

**BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE**

Testimony Of

**Tanya J. McCloskey
Acting Consumer Advocate**

**Regarding
House Bill 2075**

**Harrisburg, Pennsylvania
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**Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923
(717) 783-5048 - Office
(717) 783-7152 - Fax
Email: tmccloskey@paoca.org
249330**

**Chairman Godshall, Chairman Caltagirone
and Members of the House Consumer Affairs Committee**

My name is Tanya McCloskey and I have been serving as the Acting Consumer Advocate of Pennsylvania since 2012. I have worked at the Office of Consumer Advocate since 1987. Thank you for inviting me here today to present testimony on House Bill 2075 regarding the ratemaking treatment of customer-owned lead service lines and customer-owned damaged sewer laterals replaced by a water utility. The issue of customer-owned lead service lines and lead in drinking water presents significant public health risks and raises numerous challenges that need to be resolved timely and fairly.

The adverse public health risks of lead exposure have been known for a long time and can have a particular impact on children exposed to high levels of lead. Over the decades, we have moved to remove lead from our environment. The removal of lead from our gasoline and from our paint are just two examples. For water utility systems, the use of lead pipe ended in the 1950s or 1960s for most utilities. The use of lead in solder, faucets, and other plumbing fixtures was not banned until the enactment of the Safe Drinking Water Act in 1986.¹ 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. 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%.²

¹ 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-fluxdrinking-water>.

² Reduction of Lead in Drinking Water Act, P.L. 111-380, 124 Stat. 4131 (enacted Jan. 4, 2011), amending the definition of "lead free" in Section 1417(d) of the SDWA.

While the use of lead in service lines ended by the 1960s, there are still lead service lines in public water systems. Research sponsored by the American Water Works Association estimated that there were 6.1 million lead service lines in use in the United States, of which 160,000 are in Pennsylvania.³ 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, but it may not be 100% effective. When water sources or drinking water chemistry changes, or when financial pressures limit the use of corrosion control as was the unfortunate experience in Flint, Michigan, there can be a significant risk of lead exposure to the public from old service lines. 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.

Research is continuing into other methods that may be less costly. Recent research into lining or coating of the interior of lead service lines suggests that in certain conditions, this could provide similar public health protections at lower cost. In March 2017, the Environmental Protection Agency (EPA) and the Water Research Foundation published the results of a study that evaluated lining and coating technologies that are being used in North America and Europe.⁴ The report concluded:

Linings and coatings can effectively reduce exposure to lead, on either a short-term or long-term basis, and should be considered by all stakeholders as viable tools that can be used for that purpose, where appropriate, taking their pros and cons into consideration on a site-specific basis. Any system-wide lead control or LSLR program is going to be full of challenges, and linings and coatings can potentially play an important role in meeting some of those challenges in a timely and cost-effective manner.

Stephen Randtke, et al., *Evaluation of Lead Service Line Lining and Coating Technologies* (Water Research Foundation 2017), Executive Summary, page 6.

³ David Cornwell, et al., National Survey of Lead Service Line Occurrence, *JAWWA*, 108:4:E182-E191 (Apr. 2016), <http://dx.doi.org/10.5942/jawwa.2016.108.0086>.

⁴ Stephen Randtke, et al., *Evaluation of Lead Service Line Lining and Coating Technologies* (Water Research Foundation 2017), <http://www.waterrf.org/PublicReportLibrary/4351.pdf>.

With this backdrop, and given the significant public health risks of lead in drinking water associated with lead service lines, my Office strongly supports efforts to address the potential sources of lead in our drinking water in a timely, reasonable, cost-effective and fair manner.

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. Each utility should have a plan for addressing lead within its own service lines and will receive traditional regulatory treatment for its costs of remediating the lead in its own service lines.

The more challenging issue from a regulatory perspective is the pipe that runs from the curb stop to the meter. This pipe, owned by the customer in the water utility industry and referred to as the customer-owned service line, is the subject of House Bill 2075. In general, a customer is responsible for maintaining and replacing the customer-owned portion of the service line. Customers are often offered, and purchase, service line protection insurance to assist with the costs of any repair or replacement of the customer-owned service line under certain specified conditions. It does not appear that simply being a lead service line is a qualifying condition under most of these service line protection plans.

Of importance to the discussion is the fact that a partial replacement of the lead service line, that is the replacement of only the utility-owned portion of the line, should be avoided. Partial replacements have not been shown effective in reducing lead exposure and under certain circumstances may increase lead exposure. The problem the water utility faces is that the utility may be prepared to replace its utility-owned lead service lines in a certain neighborhood, but the homeowners may not be able to replace the customer-owned service line on the same schedule, or may not be able to afford to replace the customer-owned service line at all. The replacement of a customer-owned service line can run into the thousands of dollars, depending on the distance from

the curb stop to the meter and the condition of the area that must be crossed. This can present a significant barrier to customers, and can impede the utility's efforts to remediate lead in drinking water.

To address this on-going public health risk, my Office supports allowing the water utility to replace the customer-owned service line. As further discussed in my testimony below, my Office has recently joined with York Water Company in a settlement before the Public Utility Commission to address an issue with customer-owned lead service lines that arose in York Water's service territory in a fair and equitable manner. By all reports, York Water's initiative is progressing well.

Where I differ from House Bill 2075, is the ratemaking treatment that should be provided for such work. The removal of customer-owned lead service lines is an extraordinary event that is essential for public health protection. This extraordinary set of circumstances requires a sharing of responsibility of the costs to remediate this public health risk. Ideally, responsibility should be shared among the utility, the homeowner, other ratepayers, and federal or state government funding. Within the past two years, utility regulators in New York, Missouri and Nova Scotia have adopted different types of ratemaking mechanisms to share the costs of lead service line replacements among utilities, homeowners, and ratepayers.⁵ In addition, in 2017, New York state provided \$20 million in grants to local governments to help fund lead service line replacements.⁶

I recognize, however, that obtaining homeowner contribution could be difficult or unaffordable, and waiting for federal or state grant funding may unnecessarily delay projects. We do, however, have at our disposal ratemaking methodologies that can properly effectuate a sharing

⁵ New York American Water Co., NY PSC Case 16-W-0259 (Order entered May 18, 2017); Missouri-American Water Co., Mo. PSC File No. WU-2017-0296 (Order pending); and Halifax Regional Water Commission, Nova Scotia Utility and Review Board Matter No. M07891 (Decision dated August 22, 2017).

⁶ <https://health.ny.gov/environmental/water/drinking/lslrp/faq.htm>

of the responsibility and allow for reflection of homeowner contribution and federal or state grant funding if and when they become available.

House Bill 2075, however, does not call for, or provide for, any sharing of the costs of addressing this public health issue. House Bill 2075 provides that this extraordinary expenditure for customer-owned service lines be treated as spending on utility-owned property, plant, or equipment, allowing a full return of and return on the costs, that is allowing a profit to shareholders. This approach essentially turns a customer's health risk into a profit center for the utility shareholders at the expense of all other customers. All of the costs would be paid for by other customers, who have already paid for their own service line, and customers would also pay the profit on the investment for decades. Meanwhile, the utility would return the customer-owned service line to the homeowner and would not be responsible for any future repairs to the line or any future replacement of the line.

This profit on a service line not even owned by the utility, is not insignificant. Using a simplified example of replacement of a customer-owned service line at a cost of \$2,500 with a 50 year depreciation life, in the first 20 years, customers would pay \$1,000 in depreciation and return on investment (profit) of \$3,950 for a total of \$4,950.⁷ This is nearly twice the original expenditure. This stream of revenues would actually continue on as the program to replace customer-owned service lines will, by necessity, be a multi-year program. Under the approach provided for in House Bill 2075, the utility would have a stream of profits for more than 60 years,

⁷ In this simplified example, it is assumed that the replacement of a customer-owned service line costs \$2,500 and has a depreciation life of 50 years, or 2% per annum. The investment thus depreciates by \$50 per year in the example. The example also conservatively assumes a pre-tax return for the utility of 10% (a figure that is lower than most utility's current pre-tax returns). So, after two years, the utility would have \$2,400 in rate base for which customers would pay \$240 in return, plus \$50 in depreciation, for \$290 per year. After 10 years, there would still be \$2,000 on the books, at which time the customers would pay \$200 in return plus \$50 in depreciation, for a total of \$250 that year. This carries forward for the full depreciable life of the customer-owned service line.

all of which would be paid for by other customers, none of which would be borne by the utility's shareholders, the customers whose service lines were replaced, or federal or state grant funding.

There are regulatory mechanisms to allow for the replacement of customer-owned lead service lines and effect a fair sharing of the costs of customer-owned service line replacements. Given the extraordinary, one-time nature of such a replacement program and the public health benefits that result, my Office has supported the approach of establishing a regulatory asset to account for any expenses a company incurs to replace customer-owned service lines pursuant to an approved plan by the Commission and allow for recovery of these costs in base rates. This is the approach that was successfully used in the York Water Settlement that was approved by the Public Utility Commission.⁸ Under the Settlement, York Water is permitted to replace the customer-owned portion of the lead service line and to book as a regulatory asset the costs of replacing 1,660 lead service lines in Phase 1. During the second Phase of the replacements, York Water is permitted to book as a regulatory asset the average cost of replacement. In Phase 2, the customer is responsible for any amount in excess of the average cost, paid as either a lump sum or billed monthly to the customer without interest. The deferred amount in the regulatory asset is then eligible for recovery in the Company's next base rate case over a period of no more than six years, but the Company does not earn a return or profit on this extraordinary expense.

Deferred regulatory asset treatment can be used to account for not only the expenses of the replacement, but it can also be used to account for any grants or funding that the utility may receive if federal or state funding becomes available. These grants are accounted for as an offset to the expenses in the regulatory asset. Similarly, any contributions collected from the homeowners can be used to offset the expenses. The ratemaking recovery of the deferred amount is determined in

⁸ York Water Co. v. PA PUC, Docket No. P-2016-2577404 (Order entered March 8, 2017)

the utility's next base rate case but the deferred amount does not earn a return, consistent with Pennsylvania practice. This will have the effect of sharing the costs of this extraordinary, public health program between the utility's investors and customers as well as providing for the possibility of homeowner contribution when possible and future federal or state funding.⁹

There are several benefits to this type of approach. This approach allows a utility to move forward with a customer-owned lead service line replacement program expeditiously and efficiently. Second, by removing the profit motivation in performing the work, it ensures that if less expensive technology becomes available and workable, the Company would not have any disincentive to using a lower-cost approach. Third, it continues to keep the Company engaged in pursuing other funding sources since obtaining other sources of funding would not reduce the profit to shareholders the Company may expect. Fourth, it will lower the overall cost to consumers of performing this work.

The use of the regulatory asset approach as I described above, or simply including an on-going annual expense in rates during a base rate case for the removal of customer-owned service lines, does not require any additional legislation or authority to the Commission. These are long-used regulatory mechanisms that allow the Commission to craft the best plan for the circumstances of each utility. These mechanisms will also allow a utility to proceed at a pace of replacement that is appropriate for the needs of its service territory. As I mentioned above, the scope of the customer-owned lead service line issue is not yet well known. As more information becomes known to the utility, it can adjust any plans yet still account for all expenses in the regulatory asset mechanism and recover those expenses in a future base rate case.

⁹ At the first base rate case, it is also possible for the utility to include an expense in its base rates for any on-going program to replace customer-owned lead service lines.

While not the subject of legislation, I would like to note some additional aspects that should be part of any of lead service line remediation plan when replacing customer-owned lead service lines. If the water utility performs the work of replacing a customer-owned lead service line, it is only right that the utility warrant that work to the customer. The length of the warranty should be sufficient to account for weather conditions that can cause disturbances when a pipe is not installed properly and to assure the customer that the work is free from contractor or manufacturer error.

A second component of a customer-owned service line replacement program is to provide a flushing allowance, that is a water usage credit, to customers whose lead service line will not be replaced in the initial phase of the program. While the exact number of customer-owned lead service lines is not well known, we do know that there are enough that the utility will not be able to replace all lead service lines in the first phase of a program. One means of assisting customers who still have a lead service line is to educate and encourage the customer to run water through the lines after a period of non-use to flush out lead that may have accumulated in the line.

A third component of a sound program is a partial compensation program to customers who have replaced a lead service line within the past four years. I would use four years as it is consistent with the general limitation on refunds found in Section 1312(a) of the Public Utility Code. A partial compensation program is a means of ensuring fairness to all customers. Reimbursing customers who recently replaced a lead service line at their own expense will help to avoid customers feeling as if they are disadvantaged by the new program. These customers have not only recently replaced their own lead service line, but under the new program will be asked to subsidize the line replacements of other customers. A partial compensation program can help to address this potential unfairness.

The fourth component is a thorough communications program. Consumers should be fully informed about the risks of lead contamination and how to identify whether they have a lead service line. Education programs should engage consumers and stakeholders alike, such as public health workers and community based organizations. The education program should include information on how and where to test for lead, how to remediate lead before line replacement, and who to contact at the Company to evaluate whether the customer should be placed on the service line list.

Before I close, I wanted to take a moment to discuss customer-owned damaged sewer laterals that are also included in House Bill 2075. At this point, I think we have insufficient information to fully evaluate the scope of this problem. While damaged sewer laterals can pose environmental or health risks as untreated sewage may leak from the break, this impact is often localized and can be remedied by a repair to the damaged area of the lateral. This is a homeowner responsibility that can often be covered by insurance protection. In this case, there is a line that is broken (as opposed to removing a functioning lead service line) and the remedy seems to rest with the homeowner. If at some point, a public health risk of a wide spread nature were to occur, I believe the Commission already has the regulatory tools available to address the issue.

I thank you again for inviting me to testify on this important topic. I look forward to your questions.