA and the OSBA filed Replies to Exceptions on June 14, 2018. In October 2018, while PAWC's Exceptions to the Recommended Decision were pending, Governor Thomas W. Wolf signed into law Act 120 of 2018 ("Act 120"), which became effective on December 23, 2018. Act 120 amended Section 1311(b) of the Public Utility Code, 66 Pa. C.S. § 1311(b), in order, *inter alia*, to authorize investor-owned water utilities to pursue comprehensive replacement of lead service lines that remain in service across the Commonwealth subject to budget caps approved by the Commission.⁷

Act 120 provides that replacing a LSP does not make the utility the owner of the new service line on the customer's property.⁸ Act 120 also directs the Commission to establish standards to ensure a warranty on the utility's replacement work and reimburse customers who replaced lead service lines at their own cost.⁹ Additionally, Act 120 establishes the accounting and ratemaking treatment of lead service line replacement costs by providing that the customer-owned portion of lead service lines (and damaged wastewater service laterals also covered by the law) may be included in a regulated utility's rate base upon which it is authorized to earn a return.¹⁰

On January 4, 2019, in response to Act 120, the Commission set aside the Recommended Decision dealing with accounting and ratemaking treatment of Replacement Plan Costs.¹¹ The Commission found that Act 120 prescribes the cost recovery for LSP Replacement Costs and addresses other contested issues in this proceeding such as warranties for the work

⁵ The decision did not recommend a particular amortization period, but rather stated that the amortization period should be established in PAWC's next rate base proceeding. R.D., p. 2.

⁶ *Id.*, pp. 21-25.

⁷ 66 Pa.C.S. §§ 1311(b)(2)(v)-(vi).

⁸ *Id.* at § 1311(b)(2)(i).

⁹ *Id.* at § 1311(b)(2)(vii).

¹⁰ *Id.* at §§ 1311(b)(2)(i)-(iii).

¹¹ *Petition of Pennsylvania-American Water Co. For Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Serv. Pipes*, Docket No. P-2017-2606100 (Opinion and Order entered Jan. 4, 2019) ("January 2019 Order").

performed.¹² The Commission remanded this proceeding for further consideration of the Petition under the new Act 120 and to develop a solution that might become a model for other Pennsylvania water utilities to address customer-owned LSPs in accordance with Act 120.¹³ The Commission neither dismissed the Petition nor directed PAWC to file a new Petition.

Instead, the Commission directed PAWC to either conform its Petition to Act 120 and supplement the record in this proceeding as necessary or to file a revised Petition at a new docket.¹⁴ On January 11, 2019, the parties advised the Administrative Law Judge (ALJ) that the Company elected to continue proceeding at this docket rather than withdrawing the Petition and filing a new Petition. The parties requested an opportunity to collaborate to enhance the previously proposed Replacement Plan before initiating further formal proceedings.

On January 14, 2019, I approved the parties' request to explore the possibility of amicably resolving any outstanding remaining issues among the parties in light of Act 120 without the need for further litigation with the caveat that monthly status reports of the settlement negotiations would be provided to the presiding officer.

After several months of negotiations, the parties reached a settlement in principle on June 7, 2019 and notified me. On June 12, 2019, I issued an Interim Order on Remand pursuant to 52 Pa. Code § 5.224, giving the parties leave until July 17, 2019 within which time to submit a Joint Stipulation for Admission of Evidence and Copies of Statement and Exhibits as well as a Joint Petition for Approval of Settlement with verified statements in support. On July 17, 2019, the Joint Petition for Settlement on Remand with a proposed tariff supplement to Tariff Water – PA PUC No. 5, and verified Statements in Support of PAWC, OCA, I&E and OSBA (collectively, the “Joint Petitioners”) were filed. The Petition as modified by a Joint Petition for Settlement on Remand is ripe for a decision.

¹² See January 2019 Order, p. 13.

¹³ *Id.*, pp. 14-15.

¹⁴ *Id.*, p. 14.

FINDINGS OF FACT

1. 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. PAWC St. 1 at 3.

2. PAWC provides wastewater service to approximately 54,478 customers. PAWC St. 1 at 3.

3. 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.

4. 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. Galvanic corrosion will occur at the connection of the old lead service pipe on the private side of the home and then newly installed copper service line on the public side. However, 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 average cost of lead service pipe replacement is approximately \$3,500. PAWC St. Nos. 1, p. 14 & 1-R, pp. 12-13.

7. By providing PAWC with the ability to replace customer-owned LSPs, the Commission will limit partial lead service line replacements thereby protecting customers from significant lead exposure. OCA St. 1 at 8.

TERMS AND CONDITIONS OF SETTLEMENT

The Settlement consists of the following terms and conditions – subsections and paragraph numbers are listed as they appear in the original settlement filed with the Commission:

A. Nature of Replacement Plan and Tariff Revisions

18. Notwithstanding Rules 2.12, 2.14 and 4.9 of Tariff No. 5, PAWC shall, provided that the customer consents, replace LSPs: (1) encountered as part of the Company's ongoing main and/or Service Line replacement work; and (2) at a customer's request, subject to certain conditions, including verification of the presence of an LSP and the Company's determination of when the replacement will occur based on various factors such as the number of customer requests, site conditions, contractor proximity, the annual cap described in Paragraph 35 below and availability of funds within the budgeted allotment of \$6.0 million per year. The costs PAWC incurs as a result of replacing LSPs shall be subject to cost recovery as outlined in Section F.

19. Under both Parts of the Replacement Plan, the customer will own and retain responsibility for the maintenance, repair and replacement of its Service Pipe after it is replaced by the Company.

20. The Company will not replace a customer-owned LSP unless the customer enters into an agreement, in a form provided by the Company, that includes granting permission for the Company to enter onto the customer's property to do the replacement. If a customer refuses to enter into such an agreement with the Company, the Company will replace only the Company-owned portion of such customer's lead service line if the location of the Company's new main precludes connecting it to the existing Company-owned Service Line. The potential health risks associated with a partial lead service line replacement will be outlined in a communication to the homeowner.

21. The Joint Petitioners agree that PAWC shall be permitted to implement Rule 4.9.1 set forth in the Supplement to Tariff No. 5 attached to the Joint Petition as Exhibit 1.

22. The tariff revisions reflected in Rule 4.9.1 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 an LSP prior to replacement by the Company.

23. In light of the annual cap provisions in Act 120, the Company's Replacement Plan does not specify an initial or any renewal terms. As discussed in Paragraph 41 below, the Company is providing information that will enable the parties to assess the operation of the program and will meet with the parties to discuss the program and its implementation if requested. The Joint Petitioners, however, reserve the right to review and challenge the Company's Replacement Plan in future proceedings.

B. Implementation of Part 2 of the Replacement Plan

(1) Coordination of Customer-Requested Lead Service Pipe Replacements

24. Customer requests will be grouped by geographic location, and replacements will be undertaken when the number of customer requests in a given location allows the Company to realize reasonable economies of scale described in the Rebuttal Testimony of David R. Kaufman (PAWC Statement No. 1-R, pp. 7-8) by doing those replacements as a single project. With full implementation of Part 2, PAWC anticipates segmenting its service territory into at least five geographic regions.

(2) Wait Time for Part 2 Replacements

25. PAWC will strive to maintain the wait-time following a customer request under Part 2 to less than one year after the Company has the opportunity to evaluate the level of customer requests and address any program start-up issues.

26. The Company will verify whether the property for which a Part 2 replacement was requested has an LSP, and if so, will test water from the tap of the dwelling within four weeks after receiving such a request from the customer or property owner, as applicable. The Company will notify the customer occupying such property within three days of obtaining the test results. The Company also agrees that all customers will be informed of the use of a water filter while awaiting the replacement of a customer-owned LSP.

27. The Company will provide a 10-cup filtered water container to low-income residential customers who request (or if the customer occupies a rental property, the property-owner has made, or has authorized the customer to make, such request) that the Company replace their LSPs under Part 2 of the Company's Replacement Plan, provided that:

(a) The customer's household income is at or below 150% of the Federal Poverty Income Guidelines as determined by the Dollar Energy Fund, which PAWC will engage to make this determination based on information available to, or obtained by, Dollar Energy Fund in the same manner Dollar Energy Fund determines residential customers' low-income status for other low-income programs of the Company;

(b) The Company has verified that the customer has a lead Service Pipe; and

(c) The Company's testing of water from the customer's tap shows that the water has a lead level above the action level established by the Pennsylvania Department of Environmental Protection under the Environmental Protection Agency's LCR.

28. The Company agrees that its customer service representatives will be performing affirmative outreach to low-income customers making them aware of the offer of the water filter.

(3) Cost of Part 2 Lead Service Pipe Replacements

29. The actual costs of a customer-owned LSP replacement reflects a number of site-specific factors, including the length of the Service Pipe. Therefore, the Company will proceed with replacements at the actual costs of such replacement up to the budget amount of \$6.0 million per year.

30. The Company will independently track customer-owned LSP replacement costs under both Parts of the Replacement Plan and will report these costs as part of its DSIC quarterly filings.

C. Warranty

31. The Company will provide a two-year warranty on workmanship and materials for customer Service Pipes that it replaces.

D. Reimbursement to Customers Who Recently Paid for Their Own Lead Service Pipe Replacement

32. If PAWC, at the request of a customer or property-owner (as applicable), visits a customer's site and determines that the Service Pipe has been replaced at or within one-year of the date PAWC commenced a project to replace lead Service Pipes and the customer or property-owner (as applicable) provides the Company with a paid invoice, a certification from a certified plumber, and other documentation determined by the Company to be appropriate to verify the replacement, the Company will reimburse the customer's or property-owner's (as applicable) reasonable costs up to an amount not to exceed 125% of the costs the Company would have incurred to perform the replacement of a similarly-sized service in the project area. A lead Service Pipe project will commence on the date the Company begins physical main replacement work in the project area that includes the customer's site or when PAWC deploys a contractor crew to the geographic area of a Part 2 project to perform grouped work activity, whichever is sooner.

E. Customer Outreach and Communications Plan

33. PAWC's customer outreach and communications plan for the Replacement Plan will include, but is not limited to, 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.

34. The Company will share with the statutory advocates the communications materials to be used in its customer outreach plan. Some of these materials have already been provided as exhibits to Mr. Kaufman's testimony. PAWC agrees to work with the statutory advocates on the communication plan for how it intends to roll-out to customers the approved PAWC-specific elements of its Replacement Plan.

F. Cost Recovery

(1) Annual Cap, Budgetary Allotment and Priority of Expenditures

35. Upon full implementation of the plan, PAWC will perform a maximum of 1,800 LSP replacements per year within a maximum budgetary amount of approximately \$6 million per year. As the Replacement Plan is rolled-out during the first year of implementation, the Company expects that the number of LSP replacements will be less than the annual maximum of 1,800.

36. LSP replacements under Part 1 will have priority on the use of the 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, subject to the cap on number of LSP replacements per 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 carryforward on a cumulative basis, subject to the cap on the number of LSP replacements per year.

(2) Accounting and Ratemaking Treatment of Lead Service Pipe Replacement Costs

37. The Company will capitalize LSP replacement costs and record those costs in Account 333 – Services.

38. PAWC agrees to create a separate sub-account in Account 333 – Services to record LSP replacement costs. Only customer-side replacement costs will be included in this sub-account.

39. The Company will include its actual LSP replacement costs in the Company's rate base in a subsequent base rate case and will recover the fixed costs of such investments in property placed in service between base rate cases through the Company's existing DSIC.

(3) Cost Allocation

40. LSP Replacement Costs will be allocated to all water customers.

G. Reporting

41. PAWC shall provide to I&E, OCA, and OSBA an annual report on the number of customer-owned LSPs replaced, and the cost of replacements, broken down by customer rate class and, secondarily, geographic location. Settlement at 7-13.

Public Interest

PAWC, the OCA, I&E and OSBA agree that the Settlement is in the public interest for the following additional reasons:

The Settlement Provides a Framework to Implement Act 120. The Settlement represents the collaborative effort of the parties to develop an approach to facilitate comprehensive replacement of customer-owned lead service lines in PAWC's service territory in the Commonwealth consistent with Act 120. The Replacement Plan, as set forth in the Settlement, should provide a way to eliminate a possible risk of lead exposure at the customer's tap from Service Pipes.

Substantial Litigation and Associated Costs Will Be Avoided. The Settlement resolves a number of important and contentious issues that were litigated before the Commission.

The Settlement Is Consistent With Commission Policies Promoting Negotiated Settlements. The Joint Petitioners arrived at the Settlement terms after conducting extensive discovery and engaging in in-depth discussions over several weeks. The Settlement terms and conditions constitute a carefully crafted package representing reasonable negotiated compromises on the issues addressed herein. Thus, the Settlement is consistent with the Commission's rules and practices encouraging negotiated settlements (*See* 52 Pa. Code §§ 5.231, 69.391 and 69.401), and is supported by substantial record evidence. Settlement at 14.

The Joint Petitioners stipulate that if the ALJ recommends that the Settlement be adopted without modification, the Joint Petitioners agree to waive the filing of Exceptions. However, the Joint Petitioners do not waive their rights to file Exceptions with respect to any modifications to the terms and conditions of this Settlement, or any additional matters proposed by the ALJ in her Recommended Decision. The Joint Petitioners also reserve the right to file Replies to any Exceptions that may be filed. Settlement at 15-16.

PAWC's Proposed Tariff Rule 4.9.1

PAWC requests leave to file the following Tariff Supplement effective with one day's notice from filing:

4.9.1 Replacement of Lead Service Pipes

4.9.1.1 Notwithstanding Rules 2.11, 2.12, 2.14 and 4.9, the Company shall, provided that the customer consents, replace lead Service Pipes pursuant to Parts 1 and 2 of its lead Service Pipe replacement plan (Replacement Plan), subject to the budgeted allotment of \$6.0 million per year for all lead Service Line replacements under its Replacement Plan.

Pursuant to its Replacement Plan – Part 1, the Company will replace lead Service Pipes it encounters when replacing its mains and/or Service Lines up to 1,800 lead Service Pipe replacements per year within a maximum amount of approximately \$6.0 million per year.

Pursuant to its Replacement Plan – Part 2, the Company will replace a lead Service Pipe at a Customer's request subject to the following conditions:

(1) verification that the Customer has a lead Service Pipe;

(2) the time when the replacement occurs will be determined by the Company based on factors determined by the Company including, without limitation, the number of customer requests for Service Pipe replacements in Company-designated geographic areas;

(3) the annual cap of 1,800 lead Service Pipe; and

(4) availability of funds not used for Part 1 replacements under the Company's budgeted allotment of \$6.0 million per year. Lead Service Pipe replacements performed pursuant to Replacement Plan – Part 1 will have priority on the use of funds under the annual budget allotment and, therefore, in any year, funds will be used for lead Service Pipe replacements under Replacement Plan – Part 2 only to the extent that funds are available within the budget allotment and are not allocated to Part 1 replacements planned for that year. Portions

of the annual budget allotment of \$6.0 million that are not expended on lead Service Pipe replacements under Part 1 or Part 2 of the Replacement Plan in a year will roll-over to the next subsequent year, but use of the roll-over funds will still be subject to the requirement that priority be given to Part 1 replacements. 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 carryforward on a cumulative basis, subject to the cap on the number of lead Service Pipe replacements per year. The Company may, but shall not be required, to petition the Commission for approval to modify its annual budget allotment of \$6.0 million if the Company, in its sole discretion, determines that its annual budget allotment no longer meets the future needs of administering both Parts of the Replacement Plan. However, no change may be made without prior Commission approval. Costs the Company incurs to replace lead Service Pipes under the Company's Replacement Plan shall be subject to the accounting and rate treatment approved by the Order of the Pennsylvania Public Utility Commission (Commission) entered [date to be determined] and Settlement at Docket No. P-2017-2606100 (Approval Order). After a lead Service Pipe is replaced by the Company, the Customer shall own the Service Pipe and shall have full responsibility for the repair, replacement and maintenance of the new Service Pipe, which, upon installation, shall thereafter be subject to the terms of Rules 2.12, 2.14 and 4.9.¹⁵

4.9.1.2 The Customer shall enter into an Agreement for Replacement of Lead Service Pipe, in a form provided by the Company, prior to the initiation of any work by the Company to replace a Customer's Service Pipe. The Company will provide a two-year warranty on workmanship and materials for any Customer lead Service Pipes it replaces.

4.9.1.3 The Company will verify whether the property for which a Replacement Plan - Part 2 replacement was requested has a lead Service Pipe, and if so, will test water from the tap of the dwelling within four weeks after receiving such a request from a Customer or property owner, as applicable. The Company will notify the Customer occupying such property within three days of obtaining the test results.

¹⁵ Joint Petitioners may have meant to also include Rule 2.11.

4.9.1.4 The Company will provide a 10-cup filtered water container to low-income residential Customers who request (or if the Customer occupies a rental property, the property-owner has made, or has authorized the Customer to make, such request) that the Company replace their LSPs under Part 2 of the Company's Replacement Plan, provided that:

- (1) The Customer's household income is at or below 150% of the Federal Poverty Income Guidelines as determined by the Dollar Energy Fund, which the Company will engage to make this determination based on information available to, or obtained by, Dollar Energy Fund in the same manner Dollar Energy Fund determines a residential Customer's low-income status for other low-income programs of the Company;
- (2) The Company has verified that the Customer has a lead Service Pipe; and
- (3) The Company's testing of water from the Customer's tap shows that the water has a lead level above the action level established by the Pennsylvania Department of Environmental Protection under the Environmental Protection Agency's Lead and Copper Rule.

4.9.1.5 If the Company, at the request of a Customer or property-owner (as applicable), visits a Customer's site and determines that the Service Pipe has been replaced at or within one-year of the date the Company commenced a project to replace lead Service Pipes and the Customer or property-owner (as applicable) provides the Company with a paid invoice, a certification from a certified plumber, and other documentation determined by the Company to be appropriate to verify the replacement, the Company will reimburse the Customer's or property-owner's (as applicable) reasonable costs up to an amount not to exceed 125% of the costs the Company would have incurred to perform the replacement of a similarly-sized Service Pipe in the project area. A lead Service Pipe project will commence on the date the Company begins physical main replacement work in the project area that includes the Customer's site or when the Company deploys a contractor crew to the geographic area of a Replacement Plan – Part 2 project to perform grouped work activity, whichever is sooner. Settlement Exhibit 1.

DISCUSSION

The Commission's policy is to encourage settlements and in the Commission's judgment, settlement rates are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code §§ 5.231, 69.401. However, the Commission must review proposed settlements to determine whether the terms and conditions are in the public interest. *Pa. Pub. Util. Comm'n v. Philadelphia Gas Works*, M-00031768 (January 7, 2004); *Pa. Pub. Util. Cmm'n. v. CS Water and Sewer Associates*, 74 Pa. PUC 767 (1991); *Warner v. GTE North, Inc.*, C-00902815 (April 1, 1996); *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered October 4, 2004); 52 Pa. Code § 69.1201.

A proposed settlement satisfies the "public interest" standard by a preponderance of evidence and benefits that show a likelihood or probability of public benefits that need not be quantified or guaranteed. *Powpowsky v. Pa. Pub. Util. Cmm'n*, 594 Pa. 583, 937 A.2d 1040 (2007)(*Popowsky*). The Commission has traditionally defined the public interest as including ratepayers, shareholders, and the regulated community. *Pa. Pub. Util. Comm'n v. Bell Atlantic-Pennsylvania, Inc.*, Docket No. R-00953409 (Order entered September 29, 1995).

Act 120 became effective on December 23, 2018, and amended Section 1311(b) of the Public Utility Code, 66 Pa. C.S. § 1311(b). Section 1311(b), as amended, states in relevant part:

§ 1311. Valuation of and return on the property of a public utility.

* * *

(b) Method of valuation.

(2)(i) The value of the property of a public utility providing water or wastewater service shall include the original cost incurred by the public utility for the replacement of a customer-owned lead water service line or a customer-owned damaged wastewater lateral, performed concurrent with a scheduled utility main replacement project or under a commission-approved program, notwithstanding that the customer shall hold legal title to the replacement water service line or wastewater lateral.

- (ii) The original cost of the replacement water service line or wastewater lateral shall be deemed other related capitalized costs that are part of the public utility's distribution system.

* * *

(vi) A new tariff or supplement to an existing tariff approved by the commission under subparagraph (v) shall include a cap on the maximum number of customer-owned lead water service lines or customer-owned damaged wastewater laterals that can be replaced annually.

(vii) The commission shall, by regulation or order, establish standards, processes and procedures to:

(A) Ensure that work performed by a public utility or the public utility's contractor to replace a customer-owned lead water service line or a customer-owned damaged wastewater lateral is accompanied by a warranty of a term that the commission determines appropriate and the public utility and the public utility's contractor has access to the affected customer's property during the term of the warranty.

(B) Provide for a reimbursement to a customer who has replaced the customer's lead water service line or customer-owned damaged wastewater lateral within one year of commencement of a project in accordance with a commission-approved tariff.

66 Pa.C.S. § 1311(b)(2).

Act 120 authorizes public utilities providing water and/or wastewater service to, *inter alia*, replace customer-owned LSPs, include the costs incurred between base rate proceedings in the DSIC, and, upon the filing of a base rate case, include the costs in rate base thereby earning a return of and on the costs to replace customer-owned LSPs. Additionally, Act 120 provides that there shall be a cap on the number of customer-owned LSPs replaced annually, that a reasonable warranty accompany the replacement, and that any customer that previously replaced their LSP within one year of commencement of a Commission-approved project to replace a customer-owned LSP shall be reimbursed. *Id.*

This is the first petition of its kind under the new Act 120. The Petition as modified by the proposed Settlement filed on July 17, 2019, is in compliance with the plain meaning of Section 1311, 66 Pa. C.S. § 1311. 1 Pa. Code § 1.7 (Statutory Construction Act of

1972 applicable). Words and phrases in a statute must be construed according to rules of grammar and their common and approved usage. *Martin Media v. Dept. of Transportation*, 641 A.2d 630 (1994); *Velazquez v. East Stroudsburg*, 949 A.2d 354, 358-359 (Pa. Cmwlth. 2008). Administrative interpretations of a statute are entitled to some deference, particularly where a statute is technical or complex, but such deference will exist only where the reviewing court is satisfied that the regulation tracks the meaning of the statute and does not violate the intent of the legislation. *Commonwealth v. Gilmour Mfg. Co.*, 822 A.2d 676, 679 (Pa. Cmwlth. 2003), order aff'd, 384 A.2d 1103 (Pa. 2003).

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 (LTIIP). On May 18, 2017, the Commission held PAWC's LTIIP 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 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),¹⁶ 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.

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.¹⁷ 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

¹⁶ See 40 C.F.R. § 141.80 *et seq.*; 25 Pa. Code § 109.1101 *et seq.*

¹⁷ 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.

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 as agreed upon between PAWC and the Statutory Advocates in this proceeding, 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, Settlement.

Although it is noted that the Commission has not yet issued an Implementation Order or initiated a proposed rulemaking proceeding per Section 1311(b)(2)(vii), the proposed Settlement generally complies with the framework of Section 1311, and approval of the Settlement and accompanying Tariff Supplement prior to the promulgation of regulations is not in conflict with and represents a reasonable interpretation of Section 1311. In the event a regulation should become effective that is in conflict with the proposed tariff supplement, another supplement may be filed in the future. For example, if it is determined after a rulemaking procedure that a different warranty period other than a 2-year warranty on construction of LSPs should become a standard to the industry, then PAWC would be subject to that regulatory requirement. Further, each party reserves the right to review and challenge the Company's Replacement Plan in future proceedings.

In the interest of expediting a deployment of lead-free service lines to the public in PAWC's service territory during its own lead service line replacement schedule, and because the material terms in the Replacement Plan and the treatment of customer-owned service lines

for accounting purposes are in compliance with 66 Pa. C.S. § 1311, it is in the public's interest to approve the Settlement.

A. Nature of Replacement Plan and Tariff Revisions (Settlement ¶¶ 18-23)

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.

The Joint Petitioners recognize lead in water service lines creates major safety and reliability concerns for customers. OCA St. 1 at 5-6. For example, lead exposure can cause a range of health effects including permanent cognitive impairment in infants and children. *Id.* Current protections against lead exposure such as corrosion control, however, may be insufficient. OCA St. 1 at 6. Additionally, while replacing the entire portion of the entire lead service line, including both the Company portion and the customer portion, is best practice within the water utility industry, replacing only a portion of the lead service line can create just as much lead exposure as it seeks to eliminate. OCA St. 1 at 10-11. By providing the Company with the ability to replace customer-owned LSPs, the Commission will limit partial lead service line replacements thereby protecting customers from significant lead exposure. *See* OCA St. 1 at 8 (detailing the problematic nature of partial lead service line replacements).

The Settlement also provides additional measures for continued development and improvement of the Company's Replacement Plan. By way of example, the Settlement provides that the Company will meet with the parties, if requested, to discuss the program and its implementation. Settlement ¶ 23. Furthermore, each party reserves the right to review and

challenge the Company's Replacement Plan in future proceedings. *Id.* The Settlement allows for continued discussions and forums for further refinement of the program, if necessary.

B. Implementation of Part 2 of the Replacement Plan (Settlement ¶¶ 24-30)

Replacement Plan - Part 2 addresses remaining customer-owned lead Service Pipes that the Company does not encounter during its ongoing main and service line replacement program. Petition at 8. For Part 2 replacements, PAWC will replace the customer-owned LSP at the customer's request if the Company verifies that the customer's service pipe is made of lead. Petition at 9. The Settlement contains numerous provisions detailing the parameters of Replacement Plan – Part 2, considering the logistical issues that may arise.

First, the Settlement indicates that customer requests for Part 2 replacements will be grouped by geographic location and replacements will be undertaken 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. Settlement ¶ 24. In other words, the Company seeks to minimize repeated contractor mobilization/demobilization costs by aggregating ten to twenty LSP replacements for a given week in a geographic region, with a similar amount planned for the following two weeks. PAWC St. 1-R at 7-8. PAWC will segment its service territory into at least five geographic regions. Settlement ¶ 24.

The parties indicated in the underlying proceeding that the Company's proposal could lead to extended wait times for Part 2 replacements, which would be imprudent considering those customers have lead service lines. I&E St. 1 at 4. To that end, the Settlement provides several provisions that protects the interest of customers. First, the Settlement states that PAWC will strive to undertake Part 2 replacements less than one year after the Company has had an opportunity to evaluate the customer requests and address any program start-up issues. Settlement ¶ 25. Second, the Settlement provides that once a Part 2 replacement request is placed, the Company will test lead levels in the water at the customer's tap within four weeks and will notify the customer within three days of receiving test results. Settlement ¶ 26. Lastly, for low-income customers, the Company will provide a 10-cup filtered water container provided

that the customer is at or below 150 percent of the Federal Poverty Income Guidelines and has a lead level at the tap that exceeds the lead action level established by the Lead and Copper Rule. Settlement ¶ 27. These above provisions provide numerous conditions and parameters for the Company as it undertakes Replacement Plan – Part 2. These additional conditions serve to protect customers during the time the Company requires to reach economies of scale for Part 2 replacements.

Under the Settlement, customer requests will be grouped by geographic location, and replacements will be undertaken 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, as described in the Rebuttal Testimony of David R. Kaufman (PAWC St. No. 1-R, pp. 7-8). With full implementation of Part 2, PAWC anticipates segmenting its service territory into at least five geographic regions. Joint Petition, ¶ 24.

Under the Settlement, PAWC will strive to maintain the wait-time following a customer request under Part 2 to less than one year after the Company has the opportunity to evaluate the level of customer requests and address any program start-up issues. The Company will verify whether the property for which a Part 2 replacement was requested has an LSP, and if so, will test water from the tap of the dwelling within four weeks after receiving such a request from the customer or property owner, as applicable. The Company will also provide water filters to low-income residential customers who satisfy the criteria in Paragraph No. 27 of the Joint Petition.

The OSBA generally supported PAWC's Replacement Plan-Part 1, whereby PAWC plans to replace customer-owned lead service lines encountered in connection with scheduled main replacement projects ("Part 1"). The OSBA agreed that Part 1 projects should have priority due to the relatively greater risk of raising lead levels for affected customers when replacing mains. OSBA's concerns remained with the Company's proposal to recover potentially excessive costs from ratepayers in connection with Replacement Plan-Part 2 ("Part 2").

C. Warranty (Settlement ¶ 31)

Under the Settlement, PAWC commits to a two-year limited workmanship warranty to the customer on the newly installed customer-owned Service Pipe. Settlement ¶ 31. In the underlying proceeding, the OCA recommended that the Company provide a five-year warranty to each customer that had an LSP replaced by the Company. OCA St. 1 at 23. A five-year warranty would give the customer assurance that the work was performed properly. *Id.* In response, the Company was willing to provide a one-year limited warranty on workmanship and materials. PAWC St. 1-R at 11. The OCA, however, noted that a one-year warranty was not reasonable, given that faulty replacements may only be affected by extreme occurrences in weather, which might take a few years to occur. OCA St. 1-SR at 2-3. In my initial Recommended Decision, I agreed with the Company and adopted a one-year limited warranty. R.D. at 26.

The Joint Petitioners have compromised and the Settlement provides for a two-year limited warranty on workmanship and materials. While this is not the five-year period that the OCA initially requested, two years should be sufficient to expose the replacements to extreme weather conditions and/or substantial usage, which would allow the customer to assess whether the work was performed properly. Act 120 does not prescribe the length of the warranty that water utilities or their contractors must provide to replace customer-owned LSPs concurrent with a scheduled main replacement project or under a Commission-approved program. As the Joint Petitioners have agreed to a two-year warranty, I recommend the Commission adopt this as it appears to comply with the plain meaning of Act 120 and is appropriate because such commitment is consistent with other routine utility work performed by its contractors and addresses the OCA's concern about the length of the warranty.

D. Reimbursement Program (Settlement ¶ 32)

The Settlement also requires the Company to provide reimbursements for customers that have replaced their LSP at their own expense. Settlement ¶ 32. Specifically, the Settlement states that the customer must have replaced their LSP within one-year of the date

PAWC begins physical main replacement work in the project area that includes the customer's site or when PAWC deploys a contractor crew to the geographic area of a Part 2 project, whichever is sooner. *Id.*

This provision is in response to the OCA's recommendation in the underlying proceeding. The OCA initially recommended that the Company provide reimbursements to customers that have replaced their LSP within four years of the effective date of the Company's Replacement Plan. OCA St. 1 at 23. Further, the customer would be reimbursed a percentage of the costs to replace the LSP depending on how recently the customer-owned LSP was replaced. OCA St. 1 at 24. The OCA advocated for the reimbursement program because failure to provide reimbursements would lead to equity concerns, considering that these customers had replaced their own LSP at their expense, but would now be expected to pay the costs to replace other customer-owned LSPs. OCA St. 1-SR at 3-4. As a result, the Recommended Decision adopted the OCA's proposal on the basis that failure to reimburse these customers would result in undue discrimination for the reasons previously stated. R.D. at 27-28.

While this decision was pending before the Commission, the General Assembly passed Act 120 of 2018, which addresses reimbursement of customers who replaced their LSPs. This provision requires that the Commission shall, by regulation or order, establish a process to:

Provide for a reimbursement to a customer who has replaced the customer's lead water service line or customer-owned damaged wastewater lateral within one year of commencement of a project in accordance with a commission-approved tariff.

66 Pa.C.S. § 1311(b)(vii)(B). This amended statute provides a statutory period of a one-year reimbursement program for customers that previously replaced their LSP at their own expense.

Accordingly, while the Settlement does not adopt the OCA's initial position in this matter, the reimbursement program complies with the express and unambiguous language of Section 1311(b)(vii)(B) and the general framework of Act 120. These reimbursements partially

address the OCA’s equity concerns and provides a meaningful approach to ensure that more customers with LSPs can benefit from this program.

E. Customer Outreach and Communications Plan (Settlement ¶¶ 33-34)

The Settlement provides that the Company will perform customer outreach and implement a communication plan to notify potentially affected customers through various means, including direct mailings, bill inserts, information on the Company’s website, and an educational video. Settlement ¶ 33. Additionally, the Company has agreed to share its communications with the statutory advocates and work with them to develop certain communications sent to customers. Settlement ¶ 34. These provisions allow for a collaborative effort between the parties to ensure that affected customers receive accurate, timely, and detailed information concerning the Replacement Plan.

In his testimony in this proceeding, PAWC witness Kaufman explained that the Company’s current public education efforts regarding lead service lines are consistent with the National Drinking Water Advisory Council’s recommendations. He also described PAWC’s communications plan for the Replacement Plan, which 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. PAWC St. Nos. 1, p. 14 & 1-R, p. 12.

Under the Settlement, PAWC will share its communications materials to be used in its customer outreach plan with the statutory parties and will work with them to implement the PAWC-specific elements of that plan. Joint Petition, ¶ 23. This commitment ensures that the Company will collaborate with the statutory advocates to develop a robust outreach and communications plan as recommended by the OCA.

The Settlement also addresses the OSBA’s concern about Part 2 LSP replacement costs. Under the Settlement the Company committed to provide to the Joint Petitioners an annual report on the number of customer-owned LSPs replaced, and the cost of replacements,

broken down by customer rate class. Joint Petition, ¶ 41. Based on those reports, the issue of whether costs of specific investments in LSP replacements are reasonable and prudently incurred can be reviewed and addressed in base rate cases or DSIC filings when actual LSP replacement costs are claimed for recovery. In addition, the information provided by the Company in the annual reports will enable the Commission and interested parties to assess the operation of the Replacement Plan on an ongoing basis.

F. Cost Recovery (Settlement ¶¶ 35-40)

The Settlement provides that the Company will perform a maximum of 1,800 LSP replacements per year within a maximum budgetary allotment of approximately \$6 million per year. Settlement ¶ 35. This provision is consistent with Act 120, which requires that any lead service line replacement program have an annual cap. *See* 66 Pa. C.S. § 1311(b)(vi). Additionally, PAWC has provided evidence demonstrating that there are approximately 18,000 company-owned lead service lines, indicating that there could likely be a similar amount of customer-owned LSPs in the Company's water system. PAWC St. 1 at 10-11. Accordingly, a replacement cap of 1,800 customer-owned LSPs and an annual budget of approximately \$6 million will allow the Company to replace a significant majority, if not all, customer-owned LSPs over a period of 10 years.

The Settlement also states that replacements under Replacement Plan – Part I will have priority on the use of the annual budgetary allotment. Settlement ¶ 36. This is critical as it ensures that as the Company performs its ongoing main and service line replacement program, the Company will have enough funds to replace the customer-portion of a lead service line if it encounters one. If funds were not available the Company would have to seek additional waivers for more funds, require the customer to pay for the replacement creating equity concerns, or undergo a partial lead service line replacement, which can cause a spike in lead levels at the tap.

Lastly, the Settlement provides that any excess budgetary allotment that is not used in a given year will roll over to the subsequent year. Settlement ¶ 36. Any rollover funds not used in the subsequent year, however, will not carry over into the following year. *Id.* That is,

excess budgetary allotments will not carry forward on an indefinite, cumulative basis. *Id.* This provision prevents the Company from making a significant amount of expenditures in a single year, but rather promotes consistent and gradual replacement of customer-owned LSPs.

The annual cap and budgetary allotment under the Settlement will mitigate the impact of the Replacement Plan on customer rates. PAWC originally proposed to set a budget cap of \$6.0 million per year on the amounts expended to replace LSPs in order to mitigate the impact of the Replacement Plan on customer rates. The Company also proposed the following priority of expenditures within the budgetary allotment: (a) LSP replacements under Replacement Plan – 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; (b) 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; and (c) 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. No party objected to PAWC's proposed budgetary allotment, but the OCA asserted that the Company should offer a sliding scale of reimbursement to customers who recently replaced LSPs at their own cost. OCA St. Nos. 1, pp. 23-24 & 1-SR, pp. 3-4.

Act 120 provides that a Commission-approved lead service line replacement plan shall be subject to an annual cap on replacements. 66 Pa.C.S. § 1311(b)(2)(v). Under the Settlement, PAWC will perform a maximum of 1,800 LSP replacements per year within a maximum budgetary amount of approximately \$6 million per year with the same priority of expenditures originally proposed by the Company. Joint Petition, ¶¶ 35-36. This is compliant with Act 120.

In addition, to address the OCA's concerns and consistent with Act 120, the Settlement provides reimbursement to customers who replaced LSPs at their own cost within one year of commencement of a project under the Replacement Plan. Specifically, subject to the eligibility and verification requirements outlined in Paragraph 32 of the Joint Petition, the

Company will reimburse the customer's or property-owner's (as applicable) reasonable costs up to an amount not to exceed 125% of the costs the Company would have incurred to perform the replacement of a similarly-sized service in the project area.

The following Settlement provisions set forth the recovery of costs the Company incurs to replace customer-owned LSPs. Specifically, the Settlement, in accordance with Act 120, allows the Company to capitalize the replacement costs. The Company has agreed to record those costs in a sub-account of the Company's Account 333 – Services (this account generally tracks the costs associated with installation of services pipes and accessories leading to the customer's premises). Settlement ¶ 37-38. The Settlement, in accordance with Act 120, also allows the Company to include the actual costs of replacing customer-owned LSPs in the Company's rate base in a subsequent base rate proceeding, thereby allowing the Company to earn a return of and on those costs. Settlement ¶ 39. Additionally, pursuant to the Settlement, the Company will be allowed to recover the fixed costs of those replacements placed in service between base rate cases through the Company's existing DSIC. *Id.*

Cost recovery was a contentious issue in the underlying proceeding. The Settlement outlined above reflects the initial proposal of PAWC. The OCA and I&E, however, argued that it would be inappropriate for the Company to earn a return on the costs associated with customer-owned property not for public use. OCA St. 1 at 16-17; *see also* I&E St. 1 at 7-8. Rather, the OCA and I&E recommended that the Company establish a regulatory asset to record the costs incurred and amortize those costs over a reasonable period to be determined in the Company's next base rate proceeding. OCA St. 1 at 21-22; *see also* I&E St. 2 at 2-4. The Recommended Decision recommended adopting the recommendation of the OCA and I&E. R.D. at 21.

Subsequently, Act 120 of 2018 was signed into law, which states that “[t]he value of the property of a public utility providing water or wastewater service shall include the original cost incurred by the public utility for the replacement of a customer-owned lead water service line or a customer-owned damaged wastewater lateral,” that is replaced pursuant to a Commission-approved program. 66 Pa. C.S. § 1311(b). Furthermore, Act 120 states that “[t]he

original cost of the replacement water service line or wastewater lateral shall be deemed other related capitalized costs that are part of the public utility's distribution system." *Id.* In other words, pursuant to Section 1351 of the Public Utility Code, such costs would be eligible for recovery under the Company's existing DSIC. *See* 66 Pa. C.S. §§ 1351, 1357(a).

Notwithstanding the problematic nature of earning a return on customer-owned property, the OCA understands that the Commission and regulated utilities are bound by statutory law. *See* 66 Pa. C.S. § 501. Considering that Section 1311 of the Public Utility Code, as amended, allows for utilities to include in rate base, and in the DSIC between rate cases, the actual costs to replace customer-owned LSPs, the Settlement reflects that newly-enacted amendment to the Public Utility Code. 66 Pa. C.S. § 1311(b). The OCA would, however, continue to encourage utilities to minimize costs and the impacts to ratepayers in undertaking plans to remove lead service lines from water systems.

The Settlement provides that the costs to replace customer-owned LSPs shall be recovered from water customers. Settlement ¶ 40. This is a reasonable allocation of the costs as all water customers, regardless of rate class, will be able to benefit from this program.

In its 2017 Petition, PAWC proposed to capitalize LSP replacement costs up to the annual budget cap of \$6.0 million 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. As demonstrated in the direct testimony of PAWC's Director of Rates and Regulations, John R. Cox, under the Company's proposed accounting and ratemaking treatment, the LSP Replacement costs would have a negligible effect on customers' bills for water service (i.e., an annual increment of less than 10 cents per month). PAWC St. No. 2, pp. 10-11; PAWC Exhibit No. 2. The Company's testimony also explained that such proposed accounting and ratemaking treatment is appropriate because PAWC's investment in replacing customer-owned LSPs provides a multi-year assurance that it can continue to comply with important drinking water standards, including the LCR. PAWC St. Nos. 2, pp. 7-8 & 1-R, pp. 14-15.

Despite emphasizing that proactive investments in customer-owned LSPs are needed to protect the public health, I&E and the OCA both opposed the Company's cost recovery proposal, asserting that any LSP replacement costs incurred by PAWC should be deferred through a regulatory asset and amortized without a return or carrying charge. I&E St. No. 1, pp. 7-8; OCA St. No. 1, pp. 18-20. The ALJ recommended that the Commission approve the cost recovery proposals offered by I&E and the OCA. R.D., pp. 21-25, 37.

Accordingly, the Settlement adopts PAWC's original proposed accounting and ratemaking treatment for LSP replacement costs and provides that PAWC will record LSP replacement costs in a separate subaccount in Account 333 - Services. Joint Petition, ¶¶ 37-39. In addition, consistent with Act 120, under the Settlement, the Company will allocate LSP replacement costs to all water customers. Joint Petition, ¶ 40.

G. Reporting (Settlement ¶ 41)

The Settlement provides that the Company shall provide to the statutory advocates an annual report on the number of customer-owned LSPs replaced and the costs of those replacements, separated by rate class and geographic region. Settlement ¶ 41. This provision is helpful for the parties to continue to monitor the program and ensure that it is operating effectively and efficiently.

CONCLUSION

For all of the reasons stated above, I find that the proposed Settlement filed on July 17, 2019, is in compliance with Section 1311, 66 Pa. C.S. § 1311. The Settlement sets forth a comprehensive list of issues which were resolved through the negotiation process. Specifically, the Joint Petition for Settlement continues the annual program budgeted allotment of \$6.0 million per year. Further, the Company will track customer-owned LSP replacement costs, report those costs as part of its quarterly DSIC filings, and also provide to the OSBA, the OCA and I&E an annual report on the number of customer-owned LSPs replaced, and the cost of those replacements broken down by customer rate class, as well as geographic location. The

instant proposed settlement satisfies the “public interest” standard by a preponderance of evidence and benefits that show a likelihood or probability of public benefits that need not be quantified or guaranteed.

I recommend PAWC be required to report costs as not only part of its quarterly DSIC filings but also as part of the Company’s Annual Asset Optimization Plan filing, disaggregated by unit costs per service line for easier Commission review. Additionally, the Tariff Supplement should be effective upon three days’ instead of one day’s notice, to allow the Commission’s Bureau of Technical Utilities Services an opportunity to review the Tariff Supplement prior to its effective date.

Pennsylvania American Water Company’s customers will likely benefit from the Replacement Plan, as enhanced by the Settlement, as the risk of lead exposure at the customer’s tap from Service Pipes will be reduced through implementation of the Replacement Plan consistent with Act 120. Moreover, the Settlement terms resolved the issues and concerns of Statutory Advocates that were raised by the testimony in this case without the need for additional costly litigation. The annual reporting requirements, coupled with the retention of PAWC’s proposed maximum budgetary cap of \$6.0 million per year, should help mitigate against the Company incurring excessive costs in connection with its Part 2 replacement plan in any given year. The capitalization of the replacement costs to be recorded in a subaccount under Account 333-Services, will enable I&E to determine which portion of Account 333-Services is related to lead service line replacement for easier review. I&E avers the settlement groups customers into geographical locations for project specifications. This will be more cost-effective and may lower a customer’s wait-time for line replacement.

The terms and conditions of the proposed Settlement, taken as a whole, represent a fair and reasonable resolution of the issues raised by OCA, I&E, and OSBA in this matter. Therefore, I recommend the Petition as modified by the Joint Settlement Petition be approved by the Commission, with the additional reporting requirement discussed above, as being in the public interest. I further recommend that the Commission grant PAWC leave to file its proposed

Tariff Supplement in Exhibit 1 attached to the Joint Settlement Petition effective in three days' notice from the filing.

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. The benchmark for determining the acceptability of a settlement is whether the proposed terms and conditions are in the public interest. *Warner v. GTE North, Inc.*, Docket No. C-00902815 (Opinion and Order entered April 1, 1996); *Pa. Pub. Util. Comm'n v. CS Water and Sewer Associates*, 74 Pa. PUC 767 (1991).

3. An approved tariff is legally binding on both the utility and its customers. *Brockway Glass Company v. Public Utility Commission*, 437 A.2d 1067, 1070 (Pa.Cmwlth. 1981).

4. Value of the property of a public utility providing water or wastewater service shall include the original cost incurred by the public utility for the replacement of a customer-owned lead water service line or a customer-owned damaged wastewater lateral that is replaced pursuant to a Commission-approved program. 66 Pa. C.S. § 1311(b).

5. The replacement costs of PAWC's water service line may be recorded in Account No. 333 – Services (Services Account) because they are “eligible property” for water utilities under Section 1351, a recoverable cost under a Distribution System Improvement Charge (DSIC). 66 Pa. C.S. §§ 1351, 1553 and 1557.

6. Ownership of replaced pipes should transfer to the customer-owner with a two-year warranty and only those customers who have already replaced their lead service pipes within the past year should be compensated. 66 Pa.C.S. § 1311(b)(vii)(B).

ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Petition of Pennsylvania-American Water Company filed on May 22, 2017 at P-2017-2606100 as modified by a Joint Petition for Settlement on Remand filed on July 17, 2019, be granted consistent with the body of this Recommended Decision on Remand and the Ordering Paragraphs below.
2. That approval of the Joint Settlement on Remand's Replacement Plan as set forth in the Joint Petition for Settlement on Remand be granted.
3. That Pennsylvania-American Water Company be given leave to file a Tariff Supplement 4.9.1.1 – 4.9.1.5, revising Tariff Water – PA P.U.C. No 5 as attached to the Joint Settlement on Remand as Exhibit 1, (the pages to be identified as Original 47.1 and Original 47.2, respectively) incorporating the terms of the settlement and changes to its rates, rules, and regulations as set forth in Exhibit 1 of the Joint Petition for Settlement on Remand, to become effective on three (3) days' notice from the date of the tariff filing.
4. That Pennsylvania-American Water Company be directed to provide the statutory advocates to this proceeding and the Commission reports on the number of Company-owned and customer-owned service pipes replaced regarding Parts 1 and 2, and the total annual cost and average unit cost of replacements, disaggregated by customer rate category (*i.e.*, residential, commercial, industrial) and, secondarily, geographic location. Quarterly DSIC filings shall contain this information and the Company's Annual Asset Optimization Plan filing shall contain this information, disaggregated by unit costs per service line.

5. That Pennsylvania-American Water Company be directed to collaborate with the statutory advocates to improve its customer outreach efforts to advise customers to check their services for the possibility of lead. The customer outreach efforts will be an ongoing effort over the next ten years.

6. That Pennsylvania-American Water Company be directed to report on its outreach efforts and results annually as part of its Annual Asset Optimization Plan filing.

7. That the Bureau of Technical Utility Services be directed to monitor Pennsylvania-American Water Company's annual reporting in conjunction with the Commission's final Order.

8. That Docket No. P-2017-2606100 be marked closed.

Date: August 7, 2019

/s/

Elizabeth H. Barnes
Administrative Law Judge