

Prepared Testimony of

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*before the*

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## **Introduction**

Good morning Chairman Godshall, Chairman Caltagirone, and members of the House Consumer Affairs Committee. I am Commissioner David Sweet of the Public Utility Commission (Commission or PUC). I am here today, on behalf of the Commission, to offer testimony concerning House Bill No. 2075 (HB 2075), which amends Title 66 (Public Utilities) of the Pennsylvania Consolidated Statutes, to classify replacement or repair of customer-owned lead utility water service lines and damaged utility wastewater service laterals as property on which a regulated public utility may recover a return on and of investment.

I am confident that we all agree that the replacement of lead or damaged water or wastewater pipes is of vital importance, and that the issue is to determine the best way to accomplish that goal.

The Commission maintains a neutral position on this bill, however the agency has been, and continues to be very engaged in matters involving lead service water lines in distribution systems operated by regulated public utilities. A prime example is the York Water Company and the Commission's approval of their first-of-its-kind program involving the replacement of customer-owned lead water service lines. This effort and subsequent results serve as a national model for addressing this serious public health concern. I note that a similar case filed by the Pennsylvania American Water Company is still pending before the Commission. Because it is still pending, I am not free to discuss it further at this point.

## **Overview**

HB 2075 seeks to amend 66 Pa. C.S. § 1311, *Valuation of and return on the property of a public utility*, by classifying the replacement or repair of customer-owned lead utility water service lines and damaged utility wastewater service laterals as property on which a regulated utility may obtain a return on and of its investment, notwithstanding that the utility will not hold legal title to the property.

According to the Sponsorship Memorandum accompanying HB 2075, the legislation is intended to provide parity among regulated utilities and municipal authorities and municipal governments providing water and wastewater service such that both may replace lead water service lines and damaged sewer laterals when there is a public health concern related to the customer-owned portion of water and wastewater service. While the sponsorship memorandum implies that the bill is directed to the

repair or replacement of facilities serving residential customers, the text of the bill does not limit beneficiaries to that class.

## **Valuation and Rate of Return**

HB 2075 proposes to amend 66 Pa. C.S. § 1311, *Valuation of and return on the property of a public utility*, to expand the value of utility property to include the cost of repair or replacement of certain customer-owned property. The primary clarification of HB 2075 is that it mandates that utilities include the replacement capital investment cost of customer-owned property in their respective rate base accounting, and thus, in rates. To be clear, this means that HB 2075 will mandate the inclusion of non-jurisdictional property in a regulated utility's rate base.

The amendments proposed by HB 2075 are included in 66 Pa. C.S. § 1311(b), *Method of valuation*, as follows. HB 2075 proposes to add a new subsection to Section 1311(b):

### **66 Pa. C.S. § 1311(b)(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 customer-owned lead water service lines and the replacement or rehabilitation of damaged customer-owned sewer laterals, notwithstanding that the customer will hold legal title to the replacement water service line or replacement or rehabilitated sewer lateral.

HB 2075 also mandates specific accounting treatment for the customer-owned property. Proposed Section 1311(b)(2)(ii) provides:

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

That is, these costs will be capitalized and subject to recovery of and return on investment, ~~through~~ including the use of depreciation expense. As to water service lines and sewer laterals, this language is very similar to the definition of "eligible property" in 66 Pa. C.S. § 1351.

## **Approvals and Reviews**

At a minimum, HB 2075 requires a utility seeking cost recovery for lead service lines (1) to show that the replacement costs were prudently incurred and (2) to meet at least one prong of the four-prong standard discussed below.

As to damaged sewer laterals, HB 2075 requires a utility to seek prior Commission approval, perhaps on a case-by-case basis, for a determination on whether replacement or repair of a damaged sewer lateral is prudent and meets at least one prong of its enumerated four-prong standard: (1) prevention of adverse effects on public health; (2) prevention of adverse effects on public safety; (3) help the utility comply with law or regulation pertaining to drinking water; or (4) help the utility comply with law or regulation pertaining to environmental standards. HB 2075 provides that approved repair or replacement expenses may be allocated to all customer classes and types of service.

### **Cost Allocation**

The proposed Section 1311(b)(2)(iv) provides for class cost allocations. That Section provides:

The commission may allocate the cost associated with the replacement of a customer-owned lead water service line and the replacement or rehabilitation of a damaged customer-owned sewer lateral among each customer, classes of customers and types of service.

It appears that all customer classes may be subject to cost recovery and HB 2075 would include all customer classes as beneficiaries of subsidized water line or sewer lateral replacement costs.

### **Replacement of Customer Service Lines**

Chapter 13 of the Public Utility Code currently permits the Commission to provide water and wastewater utilities the authority to recover costs for in-kind replacement of water and wastewater utility lines if the Commission finds it in the public interest.

Explicit authority for utility replacement of customer-owned service lines does not appear in the Public Utility Code, the Commission has determined that utilities are able to remove lead service lines from distribution systems under the current regulatory framework with a recovery of those prudently-incurred costs ensured.

Beyond incorporating current practice, this proposed bill will allow the utilities to earn a profit on portions of the distribution system that they do not own.

As noted earlier, the York Water Company petitioned the Commission for tariff waivers that would permit the Company to replace customer-owned lead service lines and to seek rate recovery of those costs. In March 2017, the Commission approved a settlement whereby York Water could book costs related to lead customer service line replacements as a regulatory asset account and required various reporting on the company's progress in replacing and financing lead service line replacements and corrosion control. This process eliminates the utility's ability to earn a return on property owned by a ratepayer while still allowing dollar-for-dollar recovery of costs incurred.

According to most recent status reports, the York Water Company program is proceeding well, with the number of lead services lines replaced running ahead of schedule, costs coming in below expectations, and – most importantly for the public – lead levels in consumers' water has have decreased significantly.

Additionally, the Commission has also previously addressed utility-financed customer service line replacement for natural gas distribution companies (NGDCs). In these instances, for system-wide stability, compliance with the utilities' infrastructure replacement plans and safety reasons, the Commission permitted Peoples Natural Gas and Columbia Gas to replace customer-owned service lines and to recover costs in Distribution System Improvement Charges (DSIC) and rates, respectively.

### **Potential Concerns**

While HB 2075 is intended to provide for additional opportunities for greater regulatory certainty regarding cost recovery and system improvements, it also adds regulatory requirements and possible uncertainty through individual prudence reviews and prior approvals –The proposed Section 1311(b)(2)(iii) provides for a prudence determination on the costs included in rate base under the proposed Section 1311(b)(2)(i):

The public utility incurring the cost under subparagraph (i) may recover a return on, and a return of, the cost that the commission determines to have been prudently incurred and will help prevent adverse effects on public health

or public safety or help the public utility comply with laws and regulations pertaining to drinking water or environmental standards.

The Section does not specify whether the determination of prudence would occur in a stand-alone proceeding or within the context of a base rate case proceeding in which the utility would claim the recovery of and a return on such capital investment outlays.

Additionally, the proposed Section 1311(b)(2)(v) provides for some type of prior commission approval before a utility may perform any repair or replacement of a customer-owned sewer lateral:

Notwithstanding any other provision of this title to the contrary, a public utility providing water or wastewater service must obtain prior approval of the commission or replacement or rehabilitation of damaged customer-owned sewer laterals.

HB 2075 does not identify which factors must be used to categorize a lateral as “damaged,” and could generate litigation over the circumstances of each individual project. Application of the current law as it appears in Section 1351 of the Public Utility Code, 66 Pa C.S.A. §1351, appears to give the Commission more latitude to approve replacement of pipe than this restriction does in the proposed legislation.

The financial impact on ratepayers is another challenging factor. For residential customers, sidewalks, parking areas, hardscaping, mature trees, and accessory structures could all contribute to capitalized costs unique to each replacement. Commercial and industrial customers would add additional complexity.

Given those circumstances, it is difficult to speculate on the range of cost to repair or replace various service lines, especially larger commercial or industrial wastewater service laterals, and it is likely that each prior approval request would be subject to litigation. As such, it is similar to the present process already in place at the PUC, and adoption of HB 2075 would not prevent or reduce litigation.

## **Closing**

We commend the Committee for highlighting this important topic and providing us with the opportunity to join this discussion.

The PUC is committed to our mission of ensuring safe and reliable utility service, which includes continued efforts to address concerns related to lead water service lines and wastewater lines that are a public health concern.

We are at your service and happy to answer any questions you may have.