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Rates could fund lead pipe replacement in critical states: Laws in states with the most lead service lines support the practice

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EXECUTIVE SUMMARY

We reviewed state laws and policies in 13 states with the most lead service lines (LSLs), and found no explicit barriers to using rate funds to replace the lines on private property. These states have an estimated 4.2 million LSLs, more than two-thirds of the nation's total. In these states, publicly-owned utilities can act pursuant to existing state legislation by determining that the practice serves a public purpose—protecting public health. Investor-owned utilities can do the same, but typically need approval of the state's utility commission. While we have not reviewed the remaining states, we anticipate that the state laws and policies are similar to the ones we evaluated.

Lead is widely recognized as one of the most pervasive environmental health threats in the United States. Even [low levels of lead](#) in the blood of children can result in behavioral and learning problems and lower IQ. An [analysis](#) from Environmental Protection Agency (EPA) scientists demonstrates that, for children less than six months of age, water is a major source of exposure, with estimates that formula-fed infants may receive 40% to 60% of their exposure to lead from drinking water.

Lead service lines (LSLs), which connect a building's plumbing to the water main under the street, contribute the greatest percentage of lead—an estimated 50% to 75%—to the tap in homes when they are present. Other sources of exposure include lead plumbing fixtures or lead solder used to connect copper pipes. Although Congress banned the use of lead in plumbing materials in 1986, more than 6 million LSLs remain in use today, delivering water to homes across the United States.

In 2015, EPA's [National Drinking Water Advisory Council](#) (NDWAC) called on the agency to support a long-term program to replace all of the nation's LSLs. Numerous organizations publicly supported this objective, including the [American Water Works Association](#) (AWWA), the largest association of water utilities and water professionals in the country.

One of the major obstacles to communities fully replacing LSLs is that drinking water utilities typically consider themselves to be prohibited by the state from using rate funds to replace LSLs on private property. The issue is critical since rates paid by customers are the primary source of funding to support water system improvements. Rates are also used to repay bonds as well as state or federal loans. A total prohibition on this use of ratepayer funds means that

a customer must pay 100% of the cost of LSL replacement on their property even when the utility is replacing the portion on public property as part of a rehabilitation of the main. If the customer refuses to have the utility replace the portion on private property, the utility may perform a partial LSL replacement, which has the potential to significantly increase the residents' lead exposure. If the customer has their own contractor perform the work without closely coordinating with the utility, it will increase the cost.

While there may be a variety of funding options, a total prohibition on the use of ratepayer funds is a serious obstacle to protecting children from lead in drinking water. Overcoming this obstacle, whether real or perceived, is a key step in ensuring that communities have sufficient funds to fully replace LSLs in a cost-effective, equitable manner.

In the years since the tragedy in Flint first came to light, six states—Indiana, Michigan, Missouri, New Jersey, Pennsylvania, and Wisconsin—have taken action to enable use of ratepayer funds for LSL replacement on private property. Of those, only Wisconsin explicitly requires a property owner to contribute funds, and even then, the state allows the utility to provide up to 50% of the cost as a grant and the remainder as a loan to alleviate the financial impact, especially for low-income property owners. Each of these states expressly approved the use of rates to pay for LSL replacement on private property—largely based on an assessment of the public health benefits of reducing children's exposure to lead and economic benefits of performing all of the work at one time.

Recognizing this trend and the lack of clarity on the specific state policies, Environmental Defense Fund and the Harvard Law School's Emmett Environmental Law & Policy

Clinic partnered to evaluate the legal authority of publicly- and investor-owned utilities to use a portion of rate funds to replace LSLs on private property. We evaluated 12 states with more than 200,000 LSLs: Florida, Illinois, Indiana, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, Ohio, Texas, and Wisconsin. We also included Pennsylvania, which has 160,000 LSLs, because recent decisions in the state have clarified utilities' authority.¹ These 13 states are estimated to have a collective 4.2 million LSLs, or more than two-thirds of the nation's total.

We found that none of the 13 states prohibit the use of rate funds to replace LSLs on private property. The table below provides a summary of the likelihood that state policy would support use of rate funds for each of the 13 states. Overall:

- Six of the 13 states have adopted policies that explicitly support the practice.
- Michigan is the only state among the 13 to require that utilities use rate funds to pay for the entire replacement. Michigan's rules, however, have been challenged in court by Detroit and other municipalities.

¹ Iowa and Kansas have an estimated 160,000 LSLs, the same as Pennsylvania. No other state is estimated to have more than 100,000 LSLs.

- Publicly-owned utilities, except in Wisconsin, are subject only to court oversight and have the widest discretion.
- Investor-owned utilities, except in Michigan and Minnesota, must seek approval from a state utility commission. Commissions in Indiana, Missouri and Pennsylvania have approved the practice with limitations.

While we did not consider the policies in the 37 other states or the District of Columbia that have the remaining third of the nation's LSLs, we would expect them to follow the recent trends and approve the use of rate funds to replace LSLs on private property.

Although our research has shown that most utilities in the states we reviewed currently have the authority to use ratepayer funds for LSL replacement on private property—either directly or with approval from a state utility commission—we recommend that all states, consistent with the six that have already acted, adopt explicit policies giving communities the authority to use ratepayer funds to replace LSLs on private property.

Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time. (States are listed by decreasing number of LSLs.)

State	Est. No. of LSLs*	Publicly-owned utility	Investor-owned utility	Comment
Illinois	730,000	Likely	Uncertain but likely	2017 law suggests support.
Ohio	650,000	Likely	Uncertain	
Michigan	460,000	Definite [†]	Definite [†]	2018 rule requires utilities to use rates to pay for LSL replacement. Utility commission approval appears not to be required.
New York	360,000	Likely	Uncertain but likely	
New Jersey	350,000	Definite under specific conditions otherwise likely	Uncertain	2018 law allows publicly-owned utilities to use public funds, but only if part of an environmental infrastructure project funded by one of two sources.
Missouri	330,000	Likely	Definite	Commission approved one proposal in May 2018, although without ruling on the ratemaking treatment of the expense.
Indiana	290,000	Likely	Definite	2017 law provides path. Commission approved one proposal in July 2018.
Texas	270,000	Likely	Uncertain	Municipality can review and approve investor-owned utility proposals.
Minnesota	260,000	Likely	Likely	Utility commission approval not required for proposals.
Wisconsin	240,000	Definite	Definite	2018 law provides criteria and process. Grants to customers capped at 50% of cost, however.
Massachusetts	220,000	Likely	Uncertain but likely	
Florida	200,000	Likely	Uncertain but likely	County approval needed in 29 of 67 counties.
Pennsylvania	160,000	Definite	Definite	2017 law allows publicly-owned utilities to use public funds. Commission approved one proposal for investor-owned utility in 2017 and 2018 law makes explicit the Commission's authority to do so.

* Estimated number of lead service lines (LSLs) based on [Cornwell et al, 2016](#)

† The Michigan rule has been challenged in court and no final decision has yet been reached in that case.

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INTRODUCTION

I. THE PROBLEM OF LEAD IN DRINKING WATER

The recent crisis in Flint, Michigan brought attention to a widespread problem in the United States: lead contamination in drinking water. In fact, cities across the country have grappled with this problem for decades. Residents in cities such as Washington, D.C.; Sebring, Ohio; and Durham, North Carolina have experienced elevated lead in their tap water, leading to potentially damaging blood lead levels.²

Lead exposure can cause health problems for all people but is particularly harmful for young children and fetuses.³ Even low levels of lead exposure can result in significant, adverse health effects in children, including developmental problems, reduced IQ, behavioral problems, and anemia.⁴ No safe level of lead exposure for infants and young children has been identified.⁵ In adults, the health effects of lead exposure include cardiovascular problems, impaired kidney function, and reproductive problems.⁶ Several United States and international agencies have also determined that lead is a probable human carcinogen.⁷ These problems disproportionately affect certain groups: African-American children are twice as likely to be exposed to lead sources resulting in elevated blood lead levels as white children, and children in low-income households are three times as likely to suffer from elevated blood lead levels as children in wealthier households.⁸

² See *Michael Wines & John Schwartz*, *Unsafe Lead Levels in Tap Water Not Limited to Flint*, *N.Y. Times*, Feb. 8, 2016; see also *Rebecca Renner*, *Out of Plumb: When Water Treatment Causes Lead Contamination*, 117 *ENVTL. HEALTH PERSP.* 542, 544 (2009).

³ EPA, *Basic Information about Lead in Drinking Water*, <https://perma.cc/ZB2C-AF83>.

⁴ *Id.*

⁵ See *Mary Jean Brown & Stephen Margolis*, *Centers for Disease Control and Prevention, Lead in Drinking Water and Human Blood Lead Levels in the United States*, 61 *MORBIDITY & MORTALITY WEEKLY RPT.* 1, 2 (2012).

⁶ See EPA, *supra note 3*.

⁷ See *Brown and Margolis*, *supra note 5*, at 2.

⁸ CDC, *Blood Lead Levels in Children Aged 1–5 Years—United States, 1999–2010*, 62 *MORBIDITY & MORTALITY WEEKLY RPT.* 245, 246 (2013).

Because of these well-established harms, Congress and federal agencies have taken a variety of steps in recent decades to reduce lead exposure. The Consumer Product Safety Commission banned lead-based paint in 1978.⁹ The Environmental Protection Agency (EPA) began lowering the maximum permitted lead content in gasoline in 1973.¹⁰ Through the 1990 Clean Air Act Amendments, Congress prohibited the use of lead in gasoline as of January 1, 1996.¹¹

With regard to exposure to lead from drinking water in particular, both Congress and EPA have taken action, but achieving significant reductions in exposure has proven difficult. Unlike most other drinking water contaminants, lead is typically not present in source water and, therefore, cannot be removed at the water treatment plant. Instead, lead enters drinking water by leaching out of pipes, plumbing fixtures, and solder as the water moves through the system to reach residents' taps. The largest source of lead in drinking water is lead service lines (LSLs), which are lead pipes connecting a building's plumbing to the water main under the street. Disturbances in water chemistry, the movement of pipes, or partial replacement of service lines—where only a portion of the LSL is removed—can lead to significant release of lead from the pipes, into the drinking water. Other sources of exposure include lead plumbing fixtures or lead solder used to connect copper pipes.

The 1986 amendments to the Safe Drinking Water Act (SDWA) banned the use of lead pipes, fixtures, and solder in plumbing systems,¹² but many older pipes remain in use. The American Water Works Association (AWWA), a water utility trade group, estimates that 6 million homes in the United States still have LSLs.¹³

Under EPA's Lead and Copper Rule (LCR),¹⁴ large water utilities and smaller ones that exceed the lead action level must use corrosion control treatment (CCT) to control

⁹ 42 *Fed. Reg.* 44,193 (Sept. 1, 1977) (codified at 16 *CFR Part 1303*).

¹⁰ 38 *Fed. Reg.* 33,734 (Dec. 6, 1973) (codified at 40 *C.F.R.* § 80.20).

¹¹ *Pub. L. No. 101-549*, § 210 (codified at 42 *U.S.C.* § 7545(n)).

¹² *Pub. L. No. 99-339*, § 109(a)(1) (codified at 42 *U.S.C.* § 300g-6).

¹³ *David A. Cornwell et al.*, *National Survey of Lead Service Line Occurrence*, 108 *AM. WATER WORKS ASS'N E182*, E182 (2016).

¹⁴ 40 *C.F.R.* §§ 141.80–141.91.

the movement of lead from the pipes into the water. CCT generally involves the addition of chemicals to the water to reduce its corrosiveness and build a protective coating, or “scale,” to limit the leaching of lead.¹⁵

The only permanent way to eliminate lead from drinking water, however, is to remove all lead pipes, as well as fixtures and solder that may contain lead. While some water utilities have made considerable progress in removing LSLs in recent years,¹⁶ the removal of all such lines across the country remains a daunting task. EPA has estimated that the cost of removing all LSLs could be between 16 and 80 billion dollars.¹⁷

¹⁵ EPA, Optimal Corrosion Control Treatment Evaluation Technical Recommendations (2016), available at <https://www.epa.gov/sites/production/files/2016-03/documents/occtmarch2016.pdf>.

¹⁶ See, e.g., Eric Lacy, BWL Removes Lansing’s Last Lead Water Service Line, *LANSING ST. J.*, Dec. 19, 2016, <http://www.lansingstatejournal.com/story/news/local/2016/12/14/lead-line-removal/95419004/>; see also Silke Schmidt, First in the Nation: City of Madison Replaced All Lead Pipes, *WISCONSIN WATCH*, Feb. 1, 2016, <http://wisconsinwatch.org/2016/02/first-in-the-nation-city-of-madison-replaced-all-lead-pipes/>

¹⁷ EPA, Lead and Copper Rule Revisions White Paper 9 (2016), available at https://www.epa.gov/sites/production/files/2016-10/documents/508_lcr_revisions_white_paper_final_10.26.16.pdf.

Water utilities may decide to remove LSLs either voluntarily or when required to do so under the LCR. The LCR requires that utilities periodically sample lead levels at customer taps. If, despite using CCT, lead concentrations still exceed an action level of 15 parts per billion (ppb) in more than 10% of customer taps sampled, the system must start replacing LSLs at an annual rate of “at least 7 percent of the initial number of lead service lines in its distribution system.”¹⁸ EPA is currently considering revisions to the LCR.¹⁹

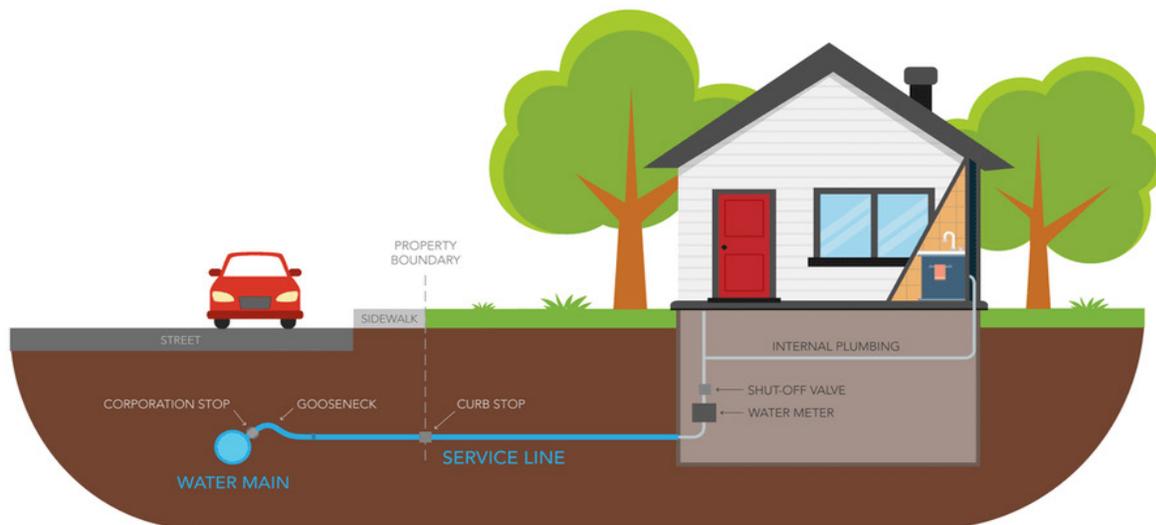
II. PARTIAL SERVICE LINE REPLACEMENTS ARE NOT THE SOLUTION

In communities that have started the process of replacing LSLs, an additional complicating factor is the question of who owns or controls the service lines. As shown in Figure 1 below, a typical LSL begins at a water main underneath a public way (on public property) and ends at the domestic

¹⁸ EPA, Lead and Copper Rule Long-Term Revisions, <https://www.epa.gov/dwstandardsregulations/lead-and-copper-rule-long-term-revisions>.

¹⁹ *Id.*

Figure 1: Typical lead service line installation



Source: Lead Service Line Replacement Collaborative

plumbing inside a house (on private property). The division of ownership between the water utility and the private property owner varies from community to community. In some places, the utility owns the entire LSL. In others, the utility claims that the private property owners are responsible for the entire LSL. Still in others, the ownership is split: the utility is thought to own the portion on public property, while individual homeowners are considered responsible for the portion of the line on their property.

This paper is focused on the challenge of giving communities access to rates paid by customers to fund LSL replacement on private property. It does not attempt to answer the questions of who does or should own which portions of an LSL, which must be answered on a city-by-city basis. Nor does it address the related question of when a utility may have “control” over a portion of an LSL that it does not own. Instead, this paper takes it as a starting point that in many communities, the actual or perceived division of ownership means that individual homeowners are often expected to bear the cost of replacing a portion of the LSL.²⁰ For many people, especially low-income residents, this cost—which can be thousands of dollars—is prohibitive.

In the face of homeowner unwillingness or inability to pay for the replacement of the portion of LSLs under private property, many utilities that have embarked on LSL replacement programs have replaced only the portion of the line on public property. Unfortunately, evidence is accumulating that these partial LSL replacements can do more harm than good. Partial replacements can increase the level of lead in tap water, at least in the short term, by both disrupting the coating that has built up on service lines (which limits the leaching of lead into water), and through chemical reactions where the new line connects to the old lead pipe.²¹ In 2010, the Centers for Disease Control and Prevention (CDC) announced that an

²⁰ *In cities where the water utility owns the entire service line, however, then there should be no barrier to the use of ratepayer funds to pay for full LSL replacements. In Lansing, Michigan, for example, it was determined that the utility owned the entire service line and the utility could therefore pay for the entire replacement project through rate increases.* Daniel C. Vock, *In Flint’s Aftermath, Water Will Run by New Rules*, GOVERNING, Sept. 2016, available at <http://www.governing.com/topics/transportation-infrastructure/gov-flint-water-epa-rules.html>.

²¹ See EPA Science Advisory Board, *Evaluation of the Effectiveness of Partial Lead Service Line Replacements 2 (2011)* (“The weight of evidence indicates that [partially replacing LSLs] often causes tap water lead levels to increase significantly for a period of days to weeks, or even several months.”).

epidemiologic study had suggested that there is a relationship between partial LSL replacements and elevated blood lead levels in children.²²

III. CAN UTILITIES USE RATEPAYER FUNDS TO REPLACE LSLs ON PRIVATE PROPERTY?

Because of the risks associated with partial LSL replacements, from the perspective of protecting public health, it is better for a utility to replace the entire line rather than just the portion on public property. It is also more efficient and cost-effective to replace the entire line at one time.

A key question then becomes how to pay for the replacement of the portion of the line on private property. As it stands now, in many communities, this burden is placed on the individual homeowner, which has several adverse consequences. Coordination of the removal of the two portions of the service line can be complicated and inefficient. In addition, low-income homeowners may find it difficult to pay for the replacement—which can cost several thousand dollars—leaving them vulnerable to greater lead exposure if they are unable to replace the portion of the line on private property. Also, renters may have little leverage to convince their landlord to replace the LSLs.

This situation raises environmental justice concerns and, if it disproportionately impacts minorities, a civil rights issue. An alternative to relying on the homeowner is for utilities to use ratepayer funds to replace these portions of the LSLs. The use of ratepayer funds is not a panacea—the increased rates that will result, while spread more broadly, can still post a significant burden to low-income residents. Therefore, it is important that other sources of funding, including federal and state grants, still be considered. Nevertheless, the use of ratepayer funds—by spreading the cost over all ratepayers and across multiple years—is an important tool for ensuring the efficient and equitable replacement of full LSLs.

²² See Rebecca Renner, *Reaction to the Solution: Lead Exposure Following Partial Service Line Replacement*, 118 ENVTL. HEALTH PERSP. A202, A206 (2010).

The fastest and most direct way to ensure that utilities across the country have the authority to use ratepayer funds for this purpose would be through federal law—either a congressional enactment or a revision of the LCR by EPA. In 1991, EPA took the position under the LCR that utilities were responsible for replacing any LSLs over which they had “control.”²³ EPA based this position on the statutory definition of a public water system as including “distribution facilities under the control of the operator.”²⁴ The 1991 LCR also established a presumption that utilities controlled the entire service line, unless they could demonstrate that they did not have “authority to set standards for construction, repair, or maintenance of the line, authority to replace, repair, or maintain the service line, or ownership of the service line.”²⁵ In other words, under this rule, utilities would have been responsible for replacing the portions of LSLs on private property in many cases even when they did not own those portions of the lines.

However, the AWWA sued EPA over this portion of the rule. In 1994, the D.C. Circuit struck it down but only because EPA had violated the Administrative Procedure Act’s notice-and-comment requirement.²⁶ In particular, EPA had not defined “control” in its proposed rule and the court therefore held that this portion of the final rule was not a “logical outgrowth” of the proposal.²⁷ The court did not address the merits of the control test. On remand, however, EPA abandoned the control standard and required that public water systems replace only the portions of the LSLs that they owned.²⁸ It explained that, “the broader definition of ‘control’...could result in unintended delays and other complications.”²⁹

While EPA could attempt again to impose a broad definition of control when it revises the LCR, for the time being federal law has not answered the question of responsibility for LSL replacement.

²³ 40 C.F.R. § 141.84(d) (1991).

²⁴ 56 Fed. Reg. 26,460, 26,504 (June 7, 1991); see 42 U.S.C. § 300f(4)(A).

²⁵ 40 C.F.R. § 141.84(e) (1991).

²⁶ Am. Water Works Ass’n v. EPA, 40 F.3d 1266 (1994).

²⁷ Id. at 1275.

²⁸ National Primary Drinking Water Regulations for Lead and Copper, 65 Fed. Reg. 1950, 1966 (Jan. 12, 2000).

²⁹ Id. at 1963.

IV. THREE EXAMPLES OF CHALLENGES ENCOUNTERED WHEN ATTEMPTING TO USE RATEPAYER FUNDS TO REPLACE LSLs ON PRIVATE PROPERTY

Utilities have, in some cases, been reluctant to pay for LSL replacements on private property with ratepayer funds because of the belief that they lack the authority to do so under existing laws and regulations. The following three case studies illustrate some of the challenges that water utilities have faced.

A. Madison, Wisconsin

The City of Madison operates a publicly-owned water utility. In 2000, Madison started the process of replacing its LSLs. The city council enacted an ordinance requiring the replacement of LSLs on private property and providing a 50% rebate to come from a surcharge on water sales by the municipal water utility. In Wisconsin, unlike in the other states we review in this paper, municipal utilities are regulated by the Public Service Commission (PSC), so Madison applied for approval to increase its water rates. In support of its application, Madison argued that all ratepayers would benefit from its plan because (a) it would remove the source of the City’s non-compliance with the LCR and (b) it would cost approximately \$800,000 per year, versus \$1 million for CCT plus the removal of phosphorus at the City’s sewage treatment plant.³⁰

The PSC, however, rejected the application, holding that the proposed rate increase would be “unreasonable and unjustly discriminatory.” In particular, the PSC held that “it would establish an unwise precedent for cash flows generated from charges to public utility customers to be put toward a subsidy which clearly and directly benefits a specific group of private property owners.”³¹

³⁰ The Madison Metropolitan Sewerage District (“MMSD”) operated near its permitted limit for discharge of phosphorus to receiving waters, so the additional phosphorus in the water resulting from adding orthophosphate for CCT would need to be removed.

³¹ City of Madison v. Pub. Serv. Comm’n, No. 01-1678, 2002 WL 297643, at *1 (Ct. App. Wis. Feb. 28, 2002).

Madison appealed the PSC’s decision in court. The trial court sided with Madison, but on appeal, the Court of Appeals reinstated the PSC’s decision. The court stated that a “reviewing court may not substitute its judgment for that of the PSC on an issue committed to the PSC’s discretion” and that as a result “[t]he burden is on the City to demonstrate that the PSC’s decision on the rate increase is unreasonable.”³² Applying this standard of review, the court held that, “[w]hile the City presents a rational basis for approving its application, that does not, by itself mean that the PSC’s decision lacks a rational basis.... [I]t is reasonable for the PSC to view the surcharge as subsidizing a direct benefit to a select group of customers.”³³

There are three key lessons from Madison’s experience. First, the legal doctrine that blocked Madison’s plans was the “unreasonable and unjustly discriminatory” test, which, as described below, applies to both investor-owned and publicly-owned utilities in virtually all of the states we reviewed. Second, it highlights the importance of whether a utility’s rate-setting decisions are subject to review by a state public utilities commission (PUC). Here, Madison’s decision had to be approved by the Wisconsin PSC. By contrast, with the limited exception of Indiana, in the other states we reviewed, publicly-owned utilities’ rate-setting decisions are usually not subject to PUC review. Third, and relatedly, this case also demonstrates the importance of the standard of review a court employs when judging the decision of a utility or PUC. The Wisconsin Court of Appeals placed the burden of proof on Madison and granted great deference to the Wisconsin PSC’s decision. By contrast, when a publicly-owned utility’s decision is not subject to PUC review, courts instead tend to defer to the municipality, thereby greatly increasing the chances that its decision will be upheld. The Wisconsin court recognized that Madison “present[ed] a rational basis for approving its application”—in most states, that would be sufficient for the city to prevail.³⁴ In 2018, as described below, the legislature mooted the court decision.

³² Id. at *2.

³³ Id. at *3.

³⁴ *Despite its loss in court, the Madison water utility eventually found other sources of funding, including leasing antennae on its water towers, to subsidize the private portions of removals, and became the first major water utility in the United States to replace all of its LSLs.* Information for Utilities on Lead Service Replacement, MADISON WATER UTILITY, <https://www.cityofmadison.com/water/water-quality/lead-service-replacement-program/information-for-utilities-on-lead-service>.

B. East Chicago, Indiana

Another, more recent example comes from East Chicago, Indiana. The municipal utility proposed that customers would pay up to half of the cost of LSL replacement on private property, with the utility paying the rest out of ratepayer funds.³⁵ Indiana is another state, like Wisconsin, where the rates of some publicly-owned utilities are subject to review by a PUC—here, the Indiana Utility Regulatory Commission (IURC). When East Chicago presented this proposal to the IURC, it was opposed by the Indiana Office of Utility Consumer Counselor (OUCC)—a state agency whose role is to represent ratepayers in proceedings before the IURC. The OUCC objected to the proposal because it would raise rates for all customers while only benefiting some.³⁶ Before the IURC could rule on the OUCC’s objections, East Chicago and the OUCC entered into a settlement under which the city would obtain financing from the Indiana Finance Authority, “at no additional cost to ratepayers,” to pay for 100% of the replacement cost for 500 LSLs.³⁷ The IURC approved the settlement in April 2017.³⁸

This example, like the previous one, highlights the importance of whether a utility’s rates are subject to review by a PUC. In addition, it emphasizes the potentially significant

³⁵ Petition of the City of E. Chicago, Indiana for Auth. to Issue Bonds, Notes, or Other Obligations for Auth. to Increase Its Rates & Charges for Water Serv., & for Approval of New Schedules of Water Rates & Charges, Revised Joint Proposed Order of the City of East Chicago and the OUCC, Cause No. 44826, at 4 (Ind. U.R.C. Mar. 20, 2017), <https://bit.ly/2NB7bvo> [hereinafter, “East Chicago Revised Joint Proposed Order”].

³⁶ Id. at 8 (“[T]he OUCC had also expressed the concern that funding repairs to property not owned by the utility is not the type of expense typically borne by ratepayers through debt financing. Through negotiations, the Utility agreed with the OUCC.”); see also About the OUCC, INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR, <https://www.in.gov/oucc/2364.htm>.

³⁷ Press Release, OUCC, East Chicago Municipal Water Rate Settlement Approved (Apr. 26, 2017), <https://www.in.gov/oucc/files/East%20Chicago%20Muni%20Water%20Order%20NR%204-26-17.pdf>; see also East Chicago Revised Joint Proposed Order, supra note 34, at 2.

³⁸ Petition of the City of E. Chicago, Indiana for Auth. to Issue Bonds, Notes, or Other Obligations for Auth. to Increase Its Rates & Charges for Water Serv., & for Approval of New Schedules of Water Rates & Charges, Order of the Commission, Cause No. 44826, 2017 WL 1632318, at *20 (Ind. U.R.C. Apr. 26, 2017) [hereinafter, “East Chicago Settlement Approval”].

role of ratepayer advocates. When a state has a ratepayer advocate,³⁹ that entity can play a key role in PUC proceedings involving a proposal to use ratepayer funds for LSL replacement on private property. Because such a proposal likely will increase rates, at least in the short term, ratepayer advocate offices may be inclined to oppose it. Proponents of LSL replacement plans should therefore seek to develop arguments that these plans can reduce long-term costs for ratepayers by reducing compliance and water treatment costs.

C. Pittsburgh, Pennsylvania

In 2016, water sampling by the Pittsburgh Water and Sewer Authority (“PWSA”) demonstrated exceedances of the LCR action level. As a result, Pittsburgh was obligated to begin replacing LSLs in its system.⁴⁰ At first, the PWSA carried out partial service line replacements and avoided replacements on private property, based on its interpretation of a decision of the Pennsylvania Commonwealth Court involving a different program offered by the utility.

The decision, in *Dominion Products & Services, Inc. v. PWSA*,⁴¹ involved a warranty program created by the PWSA. Under this program, utility customers paid \$5 per month, which the PWSA forwarded to its chosen contractor, United Line Security, LLC (“ULS”). In return, ULS agreed to perform all necessary repairs on the water and sewer lines of every PWSA customer. Rival water and sewer line repair companies sued the PWSA, arguing that it had exceeded its powers under the Pennsylvania Municipal Authorities Act. In particular, they pointed to a provision that limited the general powers granted to municipalities:

none of the powers granted by this chapter shall be exercised in the construction, financing, improvement, maintenance, extension or operation of any project or projects or providing financing for insurance reserves which in whole or in part shall duplicate or compete with existing enterprises serving substantially the same purposes.⁴²

³⁹ See *National Association of State Utility Consumer Advocates (NASUCA)* for information on particular states. <http://nasuca.org/about-us/>

⁴⁰ *Consent Order and Agreement*, Penn. Dep’t Env’tl. Prot., Nov. 17, 2017, available at http://apps.pittsburghpa.gov/redtail/images/1005_PWSA%20Lead%20COA%2011172017%20final.pdf

⁴¹ 44 A.3d 697 (Pa. Cmwlth. 2011).

⁴² Pa. C.S. § 5607(b)(2).

As explained by the court, the purpose of this provision was “‘keeping government small’ by permitting government to become involved only where necessary services are not being furnished by private enterprise.”⁴³

The trial court judge, in an opinion that the Commonwealth Court adopted in whole on appeal, held that the warranty program violated this provision. In particular, the court held that the program “competes with existing enterprises and provides substantially the same services.”⁴⁴ It did not matter to the court whether the municipality carried out the repairs itself or hired a contractor to do them: if the latter, “[t]he purpose of such a program is to replace the status quo, in which water and sewer lines are repaired by plumbers chosen by the homeowner, with a repair program in which PWSA selects the entity that will provide the repairs.”⁴⁵

Although this decision did not directly address an LSL replacement program, Pittsburgh concluded that the court’s reasoning applied equally to it.⁴⁶ We have not identified analogues of the specific legal doctrine at issue in the *Dominion Products* case in other states, although all of the states examined in this paper have a related doctrine, under which governments can spend public funds only for activities that have a predominantly public purpose, as opposed to a predominantly private purpose.

V. SIX STATES ADOPTING PROACTIVE POLICIES TO EMPOWER COMMUNITIES

Six states—Indiana, Michigan, Missouri, New Jersey, Pennsylvania, and Wisconsin—have taken steps since the tragedy in Flint to remove barriers to the use of ratepayer funds for LSL replacement on private property. Michigan acted through rulemaking, Missouri through a commission decision and the others through legislation. While each state’s journey has been

⁴³ *Dominion Products & Services, Inc.*, 44 A.3d at 705.

⁴⁴ *Id.* at 704.

⁴⁵ *Id.*

⁴⁶ *Theresa Clift*, PWSA Said it Stopped Partial Lead Line Replacements but Kept Doing Them—Now It’s Done for Good, *PITTSBURGH TRIBUNE-REVIEW*, Dec. 21, 2017, <http://triblive.com/local/allegheny/13078697-74/pwsa-said-it-stopped-partial-lead-line-replacements-but-kept-doing-them>.

different, all shared a goal of avoiding the negative public health impacts from partial LSL replacement while allowing rehabilitation of water mains that have traditionally resulted in partial replacements. Although our analysis finds that legislation was not essential in the states we studied, they provide examples of the steps that other states can take to facilitate LSL replacement and reduce exposure to lead in drinking water.

A. Indiana

In April 2017, the same month IURC resolved East Chicago’s proposal discussed above, the Indiana General Assembly enacted HEA-1519,⁴⁷ allowing the IURC to approve an investor-owned utility’s proposal to pay for LSL replacement on private property with ratepayer funds. To qualify, a utility must submit a plan addressing 10 elements and demonstrate that the proposal is reasonable and in the public’s interest.

Pursuant to the new law, in July 2018 the IURC approved a proposal from Indiana American Water to fully replace its estimated 50,000 LSLs on public and private property using rates paid by customers.⁴⁸ In contrast to the East Chicago decision, the OUCC supported the objective of the proposal. Indiana American Water owns 21 community water systems serving more than 700,000 people in the state.⁴⁹

B. Michigan

In June 2018, the Michigan Department of Environmental Quality (MDEQ) overhauled the state’s version of the LCR.⁵⁰ While the changes do not explicitly authorize the use of ratepayer funds to replace the LSLs on private property,

⁴⁷ HEA 1519, 120th Gen. Assemb. (Ind. 2017), codified at Ind. Code § 8-1-31.6-6 (2017), <http://iga.in.gov/legislative/2017/bills/house/1519>.

⁴⁸ Petition of Indiana-American Water Company, Inc. (“Indiana American”) for (1) Approval of its Lead Service Line Plan Pursuant to Ind. Code Chap. 8-1-31.6 and (2) Approval of Associated Changes to Indiana American’s Rules and Regulations for Water Service, Cause No. 45043, 2018 WL 3632515 (Ind. U.R.C. July 25, 2018) [hereinafter, “Indiana-American IURC Approval”], <https://iurc.portal.in.gov/legal-case-details/?id=cf202ede-c405-e811-811c-1458d04eaba0>.

⁴⁹ Based on analysis of active community water systems in EPA’s Safe Drinking Water System Information System (SDIWS) database downloaded from <https://www.epa.gov/enviro/sdwis-search> on July 18, 2018.

⁵⁰ Supplying Water to the Public, Mich. Admin. Code r. 325.10101–325.12820 (Mich. Dep’t of Env’tl. Quality Drinking Water and Mun. Assistance Division June 2018), available at http://dmbinternet.state.mi.us/DMB/ORRDocs/AdminCode/1684_2017-008EQ_AdminCode.pdf.

they do so implicitly by requiring utilities to replace the entire LSL at no cost to the property owner. As discussed in greater detail below, we would expect that compliance with these rules would be sufficient to justify raising water rates to provide the necessary funding. In December 2018, however, the City of Detroit and other municipalities filed a lawsuit challenging the MDEQ rules. The suit alleges that the rules violate the state public purpose requirement, as well as the state constitution’s “Headlee Amendment,” under which a local government must seek voter approval before increasing a charge that constitutes a tax rather than a fee.⁵¹ See discussion in State Summaries below for more details.

C. Missouri

In May 2018, Missouri’s Public Service Commission determined the Missouri American Water Company (MAWC) could continue its LSL replacement program and approved a rate increase for the purpose of infrastructure improvements—including LSL replacement.⁵² For MAWC’s program, the water utility replaces LSLs (owned by MAWC and by customers) when discovered during a water main replacement. MAWC operates 33 community water systems serving more than 400,000 people in the state.⁵³ However, this decision has been challenged in court by the Missouri Office of the Public Counsel.

D. New Jersey

In August 2018, New Jersey’s Governor signed legislation authorizing municipalities to replace “lead-contaminated service connections” (including LSLs) on private property if the work is: 1) an environmental infrastructure project; and 2) funded by loans from either the New Jersey Environmental Infrastructure Trust (NJEIT) or the state’s Department of Environmental Protection (DEP).⁵⁴

⁵¹ Verified Complaint, Oakland Cty. Water Res. v. Mich. Dep’t Env’tl. Quality, Case 2018-____-MZ (Mich. Ct. Cl. Dec. 12, 2018).

⁵² Press Release, Missouri Public Service Commission, New Water and Sewer Rates Filed by Missouri-American Water Company (May 7, 2018), https://psc.mo.gov/WaterSewer/New_Water_and_Sewer_Rates_Filed_by_Missouri-American_Water_Company.

⁵³ Based on analysis of active community water systems in EPA’s Safe Drinking Water System Information System (SDIWS) database downloaded from <https://www.epa.gov/enviro/sdwis-search> on July 18, 2018.

⁵⁴ A.B. 4120, 218th Gen. Assemb. (N.J. 2018), https://www.njleg.state.nj.us/2018/Bills/PL18/114_.PDF.

E. Pennsylvania

Both the Pennsylvania legislature and the state PUC have taken steps to facilitate the use of ratepayer funds for LSL replacement on private property. First, with respect to investor-owned utilities, in May 2017, the PUC approved a modification of the York Water Company's tariff to allow ratepayer funds to be used for LSL replacement on private property.⁵⁵ The York Water Company's system had exceeded the LCR action level, and it, therefore, needed to replace its LSLs. The PUC emphasized that:

[T]he proposed course of action by York Water coordinates the replacement of Company-owned and adjoining customer-owned service lines. As such, delay of customer-owned line replacements can result in a delay of Company-owned replacements, unnecessarily stalling the actions necessary [under the LCR consent order] and potentially harming the health and safety of York Water's customers. The efficiency of this cost minimizes total costs, thereby providing better service to York Water customers, particularly those who might find the total cost of replacing the customer-owned line to be burdensome or too expensive a task to undertake independently.⁵⁶

In October 2018, the state enacted P.L. 2018-120 (HB-2075) to establish a framework for investor-owned utilities to recoup the costs of replacing LSLs on private property from rates paid by all customers. Under the law, the cost is considered "other related capitalized costs that are part of the public utility's distribution system" and the recovery an "equity return rate."⁵⁷ However, the utility must obtain prior approval from the PUC to recoup the cost. The PUC must establish standards, processes, and procedures to: 1) ensure the work is accompanied by a warranty and ensure the utility has access to the property during the warranty; and 2) reimburse customers who have replaced their LSL within one year of commencing a PUC-approved LSL replacement project.

With regard to publicly-owned utilities, which saw themselves as barred from replacing LSLs on private property by the *Dominion Products & Services* decision described above, the

⁵⁵ Order, Pa. PUC, No. P-2016-2577404, Mar. 8, 2017.

⁵⁶ Id. at 6.

⁵⁷ Pa. P.L. 738, No. 120, § 1 (codified at 66 P.S. § 1311(b)), available at <https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2018&sessInd=0&act=120>.

legislature enacted P.L. 2017-44 (HB 674) in October 2017, which allows municipal utilities to "perform the replacement or remediation of private water laterals and use 'public funds' for this purpose if the municipality finds that it 'will benefit the public health, public water supply system or public sewer system.'⁵⁸ Before it uses public funds, the municipality must "consider the availability of public funds, equipment, personnel and facilities and the competing demands of the authority for public funds, equipment, personnel and facilities."

F. Wisconsin

In February 2018, the Wisconsin State Legislature enacted legislation that allows municipalities and water utilities to provide financial assistance to property owners to replace LSLs on private property.⁵⁹ The law enables a utility or municipality to seek approval from the state PSC to provide customers with financial assistance if the following conditions are met:

- The city, town or village has passed an ordinance:
 - Authorizing the assistance; and
 - Requiring each owner to replace customer-side water service lines that contain lead; and
- The utility-side water service line either does not contain lead or will be replaced at the same time as the customer-side; and
- The financial assistance is limited as follows:
 - Grants may not be more than 1/2 of the total cost to property owners;
 - Loans to property owners are not forgivable; and
 - Each owner in a class of customers are treated equally with respect to financial assistance.

The PSC has a webpage describing the program and, in August 2018, approved the first application by a municipality to replace LSLs under the program.⁶⁰

⁵⁸ Pa. P.L. 725, No. 44, § 14 (codified at 72 P.S. § 1719-E), available at <https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2017&sessInd=0&act=44>.

⁵⁹ S.B. 48, 2017 Leg., Reg. Sess. (Wis. 2017), available at <https://docs.legis.wisconsin.gov/2017/proposals/sb48>.

⁶⁰ Public Service Commission of Wisconsin, Lead Service Line (LSL) Replacement, <https://psc.wi.gov/Pages/ForUtilities/Water/Lead-Service-Line.aspx>.

VI. THIRTEEN STATE SURVEY OF LEGAL ISSUES

Because many states have not yet taken the kinds of actions to facilitate the use of ratepayer funds for LSL removal on private property described in the previous section, in this paper we have set out to survey the laws, regulations, and court decisions in 13 key states, including a deeper evaluation of the six mentioned above. In particular, we look at the 12 states that contain 200,000 or more LSLs: Florida (200,000 LSLs); Illinois (730,000); Indiana (290,000); Massachusetts (220,000); Michigan (460,000); Minnesota (260,000); Missouri (330,000); New Jersey (350,000); New York (360,000); Ohio (650,000); Texas (270,000); and Wisconsin (240,000).⁶¹ We also included Pennsylvania (160,000) because of its recent decisions.

For each state, we review a variety of legal issues that may be relevant to the question of whether a particular utility can use ratepayer funds to pay for LSL replacement on private property. These issues include:

- Whether the utility is investor-owned or publicly-owned;
- Whether the utility is subject to regulation by a PUC (or equivalent state agency) or not;
- Whether state law imposes particular limits on the utility’s rates, such as:
 - Allowing utilities to charge only “just and reasonable” rates;
 - Prohibiting “undue discrimination” in utility rates or the granting an “unfair preference” for particular customers;
 - Limiting the utility’s “rate base” to utility-owned property; and
 - Requiring that expenditures by publicly-owned utilities serve a “public purpose.”

Another important, cross-cutting issue is what standard of review a court will apply when reviewing the decision of a utility (when the utility is not regulated by a PUC) or the decision of the PUC.

The results of our survey are provided below in the state-specific summaries. We identify here some of the major themes we found in those surveys and provide some recommendations for advocates.

⁶¹ Estimated number of LSLs based on Cornwell, supra note 13.

A. Publicly-owned vs. Investor-owned Utilities

All of the states in the survey have both publicly-owned and investor-owned utilities. In addition, in every state evaluated, publicly-owned utilities serve a majority of the population (see Table 1). However, there are significant differences among the surveyed states in the percentage of people served by publicly-owned versus investor-owned utilities. Namely, in Florida, Massachusetts, Michigan, Minnesota, New York, Wisconsin, and Texas, less than 10 percent of the population is served by investor-owned utilities, while in Missouri, Ohio, Pennsylvania, and New Jersey the number is below roughly 30 percent. These differences can be helpful in guiding the efforts of those who support using rate funds to replacement LSLs on private property. For example, in states where the vast majority of people receive water from publicly-owned utilities, it makes sense to focus efforts on those utilities. By contrast, in states where the percentage served by publicly-owned utilities is lower, it makes more sense to direct efforts towards both publicly-owned and investor-owned utilities.

Table 1: Percentage of Population Served by Investor-Owned Water Utilities

State	Percentage of Population Served by Investor-Owned Community Water Systems
Minnesota	1.2%
Michigan	2.2%
Massachusetts	2.5%
Wisconsin	2.6%
Texas	3.2%
New York	6.3%
Florida	6.8%
Illinois	10.2%
Indiana	19.6%
Missouri	27.0%
Ohio	29.5%
Pennsylvania	30.2%
New Jersey	37.3%

Based on analysis of active community water systems in EPA’s Safe Drinking Water System Information System (SDIWS) database downloaded from <https://www.epa.gov/enviro/sdwis-search> on July 18, 2018.

In most of the states in the survey, there are significant differences in the ways that publicly-owned and investor-owned utilities are regulated. **First, in most states publicly-owned utilities are exempt from having their rates regulated by the state PUC.** The only exceptions are: (a) as mentioned above, the Wisconsin PSC reviews municipal water utility rates; (b) the New Jersey Board of Public Utilities has jurisdiction over the rates of a publicly-owned utility that serves more than 1,000 customers outside its municipal boundaries and charges different rates to those customers than to customers within its boundaries, and (c) in Texas, if a municipal utility is providing service in an area that is not within the boundaries of any municipality, then the Texas PUC has original jurisdiction over the rates for those customers, and if it is operating within the boundaries of another municipality, then it is presumptively subject to the original jurisdiction of that municipality and the appellate jurisdiction of the Texas PUC.

By contrast, in most states, investor-owned utilities can charge only rates that are approved by a PUC. Only in Michigan and Minnesota are investor-owned utilities exempt from PUC regulation; in those states, investor-owned water utilities are subject to the jurisdiction of the municipality in which they are located. Those two states also have the lowest percentage of investor-owned water utilities. In Florida, Ohio, and Texas, the regulation of investor-owned water utilities is shared between local governments and the state PUC; see the state-specific summaries for the details.

This difference in the regulation of publicly-owned versus investor-owned utilities is important in two related ways. First, it determines the key decision maker and therefore the focus of advocacy efforts. Because publicly-owned utilities are generally not subject to PUC rate regulation, supporters of using rates to fund replacement on private property can focus their efforts on convincing the utility itself to decide to use ratepayer funds for LSL replacement on private property. For investor-owned utilities subject to PUC jurisdiction, advocates need to persuade both the utility itself and the PUC.

Second, it can affect the standard of review a court will apply in reviewing an LSL replacement program. Because municipal utilities are generally not subject to PUC jurisdiction, if someone wants to challenge their rate decisions, that person must file a lawsuit directly in court. In all of the states in the survey, courts apply a deferential standard

of review to publicly-owned utility rate decisions, meaning that they are likely to uphold the utility's decision. By contrast, investor-owned utility rate decisions must first be reviewed by the PUC and only then can be challenged in court. The court will then defer to the PUC's decision rather than the utility's. Thus, as shown by the Madison example above, if a utility decides to spend ratepayer funds on LSL replacement on private property but the PUC rejects those expenditures, the burden will be on the utility in court to overcome the thumb on the scale in favor of the PUC decision. It is therefore potentially harder to get a judicial decision approving such a program for a utility subject to PUC regulation—at least if the PUC itself does not approve the program.

B. Substantive Standards: Just and Reasonable, No Undue Discrimination, No Unfair Preference, Public Purpose

Although the specific wording varies from state to state, the basic standards that a court (and, when applicable, a PUC), will apply in judging a utility's rates are generally similar. First, all utilities are subject to some form of **reasonableness review, usually phrased as asking whether the rates are “just and reasonable.”** Second, most—but not all—utilities are subject to a test that specifically addresses the degree of difference in rates that they are allowed to charge different customers. Typically, this kind of test will ask whether the rates are **unduly discriminatory or provide an unfair preference or disadvantage to any customer.** Third, in all of the states in the survey, **publicly-owned utilities (but not investor-owned ones) must satisfy some form of a test requiring that their expenditures be primarily for public purposes rather than private ones.**

Of the two kinds of tests applicable to both publicly-owned and investor-owned utilities, the first is typically considered to be the more flexible and easier to satisfy. Whether rates are just and reasonable requires the balancing of multiple factors, including whether the overall level of the rates is too high or too low, as well as questions related to differences in rates among customers. Given the deference that courts grant either to the utilities themselves or to the PUC, they should uphold a decision concluding that the use of ratepayer funds for LSL replacement on private property is reasonable, for the reasons articulated in the State Summaries below.

The second type of test is more specifically focused on rate differentials among customers. This type of test might present a greater barrier to using ratepayer funds for LSL replacement on private property. Because not all customers will have LSLs, a challenger could argue that spending ratepayer funds for replacements constitutes undue discrimination among customers or provides an unfair benefit to some customers. Thus, the Wisconsin Court of Appeals in the *Madison* case held that “it is reasonable for the PSC to view the surcharge as subsidizing a direct benefit to a select group of customers.”⁶²

The public purpose test, which applies only to publicly-owned utilities, generally derives from state constitutional provisions. Recognizing that most actions can create both public and private benefits, courts will typically ask whether the public purpose or the private purpose predominates when reviewing a proposed program.

Despite the differences among these types of tests, there are strong arguments that a program of using ratepayer funds to pay for full LSL replacement—including the portions of lines on private property—satisfies all three.

First, the accelerated replacement of LSLs will reduce lead exposure and result in clear public health benefits. There is evidence that reducing early childhood lead exposure results in lower public medical expenses and educational expenses (for example, on special education programs), reduces crime, and otherwise avoids the imposition of significant costs on public budgets.⁶³ The achievement of these benefits are obviously public purposes and would thus satisfy the public purpose doctrine for publicly-owned utilities.

Second, it is generally far cheaper and faster to replace the entire service line for every house along a street or in a neighborhood at once, rather than to do the replacements piecemeal based on individual customers’ willingness to pay. By avoiding delays in the process of LSL replacement,

⁶² *City of Madison v. Pub. Serv. Comm’n*, No. 01-1678, 2002 WL 297643, at *3 (Ct. App. Wis. Feb. 28, 2002).

⁶³ See, e.g., *John Paul Wright, et al.*, Association of Prenatal and Childhood Blood Lead Concentrations with Criminal Arrests in Early Adulthood, 5(5) *PLOS Medicine* e101 (2008); *S.D. Lane, et al.*, Environmental Injustice: Childhood Lead Poisoning, Teen Pregnancy, and Tobacco, 42 *J. Adolescent Health* 43 (2008); *R. Nevin*, How Lead Exposure Relates to Temporal Changes in IQ, Violent Crime, and Unwed Pregnancy, 83 *Envtl. Research* 1 (2000).

as well as by reducing the per-line replacement cost, the use of ratepayer funds thus provides benefits to all customers and serves a predominantly public purpose.

Third, it can promote regulatory compliance and avoid potential liability. By using ratepayer funds, the utility can ensure that it always replaces the entire LSL rather than just part of it, which is more effective at reducing lead levels in water. It will also allow the utility to replace the LSLs faster. Both of these benefits will help a utility avoid exceeding the LCR lead action level or, if it is currently in violation, bring it into compliance faster. The achievement of regulatory compliance benefits all ratepayers because it avoids penalties and additional oversight. Moreover, a city where high levels of lead are detected in homes’ drinking water may face private lawsuits from affected residents. If the utility needs to pay damages to resolve these lawsuits, that could result in higher rates for all ratepayers. Reducing the risk of this outcome by speeding up full LSL replacement is a benefit to all ratepayers.

Fourth, it is reasonable and fair to residents for utilities to use ratepayer funds to replace LSLs on private property when the current homeowners generally played no role in the choice of installing an LSL. All LSLs were installed before the 1986 SDWA ban on lead pipes. In addition, the use of lead in service lines was usually approved, and sometimes mandated, by the water utility or municipality. For example, Chicago’s plumbing code required the use of LSLs until 1986.⁶⁴ Removing a health risk that current homeowners played no role in creating and that is often the result of utility or municipal policy should not be seen as providing a special preference to certain ratepayers but instead as treating them fairly.

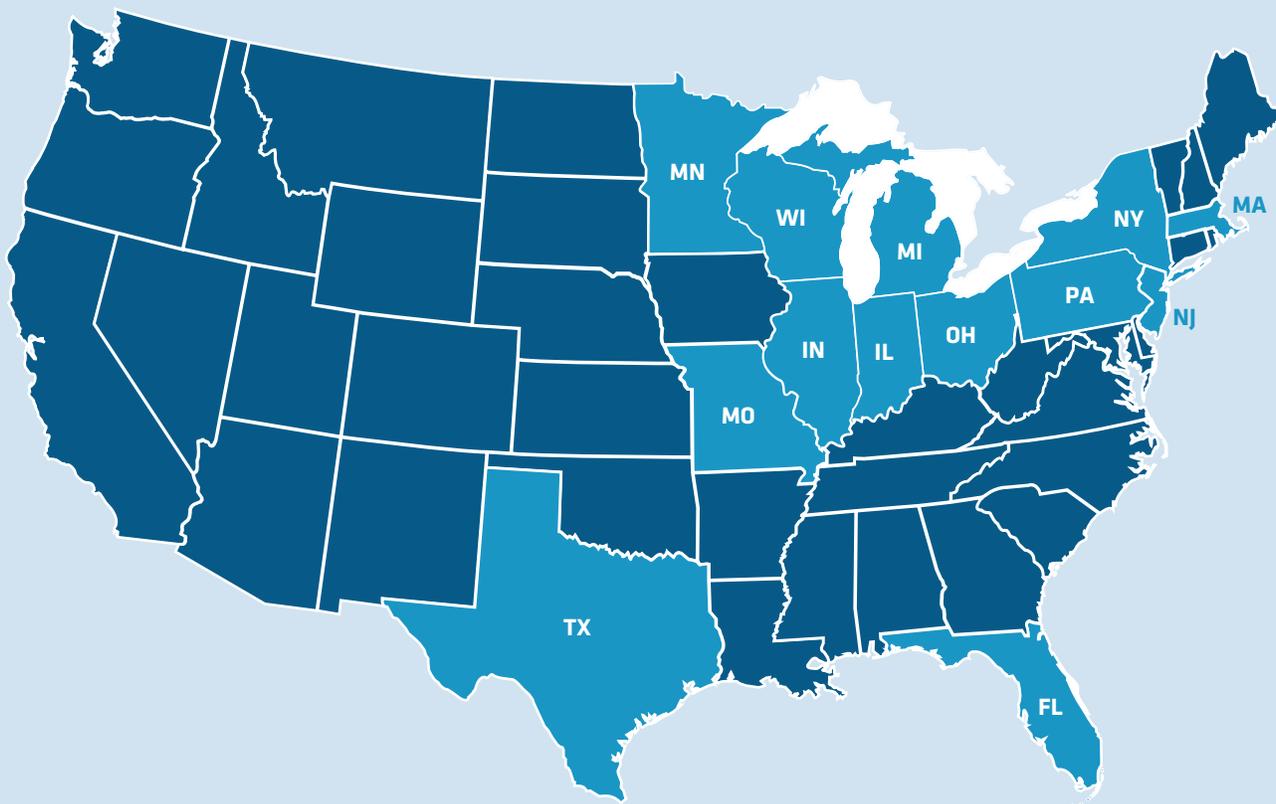
C. The Rate Base Issue

In many states, the PUC or utility is granted flexibility in the methodology it uses to set rates. In others, however—such as Ohio and Texas—state law mandates that rates be based on a combination of (a) a permissible rate of return on property included in the utility’s “rate base” and (b) permissible operating expenses. When required, this approach is a potential barrier to the use of ratepayer funds for LSL replacement on private property, because, if those portions of the lines are privately owned, they might not be considered part of the rate base.

⁶⁴ *City of Chicago Plumbing Code*, 1986.

Nevertheless, there can be strong arguments that even this approach to ratemaking does not prohibit the use of ratepayer funds for LSL replacement on private property. In Texas, for example, the Court of Appeals has held that there may be situations in which facilities are not owned by the utility but nevertheless could be included in the rate base if they are “used and useful” to the utility. *Texas Water Comm’n v. Lakeshore Util. Co.*, 877 S.W.2d 814, 821 (Tex. App. 1994). In Ohio, the state Supreme Court recently upheld a decision of the PUC that allowed a utility to use ratepayer funds for the environmental remediation of the sites of manufactured-gas plants that had not been operational for decades. *In re Application of Duke Energy Ohio, Inc.*, 82 N.E.3d 1148 (Ohio 2017). The court upheld the state commission’s decision to allow these costs as operating expenses rather than as capital expenditures included in the rate base. *Id.* at 1153.

STATE SUMMARIES



This paper focuses on 13 key states:

Florida

Illinois

Indiana

Massachusetts

Michigan

Minnesota

Missouri

New Jersey

New York

Ohio

Pennsylvania

Texas

Wisconsin

FLORIDA



Est. No. of LSLs ⁶⁵	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
200,000	6.8%	Likely	Uncertain but likely	County approval needed in 29 of 67 counties.

⁶⁵ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Publicly-owned utilities are not regulated by the Florida Public Service Commission (FPSC). While these utilities must charge “just and equitable” rates, courts grant strong deference to the municipality’s legislative role in rate setting. Courts are also very deferential to a municipality’s determination that an expenditure serves a public purpose. Thus, unless clearly unjust and unreasonable, an LSL replacement program utilizing ratepayer funds would likely be possible.

Neither the statutes nor case law in Florida provide clear authority for investor-owned water utilities to use ratepayer funds to pay for LSL replacement on private property. A utility interested in using ratepayer funds for this purpose would therefore need to seek approval from either the FPSC or the county in which it is located. Because the FPSC or county are not limited to a pure cost of service basis for rates, it is possible that they could conclude that under their “very broad authority in determining rates,” they can allow utilities to use ratepayer funds for LSL replacement on private property. Although this use of ratepayer funds likely does not qualify as a capital expenditure on used-and-useful utility property, the FPSC or county still has discretion to approve it as an operating expense. If they did so, the courts would likely defer to the FPSC or county’s judgment.

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

Water utilities operated in Florida by municipalities, counties, regional water supply districts, or special districts are not subject to the jurisdiction of the FPSC. Fla. Stat. § 367.022(2).

B. Substantive Standards: “Just and Equitable”

Both county and municipal utilities can only charge rates that are “just and equitable.” For counties, Flat. Stat. § 153.11(c) provides that the rates:

shall be just and equitable and may be based or computed upon the quantity of water consumed and/or upon the number and size of sewer connections or upon the number and kind of plumbing fixtures in use in the premises connected with the sewer system or upon the number or average number of persons residing or working in or otherwise connected with such premises or upon any other factor affecting the use of the facilities furnished or upon any combination of the foregoing factors.

Fla. Stat. § 153.11(c) (emphasis added). For municipalities,⁶⁶ the statute provides only that they “may establish just and equitable rates or charges to be paid to the municipality for the use of the utility by each person, firm or corporation whose premises are served thereby.” Fla. Stat. § 180.13(2).

The Florida courts are very deferential when reviewing the rates set by county or municipal utilities. In *I-4 Commerce Ctr., Phase II, Unit 1 v. Orange City.*, the court held that “in setting utility rates, governments agencies enjoy a significant degree of latitude,” and a government entity “may charge different rates to different classes of users so long as the classifications are not arbitrary, unreasonable, or discriminatory.” 46 So. 3d 134, 136 (Fla. Dist. Ct. App. 2010) (citing *City of Gainesville v. State*, 863 So. 2d 138, 147 (Fla. 2003)). Therefore, it is possible that a court, in applying this deferential standard, would uphold a county or municipality’s decision to use ratepayer funds to pay for the replacement of LSLs on private property.

C. Public Purpose Doctrine

The Florida Constitution provides that: “[n]either the state nor any county, school district, municipality, special district, or agency of any of them, shall become a joint owner with, or stockholder of, or give, lend or use its taxing power or credit to aid any corporation, association, partnership or person.” Fla. Const. art. VII, § 10. In applying this provision, the Florida courts require “a paramount public purpose with only an incidental private benefit.... If, however, the benefits to a private party are themselves the paramount purpose of a project, then the bonds will not be validated even if the public gains something therefrom.” *Orange Cty. Indus. Dev. Auth. v. State*, 427 So. 2d 174, 179 (Fla. 1983). Thus, in one case, the Florida Supreme Court rejected the issuance of bonds to fund the acquisition of land for and construction of a privately-owned television studio. *Id.*

In general, however, the Florida courts are deferential in their review of public purpose determinations, holding that a legislative decision that a project serves a public purpose, “while not conclusive, is presumed valid and should

⁶⁶ For purposes of this provision, the statute defines “municipality” to include “any city, town, or village duly incorporated under the laws of the state.” Fla. Stat. § 180.01.

be upheld unless it is arbitrary or unfounded unless it is so clearly erroneous as to be beyond the power of the legislature.” *State v. Miami Beach Redevelopment Agency*, 392 So.2d 875, 886 (Fla. 1980). For example, in one recent case, the Florida Supreme Court upheld the use of public funds for a beach renourishment project even though private property owners adjacent to the project would receive a special benefit from it. Those special benefits did

not convert beach restoration into a project that in terms of direct, actual use, is purely a private enterprise. Beach and shore preservation projects confront a critical threat to the welfare of the people of this state. Those special benefits that flow incidentally to certain properties because of the nature of the project do not diminish its predominantly public character.

Donovan v. Okaloosa Cty., 82 So. 3d 801, 811 (Fla. 2012) (citations and internal quotation marks omitted).

In an earlier case, the Court upheld the use of public money to pay for the construction of a football stadium for an NFL team. *Poe v. Hillsborough Cty.*, 695 So. 2d 672 (Fla. 1997). The court held that the development of tourism and recreational facilities served a public purpose and that an incidental private benefit did not render the bond issue improper as long as the public purpose predominated. In a third case, the Court upheld the issuance of bonds by a water control district to pay for road improvements in a limited-access private development, highlighting that the roads would be publicly-owned and that “the District’s Board of Supervisors adopted a resolution stating that the designation of roads for the exclusive use and benefit of Unit 31 is a public purpose ‘in the best interest of the health, safety, and general welfare of these areas and their inhabitants, visitors, property owners and workers.’” *N. Palm Beach Cty. Water Control Dist. v. State*, 604 So. 2d 440, 442 (Fla. 1992).

The public purposes of an LSL replacement program (protecting public health, ensuring regulatory compliance, and reducing costs) seem at least as predominant as those upheld in these cases. The one cause for concern is that in all of the cases described above, the relevant property (the beach, stadium, and roads) was owned by the government, whereas here the portions of the LSLs on private property may be privately owned.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission or County Approval

Investor-owned utilities in Florida are regulated either by the FPSC or by the government of the county in which they are located. Under Fla. Stat. § 367.171(1) county governments have the option of either regulating the rates, services, and territory of investor-owned water companies within their jurisdiction or ceding such jurisdiction to the FPSC. According to the FPSC, it currently exercises jurisdiction over 38 of the state's 67 counties and does not have jurisdiction over the remaining 29.⁶⁷

If a utility is regulated by the FPSC, it may charge only rates that have been approved by the commission. Fla. Stat. § 367.081(1); see also Fla. Stat. § 367.091(4). “The burden of proof in ratemaking cases in which a utility seeks an increase in rates rests on the utility.” *Fla. Pub. Serv. Comm’n v. Fla. Waterworks Ass’n*, 731 So. 2d 836, 841 (Fla. Dist. Ct. App. 1999). If instead a utility is regulated by the county, then it may charge only rates that have been approved by the county. Fla. Stat. § 367.171(8) (providing that when setting rates for a private water utility, “the county or its agency shall proceed as though the county or agency is the commission”).

B. Substantive Standards: Just, Reasonable, Compensatory, and Not Unfairly Discriminatory

For utilities subject to its jurisdiction, the FPSC must establish rates that are “just, reasonable, compensatory, and not unfairly discriminatory.” Fla. Stat. § 367.081(2)(a). Utilities under the jurisdiction of a county are held to the same standard. Fla. Stat. § 367.171(8). The factors that the FPSC or county must consider when setting rates include:

the value and quality of the service and the cost of providing the service, which shall include, but not be limited to, debt interest; the requirements of the utility for working capital; maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service;

⁶⁷ FPSC, PSC Jurisdictional and Non-jurisdictional Counties, <http://www.psc.state.fl.us/Files/PDF/Utilities/WaterAndWastewater/wawtex-chart.pdf>.

and a fair return on the investment of the utility in property used and useful in the public service.

Id. The Florida courts have held that under this statutory language, “[t]he Legislature has given the PSC very broad authority in determining rates.” *S. States Utilities v. Fla. Pub. Serv. Comm’n*, 714 So. 2d 1046, 1051 (Fla. Dist. Ct. App. 1998). In one case, in upholding the FPSC’s decision to set equivalent rates for a utility across multiple service areas, the Florida District Court of Appeals held that “a pure cost of service basis as to each individual ratepayer [is not] mandated by a statute which directs that ‘the commission shall consider the value and quality of service and the cost of providing service.’” *S. States Utilities*, 714 So. 2d at 1053 (quoting Fla. Stat. § 367.081(2)). Because the FPSC or county is not limited to a pure cost of service basis for rates, it is possible that they could conclude that under their “very broad authority in determining rates,” they can allow utilities to use ratepayer funds for LSL replacement on private property. If they did so, the courts would likely defer to their judgment.

C. Inclusion of LSLs on Private Property in Rate Base

Under existing regulations and FPSC decisions, it is unlikely that the portions of LSLs on private property could be included in a utility’s rate base as property used and useful. Therefore, to be approved by the FPSC, the cost of replacing these portions of the lines would need to be counted as an operating expense.

As indicated above, a utility’s rates can include “maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service.” A Florida statute defines the “system” of a water utility to be the “facilities and land used or useful in providing service.” Fla. Stat. Ann. § 367.021(11). The FPSC’s regulations in turn provide that utilities “shall operate and maintain in safe, efficient and proper condition all of the facilities and equipment used in connection with... the distribution, regulation, measurement and delivery of water service to the customer up to and including the point of delivery into the piping owned by the customer.” Fla. Admin. Code Ann. r. 25-30.231 (emphasis added).⁶⁸ “Point of delivery,”

⁶⁸ Similarly, another regulation provides that “[e]ach utility which provides both water and wastewater service shall operate and maintain in safe, efficient, and proper condition, all of its facilities to the point of delivery.” Fla. Admin. Code Ann. r. 25-30.225(7).

in turn, is defined as “the outlet connection of the meter for metered service or the point at which the utility’s piping connects with the customer’s piping for non-metered service.” Fla. Admin. Code Ann. r. 25-30.210(7).

In one proceeding, the FPSC investigated the rates of a utility, some of whose customers were experiencing “black water” caused by the corrosion of copper service lines. *In Re Investigation of Util. Rates of Aloha Utilities, Inc. in Pasco Cty.*, 960545-WS, 2000 WL 1100324 (July 14, 2000). The Commission observed that “the only known way to completely eliminate the black water problem is to repipe the homes with CPVC or a material other than copper.” *Id.* at *14. The FPSC considered whether the utility should offer customers a rebate or a low-cost loan to pay for the replacement of the copper service lines. Citing the regulations quoted above, the Commission held that:

Because the utility’s responsibility ends at the meter, we cannot require the utility to offer low cost loans or rebates for the purpose of repiping customers’ homes. However, we note that, if the utility were to propose a financial incentive program to the customers for repiping, we could review the recovery of the associated program costs for appropriateness.

Id. at *15. In other words, it determined that because the portions of the service lines on private property were not part of the water system for which the utility was responsible, the FPSC could not mandate that the utility pay for their replacement. However, it left open the possibility that if the utility itself proposed to use ratepayer funds for the replacement, it might determine on a case-by-case basis that this use constituted a reasonable operating expense.

ILLINOIS



Est. No. of LSLs ⁶⁹	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
730,000	10.2%	Likely	Uncertain but likely	2017 law suggests support. ⁷⁰

⁶⁹ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass’n E182, E182 (2016).

⁷⁰ S.B. 550, 99th Gen. Assemb., Reg. Sess. (Ill. 2015), available at <http://www.ilga.gov/legislation/publicacts/99/099-0922.htm>.

Publicly-owned utilities, which are not regulated by the Illinois Commerce Commission (“ICC”), have broad authority to determine their own rates, limited by the requirement that any rate structure cannot result in excessive or unreasonably discriminatory rates. In addition, the charters of individual municipalities may impose greater restrictions on municipal utilities’ ability to pay for LSL replacement on private property.

Illinois has no express statutory prohibitions on utilities using rate revenue to pay for LSL replacement on private property. Although statutory requirements, such as 220 Ill. Comp. Stat. Ann. §5/9-241,⁷¹ seem to limit the ability of the ICC to use ratepayer funds for an LSL replacement project, courts have given the Commission’s decision-making great deference.

While not directly related to LSL replacement, in 2017, the Illinois General Assembly enacted Public Law 099-0922 that may provide support for use of rate revenue for lead-related activities that take place on property that is not owned by the utility.⁷² While the relevant provisions address lead in drinking water at schools, 225 Ill. Comp. Stat. Ann. 320/35.5 (c)(6) enables utilities to pay for laboratory analysis for lead of drinking water samples collected by

⁷¹ 220 Ill. Comp. Stat. Ann. § 5/9-241 (2019).

⁷² S.B. 550, 99th Gen. Assemb., Reg. Sess. (Ill. 2015), supra note 70.

schools to comply with provisions of the law and to recover those costs in its rates.⁷³ The ICC is directed by 220 Ill. Comp. Stat. Ann. 5/9-246 to “allow the [investor-owned] utility to recover annually any reasonable costs incurred by the utility to comply with” the new school testing requirements.⁷⁴ More generally, section 35.5(a) states that “[t]he General Assembly also finds that infants and young children may suffer adverse health effects and developmental delays as a result of exposure to even low levels of lead,” which would support a finding that LSL replacement in private property serves a public purpose.⁷⁵

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

The ICC does not regulate utilities that are owned and/or operated by any political subdivision or municipal corporation of a state. The ICC has authority only over “public utilities,” and 220 Ill. Comp. Stat. Ann. § 5/3-105(b)(1) provides that “a public utility does not include public utilities that are owned or operated by any political

⁷³ 225 Ill. Comp. Stat. Ann. § 320/25.5(c)(6) (2019).

⁷⁴ 220 Ill. Comp. Stat. Ann. § 5/9-246 (2019).

⁷⁵ 225 Ill. Comp. Stat. Ann. § 320/25.5(a) (2019).

subdivision, institutions of higher education or municipal corporation of this State.”⁷⁶ Although municipally-owned utility systems are self-regulating, their rates are still subject to review by the courts. See *Springfield Gas & Electric Co. v. City of Springfield* (1920), 292 Ill. 236, 126 N.E. 739; *Conner v. City of Elmhurst* (1963), 28 Ill.2d 221, 190 N.E.2d 760).⁷⁷

B. Substantive Standards: Just and Reasonable and No Unreasonable Discrimination

Municipalities that elect to operate a joint waterworks and sewage system may charge customers a reasonable compensation for the use and service of the combined systems. “A municipality, such as the city, which sells water, does so in a proprietary rather than in a governmental capacity.” *Vill. of Niles v. City of Chicago*, 401 N.E.2d 1235, 1240 (Ill. App. Ct. 1980). As such, a municipal utility “is subject to the same rules that would apply to a investor-owned utility, including those forbidding unreasonableness and discrimination in utility rates.” *Id.* (citations omitted).

However, not all rate discrimination is prohibited. Instead, “when the reasonableness of the rates is challenged...the challengers must demonstrate convincingly that they are being charged a discriminatorily high rate or one that exceeds the cost of service to the point of unreasonableness. *Id.* at 1341. The court further concluded that “if the rates charged to plaintiffs are not excessive, there is no unreasonable discrimination.” *Id.* at 1342.

When a plaintiff argues that a difference in rates is discriminatory, the court asks “whether the difference is reasonable, and not arbitrary, based on a consideration of such factors as differences in the amount of the product used, the time when used, the purpose for which used, or any other relevant factors reflecting a difference in costs.” *Austin View Civic Ass’n v. City of Palos Heights.*, 405 N.E.2d 1256, 1265 (Ill. App. Ct. 1980). The courts sometimes

⁷⁶ 220 Ill. Comp. Stat. Ann. § 5/3-105(b)(1) (2019).

⁷⁷ Townships are granted authority to construct and operate waterworks or wastewater utility under 60 Ill. Comp. Stat. Ann. § 1/205-10 (2019). They are not regulated by the ICC and are not statutorily limited as to what type of rate structure they may use, nor are there any limiting terms that require rates to be non-discriminatory or reasonable. See 60 Ill. Comp. Stat. Ann §1/205-70 (2019).

phrase this test as asking whether the municipality has provided a rational basis to explain its choice. *Id.* Thus, though there is no statute that prevents municipal corporations that operate public utilities from acting in an unreasonably discriminatory manner, there is still the common law duty that prevents them from doing so.

Note that if an additional rate charge is imposed as a tax, it offends the uniformity requirement of Article IX of the constitution unless it can be regarded as a special assessment or special tax. (Const., art. IX, secs. 1, 9, S.H.A.). See *Conner v. City of Elmhurst*, 28 Ill. 2d 221, 227, 190 N.E.2d 760, 764 (1963).

C. Public Purpose Requirement

The Illinois Constitution mandates that the state government and its subdivisions may use public funds only for a public purpose.⁷⁸ This requirement is not overly burdensome, however, because the state’s courts have determined that a public purpose is “not a static concept but is flexible and capable of expansion to meet the changing conditions of a complex society.” *In re Marriage of Lappe*, 176 Ill. 2d 414, 430, 680 N.E.2d 380, 388 (1997). A public purpose is one that “serves the public interest and benefits a private individual or corporation only incidentally.” *City of Rolling Meadows v. Nat’l Advert. Co.*, 593 N.E.2d 551, 558 (Ill. App. Ct. 1991).

Moreover, the Illinois courts defer to legislative judgments about what counts as a public purpose:

[W]hat is for the public good and what are public purposes are questions which the legislature must in the first instance decide. In making this determination, the legislature is vested with a broad discretion, and the judgment of the legislature is to be accepted in the absence of a clear showing that the purported public purpose is but an evasion and that the purpose is, in fact, private.

Lappe, 176 Ill. 2d at 429–30, 680 N.E.2d 380 (citations omitted).

Thus, in the *Lappe* case, the Illinois Supreme Court held that expending public funds on child support enforcement services such as assisting “custodial parents in locating absent parents, establishing parentage, and establishing, enforcing and collecting support obligations” satisfied the public purpose

⁷⁸ Ill. Const. art. VIII, § 1(a), (b).

requirement. *Id.* at 431. The court explained that “the provision of these services clearly serves the public purpose of advancing the welfare of children by enforcing a child’s right to be supported by his parents, fostering parental responsibility and parental involvement with the child, and preventing the child and custodial parent from having to turn to welfare.” *Id.*

In another case, the court held that a surcharge on riverboat casinos, the proceeds of which would be distributed to horse racing tracks, did not violate the public purpose requirement because “the principal purpose of the Act is a public one: to stimulate economic activity, including the creation and maintenance of jobs and the attraction and retention of sports and entertainment, particularly betting on horse racing.” *Empress Casino Joliet Corp. v. Giannoulas*, 231 Ill. 2d 62, 88–89, 896 N.E.2d 277 (2008). Under these cases, it seems likely that the Illinois courts would accept that spending public funds on the replacement of LSLs on private property is a public purpose, based on the arguments outlined in the introduction.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

The ICC regulates investor-owned water companies in Illinois. Under 220 Ill. Comp. Stat. Ann. 5/4-101, ICC has the role of supervising investor-owned water and wastewater companies, as well as of examining such companies and keeping informed of their “general condition, their franchises, capitalization, rates and other charges.”⁷⁹ Investor-owned water utilities must file their proposed rates with the ICC and obtain its approval.⁸⁰

B. Substantive Standards: Just and Reasonable and No Undue Preference

The Public Utilities Act requires that rates charged by ICC-regulated utilities be “just and reasonable.”⁸¹ In addition, the act prohibits any commission-regulated utility from “making or granting, with respect to rates or charges, any preference or advantage to any corporation or person to any prejudice or disadvantage.”⁸²

⁷⁹ 220 Ill. Comp. Stat. Ann. 5/4-101 (2019).

⁸⁰ 220 Ill. Comp. Stat. Ann. 5/9-201 (2019).

⁸¹ 220 Ill. Comp. Stat. Ann. 5/9-101 (2019).

⁸² 220 Ill. Comp. Stat. Ann. 5/9-241 (2019).

The Illinois Supreme Court has held that to be “just and reasonable,” the rates of an investor-owned utility cannot “exceed the value of service to the consumer,...and...can never be made by compulsion of public authority so low as to amount to confiscation.” See *Iowa-Illinois Gas and Elec. Co. v. Illinois Commerce Comm’n*, 167 N.E.2d 414, 419 (Ill. 1960). In the same case, however, the court held that “[t]he power to make rates, of necessity, requires the use pragmatic adjustments which may be called for by the particular circumstances.” *Id.* at 117. This standard leaves the ICC with the flexibility to approve rates that vary from a strict cost-of-service basis.

The test to determine whether rate discrimination has occurred is “whether the differential treatment is reasonable and not arbitrary.” See *City of Chicago v. Illinois Commerce Comm’n* 666 N.E.2d 1212, 1216 (Ill. App. Ct. 1996). “[T]he Public Utilities Act does not prohibit, *per se*, differences as to the rates that a utility charges its various customers classes. The Act only prohibits ‘unreasonable differences’ in customer class rates.” *Air Prod. & Chemicals Co. v. Illinois Commerce Comm’n*, 2016 IL App (5th) 140266-U, ¶¶ 71.

C. Inclusion of LSLs on Private Property in Rate Base

In Illinois, “[t]he amount that a utility is permitted to recover from its customers in the rates it charges is determined by its revenue requirement. A company’s revenue requirement is the sum of a company’s operating costs and the rate of return on its invested capital.” *City of Chicago*, 666 N.E.2d at 1219. “The Commission, in any determination of rates or charges, shall include in a utility’s rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.”⁸³ The Illinois courts appear to assume that something can be included in the rate base only if it is owned by the utility. *Union Elec. Co. v. Illinois Commerce Comm’n*, N.E.2d 510, 514 (Ill. 1979) (“[T]his court has held that the Commission must use a rate base which represents the fair value of *the utility’s property*.”) (emphasis added). Therefore, LSL replacement on private property cannot be treated as a capital expense unless the utility owns that portion of the line. Instead, it would have to be treated as an operating expense.

⁸³ 220 Ill. Comp. Stat. Ann. 5/9-211 (2019).

D. Standard of Review

“[A]ny person or corporation affected” by a decision of the ICC can appeal it in court.⁸⁴ When reviewing ICC decisions, the courts in Illinois have generally given the Commission broad latitude to set rates. The Supreme Court in the recent case *People ex rel. Madigan v. Illinois Commerce Comm’n*, 25 N.E.3d 587, 594 (Ill. 2015), stated that a court’s “authority is [not only] deferential by statute, but it is also by nature. Simply put, we are judges, not utility regulators.” Because “the determination of rates is not a matter of formulas but one of sound business judgment,” “[d]eference to the Commission is especially appropriate in the area of fixing rates.” *Id.* at 595 (citations and internal quotation marks omitted); see also *Central Illinois Public Service Co. v. Illinois Commerce Comm’n*, 610 N.E.2d 1356, 1372 (Ill. App. Ct. 1993) (“Because of its complexity and need to apply informed judgement, rate design is uniquely a matter for the Commission’s discretion.”). Therefore, when reviewing rates fixed by the ICC, the Illinois courts will consider the Commission’s decision “prima facie reasonable” and will accord deference to the ICC’s interpretation of the Public Utilities Act. *Madigan*, 25 N.E.3d at 594. As a result, whatever decision the ICC reaches on a utility’s proposal to spend ratepayer funds on LSL replacement on private property will probably be upheld in court.

⁸⁴ 220 Ill. Comp. Stat. Ann. 5/10-201(a) (2019).

INDIANA



Est. No. of LSLs ⁸⁵	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
290,000	19.6%	Likely	Definite	2017 law provides path. ⁸⁶ Commission approved one proposal in July 2018. ⁸⁷

⁸⁵ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

⁸⁶ HEA 1519, 120th Gen. Assemb. (Ind. 2017), codified at Ind. Code § 8-1-31.6-6 (2017).

⁸⁷ Indiana-American IURC Approval, supra note 48.

Most municipally-owned water utilities in Indiana can set their rates without oversight by the Indiana Utility Regulatory Commission (IURC). Regardless of whether a municipal utility's rate-making authority is under the purview of the IURC or local control, the utility must charge rates that are "nondiscriminatory, reasonable, and just." Importantly, in the Commission's April 26, 2017 Order concerning the East Chicago Settlement, the IURC appeared open to balancing "concerns over ratepayer funding of customer-owned infrastructure [i.e., LSLs]" with long-term health benefits of replacement when determining whether project funding was reasonable, just, and in the public interest.⁸⁸

In April 2017, Indiana enacted House Enrolled Act 1519 (codified at Ind. Code § 8-1-31.6-6), which allows the IURC to approve an investor-owned water utility's proposal to pay for LSL replacement on private property with ratepayer funds "if the commission finds the plan to be reasonable and in the public interest." Ind. Code § 8-1-31.6-6(b).⁸⁹ On July 25, 2018, the IURC approved Indiana-American Water Company's plan to replace

⁸⁸ East Chicago Settlement Approval, supra note 37.

⁸⁹ A "water utility," subject to this section, means a "public utility (as defined in IC 8-1-2-1(a)) that provides water service to the public." Ind. Code § 8-1-31.6-4. Accordingly, this section does not apply to municipally-owned utilities.

approximately 50,748 LSLs over a 10-24 year period using ratepayer funding.⁹⁰ With such statutory provisions in place, additional LSL replacement projects are likely to be submitted in the future by investor-owned utilities. As long as the IURC approves such LSL replacement plans, courts will likely defer to the Commission's expertise.

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

By default, the rates municipally-owned water utilities are subject to IURC review and approval. Ind. Code § 8-1.5-3-8(f); see also *Burke v. Town of Schererville*, 739 N.E.2d 1086, 1093 (Ind. Ct. App. 2000) ("Pursuant to IC 8-1.5-3, et seq., the IURC has exclusive jurisdiction to approve a municipality's water rates and charges."). A municipality may, however, elect to withdraw from IURC oversight. Ind. Code § 8-1.5-3-9(b). At this time, 366 municipal water utilities have withdrawn from IURC oversight, leaving only 26 subject to its jurisdiction.⁹¹

⁹⁰ Indiana-American IURC Approval, supra note 47, at *10.

⁹¹ Municipal Utilities—A Brief Regulatory Overview, INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR, <https://www.in.gov/oucc/2720.htm>.

B. Substantive Standards: “Nondiscriminatory, Reasonable, and Just”

Regardless of whether a municipal utility is under the purview of the IURC or local control, the rates and charges made by a municipality for services rendered “must be nondiscriminatory, reasonable, and just.” Ind. Code § 8-1.5-3-8(b). “Reasonable and just rates and charges for services” are defined as rates and charges that produce sufficient revenue to: (1) pay all the legal and other necessary expenses incident to the operation of the utility;⁹² (2) provide a sinking fund for the liquidation of bonds or other obligations, including leases; (3) provide a debt service reserve for bonds or other obligations, including leases, in an amount established by the municipality, not to exceed the maximum annual debt service on the bonds or obligations or the maximum annual lease rentals; (4) provide adequate money for working capital; (5) provide adequate money for making extensions and replacements to the extent not provided for through depreciation; and (6) provide money for the payment of any taxes that may be assessed against the utility. *Id.* § 8-1.5-3-8(c). Furthermore, rates and charges must be sufficient to maintain the utility “in a sound physical and financial condition to render adequate and efficient service.” *Id.* § 8-1.5-3-8(d).

With regard to the nondiscrimination standard, Indiana courts have held that “bright-line adherence to such language would render many utility rates invalid and compel our utility rate-making scheme unworkable.” *Office of Util. Consumer Counselor v. Bd. of Directors for Utilities of the Dep’t of Pub. Utilities of the City of Indianapolis*, 678 N.E.2d 1127, 1129 (Ind. Ct. App. 1997). Accordingly, the Public Service Commission Act “does not prohibit differing rates for differing types of service, but rather proscribes unreasonable differences or unjust discrimination. It is only unreasonable differences in rates between customers or classes of customers that violate this statute.” *Id.* (quoting *Capital Improvement Bd. of Managers of Marion Cty. (Convention Ctr.) v. Pub. Serv. Comm’n*, 375 N.E.2d 616, 633 (1978)). Whether the IURC

⁹² Expenses incident to the operation of the utility include maintenance costs, operating charges, upkeep, repairs, depreciation, interest charges on bonds or other obligations, and costs associated with the acquisition of utility property under section 8-1.5-2. Ind. Code § 8-1.5-3-8(c)(1).

views ratepayer funding for replacement of customer-owned lead lines to be unjust and unreasonable discrimination is seemingly dependent on the impact on customer water rates.

As noted above, most municipal water utilities in Indiana are not subject to IURC review of their rates. For these utilities, the courts will apply the deferential standard described above.

For the 26 municipal water utilities subject to IURC rate review, the main indication of the IURC’s approach to this issue is in its April 26, 2017 approval of the East Chicago Settlement. In the East Chicago Settlement, the City developed capital for an LSL replacement program by doubling the \$1.3 million cost in the utility’s original application to the State Revolving Fund (SRF) to arrive at a total cost of \$3.1 million.⁹³ This proposal increased the principal of the 2017 SRF bond issue from \$14.9 million to \$18 million. However, because the interest rate was reduced from 2.0% to 0.5742%, the total cost of the debt remained the same. In its review of this funding, the IURC asserted that it was “clear that all ratepayers will be paying debt service on the proposed \$18 million in financing, which includes funding for replacement of customer-owned lines.”⁹⁴ The IURC noted, however, that “with the lower interest rate offered by SRF to apply to the entire debt issuance,... it would be short-sighted for [the] Commission to ignore the potential benefits of replacing customer-owned lead infrastructure in light of the health concerns that were raised.”⁹⁵ The Commission concluded that:

Ultimately, our decision in this Cause is to determine whether the Settlement is in the public interest. The Subsidization Program addresses a public health concern over heightened lead levels, both in the environment and in drinking water, for a number of residential customers. Because the inclusion of the Subsidization Program has no impact on the water rates applied to customers, due both to the lower interest rate provided for the debt issuance that includes the Subsidization Program and Petitioner’s commitment to offset any change in debt service with adjustments to its proposed PILT and/or depreciation expense, we find that public interest requires the Subsidization Program should be included in the capital projects that will be funded by the debt issue.⁹⁶

⁹³ See East Chicago Settlement Approval, *supra* note 37, at *15.

⁹⁴ *Id.* at *20.

⁹⁵ *Id.*

⁹⁶ *Id.*

This finding suggests that the IURC views ratepayer funding for replacement of customer-owned lead lines to be in the public interest and nondiscriminatory so long as the impact on customer water rates is not discernable. It is unclear from this decision, however, whether the IURC would take the same view of an increase in rates separate from what customers would have paid without an LSL replacement program.

C. Standard of Review

Indiana courts are very deferential when reviewing rates set by municipal utilities. When municipal utilities have removed themselves from the jurisdiction of the IURC, courts have found that cities, in support of their rate increases, are not limited to methodologies generally accepted by the IURC. *In re City of Clinton*, 707 N.E.2d at 809-810. Furthermore, as with the IURC, courts have refused to substitute the expert findings of a government body with that of the judiciary. See *City of Indianapolis v. Nickel*, 165 Ind. App. 250, 265 (1975). Accordingly, as long as there is sufficient evidence to find that a municipal utility's rates and charges are "nondiscriminatory, reasonable, and just," courts will defer to the city's judgment.

D. Public Purpose Doctrine

Under Ind. Const. Art. 1, sections 1 and 21, a local government may expend public funds for private benefit as long as there is a valid public purpose. The standard of review to determine if legislation is a valid exercise of police powers for a public purpose was set forth in *Department of Financial Institutions v. Holt*, 231 Ind. 293, 302 (1952), where the court held that: "If the law prohibits that which is harmless in itself, or if it is unreasonable and purely arbitrary, or requires that to be done which does not tend to promote the health, comfort, morality, safety or welfare of society, it is an unauthorized exercise of power."

Under this standard, Indiana courts have given great deference to legislative judgments about what counts as a public purpose. For example, an Indiana court upheld an act authorizing the use of state funds to provide suitable housing for low and middle income Indiana residents:

That the legislature has power to protect public health, safety, morals, and welfare, and to exercise

and to authorize the exercising of the power of taxation and eminent domain, and the raising and expenditure of public funds for such purposes, cannot be doubted.... The facts found by the legislature and recited in the enactments are not disputed, or their existence denied, and, since the conditions described must be assumed to exist and to affect the public welfare, it can scarcely be doubted that there is a public interest which justifies the undertaking of the projects authorized by the enactments.... If such dwellings are a menace to the public, and their replacement necessary for the protection of the public, there is a sufficient basis for the expenditure of public funds. The amount, and manner, and method of the expenditure, unless it be shown to be entirely unreasonable, must be left to the legislative discretion.... The right to secure the benefits of such projects for the public generally cannot be denied because incidental special benefits may accrue to some individuals.

Steup v. Indiana Hous. Fin. Auth., 273 Ind. 72, 81-82 (1980) (quoting *Edwards v. Hous. Auth. of City of Muncie*, 215 Ind. 330, 335-337 (1939)). The court continued:

It requires little evidence and less imagination to realize the effect upon communities and the state generally when housing is inadequate and substandard. The lack of adequate housing underlies many of the problems suffered by a state.... All citizens are then called upon to bear the cost of combating the evils which are inevitable in the absence of good, adequate, clean, and financially possible housing. Nothing could be more of a public purpose....

How the funds are disbursed is not the critical issue, but rather whether the object for which it serves is a public purpose. The test is in the end result, not in the means.... A law may serve the public interest although it benefits certain individuals or classes more than others.

Id. at 82 (quoting *State ex rel. Douglas v. Nebraska Mortg. Fin. Fund*, 204 Neb. 445, 457-460 (1979)). Based on this dicta, it is likely that Indiana courts would recognize that paying for the replacement of LSLs on private property serves a proper public purpose although some individuals may benefit more than others.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

The rates of investor-owned utilities must be approved by the IURC. Specifically, the IURC must review the rates of regulated utilities at least once every four years, Ind. Code § 8-1-2-42.5(a), and no change in a utility's schedule of rates is effective without the approval of the Commission, Ind. Code § 8-1-2-42(b).

B. Substantive Standard

As described above, in April 2017, Indiana enacted House Enrolled Act 1519, which allows the IURC to approve a utility's proposal to pay for LSL replacement on private property with ratepayer funds "if the commission finds the plan to be reasonable and in the public interest." Ind. Code § 8-1-31.6-6(b). For a water utility to include customer LSL improvements as eligible infrastructure improvements in its rate plan, the utility must file a petition and a case-in-chief with the IURC and obtain the Commission's approval. Ind. Code § 8-1-31.6-5(a). The water utility's petition must address the following issues:

1. The availability of grants or low interest loans and how the water utility plans to use available grants or low interest loans to help the water utility finance or reduce the cost of the customer lead service line improvements for the water utility and the water utility's customers, including any arrangements for the customer to receive available grants or financing directly.
2. A description of how the replacement of customer owned lead service lines will be accomplished in conjunction with distribution system infrastructure replacement projects.
3. The estimated savings in costs per service line that would be realized by the water utility replacing the customer owned portion of the lead service lines versus the anticipated replacement costs if customers were required to replace the customer owned portion of the lead service lines.

4. The number of lead mains and lead service lines estimated to be part of the water utility's system.
5. A range for the number of customer owned lead service lines estimated to be replaced annually.
6. A range for the total feet of lead mains estimated to be replaced annually.
7. The water utility's proposal for addressing the costs of unusual site restoration work necessitated by structures or improvements located above the customer owned portion of the lead service lines.
8. The water utility's proposal for:
 - A. communicating with the customer the availability of the water utility's plan to replace the customer owned portion of the lead service line in conjunction with the water utility's replacement of the utility owned portion of the lead service line; and
 - B. documenting the customer's consent or lack of consent to replace the customer owned portion of the lead service line.
9. The water utility's proposal concerning whether the water utility or the customer will be responsible for future replacement or repair of the portion of the new service line corresponding to the previous customer owned lead service line.
10. The estimated total cost to replace all customer owned portions of the lead service lines within or connected to the water utility's system and an estimated range for the annual cost to be incurred by the water utility under the water utility's plan.

Ind. Code § 8-1-31.6-6(a). If the petition has addressed the above-mentioned categories, then the IURC may approve the utility's proposal if it finds the plan to be reasonable and in the public interest. *Id.* § 8-1-31.6-6(b). On July 25, 2018, the IURC issued its first approval of an LSL replacement plan under this provision.⁹⁷

⁹⁷ Indiana-American IURC Approval, *supra* note 47, at *9-*11.

MASSACHUSETTS



Est. No. of LSLs ⁹⁸	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
220,000	2.5%	Likely	Uncertain but likely	

⁹⁸ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Government-owned utilities have broad rate-making authority and are not subject to oversight by the Massachusetts Department of Public Utilities (DPU). However, because municipalities operate under their own individual home rule charters, there may be limitations on rate setting for water utilities in such charters.

The rates of investor-owned utilities must be approved by the DPU before they go into effect. Such rates must be just and reasonable and not unduly or irrationally discriminatory. The Supreme Judicial Court gives great deference to the DPU. In addition, there are favorable cases involving the regulation of electrical utilities in which courts have upheld DPU approval of using ratepayer funds to pay for reduced rates for low-income, elderly customers and for the acquisition of power from an offshore wind facility.

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

Under M.G.L. c. 165, § 1, the DPU does not regulate municipal corporations. Massachusetts municipalities have the authority to adopt local ordinances and by-laws pursuant to the Home Rule Amendment in Mass. Const. art. 89 and the Home Rule Procedures Act, M.G.L. c. 43B. Under this authority, municipalities can regulate and set rates for municipally-owned public utilities.

B. Substantive Standards: Reasonable and not Unreasonably Discriminatory

A town has the authority, by majority vote at town meeting, “to establish a water supply or water distributing system and maintain and operate the same.” M.G.L. c. 40, § 39A. Either a city or a town also has the authority to vote to acquire a water utility. M.G.L. c. 40, § 38. Cities and towns can elect to create a water and sewer commission to operate their water system. M.G.L. 40N, § 4. The Massachusetts Water Resources Authority (MWRA) provides wholesale water and sewer services to 61 communities, mostly in the Boston metropolitan area.

Cities or towns that operate their own water systems must “adopt a pricing system which includes the costs of the provision of water and sewer services to the residents and industrial and commercial users of said city or town receiving said services.” M.G.L. c. 40, § 39J. They are forbidden from charging for “water or sewer services on a descending unit rate basis.” M.G.L. c. 40, § 39L. In addition, municipalities that obtain their water from the MWRA must “institute water charges and fees that incorporate a base rate for all users” and this base rate must “be increased at an increasing block rate to fairly reflect the resource demand and consumption of high volume users of water.” M.G.L. c. 165, § 2B. If the municipality elects to create a water and sewer commission, then the commission’s rates must “provide revenues at least sufficient” to meet certain operating expenses and any surplus at the end of a fiscal

year must be used to reduce rates the following year or reduce capital debt. M.G.L. c. 40N, § 9(b), (e). Although they impose some constraints on rate-setting, on the whole these “legislative provisions grant the water commissioners considerable discretion in determining the methods of fixing prices or rates related to the use of water.” *Henry B. Byors & Sons, Inc. Board of Water Comm’rs of Northborough*, 264 N.E.2d 657, 661 (Mass. 1970).

A series of decisions of the Massachusetts courts have imposed some common-law limitations on the rates that municipalities can charge for water service. These cases prohibit unreasonable rates and undue discrimination, but still grant considerable deference to a municipality’s rate setting authority. See, e.g., *Morton v. Town of Hanover*, 682 N.E.2d 889, 896 (Mass. App. Ct. 1997) (rejecting a claim because “[t]he plaintiffs fail[ed] to show the surcharge is unreasonable or unreasonably discriminatory”). Thus in one case the Supreme Judicial Court held that:

[a]n equitable determination of the price to be paid for supplying water does not look alone to the quantity used by each water taker. The nature of the use and the benefit obtained from it, the number of persons who want it for such a use, and the effect of a certain method of determining prices upon the revenues to be obtained by the city, and upon the interests of property holders, are all to be considered.

Henry B. Byors & Sons, 264 N.E.2d at 661. “[D]iscrimination of rates is permissible, within reasonable limits, except as between customers who receive the same service under similar conditions.” *Brand v. Bd. of Water Comm’rs of Town of Billerica*, 136 N.E. 389, 390 (Mass. 1922).

In applying these standards, the Court of Appeals upheld the City of Malden’s rate structure, under which users paid higher rates for higher water usage, even though apartment buildings were treated as single customers. The result of this scheme was that the per unit cost of water, when passed on by the landlord, was higher for people who lived in apartments than for those in single-family homes. The court, however, held “that because apartment residents do not pay for their actual use of water as do residents of single family homes, and have no individual liability to the City for water use,...[the plaintiff] has failed to demonstrate that the [apartment] residents receive the same service under the same conditions as residents of single family residences.” *Flatley v. City of Malden*, 660 N.E.2d 704, 706 (Mass. Ct.

App. 1996). The court also relied on the fact “that, without installing individual meters in each apartment, there is no rate system that could place apartment dwellers on exactly the same footing as residents of single family homes.” *Id.*

C. Public Purpose Doctrine

The Massachusetts Constitution in Part II, Chap. 1, § 1, art. 4 authorizes the legislature to enact laws and utilize funds “for the public service.” The determination of what constitutes a public purpose or a public use is a matter of constitutional law determined by the courts. *Allydonn Realty Corp. v. Holyoke Housing Authority*, 23 N.E.2d 665, 667 (Mass. 1939). The Supreme Judicial Court has established eight factors to be considered in determining whether the use of funds would benefit the public. The following factors would be relevant to funding an LSL replacement program:

1. Whether the benefit is available on equal terms to the entire public in the locality affected, *id.* at 667;
2. Whether the service or commodity supplied is one needed by all or by a large number of the public, *id.*;
3. Whether the enterprise bears directly and immediately, or only remotely and circumstantially, upon the public welfare, *id.* at 668;
4. Whether the need to be met in its nature requires united effort under unified control, or can be served as well by separate individual competition, *id.*;
5. Whether, insofar as benefits accrue to individuals, the whole society has an interest in having those individuals benefited, *id.*;
6. Whether a proposed extension of governmental activity is in line with the historical development of the Commonwealth and with the general purpose of its founders, *id.*

There are strong arguments that an LSL replacement program satisfies most or all of these factors. While not all members of the community will have LSLs, a replacement program could be designed to be available on equal terms to all residents who have LSLs. In many Massachusetts communities, a large number of residents have LSLs. As described above, the removal of LSLs bears directly on the public welfare by improving public health. Although the removal of LSLs may not strictly require united effort under unified control, such an approach will greatly improve the

speed, efficiency, and cost-effectiveness of LSL replacement. Although the residents will benefit most directly from removal of LSLs, all of society has an interest in the improved public health that results. Finally, as described below, public programs to assist with removal of LSLs on private property have been in place in Massachusetts for over a decade. Another consideration increasing the chance that a court will uphold a municipality's LSL replacement program is that "in deciding upon the validity of an enactment courts will give weight whenever possible to legislative findings of fact material in such determination." *Opinion of the Justices*, 150 N.E.2d 693, 697 (Mass. 1958).

In addition, the *Allydonn* factors are not meant to be exclusive. *Id.* "The paramount test should be whether the expenditure confers a direct public benefit of a reasonably general character, that is to say, to a significant part of the public, as distinguished from a remote and theoretical benefit." *Id.* The benefits of LSL replacement are direct and affect a significant part of the public.

An additional factor favoring the legality of LSL replacement programs is that public subsidies to private citizens to replace LSLs is commonplace in Massachusetts and has not been the subject of any identified constitutional litigation. For example, the *Boston Globe* in 2016⁹⁹ noted that "[t]he City of Boston will give property owners up to \$2,000 and four years of no-interest financing to help them replace water lines at their homes or businesses that may be leaching harmful lead into drinking water." This program has been in place since 2005, although originally at a lower level. As such, a variation on such a program would be unlikely to face legal challenge.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

Under M.G.L. c. 165, § 4 the DPU regulates investor-owned water companies. DPU's authority over investor-owned utilities is supervisory (M.G.L. c. 165, § 4), and includes a supervisory

⁹⁹ Matt Rocheleau, Do you Have Lead in your Water? City of Boston Wants to Help, *Boston Globe*, Apr. 7, 2016, <https://www.bostonglobe.com/metro/2016/04/07/boston-launch-es-new-program-address-lead-water-contamination-dangers/N1q9dfjNjmv9McHadctWYJ/story.html>; Boston Water & Sewer Comm'n, The Lead Replacement Initiative (2016), available at <https://www.bwsc.org/environment-education/lead-your-water/lead-replacement-incentive-program>.

role over rate-setting. Moreover, M.G.L. c. 165, § 1B grants DPU's Water Division the power to establish reasonable rules and regulations to carry out its supervisory duties.

Pursuant to M.G.L. c. 165, § 2, multiple sections from chapter 164 are incorporated by reference and apply to investor-owned water utilities. Among these incorporated sections, M.G.L. c. 164, § 94 establishes the authority for DPU "rate cases." Pursuant to section 94, an investor-owned utility may apply for a change in its rates, prices, and charges by "filing a schedule setting forth the changed rates, prices and charges; provided, however, that until the effective date of any such change no different rate, price or charge shall be charged, received or collected." Additionally, M.G.L. c. 164, § 93 gives the DPU authority to hold hearings on complaints about rates. According to the DPU, the Water Division's supervisory role is administered through the Rates and Revenue Requirements Division, which develops "the evidentiary record in adjudicatory proceedings concerning the rates or finances of the public water companies doing business in Massachusetts."¹⁰⁰ The Department's decisions in these proceedings are directly appealable to the Supreme Judicial Court of Massachusetts under M.G.L. c. 25, § 5.

B. Substantive Standards: Just and Reasonable and not Unduly or Irrationally Discriminatory

Under M.G.L. c. 164, § 94, the DPU must determine the "propriety" of the proposed rates. The Massachusetts courts have decided that this determination involves addressing whether the rates are "just and reasonable." *Bay State Gas Co. v. Dep't of Pub. Utilities*, 947 N.E.2d 1077, 1085 (Mass. 2011). In addition, public utilities may "not recover costs which are excessive, unwarranted, or incurred in bad faith." *Id.* Utilities may charge different rates to different categories of customers, as long as "the discrimination is based on a reasonable classification." *Massachusetts Oilheat Council v. Dep't of Pub. Utilities*, 641 N.E.2d 1318, 1322 (Mass. 1994). The law prohibits only rates that "unduly or irrationally discriminatory." *Am. Hoechst Corp. v. Dep't of Pub. Utilities*, 399 N.E.2d 1, 3 (Mass. 1980).

¹⁰⁰ DPU, Department of Public Utilities Annual Report 2017, at 37 (2017), <https://www.mass.gov/files/documents/2018/01/26/DPU%202017%20AR%20-%20Final.pdf>.

Several decisions of the Supreme Judicial Court show that the DPU can approve rates that provide more direct benefits to some customers, produce non-economic benefits such as environmental ones, or increase long-term efficiency at greater short-term cost. For example, in one case, the Supreme Judicial Court upheld a reduced electricity rate for low-income, elderly customers. *Id.* at 1, 4. In that case, the court also allowed the cost of that reduced rate to be imposed on both residential and commercial customers, because all classes of customers would benefit from it. *Id.* at 4. Similarly, in a recent case the court allowed a utility to recover the cost of purchasing energy from a proposed offshore wind farm from all customers because “[t]he department permissibly determined that the environmental benefits of [the purchase agreement]...will accrue to all [utility] customers, and it is therefore appropriate to require all customers to share in the costs of acquiring these benefits.” *All. to Protect Nantucket Sound, Inc. v. Dep’t of Pub. Utilities*, 959 N.E.2d 413, 432 (Mass. 2011).

Finally, in *Wannacomet Water Co. v. Department of Public Utilities* 194 N.E.2d 109 (Mass. 1963), the DPU had ordered the local water utility to install water meters for each customer. The “town contend[ed] that the meters were placed in concrete vaults under the public way or sidewalk area at an unnecessary installation cost of \$73 each instead of \$8 each for installation inside the houses served.” *Id.* at 111. The DPU allowed the utility to recover the cost of installing the meters under the public way or sidewalk and, on appeal, the court relied on the DPU’s expertise in affirming the decision. The court agreed with the department’s conclusion that “the long run advantages of efficiency of meter reading and of safety of the meter...will outweigh [the] added investment costs.” *Id.* at 111. The court deferred to DPU’s conclusion that many such installations would be

inconvenient to the customers and to the utilities company itself. The court “assume[d] that the department would not have been bound to follow Wannacomet’s decision if the decision had been shown to be plainly unreasonable.” *Id.* at 112.

C. Standard of Review

As the latter case indicates, the Massachusetts courts are extremely deferential in reviewing the DPU’s ratemaking decisions. As the Supreme Judicial Court has summarized it:

Our standard of review...is well settled: a petition that raises no constitutional questions requires us to review the department’s finding to determine only whether there is an error of law.... The burden of proof is on the appealing party to show that the order appealed from is invalid, and we have observed that this burden is heavy.... Moreover, we give deference to the department’s expertise and experience in areas where the Legislature has delegated to it decision-making authority, pursuant to G.L. c. 30A, § 14. We shall uphold an agency’s decision unless it is based on an error of law, unsupported by substantial evidence, unwarranted by facts found on the record as submitted, arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with law. G.L. c. 30A, § 14(7).

Bay State Gas Co., 947 N.E.2d at 1085 (additional citations and internal quotation marks omitted).

Given the case law described above, Massachusetts presents one of the strongest cases among the states examined for this paper for the DPU to have the existing authority to authorize the use of ratepayer funds by investor-owned utilities for LSL replacement on private property.

MICHIGAN



Est. No. of LSLs ¹⁰¹	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
460,000	2.2%	Definite [†]	Definite [†]	2018 rule requires utilities to use rates to pay for LSL replacement. ¹⁰² Utility commission approval appears not to be required.

[†] The Michigan rule has been challenged in court and no final decision has yet been reached in that case.

¹⁰¹ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

¹⁰² Supplying Water to the Public draft rule, codified at Mich. Admin. Code r. 325.10101–325.12820 (Mich. Dep't of Env'tl. Quality Drinking Water and Mun. Assistance Division 2017), available at http://dmbinternet.state.mi.us/DMB/ORRDocs/ORR/1684_2017-008EQ_orr-draft.pdf. See supra note 50.

In June 2018, the Michigan Department of Environmental Quality (MDEQ) adopted new regulations implementing the SDWA and the Michigan Safe Drinking Water Act. These rules require all water utilities, both municipally-owned and investor-owned, to replace all LSLs, including the portions on private property, over a 20-year period. The City of Detroit and several other local governments have challenged these rules in court, and we therefore also summarize the pre-existing standards applicable to both types of utilities, in case the regulations are struck down.

In Michigan, municipal utilities are exempt from regulation by the Michigan Public Service Commission (MPSC). Municipal utility rates are subject to a “reasonableness” standard. The “Headlee Amendment,” which prohibits local governments from increasing taxes without voter approval, is likely to be the most significant barrier, in that the Michigan courts have held that somewhat analogous programs amounted to taxes rather than user fees. There is a reasonable argument, however, that the Headlee Amendment would not apply in this situation. Even if the

Headlee Amendment applies, municipalities can overcome this barrier by holding a vote on the issue.

We have been unable to identify controlling judicial decisions on the scope of investor-owned utilities’ discretion to set rates. Although some statutes reference MPSC oversight of investor-owned water utilities, such regulation does not occur in practice. It is therefore difficult to predict how significant a barrier investor-owned utilities would face in using ratepayer funds to pay for the replacement of LSLs on private property if the MDEQ rules are struck down.

I. MDEQ’S NEW REGULATIONS

On June 14, 2018, MDEQ adopted revisions to its regulations implementing the federal SDWA as well as the Michigan Safe Drinking Water Act. Among other changes, these rules mandate that all water utilities replace their LSLs. In particular, the regulations require that utilities carry out a “preliminary distribution system materials inventory” by January 1, 2020. Mich. Admin. Code, R

325.11604(c)(i). Beginning in 2020, utilities must then replace their LSLs “at a rate averaging 5% per year, not to exceed 20 years total for replacement of all service lines under this subrule, unless an alternate schedule in an asset management plan is approved by” the MDEQ. Mich. Admin. Code, R 325.10604f(6)(b).

In carrying out these replacements, the utilities must replace “the supply shall replace the entire service line at the water supply’s expense” if it “controls the entire service line.” *Id.*, R 325.10604f(6)(c). A utility is presumed to control the entire LSL unless they can demonstrate that they do not have either ownership of the entire line or authority “to set standards for construction, repair, or maintenance of the service line” or “to replace, repair, or maintain the service line.” *Id.*, R 325.10604f(6)(d).

The rules also state categorically that: “A water supply shall replace the entire lead service line.” *Id.*, R 325.10604f(6)(e). The only exception to this requirement is that:

[i]f the supply does not own the entire service line, the supply shall notify the owner of the line, or the owner’s authorized agent, that the supply will replace the portion of the service line that it owns and the owner’s portion of the line at the supply’s expense. If the building owner does not consent, the supply shall not replace any portion of the service line, unless in conjunction with emergency repair.

Id. The practical effect of these rules is to mandate that all water utilities replace in full virtually all of their LSLs—and to do so using ratepayer funds, given the requirement that the replacements be carried out “at the water supply’s expense.”

As mentioned above, however, on December 11, 2018, several local governments sued the MDEQ, alleging that the rules violate the state constitution’s public purpose doctrine, as well as the “Headlee Amendment,” both of which are discussed below, as well as arguing that the rule is procedurally and substantively deficient under the Michigan Administrative Procedures Act.¹⁰³ It is too early to predict the outcome of this lawsuit, although, as we outline below, there are strong arguments that the use of ratepayer funds for LSL replacement on private property is permissible under both the public purpose doctrine and the Headlee Amendment.

¹⁰³ *Verified Complaint*, Oakland Cty. Water Res. v. Mich. Dep’t Envtl. Quality, Case 2018-____-MZ (Mich. Ct. Cl. Dec. 12, 2018).

II. PUBLICLY-OWNED UTILITIES

A. Authority to Create Water Utilities and Exemption from MPSC Regulation

Under the Michigan Constitution, “any city or village may acquire, own or operate, within or without its corporate limits, public service facilities for supplying water...to the municipality and the inhabitants thereof.” Mich. Const. art. VII, §24. Article VII, Section 34 strengthens the hand of local governments, stating that “the provisions of this constitution and law concerning counties, cities, and villages shall be liberally construed in their favor.” Municipal utilities are exempt from regulation by the MPSC. Mich. Comp. Laws § 460.6.

B. Substantive Standard: Reasonableness

The only statutory reference to limits on municipal rate-setting authority is found in Mich. Comp. Laws § 123.141, which provides that “the price charged by the city to its customers shall be at a rate which is **based on the actual cost of service as determined under the utility basis of rate-making.**” (emphasis added) Mich. Comp. Laws § 123.141 is found in a part of the Michigan code entitled “Water Furnished Outside Territorial Limits,” and therefore appears to refer only to sales of water to customers outside the territorial limits of the municipality.

Despite the language and location of this provision, however, the Michigan courts interpret it (1) to require not rates based precisely on the cost of service, but instead just “reasonable” rates; and (2) apply this reasonableness standard to all municipal rates, not only those for customers outside the municipality’s jurisdiction. As to the first point, the Michigan Supreme Court has stated:

The Legislature’s use of the phrase “based on the actual cost of service as determined under the utility basis of rate-making” cannot be construed to mean “exactly equal to the actual cost of service,” in light of the difficulties inherent in the rate-making process and the statutory and practical limitations on the scope of judicial review. The concept of reasonableness, as recognized by the courts of this state and other states in utility rate-making contexts, must remain operable, in order to provide a meaningful and manageable standard of review.

City of Novi v. City of Detroit, 433 Mich. 414, 431, 446 N.W.2d 118, 126 (1989) (emphasis added).

As to the second point, a recent Court of Appeals decision applied Novi's reasonableness standard of review to a case brought by a resident of the city setting the rates, while explicitly citing Mich. Comp. Laws § 123.141. See *Trahey v. City of Inkster*, 311 Mich. App. 582, 597, 876 N.W.2d 582 (2015) (holding that the statute "does not alter the general standard of reasonableness applied by courts when reviewing utility rates") (citing *City of Novi*, 433 Mich. at 431–432, 446 N.W.2d 118).

In deciding whether the rates charged by a municipal utility are reasonable, the Michigan courts grant considerable deference to the city's judgment. Thus *Trahey* stated that Michigan courts have long recognized the principle that municipal utility rates are presumptively reasonable. This presumption exists because "[c]ourts of law are ill-equipped to deal with the complex, technical processes required to evaluate the various cost factors and various methods of weighing those factors required in rate-making." *Trahey*, 311 Mich. App. at 594.

The courts also explain that the reasonableness standard does not require municipalities to follow any particular mathematical formula and allows them to consider multiple factors in setting rates. The Michigan Supreme Court has stated that where the determination of "reasonableness" is generally considered by the courts to be a question of fact "incapable of mathematical precision." *Plymouth v. Detroit*, 423 Mich. 106, 133–134, 377 N.W.2d 689 (1985). In an earlier case, it explained that "[t]he 'word 'reasonable' with respect to rates charged by utilities is a word of the most universal employment.... The determination of its meaning... depends upon a comprehensive examination of all factors involved, having in mind the objective sought to be attained in its use." *Meridian Twp. v. East Lansing*, 342 Mich. 734, 749, 71 N.W.2d 234 (1955). Moreover, the Court of Appeals in *Trahey* responded to plaintiff's claim that the rate charged was unreasonable by holding that "the phrase 'actual cost of providing the service' as used in the statute does not mean exactly equal to the actual costs of providing the service." *Trahey*, 311 Mich. App. at 597; see also *Futernick v. Sumpter Twp.*, No. 221697, 2002 WL 483507, at *4 n.2 (Mich. Ct. App. Mar. 26, 2002) ("[T]he principle that the reasonableness of a utility rate is not subject to mathematical computation with scientific exactitude, but rather, depends on an examination of all factors involved.").

Thus, Michigan's statutes and constitution appear to provide municipalities with broad rate-setting authority with few explicit limitations on their ability to utilize different rate structures.

Under article VII, section 24, any city or county may provide utilities services outside its corporate limits. Any limits "may be determined by the legislative body of the city or village." Additionally, for customers outside the city boundaries "[t]he price charged by the city to its customers shall be at a rate which is based on the actual cost of service as determined under the utility basis of rate-making." Mich. Comp. Laws Ann. § 123.141(2). As indicated above, the Michigan courts have interpreted this language to require only that municipalities charge "reasonable" rates.

C. Limits on Municipal Taxing Authority

Michigan's "Headlee Amendment" prohibits local governments from increasing taxes without voter approval. Mich. Const. art. 9, § 31. This constitutional provision is relevant to potential LSL replacement programs because the Michigan Supreme Court in *Bolt v. City of Lansing*, 587 N.W.2d 264 (Mich. 1998), ruled that a storm water charge that exceeded the actual cost of service was an invalid tax. The case involved a plan by Lansing to improve its storm-water system in a way that provided a direct benefit to approximately one quarter of its population, while charging the cost to all properties. The court laid out a three-prong test to determine the difference between a tax and a fee:

1. A user fee is meant for regulation, whereas a tax is meant to generate revenue, *id.* at 269;
2. A user fee must be proportionate to the necessary cost of service, *id.*;
3. Unlike taxes, fees should be voluntary, meaning that people have the right to refuse use of the commodity, *id.* at 269-70.

The court held that the Headlee Amendment was created to prevent the "abuse" of "mandatory user fees" to supplement existing revenue for various government activities or services that only benefit individual property owners. *Id.* at 273. In *Bolt*, the court concluded that the challenged storm water service charge was a tax and was illegal because it had not been put to the voters of Lansing for approval.

Under the Michigan Supreme Court's interpretation of the Headlee Amendment, opponents of an LSL replacement program could argue that setting rates in order to generate revenues, which would in turn be used to subsidize private homeowners, is an invalid tax according to *Bolt's* three-prong test, unless voters approve such a rate-setting program.

However, more recent decisions of the Michigan Court of Appeals have interpreted *Bolt* narrowly. Thus, for example, the court stated in one case that “the *Bolt* test is only designed to distinguish between user fees and taxes on real property.” *Lapeer Cty. Abstract & Title Co. v. Lapeer Cty. Register of Deeds*, 691 N.W.2d 11, 21 (Mich. Ct. App. 2004). A subsequent case reaffirmed this position and held that *Bolt* did not apply to an airport authority’s commercial access fees imposed on hotels and parking and limousine companies that provided shuttle services to the airport because these fees did “not involve a charge imposed on real property.” *A & E Parking v. Detroit Metro. Wayne Cty. Airport Auth.*, 723 N.W.2d 223, 227 (Mich. Ct. App. 2006). While a 2013 case held that a city’s storm water management charge was a tax under *Bolt* and therefore needed to be approved by city-wide vote, that charge was imposed directly on all property owners in the city. *Jackson Cty. v. City of Jackson*, 836 N.W.2d 903, 905 (Mich. Ct. App. 2013).

In 2015 the Legislative Policy Division of the City of Detroit provided the Detroit City Council with a legal opinion about a proposed water affordability program, under which indigent customers would need to pay only a low amount, regardless of the amount that would otherwise be charged. Based on the decisions cited above and others, the opinion concluded that the program would not constitute a tax under *Bolt* and would otherwise be legal under existing law. Memorandum from David Whitaker, Director, Legislative Policy Division Staff to Detroit City Council, Oct. 21, 2015, re: Legality of Water Affordability Program (WAP). A similar argument could be made that an LSL replacement program is also not a tax under *Bolt* because it would be paid for by rates charged to customers of the water utility rather than to people in their capacity as property owners and because it would be proportionate to the cost of service and serve a regulatory purpose (eliminating the risk that the community will come into violation of the Lead and Copper Rule) rather than a revenue-raising one.

D. The Public Purpose Doctrine

Mich. Const. art VII, § 26 provides that “no city or village shall have the power to loan its credit for any private purpose or, except as provided by law, for any public purpose.” Additionally, Mich. Const. art. IX, § 18 mandates that “the credit of the state shall not be granted to, nor in aid of any person, association or corporation, public or private, except as authorized in [Art VII, § 26].”

Michigan courts have been deferential in applying the public purpose doctrine. The Michigan Supreme court in *Hays v City of Kalamazoo*, 25 N.W.2d 787, 790-91 (Mich. 1947) explained that:

Generally, a public purpose has for its objective the promotion of the public health, safety, morals, general welfare, security, prosperity, and contentment of all the inhabitants or residents within the municipal corporation, the sovereign powers of which are used to promote such public purpose.... The right of the public to receive and enjoy the benefit of the use determines whether the use is public or private.

Subsequent decisions have developed the doctrine set out in *Kalamazoo*. In *Gregory Marina, Inc. v. City of Detroit*, 144 N.W.2d 503, 518 (Mich. 1966) the Michigan Supreme Court determined that it is not essential that the entire community “nor even a considerable portion” should directly enjoy the benefits a project that is established under the public purpose doctrine. The court held that the governmental use of public funds for the construction of harbors, yacht basins, or marinas could not be properly questioned by a court. Thus, if a municipal LSL replacement program project were funded by public funds it is unlikely that it would be barred by the public purpose doctrine.

III. INVESTOR-OWNED UTILITIES

Michigan, like Minnesota (discussed below) is among the half-dozen states in which investor-owned water utilities are not regulated by a state utility commission. Michigan law appears to grant the MPSC the power to set the rates of investor-owned water utilities. Specifically, Mich. Comp. Law § 460.6 provides that the MPSC:

is vested with the power and jurisdiction to regulate all rates, fares, fees, charges, services, rules, conditions of service, and all other matters pertaining to the formation, operation, or direction of public utilities. The public service commission is further granted the power and jurisdiction to hear and pass upon all matters pertaining to, necessary, or incident to the regulation of public utilities, including...water...companies.

The Michigan Supreme Court has explained that, as a result of a statutory amendment, “[a]ll private water companies became public utilities on April 19, 1960” and were therefore subject to the jurisdiction of the MPSC after

this date. *Northern Michigan Water Co. v. Michigan Public Service Comm'n*, 161 N.W.2d 584, 590 (1968). In addition, according to a Michigan legal treatise, “each company in Michigan [is] automatically obligated to file its rates with the commission and obtain commission approval for them.” 25 Mich. Civ. Jurisprudence Water § 150.

However, we have not been able to locate any statutory or regulatory provision that elaborates on the MPSC’s authority to regulate water utilities or the standards by which it is to assess those utilities’ rates. In addition, the MPSC does not list on its website water utilities as being among the utilities that it regulates.¹⁰⁴

The Michigan statutes also give municipal governments the power to regulate the rates of private utilities operating within their borders. Under Mich. Comp. Laws § 486.301(1), municipalities can determine that “it is

inexpedient” for the municipality to build its own water system; when this occurs, “it shall be lawful for any number of persons, not less than 5, to organize a company for the construction of such water-works.” If such a private water company is created, the municipal government can “prescribe such just and reasonable terms, restrictions and limitations upon such company... to protect... its inhabitants from the imposition of undue or excessive rates or charges for the supply of water.” Mich. Comp. Laws § 486.315. Such municipal restrictions, however, cannot “prevent such company realizing upon its capital stock and annual income or dividend of 10 per cent, after paying the cost of all necessary repairs and expenses, interest on all moneys borrowed, and 5 per cent. per annum, into sinking funds, for the extinguishment of funded debts.” *Id.* Again, however, we have been unable to identify any cases or other materials discussing the regulation of private water utilities by municipalities in Michigan.

¹⁰⁴ About the MPSC, DEP’T OF LICENSING AND REGULATORY AFFAIRS (2019), available at <https://www.michigan.gov/mpsc/>.

MINNESOTA



Est. No. of LSLs ¹⁰⁵	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
260,000	1.2%	Likely	Likely	Utility commission approval not required for proposals.

¹⁰⁵ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Neither municipally-owned nor investor-owned utilities are subject to the jurisdiction of the Minnesota Public Utilities Commission (MPUC). Judicial review of municipal utility rates is deferential. We have been unable to identify any statutes or case law describing the standard of review applicable to the rates of investor-owned utilities.

I. PUBLICLY-OWNED UTILITIES

There are two categories of municipalities in Minnesota: home rule cities and statutory cities.¹⁰⁶ Both types of municipalities have the authority to operate and finance a waterworks system or facility. Minn. Stat. § 444.075; Minn. Stat. § 412.331.

A. Exemption from MPUC Jurisdiction

Neither type of municipal utility is subject to the jurisdiction of the MPUC.

B. Substantive Standards: Just and Equitable and as Nearly as Possible Proportionate to the Cost of Furnishing the Service

According to Minn. Stat. § 456.37, home rule charter cities “may charge a **reasonable fee** for supplying water.” (emphasis

¹⁰⁶ For a discussion of home rule cities vs. statutory cities, see Types of Cities in Minnesota, LEAGUE MINN. CITIES, available at <https://www.lmc.org/page/1/types-of-cities.jsp> (last visited March 4, 2019).

added) Moreover, Minn. Stat. § 444.075(3), which applies to both statutory cities and home rule cities, provides that rates should be “**just and equitable**” and that, notwithstanding local charter restrictions, all municipal rates shall be “**as nearly as possible proportionate to the cost of furnishing the service.**” (emphasis added) Under the same statute (Subd. 3g), the municipal council, in determining the reasonableness of charges for water services, “may give consideration to all costs of the establishment, operation, maintenance, depreciation and necessary replacements of the system, and improvements... necessary to serve adequately the territory of the municipality or county.” Thus the strongest potential challenge to using ratepayer funds to finance an LSL replacement program is found in the requirement that rates be “as nearly as possible [emphasis added] proportionate to the costs of furnishing the service” under Minn. Stat. § 444.075(3). However, recent cases have adopted a deferential scope of review when applying this test.

For example, in a case addressing water rates charged to an apartment complex, the Minnesota Court of Appeals explained that “perfect equality in establishing a rate system” should not be “expected, nor can quality be measured with mathematical precision.” *Daryani v. Rich Prairie Sewer & Water Dist.*, No. A05-1200, 2006 WL 619058, at *2 (Minn. Ct. App. Mar. 14, 2006). The court stated that “apportionment of utility rates among different classes of users may only be roughly equal.” *Id.* In addition, it would “uphold an established rate system unless it is shown by clear and

convincing evidence to be in excess of statutory authority or results in unjust, unreasonable, or inequitable rates.” *Id.* The court held that while services are required to be “as nearly proportionate to the cost of furnishing the service,” this statutory provision “[does] not prevail over the specific provision that bases charges on water consumption or other equitable means.” *Id.* at *3.

Similarly, in a recent case the plaintiff argued that a city’s water-connection charges were unjust and unreasonable. The court stated that rates adopted by city ordinances were “presumed to be just and reasonable and will be upheld unless shown to be in excess of statutory authority or resulting in unjust, unreasonable, or discriminatory rates by clear and convincing evidence.” *Park Estates, Inc. v. City of St. Paul Park*, No. A16-1375, 2017 WL 2062122, at *2 (Minn. Ct. App. May 15, 2017) (citing *City of Moorhead v. Minn. Pub. Utils. Comm’n*, 343 N.W.2d 843, 846 (Minn. 1984)). The court further addressed the requirement that charges must be “as nearly as possible proportionate to cost of furnishing service,” holding that all individuals used the city-owned water and sanitary-sewer infrastructure and therefore benefited from its maintenance and continued infrastructure improvement. *Id.* at *3. The court concluded by stating that the plaintiff did not provide sufficient evidence to create a genuine issue of material fact as to whether the city exceeded its statutory authority.

Other cases have similarly given Minn. Stat. § 444.075(3) a broad interpretation, stating that the “statute allows municipalities ‘maximum flexibility in financing municipal sewer and water services,’” *Crown Cork & Seal Co. v. City of Lakeville*, 313 N.W.2d 196, 201 (Minn. 1981), or that charges adopted by ordinance in the city’s legislative capacity are presumed to be just and reasonable and will be upheld unless shown to be in excess of statutory authority or resulting in unjust, unreasonable, or discriminatory rates by clear and convincing evidence, *City of Moorhead v. Minn. Pub. Utils. Comm’n*, 343 N.W.2d 843, 846 (Minn. 1984).

C. The Public Purpose Doctrine

In Minnesota, for an expenditure of public funds to be lawful, there must be a specific public purpose and authority for that purpose (arising out of a city’s charter or statute). The public purpose doctrine is rooted in several state

constitutional provisions, including Minn. Const. art. X, § 1, which provides that “taxes shall be levied and collected for public purposes,” art. XI, § 2 (“The credit of the state shall not be given or loaned in aid of any individual, association or corporation.”), and art. XII, § 1 (“The Legislature shall pass no local or special law...authorizing public taxation for a private purpose.”). A legislative declaration of public purpose is not always controlling; in the final analysis the determination of what is a public purpose rests with the courts. *City of Pipestone v. Madsen*, 178 N.W.2d 594, 600 (Minn. 1970). Nevertheless, the Minnesota courts give “great weight” to “legislative determinations of public purpose.” *Minnesota Energy & Econ. Dev. Auth. v. Printy*, 351 N.W.2d 319, 338 (Minn. 1984).

What is a “public purpose” that will justify the expenditure of public money is not capable of a precise definition, but the courts generally construe it to mean such an activity as will serve as a benefit to the community as a body and which, at the same time, is directly related to the functions of government.

Visina v. Freeman, 89 N.W.2d 635, 643 (Minn. 1958). The Minnesota Supreme Court has held that there is a public purpose if the municipal expenditure can reasonably be expected to achieve a legitimate public goal or benefit, even if some benefit may result for nonpublic interests. *City of Pipestone*, 178 N.W.2d at 603. “We have gone so far as to approve the condemnation of land by a public authority and its later sale or lease to private developers, and the construction of buildings by the public authority to be leased to private persons as permissible inducements to lure the private sector into the redevelopment plan.” *R. E. Short Co. v. City of Minneapolis*, 269 N.W.2d 331, 339 (Minn. 1978) (citations omitted). Given the broad construction of the public purpose doctrine in Minnesota, it is likely that courts would uphold the use of ratepayer funds to establish an LSL replacement program.

D. Service of Customers Outside Municipal Borders

Under Minn. Stat. § 412.321(3), any city may extend a utility outside its limits and furnish service to consumers in such area “at such rates and upon such terms as the council or utility commission, if there is one, shall determine.”

II. INVESTOR-OWNED UTILITIES

Minnesota is another state (like Michigan) in which investor-owned utilities are not regulated by a state utilities commission.¹⁰⁷ Municipal water utilities are regulated by the local government within which they operate. We have not identified the standards that these local governments apply when regulating investor-owned utilities. This issue is of limited importance, however, given that only approximately 1% of customers are served by investor-owned water utilities in Minnesota.

¹⁰⁷ According to the Minnesota Department of Health, the majority of non-municipal (investor-owned) water utility systems are utilized by mobile home parks, correctional facilities, schools, and treatment facilities. See Nonmunicipal Water Systems Are Many and Varied, Minn. Dept. Health, available at <https://www.health.state.mn.us/communities/environment/water/waterline/featurestories/nonmunicipal.html>.

MISSOURI



Est. No. of LSLs ¹⁰⁸	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
330,000	27%	Likely	Definite	Commission approved one proposal in May 2018, although without ruling on the ratemaking treatment of the expense. ¹⁰⁹

¹⁰⁸ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

¹⁰⁹ Order Admitting Exhibits, In re Missouri-American Water Company's Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas, No. WR-2017-0285 (MPSC May 2, 2018), available at https://psc.mo.gov/WaterSewer/New_Water_and_Sewer_Rates_Filed_by_Missouri-American_Water_Company.

There are two types of publicly-owned water utilities in Missouri: municipal utilities and public water supply districts. Neither is subject to the jurisdiction of the Missouri Public Service Commission (MPSC). Courts will uphold the rates of publicly-owned utilities unless they are “clearly, palpably and grossly unreasonable.” Courts are also deferential in their application of the public purpose doctrine.

Investor-owned utilities must have their rates approved by the MPSC. The rates of Commission-regulated utilities must be just and reasonable, cannot provide any undue or unreasonable preference or advantage to particular customers, and may not include any special rates or rebates for any person. Under these standards, however, the rates need not be precisely based on the cost of service to an individual and there can be some degree of cross-subsidization among customers. Courts will uphold the MPSC’s decision unless it is arbitrary or capricious or an abuse of the Commission’s discretion.

In May 2018, the MPSC approved a rate increase for the Missouri American Water Company (MAWC) to fund infrastructure improvements, including LSL replacement

on private property.¹¹⁰ This decision was initially challenged in court by the state Office of the Public Counsel, but that appeal was subsequently abandoned.

I. PUBLICLY-OWNED UTILITIES

A. Exemption from MPSC Jurisdiction over Rates

There are two types of publicly-owned utilities in Missouri: municipal utilities, which are owned directly by cities and authorized by chapter 91 of the Missouri Revised Statutes, and public water supply districts, which are separate legal entities authorized by chapter 247 of the Missouri Revised Statutes. The MPSC does not have jurisdiction over the rates charged by either municipal utilities, *Forest City v. City of Oregon*, 569 S.W.2d 330, 333 (Mo. App. 1978),

¹¹⁰ New Water and Sewer Rates Filed by Mo.-Am. Water Co., MO. PUB. SERV. COMM’N (May 7, 2018), available at https://psc.mo.gov/WaterSewer/New_Water_and_Sewer_Rates_Filed_by_Missouri-American_Water_Company.

or public water supply districts, *Staff of Missouri Pub. Serv. Comm'n v. Consol. Pub. Water Supply Dist. C-1 of Jefferson Cty., Missouri*, 474 S.W.3d 643, 649 (Mo. Ct. App. 2015) (“The Supreme Court’s rationale extends by logical implication to public water supply districts, which are ‘municipal corporations’ in the broad sense of the word.”).

B. Substantive Standards: Reasonable, No Discrimination within the Class

The Missouri courts “have an equitable jurisdiction to prevent a municipality from enforcing public utility charges which are clearly, palpably and grossly unreasonable.” *Forest City v. City of Oregon*, 569 S.W.2d 330, 333 (Mo. App. 1978). The courts are very deferential in their review of municipal rates: “There is a strong presumption that the rates fixed by the municipality are reasonable and the burden of proving that the rates fixed by the municipality are unreasonable is upon the party challenging the rates.” *Shepherd v. City of Wentzville*, 645 S.W.2d 130, 133 (Mo. Ct. App. 1982). “A municipality may classify its users for the purpose of fixing rates if the classification is reasonable and if there is no discrimination within the class.” *Id.* In addition, in the face of an allegation that the rate charged by a municipality had “no relation to the cost of service,” a court has held that “[c]ost of service is but one consideration in the determination of the reasonableness of the rate.” *Id.*

C. Service to Nonresidents

According to the Missouri Court of Appeals, even the highly deferential substantive standards described above do not apply to municipal utilities when they are providing service to customers located outside their municipal boundaries. “[A]s to nonresidents, the municipality owes no duty of service, sells in purely private capacity on a purely contractual basis, and cannot be regulated as to the rates charged.” *Forest City v. City of Oregon*, 569 S.W.2d 330, 334 (Mo. App. 1978); see Mo. Ann. Stat. § 91.060 (authorizing a municipal utility to provide service to other cities “upon such terms and under such rules and regulations as it may deem proper”).

D. Public Purpose Doctrine

Mo. Const. art. III, § 38(a) states that “[t]he general assembly shall have no power to grant public money or property, or lend or authorize the lending of public credit, to any

private person, association or corporation.” Additionally, “[t]axes may be levied and collected for public purposes only.” Mo. Const. art. X, § 3. Moreover, “[n]o county, city or other political corporation or subdivision of the state shall be authorized to lend its credit or grant public money or property to any private individual, association or corporation.” Mo. Const. art. VI, § 25.

“[D]etermination of what constitutes a public purpose is primarily for the legislative department and will not be overturned unless found to be arbitrary and unreasonable.” *State ex rel. Wagner v. St. Louis Cty. Port Auth.*, 604 S.W.2d 592, 596 (Mo. 1980).

The consensus of modern legislative and judicial thinking is to broaden the scope of activities which may be classified as involving public purpose. No hard and fast rules exist to determine whether purposes are public or private. For an expenditure to have a public purpose it must be for the support of the government or recognized objects of government, or to promote the welfare of the community.

Neuner v. City of St. Louis, 536 S.W.3d 750, 766–67 (Mo. Ct. App. 2017) (citations and internal quotation marks omitted). “[I]f the primary purpose of the act is public, the fact that special benefits may accrue to some private persons does not deprive the government action of its public character.” *State ex rel. Atkinson v. Planned Indus. Expansion Auth. of St. Louis*, 517 S.W.2d 36, 45 (Mo. 1975). Applying these standards, the Missouri courts have found that there was a primary public purpose in the development of a baseball stadium, *Moschenross v. St. Louis County*, 188 S.W.3d 13, 22 (Mo. App. E.D. 2006), or football stadium, *Rice v. Ashcroft*, 831 S.W.2d 206, 210 (Mo. App. W.D. 1991).

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

The MPSC has supervisory authority over investor-owned water utilities under Mo. Rev. Stat. § 393.140(1). Under § 393.140(11), utilities must give the commission 30 days’ notice before making any change in rates.

Once such rules and regulations are filed and approved, then the public utility is prohibited by law from changing them without filing the new rule with the Commission, and it is also prohibited

from extending...any privilege except such as are regularly and uniformly extended to all persons and corporations under like circumstances.

Fields v. Missouri Power & Light Co., 374 S.W.2d 17, 31 (1967).

B. Substantive Standards: Just and Reasonable, no Undue or Unreasonable Preference or Advantage

Pursuant to Mo. Rev. Stat. § 393.130(1) all charges made or demanded by any MPSC-regulated water utility corporation for any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission. In addition, under Mo. Rev. Stat. § 393.130(2), Commission-regulated utilities may not grant any special rates or rebates to any person or charge greater or less compensation for water services than charged to any other person “for doing like and contemporaneous service with respect thereto under the same or substantially similar circumstances or conditions.” Finally, under § 393.130(3) no “water corporation or sewer corporation shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.”

In *State ex rel. Marco Sales, Inc. v. Public Serv. Comm’n*, 685 S.W.2d 216, 221 (Mo. App. 1984) the court held that rate discrimination is not unlawful under § 393.130(3), when it is based upon “a reasonable classification corresponding to actual differences in the situation of the consumers or the furnishing of the service.” Similarly, in another case, the court held that a rate structure under which current ratepayers would temporarily subsidize the extension of service to new customers, although resulting in some rate discrimination, “does not grant any undue or unreasonable preference or advantage to the developers and those similarly situated.” *State ex rel. Missouri Office of Pub. Counsel v. Missouri Pub. Serv. Comm’n*, 782 S.W.2d 822, 825 (Mo. Ct. App. 1990). Moreover, “[t]he plain language of the statute does not mandate that customers pay only the exact cost of service and no more.” *Missouri-Am. Water Co.’s Request for Auth. to Implement a Gen. Rate Increase for Water & Sewer Serv. Provided in Missouri Serv. Areas v. Office of Pub. Counsel*, 526 S.W.3d 253, 261 (Mo. Ct. App. 2017).

The MPSC’s power to determine that a utility’s rates are just and reasonable also “necessarily includes the power and authority to determine what items are properly includable in a utility’s operating expenses and to determine and decide what treatment should be accorded such expense items.” *In Matter of Kansas City Power & Light Co.’s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm’n*, 509 S.W.3d 757, 777 (Mo. Ct. App. 2016) (citing *State ex rel. City of West Plains v. Pub. Serv. Comm’n*, 310 S.W.2d 925, 928 (Mo. 1958)) (internal quotation marks omitted). The MPSC applies a “prudence” standard for such costs; while a “utility’s costs are presumed to be prudently incurred,” they will be disallowed upon “a showing of inefficiency or improvidence.” *Id.* (citations and internal quotation marks omitted).

C. Standard of Review

Courts review the Commission’s order by determining whether the order is arbitrary or capricious and whether it is an abuse of the Commission’s discretion. *See Office of Pub. Counsel v. Mo. Pub. Serv. Comm’n*, 409 S.W.3d 371, 375 (Mo. 2013). The decision of the Commission is reasonable when the order “is supported by substantial, competent evidence on the whole record.” *State ex. Rel. Praxair, Inc. v. Missouri Pub. Serv. Comm’n*, 344 S.W.3d 178, 184 (Mo. 2011). Additionally, Missouri courts have established a “presumption of prudence,” when determining whether an investor-owned utility properly passed rates to its customers. As stated in *Office of Public Counsel*, while the burden of proof is on the utility to prove that the costs it proposes to pass along to customers are just and reasonable, “a utility’s costs are presumed to be prudently incurred [emphasis added].... However, the presumption does not survive a showing of inefficiency or improvidence that creates serious doubt as to the prudence of an expenditure.” 409 S.W.3d at 376 (citation omitted).

D. MAWC Order

The MPSC on May 2, 2018 approved a MAWC LSL replacement program, which includes replacing the portions of LSLs owned by customers.¹¹¹ MAWC estimated

¹¹¹ *Report and Order*, In re Missouri-American Water Company’s Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas, No. WR-2017-0285 (MPSC May 2, 2018), available at https://www.efis.psc.mo.gov/mpsc/commoncomponents/view_itemno_details.asp?caseno=WR-2017-0285&attach_id=2018018249.

that there were approximately 30,000 LSLs in its service area.¹¹² In most cases, the customer owns the portion of the LSL on its property, while MAWC owns the portion from the water main to the property line; in St. Louis County, the customer owns the entire service line.¹¹³ MAWC has started a program of replacing full LSLs whenever it encounters them during the replacement of water mains. It estimates that it will replace 3,000 LSLs per year over the next ten years.¹¹⁴ The Commission approved MAWC’s continuation of this program and allowed the utility to “defer and capitalize certain expenses until it files its next rate case;” it did not decide, however, what ratemaking treatment these deferred costs would receive.¹¹⁵

In July 2018, the Missouri Office of the Public Counsel—the state’s ratepayer advocate—filed suit, alleging that “Commission’s order is unlawful because the Commission exceeds its jurisdiction in that the Commission authorized the Company to charge all residential customers for the replacement of some residential customers’ privately owned

assets.”¹¹⁶ The Office contended that because Section 393.140(1) grants the Commission statutory authority over “water corporations...to lay down, erect or maintain wires, pipes, conduits, ducts, or other fixtures *in, over or under the streets, highways and public places of any municipality*” (emphasis added), and “Section 386.250 limits the jurisdiction of the Commission to ‘all water corporations, and to the land, property, dams, water supplies, or power stations thereof and the operation of the same,’” the Commission has no jurisdiction “to grant rate recovery to the replacement of customer-owned assets located on customer premises.”¹¹⁷ However, the Office of Public Counsel subsequently voluntarily dismissed its appeal after MAWC made some minor changes to its tariff and agreed to keep the Office informed regarding developments in its LSL replacement work.¹¹⁸

¹¹² Id. at 12.

¹¹³ Id.

¹¹⁴ Id. at 13–14.

¹¹⁵ Id. at 15–17.

¹¹⁶ *The Office of the Public Counsel’s Application for Rehearing at 2*, attached to *Notice of Appeal*, available at https://www.efis.psc.mo.gov/mpsc/commoncomponents/view_itemno_details.asp?caseno=WR-2017-0285&attach_id=2019000854.

¹¹⁷ Id. at 2–3.

¹¹⁸ *Personal communication with Missouri American Water’s Tim Luft on Jan. 22, 2019.*

NEW JERSEY



Est. No. of LSLs ¹¹⁹	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
350,000	37.3%	Definite under specific conditions otherwise likely [†]	Uncertain	2018 law allows publicly-owned utilities to use public funds. ¹²⁰

[†] If an environmental infrastructure project funded by one of two sources.

¹¹⁹ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

¹²⁰ 2018 NJ Sess. Law Serv. Ch. 114 (2019).

Municipally-owned utilities in New Jersey fall into two categories: those owned and operated directly by counties or municipalities, and “municipal utilities authorities” or “county utilities authorities,” which are separate legal entities created by a municipality or county. Both types of utility are generally not subject to the jurisdiction of the New Jersey Board of Public Utilities (“BPU”). By statute, the rates charged by such publicly-owned utilities must be uniform, fair, and equitable. The New Jersey courts apply these standards deferentially. However, the existence of explicit authority to provide reduced rates for senior citizens, disabled individuals, and service members on active duty could be read to limit the ability of these utilities to treat customers differently on other bases.

The BPU reviews the rates of investor-owned utilities in New Jersey. Such rates must be just and reasonable, and not unjustly discriminatory or unduly preferential. Courts defer to the BPU’s rate-setting decisions. As with publicly-owned utilities, the existence of explicit authority to offer reduced rates to some customers could be read to limit

the ability of these utilities to treat customers differently on other bases. Thus, BPU takes the position that the utilities it regulates are unable to provide low-income customer assistance programs (CAPs) funded by rate revenues.

The New Jersey legislature recently enacted a bill that addresses LSL replacement on private property.¹²¹ The bill grants municipal utilities the explicit authority to replace the portions of LSLs on private property and to pay for these replacements using special assessments and the proceeds of bonds. However, the provision only applies to: an environmental infrastructure project, as defined under section 3 of P.L.1985, c.334 (C.58:11B-3) that is “funded either by loans from the New Jersey Infrastructure Bank, created pursuant to section 4 of P.L.1985, c.334 (C.58:11B-4), or by loans issued through the Department of Environmental Protection.” On the one hand, this bill is a positive step towards the achievement of LSL replacement. On the other, it could be read to imply a lack of authority to use general rate revenues for these purposes.

¹²¹ 2018 NJ Sess. Law Serv. Ch. 114 (2019).

I. PUBLICLY-OWNED UTILITIES

A. Exemption from BPU Jurisdiction over Rates, except when Charging Higher Rates to 1,000 or more Customers Outside Municipal Boundaries

There are two types of publicly-owned water utilities in New Jersey. The first is utilities owned and operated directly by counties or municipalities, as authorized by N.J. Stat. Ann. § 40A:31-5. The second is a “municipal utilities authority” or “county utilities authority,” which is a separate legal entity created by a municipality or county. See N.J. Stat. Ann. § 40:14B-4.

Both types of publicly-owned utilities are exempt from the jurisdiction of the BPU, except that when a publicly-owned utility serves more than 1,000 customers outside its boundaries and charges different rates to those customers than to customers within its boundaries, then the BPU may regulate those outside-of-boundary rates. N.J. Stat. Ann. § 40A:31-23(e); see *Twp. of Wyckoff v. Vill. of Ridgewood*, No. A-2703-13T4, 2014 WL 10093617, at *3 (N.J. Super. Ct. App. Div. July 15, 2015) (“N.J.S.A. 40A:31-23(e) affirmatively exempts from the jurisdiction of the BPU municipal water utilities that charge the same rate to all of its customers regardless of their place of residence.”).

B. Substantive Standards: Uniform, Fair, and Equitable

The rates charged by a municipality are governed by N.J. Stat. Ann. § 40A:31-10, which provides that the rates “shall be uniform and equitable for the same type and class of use or service of the facilities, except as permitted by... [N.J. Stat. Ann. §] 40A:31-10.1.” N.J. Stat. Ann. § 40A:31-10.1, in turn, allows municipalities to offer partial or total rate abatements to senior citizens, people who are permanently and totally disabled, and active service members who are deployed in time of war.

The rates charged by a “municipal utilities authority” or “county utilities authority” are governed by N.J. Stat. Ann. § 40:14B-21, which provides that “[s]uch rents, rates, fees and charges shall as nearly as the municipal authority shall

deem practicable and equitable be uniform throughout the district for the same type, class and amount of use, products or services of the water system, except as permitted by...[N.J. Stat. Ann. §] 40:14B-22.2.” N.J. Stat. Ann. § 40:14B-22.2, as with the statute for municipalities, allows authorities to offer partial or total rate abatements to senior citizens, people who are permanently and totally disabled, and active service members who are deployed in time of war.

Courts have not been overly strict in applying the uniformity requirement contained in these statutes. Thus in one case, applying language regarding sewer rates that is identical to N.J. Stat. Ann. § 40:14B-21, the New Jersey Supreme Court explained that “the statute need not be read to require precise mathematical equality, but rather to contemplate rough equality, keeping in mind that we are in an area in which, as with respect to other tax impositions, absolute equality is neither feasible nor constitutionally vital.” *Airwick Indus., Inc. v. Carlstadt Sewerage Auth.*, 270 A.2d 18, 26 (N.J. 1970).

More generally, the New Jersey Supreme Court in *Meglino v. Township Committee of Eagleswood Township*, 510 A.2d 1134 (N.J. 1986), held that “[a]n ordinance establishing [such] rates*** will be upset only if patently unreasonable.” *Id.* at 1138 (citations and internal quotation marks omitted). The court explained that

[u]nlike those of private utilities, the rates that municipal utilities charge their customers are not subject to review by the Board of Public Utility Commissioners. In such cases the Legislature may not regard the need for local consumer protection as compelling. If the resident consumer-voter does not like the management or the rates, he can vote the governing body out of office, and thus achieve reform.

Id. (citations and internal quotation marks omitted).

On the one hand, the very deferential standard adopted by the New Jersey courts should favor municipalities or authorities that want to use ratepayer funds for LSL replacement. On the other hand, the existence of specific statutory exceptions from general rate-setting requirements for senior citizens, disabled individuals, and members of the armed services might be read to imply that utilities cannot distinguish customers on other bases, such as whether their homes are connected by LSLs.

C. Public Purpose Doctrine

The N.J. Constitution article VIII, section 3, paragraph 2 provides that “[n]o county, city, borough, town, township or village shall hereafter give any money or property, or loan its money or credit, to or in aid of any individual, association or corporation.” Additionally, article VIII, section 3, paragraph 3 states: “No donation of land or appropriation of money shall be made by the State or any county or municipal corporation to or for the use of any society, association or corporation whatever.”

Generally, New Jersey courts give great deference to the public agency or municipality to determine what constitutes a public purpose. “The determination of what constitutes a public purpose is primarily a function of the Legislature and should not be overruled by the courts except in instances where that determination is clearly arbitrary, capricious or unreasonable.” *New Jersey Sports and Exposition Auth. v. McCrane*, 292 A.2d 580, 589 (N.J. Super. L. Div. 1971). They employ a two-part test to identify a permissible public purpose.

First, whether the provision of financial aid is for a public purpose, and second, whether the means to accomplish it are consonant with that purpose. Thus, the funded activity must be one that serves a benefit to the community as a whole and at the same time is directly related to the functions of government.

Bryant v. City of Atl. City, 707 A.2d 1072, 1080 (N.J. App. Div. 1998) (citations omitted). Applying this standard, the New Jersey courts have upheld, for example, the expenditure of public money on the Meadowlands sports complex, *New Jersey Sports and Exposition Auth.*, 292 A.2d at 598, and on the private redevelopment of part of the Atlantic City marina district, *Bryant*, 707 A.2d at 1081. Given the significant public interests implicated by removing LSLs, an LSL replacement program should satisfy this test.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

The BPU regulates the rates and services of investor-owned water utilities. N.J. Rev. Stat. § 48:2-21. If a utility wants to change its rates, the BPU will hold a hearing to determine whether to approve the rate change: “[t]he burden of proof to show that the increase, change or alteration is just and reasonable shall be upon the public utility making the same.”

N.J. Rev. Stat. § 48:2-21(d). During BPU proceedings, “[t]he Ratepayer Advocate[, which] is administratively located within the BPU... represents the financial interests of customers in matters relating to utility rates and policy.” *In re Petition of New Jersey Am. Water Co., for an Increase in Rates for Water & Sewer Serv. & Other Tariff Modifications*, 777 A.2d 46, 48 (N.J. 2001).

B. Substantive Standards: Just and Reasonable, not Unjustly Discriminatory or Unduly Preferential

BPU-regulated utilities may not adopt rates that that are “unjust or unreasonable, unjustly discriminatory or unduly preferential.” N.J. Rev. Stat. § 48:3-1(a).¹²² Additionally, no commission-regulated utility may “adopt or impose any unjust or unreasonable classification in the making or as the basis of any individual or join rate.” N.J. Rev. Stat. § 48:3-1(b). Similarly, N.J. Rev. Stat. § 48:2-21(b)(1) grants the BPU the authority to “[f]ix just and reasonable...rates.”

These standards are common to most of the states examined in this paper, and therefore the arguments outlined in the introduction as to why an LSL replacement program satisfies these standards are applicable here. There are three reasons why a favorable outcome may be less likely in New Jersey than in other states, however. First, New Jersey law explicitly allows the “imposition or exaction of special, discriminatory or preferential rates...by nonprofit water companies which are owned wholly by nonprofit senior citizen cooperative associations, and which provide service only to the members of such association,” N.J. Rev. Stat. § 48:19-26, as well as the charging of “reduced rates” to the employees of natural gas and electric utilities, N.J. Rev. Stat. § 48:3-4. The existence of these exceptions could be read to foreclose utilities from offering others. Second, as reported in a recent paper, the BPU takes the position that “commission-regulated water and wastewater utilities...are unable to provide low-income customer assistance programs (CAPs) funded by rate revenues.”¹²³

¹²² This standard is, in part, reiterated in N.J. Rev. Stat. § 48:3-4, which provides that such utilities may not charge “unjustly discriminatory or unduly preferential...rates.”

¹²³ UNC ENVIRONMENTAL FINANCE CENTER, NAVIGATING LEGAL PATHWAYS TO RATE-FUNDED CUSTOMER ASSISTANCE PROGRAMS: A GUIDE FOR WATER AND WASTEWATER UTILITIES 79 (2017) (reporting personal communications with BPU).

Third, the New Jersey Supreme Court has held that a utility may not count its charitable contributions as operating expenses. *In re Petition of New Jersey Am. Water Co., for an Increase in Rates for Water & Sewer Serv. & Other Tariff Modifications*, 777 A.2d 46, 52 (N.J. 2001) (“Although we commend American Water for making charitable contributions, we are convinced that the cost of those contributions should be borne solely by its shareholders.”). It is therefore unclear whether investor-owned utilities have the authority to pay for LSL removal on private property with ratepayer funds at this time. If, however, BPU approves such a program, the deferential standard of review described below means that there would be a fair chance that the New Jersey courts would uphold this approval.

C. Inclusion of LSLs on Private Property in Rate Base

The New Jersey courts traditionally required BPU to determine a utility’s rate base and to set rates on the basis of that value, the operating expenses, and a fair rate of return, *In re New Jersey Am. Water Co.*, 777 A.2d at 50, “the BPU is not required to calculate a rate base in certain circumstances.” *In re Bd.’s Investigation & Review of Local Exch. Carrier Intrastate Exch. Access Rates*, No. A-2974-09T2, 2012 WL 2344585, at *16 (N.J. Super. Ct. App. Div. June 21, 2012); see N.J. Stat. Ann. § 48:2-21.2. As expressed in one decision, the BPU “is not required to employ any

particular mode of computing rates,” but “is free to make ‘pragmatic adjustments’ designed to fit the circumstances.” *Petition of Pub. Serv. Elec. & Gas Co.*, 699 A.2d 1224, 1233 (N.J. App. Div. 1997). Thus, for example, courts have upheld BPU rate-setting decisions based on an operating margin methodology rather than a rate base/rate of return methodology. *Penpac, Inc. v. Passaic Cty. Utilities Auth.*, 843 A.2d 1153, 1164 (N.J. App. Div. 2004). Accordingly, the rate base issue should not be a barrier to an LSL removal program in New Jersey.

D. Standard of Review

The New Jersey courts defer to BPU’s rate-setting decisions. In particular, the New Jersey Supreme Court has held that “rate making is a legislative and not a judicial function, and that the [BPU], to which the Legislature has delegated its rate-making power, is vested with broad discretion in the exercise of that authority.” *In re Petition of New Jersey Am. Water Co., for an Increase in Rates for Water & Sewer Serv. & Other Tariff Modifications*, 777 A.2d 46, 50 (N.J. 2001) (citation and internal quotation marks omitted). Thus a court will overturn a decision of the BPU only when it was “arbitrary, capricious, unreasonable, or beyond the agency’s delegated powers,” *id.*, or “when it clearly appears that there was no evidence before the board to support the same reasonably or that the same was without the jurisdiction of the board.” N.J. Stat. Ann. § 48:2-46.

NEW YORK



Est. No. of LSLs ¹²⁴	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
360,000	6.3%	Likely	Uncertain but likely	

¹²⁴ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Publicly-owned utilities in New York may be owned by cities, towns, villages, counties, or water authorities. The New York Public Service Commission (“NYPSC”) does not have any authority over the rates of any of these types of utilities. The specific substantive standards against which rates are judged varies with the type of publicly-owned utility, but all types have broad authority over their rates. Water authorities, for example, are allowed to consider “public policy goals, and not only economic goals,” when setting rates.

Investor-owned utilities must have their rates approved by the NYPSC. Pursuant to statute, these rates must be just and reasonable, a utility cannot charge or receive greater or less compensation from one customer than it does from another “for doing a like and contemporaneous service,” and a utility cannot “grant any undue or unreasonable preference or advantage” to any customer. The New York courts grant considerable deference to the NYPSC’s rate-setting decisions.

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

Pursuant to N.Y. Pub. Serv. Law § 89-1, the NYPSC does not regulate the rates of publicly-owned utilities, including utilities owned by cities, towns, and water districts. See *Waterbury v. City of Oswego*, 251 A.D.2d 1060, 1060, 674 N.Y.S.2d 530, 531 (1998) (“[T]he Public Service

Commission has no jurisdiction over the review and determination of rates, penalties and late fees charged by a municipality that owns and operates its own water supply system.”).¹²⁵ The NYPSC’s jurisdiction over publicly-owned utilities is limited to the requirement that each municipality must file with the Commission “a copy of the annual report of its division, bureau or department of water.” N.Y. Pub. Serv. Law § 89-1(2).

B. Substantive Standards

In New York, there are several different types of publicly-owned water utilities. Water utilities may be owned by cities, towns, villages, or counties. In addition, there are 24 water and/or wastewater authorities established by state law. Each type of publicly-owned water utility is governed by different state statutes; each individual water authority has separate statutory authorization. It is therefore difficult to draw general conclusions about rate-setting authority applicable to all publicly-owned water utilities.

We may make, however, a few observations. First, the statutes authorizing water districts that we have reviewed impose no limit on the rate-setting authority of districts. Instead, they generally provide only that the district has the authority:

¹²⁵ The individual statutes authorizing water districts also provide that the NYPSC has no jurisdiction over the rates of those districts. See, e.g., N.Y. Pub. Auth. Law § 1095(6) (*Monroe County Water Authority*); N.Y. Pub. Auth. Law § 1153(6) (*Onondaga County Water Authority*).

To fix rates and collect charges for the use of the facilities of, or services rendered by, or any commodities furnished by the authority such as to provide revenues sufficient at all times to pay, as the same shall become due, the principal and interest on the bonds, notes or other obligations of the authority together with the maintenance of proper reserves therefor, in addition to paying as the same shall become due the expense of operating and maintaining the properties of the authority together with proper reserves for depreciation, maintenance and contingencies and all other obligations and indebtedness of the authority.

N.Y. Pub. Auth. Law § 1154(17) (Onondaga County Water Authority); *accord*, e.g., N.Y. Pub. Auth. Law § 1096(15) (Monroe County Water Authority); N.Y. Pub. Auth. Law § 1199-eee(22) (Saratoga County Water Authority).

In a recent case involving rates set by a water authority—the New York City Water Board—the Court of Appeals of New York (the state’s highest court) held that the Board had “unfettered discretion to fix [rates] as it will so long as invidious illicit discriminations are not practiced and differentials are not utterly arbitrary and unsupported by economic or public policy goals, as it reasonably conceives them.” *Prometheus Realty Corp. v. New York City Water Bd.*, 30 N.Y.3d 639, 646, 92 N.E.3d 778, 782 (2017) (citations and internal quotation marks omitted). Moreover, it emphasized that “water and sewer rates may be determined in accordance with public policy goals, and not only economic goals.” *Id.* (citing N.Y. Public Authorities Law § 2824[1] [g]). This very broad discretion to establish rates and especially the explicit authority to consider public policy goals suggests that water authorities should be able to use ratepayer funds for LSL replacement.

Second, state law imposes some limits on the rate-setting authority of county water utilities. In particular, the county may fix such rates “on any equitable basis,” including “a system of classification which, for purposes of establishing differential rates, charges or rentals, may allocate among areas within the district designated by the administrative head or body, the costs of establishment of the district, the furnishing of improvements therein and operation and maintenance of district facilities or any combination thereof.” N.Y. County Law § 266(1). Under this provision, the New York courts have invalidated “a \$65,100 ‘tap-in’ fee

imposed upon the developer of a shopping mall because the sewer district admitted that the actual cost of regulating the connection was less than \$1500.” *Mark IV Const. Co. v. Cty. of Monroe*, 187 A.D.2d 985, 985, 590 N.Y.S.2d 335, 336–37 (1992) (citing *Hamburg Assocs. Ltd. P’ship v. Bd. of Managers of Erie Cty. Sewer Dist. No. 3*, 129 A.D.2d 990, 514 N.Y.S.2d 298, 298 (1987)).

Third, with respect to towns and cities, their water “rates must be reasonable.” *Town Bd. of Town of Poughkeepsie, on Behalf of Arlington Water Dist. v. City of Poughkeepsie*, 22 A.D.2d 270, 273, 255 N.Y.S.2d 549, 552 (1964). “The concept of charging different rates to different consumers... is not improper... Variances in rates must have a rational basis and not be purely arbitrary and must be fair and equal to similarly situated properties, that is, there must be uniformity *within the class*.” *Id.* (citations and internal quotation marks omitted). Thus, for example, “rates may be established which will vary according to usage.” *Stepping Stones Assocs. v. City of White Plains*, 100 A.D.2d 619, 620, 473 N.Y.S.2d 578, 579 (N.Y. App. Div. 1984). The cases suggest that in reviewing a municipality’s rates, courts will determine whether the “fee system is rationally related to the city’s legitimate goals,” *id.*, or if “there is a rational reason” for the rate. *Waterbury v. City of Oswego*, 251 A.D.2d 1060, 1060, 674 N.Y.S.2d 530, 531 (N.Y. App. Div. 1998).

A 1988 opinion of the State Comptroller concluded that in setting municipal water rates, “[c]lassifications granting preferential treatment to a particular class of persons have been found to be permissible where the classification has a rational basis and is not arbitrary, where there is uniformity within the class, and where the classification bears some substantial and rational relationship to the accomplishment of a legitimate governmental purpose.”¹²⁶ Applying this standard, the Comptroller concluded that a town could “establish a schedule of water rates which charges senior citizens meeting certain income criteria at a reduced rate.”

C. Public Purpose Doctrine

As stated in N.Y. Const. art. VIII, § 1: “[n]o county, city, town, village or school district shall give or loan any money or property to or in aid of any individual, or private corporation or association, or private undertaking, or become directly

¹²⁶ 1988 Opns. St. Comp. No. 88-57 (Dec. 7, 1988), available at <https://www.osc.state.ny.us/legal/1988/op88-57.htm>.

or indirectly the owner of stock in, or bonds of, any private corporation or association.” New York Courts have generally interpreted what constitutes a public purpose broadly.

The Appellate Division has stated that “[i]n general, the gift and loan clause prohibits a municipality from expending money for the benefit of a private individual or concern unless the expenditure is in furtherance of a public purpose and the municipality is contractually or statutorily required to do so.” *Schulz v. Warren Cty. Bd. of Sup’rs*, 179 A.D.2d 118, 121, 581 N.Y.S.2d 885, 887 (N.Y. App. Div. 1992). Applying this standard, in one case a trial court found that the sale of a public building to a private entity that would convert the building into a museum did not violate the N.Y. Constitution because a museum is a public purpose. *Landmark West! v. City of New York*, 9 Misc. 3d 563, 569, 802 N.Y.S.2d 340, 347 (N.Y. Sup. Ct. 2005). In an older case, the court upheld the use of public funds to lay pipes under private streets in order to supply water to customers of the town water district. *Horsfall v. Schuler*, 217 A.D. 146, 149, 216 N.Y.S. 391, 393 (App. Div. 1926).

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

The NYPSC has the authority to regulate the rates of investor-owned utilities. N.Y. Pub. Serv. Law § 89-c. The rates charged by a NYPSC-regulated utility may “not [be] more than allowed by law or by order of the commission.” N.Y. Pub. Serv. Law § 89-b(1).

B. Substantive Standards: “Just and Reasonable,” no “Greater or Less Compensation,” and no “Undue or Unreasonable Preference”

The rates charged by NYPSC-regulated utilities “shall be just and reasonable.” N.Y. Pub. Serv. Law § 89-b(1). In addition, such utilities cannot charge or receive one person or corporation “a greater or less compensation... than it charges... or receives from any other person or corporation for doing a like and contemporaneous service with respect thereto under the same or substantially

similar circumstances or conditions.” N.Y. Pub. Serv. Law § 89-b(2). Finally, such utilities “shall [not] make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of services in any respect whatsoever.” N.Y. Pub. Serv. Law § 89-b(3).

In addition, “in its review of the utility’s operating expenses, the Commission may act to prevent unreasonable costs for materials and services from being passed on to ratepayers.” *Crescent Estates Water Co. v. Pub. Serv. Comm’n of State*, 77 N.Y.2d 611, 617, 571 N.E.2d 694, 698 (1991) (citations and internal quotation marks omitted).

These standards are common to most of the states examined in this paper, and therefore the arguments outlined in the introduction as to why an LSL replacement program satisfies these standards are applicable in New York.

C. Inclusion of LSLs on Private Property in Rate Base

The NYSPC is not required to use any particular methodology when establishing rates. “Other than the accomplishment of a just and reasonable result there is no requirement in law that any specific factors should be considered in fixing utility rates, nor that any be excluded from consideration.” *Consol. Edison Co. of New York v. New York State Pub. Serv. Comm’n*, 53 A.D.2d 131, 133–34, 385 N.Y.S.2d 209, 210 (1976). Therefore, the NYPSC does not need to determine whether LSLs on private property could be included in a utility’s rate base when deciding whether to approve an LSL replacement program.

D. Standard of Review

New York courts have held that the NYPSC has “broad discretion to review and determine the reasonableness of any rates or charges sought to be imposed by any water-works corporation” and that as a result its determinations “are entitled to deference and may not be set aside unless they are without any rational basis or without reasonable support in the record.” *Home Depot U.S.A., Inc. v. New York State Pub. Serv. Comm’n*, 55 A.D.3d 1111, 1113, 868 N.Y.S.2d 770, 772 (N.Y. App. Div. 2008) (citations and internal quotation marks omitted).

OHIO



Est. No. of LSLs ¹²⁷	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
650,000	6.8%	Likely	Uncertain	

¹²⁷ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Publicly-owned utilities are not subject to the jurisdiction of the Public Utilities Commission of Ohio (“PUCO”). If the rates are challenged, then the courts determine whether they are reasonable and contain no unjust discrimination. The Ohio courts adopt a broad and deferential view of the public purpose requirement.

Investor-owned utilities are subject to regulation by the municipality in which they operate, as well as by the PUCO (either on appeal from a municipal rate-setting or when a municipality declines to set rates). The PUCO will modify the utility’s rates if it concludes they are unjust, unreasonable, unjustly discriminatory, or unjustly preferential.”

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

Municipalities in Ohio have the power to establish municipal water utilities under Article XVIII, Section 4 of the Ohio Constitution. Water utilities owned or operated by a municipality are not subject to the jurisdiction of the PUCO. Ohio Rev. Code Ann. § 4905.02(A)(3).

B. Substantive Standards: “Reasonable” and “No Unjust Discrimination”

Regarding the rates charged by municipal utilities to customers within the municipal boundaries, the Supreme Court of Ohio has held that “The only general restraints

imposed on the distribution of water are that the rates charged be reasonable and that there be no unjust discrimination among the customers served, taking into account their situation and classification.” *State ex rel. Mt. Sinai Hosp. of Cleveland v. Hickey*, 30 N.E.2d 802, 804 (Ohio 1940). In applying this standard, the court found it permissible for a municipality to provide water free of charge to various “public, religious, educational or charitable institutions.” *Id.*; cf. Ohio Rev. Code Ann. § 743.27 (“The legislative authority of any municipal corporation owning and operating municipal water, gas, or electric light plants, may provide by ordinance that the products of such plants, when used for municipal or public purposes, shall be furnished free of charge.”).

When a municipal water utility sells water to customers outside of its boundaries, those customers have no judicially-enforceable right to reasonable rates. Instead,

absent a contract obligating a city to provide its services, a municipality has the authority to impose conditions on the sale of its utility services to extraterritorial users and, consequently, has the authority to refuse to sell its services to extraterritorial users who do not agree to the conditions demanded by the municipality.

City of Hudson v. City of Akron, 97 N.E.3d 738, 742 (Ohio Ct. App. 2017) (citations and internal quotation marks omitted). Accordingly, such “customers have no right to demand reasonable water rates from [the municipal utility], unless those rates are negotiated into a contract.” *Id.* at 743.

C. Public Purpose Doctrine

Without citing any specific provision in the state constitution, the Supreme Court of Ohio has held that “[i]t must be considered well settled that the funds of a municipality can be expended only for public purposes.” *State ex rel. McClure v. Hagerman*, 98 N.E.2d 835, 837 (Ohio 1951). The courts have repeatedly recognized that there is no simple test for what counts as a public purpose and that the trend has been towards expanding the types of activities that qualify. See, e.g., *id.* at 838-39; *Norton v. Limbach*, 585 N.E.2d 444, 447 (Ohio Ct. App. 1989).

In applying the public purpose requirement, moreover, the Ohio courts defer to the municipal government’s judgment. “The determination of what constitutes a public purpose is primarily a legislative function, subject to review by the courts when abused, and the determination of the legislative body of that matter should not be reversed except in instances where such determination is palpable and manifestly arbitrary and incorrect.” *State ex rel. McClure v. Hagerman*, 98 N.E.2d 835, 838 (Ohio 1951). “Accordingly, a municipality has broad discretion in determining what constitutes a public purpose.” *Siebert v. Columbus & Franklin Cty. Metro. Park Dist.*, No. 00AP-583, 2000 WL 1877585, at *2 (Ohio Ct. App. Dec. 26, 2000).

In the face of public purpose doctrine challenges, courts have upheld municipal decisions to construct a stadium that would be used by professional baseball and football teams, *Bazell v. City of Cincinnati*, 233 N.E.2d 864 (Ohio 1968), and to grant money to veterans’ associations “rehabilitation of war veterans and for the promotion of patriotism.” *State ex rel. Dickman v. Defenbacher*, 128 N.E.2d 59, 65 (Ohio 1955). In the latter case, the court emphasized that “the appropriation of public money to a private corporation to be expended for a public purpose is a valid act of the legislative body.” *Id.* Thus the granting of money to private individuals for LSL replacement should be acceptable, given the public purposes served by such a grant, as explained in the introduction to this paper.

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

Investor-owned utilities are potentially subject to the jurisdiction of both the local government in the municipality in which they operate and of the PUCO. Ohio Rev.

Code Ann. § 743.26 provides that municipalities “may regulate the price” that investor-owned water utilities charge within their borders and that “[s]uch companies shall in no event charge more...than the price specified by ordinance.” Utilities have the right, however, to appeal the municipality’s rate determination to the PUCO. Ohio Rev. Code Ann. § 4909.34. If the PUCO determines that the rate established by ordinance is “unjust, unreasonable, or insufficient to yield reasonable compensation for the service, the commission shall fix and determine the just and reasonable rate,... based on the factors stated in section 4909.15.” Ohio Rev. Code Ann. § 4909.39. If a municipality with authority to fix rates fails to do so, the utility may also petition to the PUCO “to fix the just and reasonable rates for the furnishing of such services.” Ohio Rev. Code Ann. § 4909.35.

The PUCO has the authority to regulate investor-owned utilities under Ohio Rev. Code Ann. §§ 4905.04, 4905.05. As defined in § 4905.02 a public utility “includes every corporation, company, co-partnership, person, or association, the lessees, trustees, or receivers of the foregoing, defined in section 4905.03 of the Revised Code, including any public utility that operates its utility not for profit, except...a public utility that is owned or operated by any municipal corporation.”

Section 4909.17 requires that utilities obtain PUCO approval before making a change in rate schedules. “No rate, joint rate, toll, classification, charge of a public utility shall become effective until the public utilities commission, by order, determines it to be just and reasonable.” Furthermore, commission-regulated utilities are also prohibited, under § 4905.32, from charging rates different than those filed with the PUCO. Under § 4905.32, “no public utility shall charge, demand, receive, or collect a different rate...or charge for any service rendered, or to be rendered, then that applicable to such service in its schedule filed with the public utilities commission which is in effect at the time.”

B. Substantive Standards: “Just and Reasonable,” No Undue Preference or Discrimination, Uniform Rates

Under Ohio Rev. Code Ann. § 4909.15(E), if the PUCO determines that a proposed rate is “unjust, unreasonable, unjustly discriminatory, [or] unjustly preferential,” then

it must “fix and determine the just and reasonable rate.” These basic requirements are elaborated upon in other provisions. Thus section 4905.22 states that “[a]ll charges made or demanded for any service rendered [by a public utility], or to be rendered, shall be just, reasonable, and not more than the charges allowed by law or by order of the public utilities commission.” In addition, “[n]o public utility shall make or give any undue or unreasonable preference or advantage to any person, firm, corporation, or locality, or subject any person, firm, corporation, or locality to any undue or unreasonable prejudice or disadvantage.” Ohio Rev. Code Ann. § 4905.35(A).

In addition, Ohio statutes limit a regulated utility’s ability to grant special rates to particular customers. First, such utilities cannot charge one customer a different rate than they charge any other person, firm, or corporation for “doing a like and contemporaneous service under substantially the same circumstances and conditions,” unless authorized by certain chapters of the Ohio Revised Code. Ohio Rev. Code Ann. § 4905.33(A). Second, utilities cannot provide reduced-cost or free service “for the purpose of destroying competition.” Ohio Rev. Code Ann. § 4905.33(B). One exception to the limitation in section 4905.33(A) is contained in section 4905.34, which allows utilities to grant “reduced rates or free service...for charitable purposes.” The Supreme Court of Ohio has held that the power granted in section 4905.34 is not limited by section 4905.33(B). *Ohio Edison Co. v. Public Utilities Comm’n*, 678 N.E.2d 922, 927 (Ohio 1997).

These standards are common to most of the states examined in this paper, and therefore the arguments outlined in the introduction as to why an LSL replacement program satisfies these standards are applicable in Ohio.

C. Inclusion of LSLs on Private Property in Rate Base

Ohio statutes prescribe the method that the PUCO must use in setting rates. First, it must determine “[t]he valuation as of the date certain of the property of the public utility used and useful or, with respect to a natural gas, water-works, or sewage disposal system company, projected to be used and useful as of the date certain, in rendering the public utility service for which rates are to be fixed and determined.” Ohio Rev. Code Ann. § 4909.15(A)(1). Then

it must identify “[a] fair and reasonable rate of return to the utility on the valuation as determined in division (A) (1) of this section.” *Id.* § 4909.15(A)(2). Based on this rate of return and the property valuation, the PUCO must calculate “[t]he dollar annual return to which the utility is entitled.” *Id.* § 4909.15(A)(3). It must also determine “[t]he cost to the utility of rendering the public utility service” during a test period. *Id.* § 4909.15(A)(4). “[T]he gross annual revenues to which the utility is entitled” are the sum of the return calculated under (A)(3) and the cost identified under (A)(4).

These provisions raise the issue of whether a utility’s expenditures on replacing LSLs on private property would be permissible if those lines were not included as “used and useful” property under section 4909.15(A)(1). It appears, however, that they would not need to be treated as such and could instead be treated as operating expenses. In 2017, the Supreme Court of Ohio upheld the PUCO’s decision to allow Duke Energy to use ratepayer funds for the environmental remediation of the sites of manufactured-gas plants that had not been operational for decades. *In re Application of Duke Energy Ohio, Inc.*, 82 N.E.3d 1148 (Ohio 2017). The court upheld the PUCO’s decision to allow these costs as operating expenses under section 4909.15(A)(4). “[B]ecause Duke is seeking to recover costs—and not its capital investment in the MGP property and facilities—the commission correctly refused to apply the used-and-useful standard under R.C. 4909.15(A)(1).” *Id.* at 1153.

“[O]perating expenses are recoverable if they were incurred in rendering service during the test period and are prudent.” *Id.* The court upheld the Commission’s decision that Duke Energy’s expenses were recoverable because the company was under a statutory mandate to remediate the sites. *Id.* at 1154. The court also held that operating expenses were not limited to “normal, recurring expenses.” *Id.* at 1155. Thus it seems likely that the PUCO could approve a utility’s LSL replacement program expenses as operating expenses.

D. Standard of Review

Decisions of the PUCO are subject to direct review by the Supreme Court of Ohio. Ohio Rev. Code Ann. § 4903.12. That court has the authority to reverse a PUCO order if it concludes that the “order was unlawful or unreasonable.” Ohio Rev. Code Ann. § 4903.13. In carrying out this

duty, the court defers to the factual conclusions of the Commission. In particular,

This court has complete and independent power of review as to all questions of law in appeals from the commission. We will not reverse or modify a commission decision as to questions of fact when the record contains sufficient probative evidence to show that the decision is not manifestly against the weight of the evidence and is not so clearly unsupported by the record as to show misapprehension, mistake, or willful disregard of duty. The appellant bears the burden of demonstrating that the commission's decision is against the manifest weight of the evidence or is clearly unsupported by the record.

In re Review of Alternative Energy Rider Contained in Tariffs of Ohio Edison Co., No. 2013-2026, 2018 WL 549915, 2018-Ohio-229, ¶¶ 14 (Jan. 16, 2018) (citations and internal quotation marks omitted).

PENNSYLVANIA

PA

Est. No. of LSLs ¹²⁸	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
160,000	30.2%	Definite	Definite	2017 law allows publicly-owned utilities to use public funds. ¹²⁹ Commission approved one proposal for investor-owned utility in 2017 and 2018 law makes explicit the Commission's authority to do so. ¹³⁰

¹²⁸ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 *Am. Water Works Ass'n E182*, E182 (2016).

¹²⁹ 2017 Pa. Laws Act 2017-44 (H.B. 674).

¹³⁰ In re York Water Co., No P-2016-2577404 (Pa. Pub. Utility Comm'n May 2, 2018), available at http://www.puc.pa.gov/about_puc/consolidated_case_view.aspx?Docket=P-2016-2577404; 2018 Pa. Laws Act. 2018-120 (H.B. 2075).

As described in the introduction, the Pennsylvania legislature has enacted legislation that (1) specifically authorizes publicly-owned utilities to use public funds to pay for LSL replacement on private property and (2) specifically authorizes the Pennsylvania Public Utility Commission (“PUC”) to authorize investor-owned utilities to use ratepayer funds for the same purpose.

I. PUBLICLY-OWNED UTILITIES

Under P.L. 2017-725 (HB 674), enacted in October 2017, municipal utilities may “perform the replacement or remediation of private water laterals and use “public funds” for this purpose if the municipality finds that it “will benefit the public health, public water supply system or public sewer system.” Pa. P.L. 725, No. 44, § 14 (codified at 72 P.S. § 1719-E(c)). Before it uses public funds, the municipality must “consider the availability of public funds, equipment, personnel and facilities and the competing demands of the authority for public funds, equipment, personnel and facilities.” *Id.*

II. INVESTOR-OWNED UTILITIES

Under P.L. 2018-120 (HB-2075), enacted in October 2018, investor-owned utilities can apply to the PUC for authorization to use ratepayer funds for LSL replacement on private property.¹³¹ Under the law, the cost is considered “other related capitalized costs that are part of the public utility’s distribution system” and the recovery an “equity return rate.” Pa. P.L. 738, No. 120, § 1 (codified at 66 Pa. C.S.A. § 1311(b)(2)). The PUC must establish standards, processes, and procedures to ensure the work is accompanied by a warranty, ensure the utility has access to the property during the warranty, and reimburse customers who have replaced their LSL within one year of commencing a PUC-approved LSL replacement project. 66 Pa. C.S.A. § 1311(b)(2)(vii).

¹³¹ 2018 Pa. Laws Act 2018-120 (H.B. 2075).

TEXAS



Est. No. of LSLs ¹³²	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
270,000	3.2%	Likely	Uncertain	Municipality can review and approved investor-owned utility proposals.

¹³² David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass'n E182, E182 (2016).

Municipal utilities operating within their boundaries are not subject to the oversight of the Public Utilities Commission of Texas (“Texas PUC”). Courts will review a municipal utility’s rates to determine whether they are reasonable and not unduly discriminatory. In conducting this review, the courts grant significant deference to the municipality’s judgments. The Texas courts are also deferential in determining whether an expenditure of public funds serves a public purpose.

By default, investor-owned utilities are under the original jurisdiction of the municipalities in which they operate. However, the Texas PUC has appellate jurisdiction to review those rates. In addition, municipal governments can decide to grant the PUC exclusive jurisdiction over private utilities’ rates. Finally, a utility operating outside of the incorporated limits of any municipality is also subject to the PUC’s exclusive jurisdiction. The rates of a utility subject to the Texas PUC’s jurisdiction must be just and reasonable, and not unreasonably preferential, prejudicial, or discriminatory. The courts defer to the PUC’s application of these standards.

I. PUBLICLY-OWNED UTILITIES

A. Prior Commission Approval

The Texas PUC does not have either direct or appellate jurisdiction over municipal water utilities operating within their boundaries. Tex. Water Code Ann. §§ 13.042(f),

13.043(a). Instead, municipalities are granted by statute the right to operate and regulate their water systems “in a manner that protects the interests of the municipality.” Tex. Local Gov’t Code Ann. § 552.001(b).

If a municipal utility is providing service in an area that is not within the boundaries of any municipality, then the Texas PUC has original jurisdiction over the rates for those customers. Tex. Water Code Ann. § 13.042(e). If it is operating within the boundaries of another municipality, then it is presumptively subject to the original jurisdiction of that municipality and the appellate jurisdiction of the Texas PUC, as described below for privately-owned utilities.

B. Substantive Standards: “Reasonable and not Unduly Discriminatory”

There are no statutory limits on the rates that municipal utilities can charge customers within their municipal boundaries. However, the Texas courts have imposed common-law restraints on municipal utility rates. In particular, municipal utilities “may not discriminate in charges or services as between persons similarly situated.” *City of Texarkana v. Wiggins*, 246 S.W.2d 622, 624 (Tex. 1952). Moreover, the utility’s “rates must be reasonable and not unduly discriminatory.” *Black v. City of Killeen*, 78 S.W.3d 686, 693 (Tex. App. 2002). With regard to discrimination, “not all price discrimination is condemned, but only discrimination that is arbitrary and without a reasonable face basis or

justification.” *Id.* at 699 (citations and internal quotation marks omitted). Thus:

[i]t is well established that a municipal corporation operating its water works or other public utility has the right to classify consumers under reasonable classification based upon such factors as the cost of service, the purpose for which the service or product is received, the quantity or amount received, the different character of the service furnished, the time of its use or any other matter which presents a substantial difference as a ground of distinction.

Gillam v. City of Fort Worth, 287 S.W.2d 494, 497 (Tex. Civ. App. 1956).

C. Standard of Review

Texas courts are very deferential when reviewing the rates that municipalities have established for customers within their municipal boundaries. As the Court of Civil Appeals explained in *Gillam*,

whether differences in rates between classes of customers of municipal water works are to be made... are legislative rather than judicial questions and are for the determination of the governing bodies of the municipalities. The presumption is in favor of the legality of the rates established by the rate-making authority, and courts may interfere only in clear cases of illegality.

287 S.W.2d at 497. Thus, unless a court were to find an LSL replacement program clearly illegal or unreasonable, such a program would be likely permitted.

D. Public Purpose Doctrine

The Texas Constitution contains several provisions restricting the use of public money and credit. Thus it prevents the legislature from “mak[ing] any grant or authorize[ing] the making of any grant of public moneys to any individual, association of individuals, municipal or other corporations whatsoever.” Tex. Const. art. III, § 51. It also prohibits the legislature from “giv[ing] or...lend[ing], or...authorize[ing] the giving or lending, of the credit of the State in aid of, or to any person, association or corporation, whether municipal or other.” Tex. Const. art. III, § 50. In addition, “the

Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association or corporation whatsoever, or to become a stockholder in such corporation, association or company.” Tex. Const. art. III, § 52. Finally, the constitution provides that “[t]axes shall be levied and collected by general laws and for public purposes only.” Tex. Const. art. VIII, § 3.

As in most other states, the Texas courts generally defer to legislative determinations that a proposed action serves a public purpose. In *Davis v. City of Taylor*, 67 S.W.2d 1033, 1034 (Tex. 1934), the Texas Supreme Court held “that unless a court can say that the purposes for which public funds are expended are clearly not public purposes, it would not be justified in holding invalid a legislative act or provision in a city charter.” Thus the Texas courts have upheld the use of public funds for public housing, *Hous. Auth. of City of Dallas v. Higginbotham*, 143 S.W.2d 79 (Tex. 1940), a county hospital, *Seydler v. Border*, 115 S.W.2d 702 (Tex. Civ. App. 1938), an irrigation district that served only 26 landowners, *Borden v. Trespalacios Rice & Irr. Co.*, 86 S.W. 11, 12 (Tex. 1905), and providing a right-of-way to a private railroad in order to reduce the number of grade crossings in a city, *Barrington v. Cokinos*, 145, 338 S.W.2d 133 (Tex. 1960).

It is thus likely that the use of public funds for LSL replacement on private property would constitute a predominant public purpose. If the state were to mandate the removal of all LSLs, then it is even more likely that the use of public funds to pay for the removal of the portions on private property would be permissible. As explained by the Texas Supreme Court:

The question to be decided then is whether the use of public funds to pay part or all of the loss or expense to which an individual or corporation is subjected by the state in the exercise of its police power is an unconstitutional donation for a private purpose. We think not provided the statute creating the right of reimbursement operates prospectively, deals with the matter in which the public has a real and legitimate interest, and is not fraudulent, arbitrary or capricious.

State v. City of Austin, 331 S.W.2d 737, 743 (Tex. 1960).

II. INVESTOR-OWNED UTILITIES

A. Prior Commission Approval

Investor-owned utilities may be regulated by either the Texas PUC or municipal governments.¹³³ By default, investor-owned utilities are under the original jurisdiction of the municipalities in which they operate. Tex. Water Code Ann. § 13.042(a). Any party to a rate proceeding before a municipality, however, has the right to appeal the decision to the Texas PUC, which engages in *de novo* review. Tex. Water Code Ann. § 13.043(a). In addition, municipal governments can elect by ordinance not to exercise their right of primary jurisdiction, in which case the PUC has exclusive jurisdiction over the utility's rates. Tex. Water Code Ann. § 13.042(b). Finally, a utility operating outside of the incorporated limits of any municipality is also subject to the PUC's exclusive jurisdiction. Tex. Water Code Ann. § 13.042(e). For all utilities subject to its jurisdiction, the Texas PUC has the authority to "fix and regulate rates." Tex. Water Code Ann. § 13.181(b).

B. Substantive Standards: "Just and Reasonable," not "Unreasonably Preferential, Prejudicial, or Discriminatory"

Municipalities have the authority to regulate the rates of utilities subject to their jurisdiction so that they are "fair, just, and reasonable." Tex. Water Code Ann. § 13.042(a). However, because all municipally-determined rates are subject to *de novo* review by the PUC, the standards that matter are those applicable to PUC-regulated utilities. Under Tex. Water Code Ann. § 13.182, these rates must be (a) "just and reasonable" and (b) "not...unreasonably preferential, prejudicial, or discriminatory but...sufficient, equitable, and consistent in application to each class of consumers." Reiterating the latter requirement, Tex. Water Code Ann. § 13.189(a) provides that a water utility "as to rates or services may not make or grant any unreasonable preference or advantage to any corporation or person within any classification or subject any corporation or person within any classification to any unreasonable prejudice or disadvantage."

¹³³ The rules described here also apply to municipal utilities acting outside of the boundaries of the municipality, as mentioned above.

There is no case law in Texas analyzing these requirements of the Water Code. However, these requirements are similar to those in several of the other states discussed in this paper. As outlined in the introduction, there are strong arguments that LSL replacement programs are permissible under these standards, though the "unreasonably preferential, prejudicial, or discriminatory" prohibition presents a greater barrier than the "just and reasonable" requirement. One potential cause for concern is Tex. Water Code Ann. § 13.182(b-1), which allows the PUC to approve "reduced rates for a minimal level of service to be provided solely to a class of elderly customers 65 years of age or older to ensure that those customers receive that level of service at more affordable rates." This provision is problematic both because the allowance of discriminatory pricing on this basis might be read to prohibit discrimination on other grounds and because, even for these reduced rates, the provision states that a "utility may not recover those costs through charges to the utility's other customer classes." Tex. Water Code Ann. § 13.182(b-1).

C. Inclusion of LSLs on Private Property in Rate Base

Texas law provides that "[u]tility rates shall be based on the original cost of property used by and useful to the utility in providing service." Tex. Water Code Ann. § 13.185(b). Similarly, Tex. Water Code Ann. § 13.183(a)(1), provides that the PUC must "permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses." If the portions of LSLs on private property that are replaced pursuant to an LSL replacement program are not considered to be the property of the utility, these provisions raise the question of whether the cost of replacement of those portions of the LSLs can be included in the utility's rate base.

Texas case law does not provide a clear answer to this question, but one decision of the Court of Appeals includes helpful *dicta*. In *Texas Water Comm'n v. Lakeshore Util. Co.*, 877 S.W.2d 814, 821 (Tex. App. 1994), the court stated that "there conceivably could be situations in which a utility's facilities are wholly owned by a separate entity, and yet the utility meets its burden of demonstrating that it is entitled to a rate of return on the facilities." The court noted that the Water Code requires only that the property be "used and useful" and says nothing about ownership. *Id.*

Because the portions of service lines on private property are clearly “used and useful” in the distribution of water to a utility’s customers, there is a strong argument that they are properly included in the utility’s rate base.

D. Standard of Review

In proceedings before the PUC, the burden of proof is on the utility to prove that a proposed rate increase is “just and reasonable.” Tex. Water Code Ann. § 13.184(c). On appeal of a PUC decision in court, the Texas courts defer to the PUC’s judgment regarding rates. In particular:

We must reverse the Commission’s order if it is not supported by substantial evidence or if the order was arbitrary, capricious, or an abuse of discretion. We must uphold the Commission’s order if (1) the findings of underlying fact in the order fairly support the Commission’s findings of ultimate fact and conclusions of law, and (2) the evidence presented at the hearing reasonably supports the findings of underlying fact.

Texas Water Comm’n v. Lakeshore Util. Co., 877 S.W.2d 814, 818 (Tex. App. 1994). Therefore, if the Texas PUC approves a utility’s request to use ratepayer funds for LSL replacement, then there is a good chance that a court would uphold that decision. Conversely, if the PUC denies the request, a court is also likely to uphold that decision.

WISCONSIN



Est. No. of LSLs ¹³⁴	Percent served by investor-owned utility	Expected likelihood that state policy would support using rate funds to replace lead service lines (LSLs) on private property based on public health and efficiencies of replacing entire service line at one time.		
		Publicly-owned	Investor-owned	Comment
240,000	2.6%	Definite	Definite	2018 law provides criteria and process. ¹³⁵ Grants to customers capped at 50% of cost, however.

¹³⁴ David A. Cornwell et al., National Survey of Lead Service Line Occurrence, 108 Am. Water Works Ass’n E182, E182 (2016).

¹³⁵ 2018 Wis. Sess. LAWS ACT 137.

In Wisconsin, publicly-owned utilities are regulated by the Wisconsin Public Service Commission (“PSC”) in the same manner as investor-owned utilities. Both types of utilities are regulated by the PSC as “public utilities.” W.S.A. §§ 196.01(5)(a); 196.02(1).

In February 2018, the Wisconsin legislature enacted SB 48, which allows public water utilities (i.e. both publicly-owned and investor-owned utilities) to use ratepayer funds to subsidize replacement of LSLs on private property. 2017 S.B. 48, 2017 Wis. Act 137 (Feb. 21, 2018). Under the statute, the water utility can carry out such a plan only if: (1) the city, town, or village in which the water utility provides service to the property has enacted an ordinance to that effect; (2) the public and private portions of the LSL are replaced at the same time; and (3) the utility submits an application to, and obtains approval for its program from, the PSC. W.S.A. § 196.372(2).

Section 196.372 allows public water utilities to provide financial assistance to their customers to replace privately-owned LSLs either in the form of a grant or a loan. For the utility to gain approval from the PSC, it must submit “an application that includes a description of the proposed financial assistance, a description of the method for funding the financial assistance, a description of the customers served by the water public utility that would be eligible

for financial assistance, and any other information relevant to the action requested by the commission.” W.S.A. § 196.372(3). The Commission may not grant approval unless the application satisfies the following conditions: (1) Grants that are provided as financial assistance to an owner are limited to no more than one-half of the total cost to the owner of replacing the customer-side water service line containing lead; (2) any loan provided may not be forgiven by the water public utility or the municipality; and (3) the financial assistance that a utility provides is the same as to each owner in a class of customers (whether measured as a percentage of the cost or as an absolute dollar amount). W.S.A. § 196.372(e)(2)-(3). If these conditions are met and the PSC finds after its review that the actions described in the application are not unjust, unreasonable, or unfairly discriminatory, the PSC must approve the application. W.S.A. § 196.372(e).

On August 31, 2018, the Commission approved the first customer-side LSL replacement program proposed under section 196.372. *Application of the City of Kenosha, As A Water Pub. Util., for Auth. to Implement A Customer-Side Lead Serv. Line Replacement Program, in the City of Kenosha, Kenosha Cty., Wisconsin, 2820-LS-100, 2018 WL 4250316, at *12 (Wis. P.S.C. Aug. 31, 2018)*. In its application, the City of Kenosha proposed offering 100 percent financial assistance to every customer with a grant

accounting for 50 percent of the total cost (with a maximum grant amount of \$2,000) and reimbursement for the balance of the cost through a loan that would not be forgiven by the utility or the municipality. *Id.* at *11. The cost of the grant portion of the program was folded into the utility's rate schedule. *Id.* at *9. Loan costs, on the other hand, were borne by the property owners and repaid in their tax bills. *Id.* The Commission found such a cost recovery structure to meet the requirements of section 196.372 and approved the plan.