COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

June 14, 2018

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, Second Floor
400 North Street
Harrisburg, PA 17120

Re: Petition of Pennsylvania-American Water Company for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes
Docket No. P-2017-2606100

Dear Secretary Chiavetta:

Enclosed please find the Bureau of Investigation and Enforcement's (I&E) **Reply Exceptions** in the above-captioned proceeding.

Copies are being served on parties as identified in the attached certificate of service. If you have any questions, please contact me at (717) 783-6156.

Sincerely,

Carrie B. Wright

Carrie B. Wright
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. #208185

CBW/wsf
Enclosure

cc: Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Pennsylvania American Water Company for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes	:	**Docket No. P-2017-2606100**

REPLY EXCEPTIONS OF THE BUREAU OF INVESTIGATION & ENFORCEMENT

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Dated: June 14, 2018

I. INTRODUCTION

I&E incorporates, by reference, both the Introduction and Procedural History sections contained in its Main Brief of March 1, 2018.[1] After the parties to this proceeding filed Main Briefs, in accordance with the established procedural schedule, the Bureau of Investigation & Enforcement ("I&E"), the Office of the Consumer Advocate ("OCA"), the Office of the Small Business Advocate ("OSBA"), and Pennsylvania American Water ("PAWC" or "Company") filed Reply Briefs on March 15, 2018.

On May 1, 2018, Administrative Law Judge Elizabeth H. Barnes (the "ALJ") issued a Recommended Decision ("RD"). In her RD, the ALJ appropriately recommended that PAWC be granted permission to file a Tariff Supplement to Tariff No. 5, to replace customer-owned service lines subject to the rate recovery treatment proposed by the OCA, OSBA and I&E. The ALJ recommended the Commission direct PAWC to treat the cost as a deferred regulatory asset to be amortized over a period that will be established in PAWC's next base rate case. PAWC filed Exceptions to the RD on June 4, 2019. I&E now files these timely Reply Exceptions in response to the Exceptions raised by PAWC.

[1] I&E Main Brief, pp. 1-3.

II. REPLY EXCEPTIONS

1. Reply to PAWC Exception No. 1: The ALJ Properly Found That PAWC Should Be Granted Permission to File a Tariff Supplement to Tariff No. 5 Which Authorizes the Company to Replace Customer-Owned Lead Service Lines Subject to the Accounting and Rate Recovery Treatment Proposals Advocated for by I&E, OCA and OSBA. (PAWC Exceptions, pp. 10-11)

After evaluating all of the testimony and reviewing the Main Briefs and Reply Briefs submitted in this proceeding, the ALJ recommended PAWC be granted permission to file a tariff supplement which authorizes the Company to replace customer-owned service lines and record the associated costs as a regulatory asset to be recovered in a future base rate case. The ALJ's recommendation is in the public interest because it addresses the safety concern associated with lead service lines and allows the Company to recover its costs, while ensuring that PAWC's ratepayers do not pay a return of and on assets that are owned by individual customers. Not all of PAWC's customers have lead service lines; however, all PAWC customers would be expected to pay for the replacement of these lines. Requiring customers who do not have lead service lines to pay for both a return of and a return on customer owned assets would be inappropriate, especially considering PAWC is not currently in violation of the Lead and Copper Rule ("LCR") and is not otherwise required to replace these customer-owned lines.

The Company begins its Exceptions to the RD by stating that because this is a voluntary program, the Commission cannot make it file a tariff supplement with modifications that the Company does not like. Further, PAWC states that it would not

implement the program if the ALJ's cost recovery mechanism is adopted.[2] While it is true that this program is voluntary, it is also true that the Company could not undertake this program without the consent of the Commission. In fact, under the Company's current tariff it would be illegal for them to replace these customer-owned lines. To imply a program for which the Company had to Petition the Commission and receive approval to undertake cannot be modified by the Commission is illogical. The Company has emphasized throughout this proceeding the dangers of lead in drinking water and the urgency to replace these customer-owned lead lines. The ALJ's RD allows PAWC to replace these lead lines, it simply does not allow the Company to earn a profit for doing so. The cost recovery mechanism recommended by the ALJ is one the Commission has already approved for another water company under its jurisdiction, thus implying the ALJ's approach in the instant proceeding, is lawful, reasonable, and just.

I&E is mindful of the fact that PAWC does not have to undertake this program currently because they are not in violation of the LCR. However, no Party to this proceeding has disputed the need to replace customer-owned lead service lines. Regardless of the conditions imposed by the Commission, it is in the best interest of PAWC's customers to replace these lines before the situation becomes an emergency. Therefore, while I&E agrees that PAWC does not have to implement this program, I&E submits that it would be appropriate for the Company to implement the program as set forth in the ALJ's RD. As noted above, the approach recommended has already been

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[2] PAWC Exceptions, p. 11.

determined by this Commission to be a lawful and reasonable approach for another similarly situated water utility.

PAWC went to great lengths to demonstrate the health concerns posed by exposure to lead in drinking water and how urgent it is that these lines be replaced. However, because it does not like the cost recovery mechanism recommended by the ALJ, PAWC is threatening to not implement the replacement program and essentially ignore those concerns. I&E submits that the recommendation that PAWC be allowed to replace the customer-owned lead lines and book the related costs in a regulatory asset account is in the public interest as it removes the lead lines, allows PAWC to recover its costs and minimizes the impact on the other ratepayers who will pay for this replacement program. York Water, who recently received Commission approval to replace customer-owned lead lines and to recover its costs through a regulatory asset, has not found the implementation of a customer-owned lead service line replacement program under these same conditions an impossible feat. Customers with lead lines are not a pawn to be used by the Company in order to earn a profit off of the identified health risk. The ALJ did not err in recommending PAWC be permitted to file a tariff allowing it to replace these lines without profiting of a known health risk to its customers.

2. Reply to PAWC Exception No. 2: The ALJ Correctly Determined that the Same Approach as Accepted in the York Water Proceeding was Acceptable in the Instant Proceeding. (PAWC Exceptions, pp. 11-13).

In the RD, the ALJ noted that the Commission had recently approved a Settlement

in the *York Water*[3] proceeding in which York Water would be allowed to replace customer-owned lead service lines and be permitted to record the costs in a regulatory asset account and amortize the amounts booked in the regulatory asset account over a period of not less than four years.[4] Because the Company would prefer to capitalize lead service line replacements and earn a return of and a return on these assets the Company takes exception to the ALJ's use of the *York Water* case relying heavily on the fact that the *York Water* settlement noted that it could not be used as precedent.[5]

First, it should be noted that the ALJ never stated that the *York Water* case was being used as precedent or controlling. The ALJ simply stated that the instant proceeding is "comparable" to the *York Water* proceeding.[6] Second, virtually all settlements are considered non-precedential. That does not mean, however, that the Commission is prohibited from treating a similarly situated utility in similar way. Approval of the *York Water* settlement inherently means that the Commission believes that the outcome agreed to in the settlement is a lawful, reasonable approach to the cost recovery of customer-owned lead service lines; otherwise, the Commission would not have issued an Order approving the settlement. The fact that it is non-precedential does not mean that the Commission is prevented from approving the same cost recovery method for the replacement of customer-owned lead service lines for other utilities, including PAWC.

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3 *Petition of York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Cost of Certain Customer-Owned Service Line Replacements to the Company's Services Account*, Docket No. P-2016-2577404 (Order entered March 8, 2017).

4 RD, pp. 22-23.

5 PAWC Exceptions, pp. 7, 11-13.

6 RD, p. 14.

Furthermore, it is disingenuous for the Company to accuse the ALJ of looking outside the four corners of the case when she noted that if PAWC's cost recovery approach is adopted York Water could Petition the Commission to consider amending the *York Water Order* to allow it to capitalize its replacement costs.[7] This is, in fact, an argument that PAWC brought up in its Main Brief in this proceeding.[8] The Company raised this as an argument for why these assets should be capitalized for PAWC; namely that because the settlement contemplated that York be able to file a Petition to change the way these costs were recovered, the Commission might approve rate base treatment of these replacement costs in the future.[9] Therefore, the Company argued, this was a reason that rate base treatment should be approved for the replacement costs. It is inappropriate for the Company to now accuse the ALJ of going outside the four corners of this case when the ALJ used the Company's own argument, i.e. that York Water would be given the opportunity to Petition the Commission and request rate base recover, to demonstrate why PAWC should not be allowed to capitalize these costs.

As noted by the Company in its Exceptions, "...each case must be decided based on its facts...."[10] I&E agrees with this statement. The main factual difference between these cases is that, unlike York Water, PAWC is not in violation of any state or federal standards. In contrast, York Water exceeded LCR lead action levels, which caused the Pennsylvania Department of Environmental Protection to require York Water to replace

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7 PAWC Exceptions, pp. 6-7, 11-12.
8 PAWC MB, pp. 21-22.
9 *Id.*
10 PAWC Exceptions, p. 12.

7% of its company-owned lead services annually. In short, York Water requested Commission approval to replace customer-owned lead lines because it had a lead problem, PAWC does not. The Company has not presented any compelling arguments as to why its program should be treated more preferentially than York Water's program. In the absence of compelling evidence otherwise, it is clear that the Commission should affirm the ALJ's determination that PAWC record the costs related to customer-owned lead service line replacements as a regulatory asset, to be recovered in future base rate proceedings.

3. Reply to PAWC Exception No. 3: The ALJ Correctly Determined that PAWC Should Not Be Permitted to Capitalize Lead Service Line Replacements for Accounting Purposes and Recover and Return on and a Return of the Investment in that Property. (PAWC Exceptions, pp. 13-23).

a. The Company's Reliance on the Commission's Decisions in the *Columbia Gas* and *Peoples Gas* Proceedings is Misplaced.

While ignoring the *York Water* case, which is the most recent and most similar to the instant proceeding, PAWC instead relies on Orders in two gas proceedings to support its requested ratemaking recovery. Because the Company prefers the outcome in the *Columbia Gas*[11] and *Peoples Gas*[12] proceedings the Company places unwarranted emphasis on these cases. In both the *Columbia* and *Peoples* proceedings, the Commission approved the Companies replacing some customer-owned gas lines and

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[11] *Petition of Columbia Gas of Pennsylvania, Inc. for Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement*, Docket No. P-00072337 (Order entered May 19, 2008).

[12] *Petition of Peoples Natural Gas Company, LLC for Approval of Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacements*, Docket No. P-2013-2346161 (Order entered May 23, 2013).

capitalizing the associated costs although the Companies would not own and maintain these lines. The ALJ, however, distinguished the instant case from the two gas cases.[13]

In Pennsylvania, it is not uncommon for a natural gas distribution company ("NGDC") to own and maintain the service line up to the consumers home. In contrast, for water companies in Pennsylvania, it is the normal course of business for the consumer to own the service line from the curb stop to the dwelling. Therefore, at the most basic level, these two types of service lines have been treated differently for quite some time. The Commission has determined that "[c]ustomer owned natural gas service lines present safety issues not present with other customer owned lines."[14] Therefore, the Commission has chosen to treat gas service lines differently than other types of service lines because of the inherent dangers related to natural gas. In her RD the ALJ noted:

> ...these natural gas distribution companies did own some service lines up to the customers' meters on dwellings; thus customer-owned lines that were vulnerable were being treated the same as eligible property of other company-owned service lines that connected to the meter at the dwelling...The instant case is distinguishable because no service lines from the curb to the dwellings are currently included in PAWC's rate base or for the water industry at large.[15]

As such, the ALJ appropriately concluded that the Company's reliance on the Commission's decisions in the *Columbia Gas* and *Peoples Gas* proceedings was misplaced and that *York Water* was a more comparable case. As noted by the ALJ, when the Commission chose to treat these costs for Columbia and Peoples as Distribution

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13 RD, pp. 15-20.
14 *Columbia Gas*, Docket No. P-00072337, pp. 4-5 (Order entered May 19, 2008).
15 RD, p. 19.

System Improvement Charge ("DSIC") eligible, the Commission was simply treating these costs in the same as the other service lines that were owned by the Company that ran up to the customers meter. In reaching its decision in the *Columbia Gas* and *Peoples Gas* cases, the Commission was not making a marked deviation from the way gas service lines are traditionally treated in Pennsylvania. However, in this proceeding PAWC is asking the Commission to deviate from traditional ratemaking principles. Therefore, the ALJ did not err in determining that these replacement costs should be treated as a deferred regulatory asset.

b. Commission Precedent Does Not Support the Capitalization of Investments In Customer-Owned Property

The Company notes in Exceptions that the RD did not address restoration costs.[16] Once again, the Company inappropriately analogizes the replacement costs associated with customer-owned lead service lines to costs associated with restoration of roadways and customer premises such as sidewalks, lawns, and driveways.[17] As the Company correctly noted I&E has objected to this analogy because the replacement costs to which the Company is referring are essential and unavoidable costs incurred directly with the installation, repair, or replacement of Company-owned property.[18] The Company's attempt to explain this away by stating that replacing the Company-owned service lines would adversely impact customer-owned lead service lines by causing lead to leach into the customer's water is quite frankly, absurd. The nexus of connection is simply not

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16 PAWC Exceptions, p. 19.
17 PAWC Exceptions, p. 19.
18 I&E MB, p. 12, PAWC Exceptions, p. 20.

there. First, this situation is unlikely to occur, because the Company has indicated that it would be replacing both the Company-owned portion and the customer-owned portion of the service line. Second, this argument has little bearing on the issue at hand; namely, that the Company does not currently own the service lines in issue and will not own them after they are replaced. As noted above, restoration costs that can be capitalized are associated with Company-owned property. As the name implies, once the road, sidewalk, etc. above the Company-owned property is replaced, the Company continues to own the Company-owned property below it. Thus, the Company has an affirmative obligation to repair and/or replace that Company-owned property should something happen to it; thereby providing the reason why the Company is allowed to capitalize these costs. The same is not true for these customer-owned service lines as they are entirely owned by the customer and it is the customer's responsibility to repair, maintain and replace those lines. Once replaced, the Company will essentially be hands off. The repair or further required replacement of these lines will be the sole responsibility of the customer to whose dwelling or business they are attached. Therefore, the costs associated with replacement of customer-owned lead service lines are not akin to replacement costs associated with Company-owned property.

Further, the Company takes exception to the fact that the ALJ, I&E, and OCA all noted that the customer-owned lead service lines that will be replaced are not assets devoted to a public use and should, therefore, not be capitalized.[19] The Company notes

[19] RD, p. 14, I&E MB pp. 10-11, OCA MB pp. 18-19.

that there are situations where certain assets such as a booster pump or the Company-owned portion of the service line will only serve one customer and those types of assets may be capitalized. First, I&E would note that dedication to public use is a decided by the intention of the utility.[20] Therefore, the mere fact that a particular asset may only serve one customer does not in some way indicate that the utility is earning a return on property that is not dedicated to the public use. Furthermore, the Company is ignoring the glaring distinction between these assets and customer-owned lead service lines. The Company owns and maintains all the types of assets that it has indicated as those types that may be used to serve a sole customer. The Company, in this proceeding is not proposing to own or maintain the customer's portion of these lead service lines.

Lastly, the Company argues that because some of these lines may go to a public building, such as a school or restaurant, this constitutes "public" service. The fact that people may consume this water in a public setting does not transform it into a public service. As noted above these assets are dedicated to a particular residence, building, or business. PAWC does not repair or replace these assets; that responsibility lies solely with the owner of the residence, building or business. As accurately summarized by the ALJ:

> In general, utilities are entitled to earn a return only on property devoted to the public use. *Keystone Water Co. v. Pa. Pub. Util. Cmm'n,* 339 A.2d 873 (Pa. Cmwlth. 1975) *citing Scranton v. Scranton Steam Heat Co.,* 176 A.2d 86 (Pa. 1961). Expenditures for the exclusive benefit of one customer such as the improvement of service lines constitutes

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20 *Peoples Nat. Gas Co.*, C-850468, 1992 WL 814076, at *8 (Dec. 7, 1992).

> customer specific costs not for the public use. *Klossman v. Duquesne Light Co.,* C-00945802 (Final Order entered July 24, 1996). In the instant case, the Service Pipe is owned by and is the responsibility of the customer.

Therefore, these assets are not devoted to the public use and PAWC should not be allowed to profit from their replacement at the expense of ratepayers.

c. The Cost Sharing Approach Recommend by the ALJ is Appropriate

The ALJ recommended that the replacement costs incurred be deferred through a regulatory asset without a return or carrying charge. As noted in the RD, the ALJ agreed with OCA and I&E that:

> ...the one-time replacement cost of a customer-owned lead service pipe and giving ownership of the replaced pipe to the customer is akin to an extraordinary cost normally classified as a regulatory asset as opposed to a capitalized cost recovered through PAWC's DSIC, which would allow a return of and a return on investment in the pipe or assets that it would no longer own.[21]

PAWC excepts to this determination because it argues that these costs are not atypical and non-recurring stating that these lines will be replaced over a period of ten years, and the Company further states that OCA and I&E are incorrect about the types of expenses the Commission typically amortizes.[22]

The Company's argument fails for several reasons. First, the fact that these pipes are being replaced over a period of ten years does not make them a recurring cost. Once

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21 RD, p. 21.

22 PAWC Exceptions, p. 22.

these lead pipes are removed from the ground, the Company will not have to do this work again considering it has not put lead pipe into service for decades. Furthermore, PAWC will not incur additional expenses related to these customer-owned service lines as the ownership and responsibility for future repair, maintenance and replacement will remain with the customer. Second, to state that I&E and OCA are incorrect about which types of expenses the Commission affords this type of ratemaking treatment is especially unfounded considering the Commission, as recently as March 2017, approved the exact type of treatment recommended by OCA and I&E in the *York Water* proceeding

As noted by the ALJ the proposal made by I&E and OCA save ratepayers money when compared to PAWC's proposed rate base treatment by not requiring all ratepayers, including those with no lead service lines, to pay a return on an investment for customers who own lead service lines. She further noted:

> A regulatory asset method provides incentive for PAWC to seek potential funding from the state or federal government that can be booked as an offset to the regulatory asset...Regulatory assets directly tie the recovered amounts to the actual costs incurred by the utility without need for forward-looking speculation of costs, which removes any guesswork from the equation and promotes visibility and accountability of this process. Additionally, this methodology will eliminate any potential for unwarranted loading of assets and will, accordingly, provide substantial consumer safeguards not found in the original Petition. Since this ratemaking treatment will allow PAWC to recover the costs of the replacement of lead customer owned service lines but not earn a return on those lines, it promotes the Company's minimalization of pertinent costs. Conversely, this ratemaking treatment will still ensure PAWC can earn

> full recovery of the costs and will be able to continue to provide safe and reliable service to its customers.[23]

At a minimum, it is apparent that the ratemaking treatment proposed by I&E and OCA, and recommended by the ALJ, protects the interests of the Company and its ratepayers (both those with and without customer-owned lead service lines). The ALJ's recommendation permits the Company to recover the amount spent on replacing customer-owned service lines. It is simply prevented from profiting off this replacement plan. Further, customers with lead lines are protected because the identified health risk is being addressed, and customers who do not own lead lines are protected by not allowing PAWC to profit from the replacement plan at their expense. Therefore, the cost sharing approach recommended by the ALJ is the appropriate ratemaking methodology.

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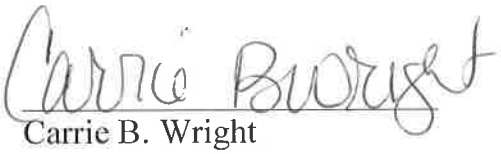
[23] RD, pp. 24-25.

III. CONCLUSION

For the reasons stated herein, the Bureau of Investigation & Enforcement respectfully requests that the Commission deny the above-referenced exceptions of Pennsylvania American Water Company and issue an Order adopting Administrative Law Judge Elizabeth H. Barnes' Recommended Decision in this proceeding. It is appropriate for PAWC to replace customer-owned lead service lines in an effort to protect the health and safety of PAWC customers. However, PAWC should not be allowed to profit from these replacements and should instead record the costs incurred as a regulatory asset to be amortized of a period to be determined in PAWC's next base rate proceeding.

Respectfully submitted,



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Dated: June 14, 2018

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Petition of Pennsylvania-American Water Company for Approval of Tariff Changes and Accounting and Rate Treatment Related to Replacement of Lead Customer-Owned Service Pipes	:	Docket No. P-2017-2606100

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Exceptions** dated June 14, 2018, in the manner and upon the persons listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

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