

COMMONWEALTH OF PENNSYLVANIA



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June 14, 2018

Rosemary Chiavetta, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Bldg.  
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:

Attached for electronic filing please find the Office of Consumer Advocate's Reply  
Exceptions to the Recommended Decision in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Very truly yours,

A handwritten signature in black ink that reads "Christine Maloni Hoover".

Christine Maloni Hoover  
Senior Assistant Consumer Advocate  
PA Attorney I.D. # 50026  
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Attachment

cc: Honorable Elizabeth Barnes, ALJ  
Office of Special Assistants (e-mail only: ra-OSA@pa.gov)  
Certificate of Service

\*251837

## CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Reply Exceptions to the Recommended Decision, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 14th day of June 2018.

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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**REPLY EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE**

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Dated: June 14, 2018

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## **I. INTRODUCTION**

On May 15, 2018, Administrative Law Judge (ALJ) Elizabeth H. Barnes issued a Recommended Decision addressing the Petition of Pennsylvania-American Water Company (PAWC or Company) to replace customer-owned lead service lines (Replacement Plan), subject to the specific accounting and rate recovery proposals contained in its Petition.<sup>1</sup>

The Office of Consumer Advocate (OCA) supported in part and opposed in part PAWC's request. Specifically, the OCA supported the Company's efforts to replace customer-owned lead service lines because lead service lines pose a significant health risk and doing so would help avoid partial lead service line replacements and achieve economic efficiencies. The OCA, however, disagreed with the Company's proposal to earn a return of and a return on the costs because utilities cannot earn a return on customer-owned property. The OCA recommended that the Company establish a regulatory asset through which it can track these extraordinary, non-recurring, one-time expenses. The Company could then recover a return of the prudent and reasonable expenses over an amortization period to be determined in PAWC's next base rate proceeding. Additionally, the OCA recommended that the Company provide a five-year warranty on all customer-owned service lines it replaces, as well as offer a partial compensation

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<sup>1</sup>PAWC proposes to undergo the Replacement Plan in two phases, Replacement Plan – Part 1 and Replacement Plan –Part 2. Under Replacement Plan – Part 1, the Company will replace customer-owned lead service lines that it encounters during its ongoing main and company-owned service line replacement program, whether or not the company-owned service line connected to the customer-owned service line is made of lead or other materials. Replacement Plan - Part 2 addresses remaining customer-owned lead service lines that the Company does not encounter during its ongoing main and company-owned service line replacement program. PAWC will replace the customer-owned lead service line at the customer's request if the customer and the Company verify that the customer's service line is made of lead. When the Company receives a reasonable number of requests in a given area, the Company will undertake all of the Part 2 replacements in an area as part of a single project.

plan for customers that replaced their lead service line in the four years proceeding this Petition. The OCA also recommended that PAWC undertake a comprehensive and robust consumer outreach and education program in conjunction with the statutory advocates.

Based on her review of the evidence and briefs submitted by the Parties, the ALJ recommended that the Commission grant the Company's Petition, as modified by the Recommended Decision. R.D. at 26-31. The ALJ determined that the Company should be allowed to replace customer-owned lead service lines as part of its proposed Replacement Plan, subject to deferred regulatory accounting treatment and the Office of Small Business Advocate's (OSBA) cost cap recommendation for Part 2 replacements. The ALJ denied the Company's request to capitalize the costs of replacing customer-owned lead service lines and recover those costs in base rates and through its Distribution System Improvement Charge (DSIC). In addition, the ALJ adopted the OCA's recommendation regarding the partial compensation plan. The ALJ also determined that PAWC should collaborate with the statutory advocates to improve its consumer education and outreach program. Lastly, the ALJ denied the OCA's recommendation for a five-year warranty on all customer-owned lead service lines that the Company replaces, instead adopting the Company's original proposal of a one-year limited workmanship warranty.

On June 4, 2018, the Company filed Exceptions taking issue with certain aspects of the Recommended Decision. The OCA submits, however, that ALJ Barnes has provided the Public Utility Commission (Commission) with a thorough and well-reasoned Recommended Decision. The OCA supports the ALJ's conclusions and respectfully submits these Reply Exceptions pursuant to Section 5.535 of the Commission's regulations. 52 Pa. Code § 5.535.



To summarize, the primary issue in this case is whether PAWC should earn a return, *i.e.* a profit, on property that it will not own and will not maintain over the long life of the plant. PAWC's request for a profit on the replacement of the customer owned service lines will have an impact on the rates of all of its water customers now and far into the future. As discussed below, earning a return on property that the Company does not own and will not maintain is not appropriate for many reasons. Moreover, PAWC's attempt to earn a return from its Pennsylvania customers, even while other American Water subsidiaries will not receive similar treatment in other jurisdictions, highlights the unreasonableness of PAWC's unwillingness to share some of the costs to remedy the important public health issue in Pennsylvania.

## II. REPLY EXCEPTIONS

**Reply to PAWC Exception No. 1:** The ALJ Made Reasonable Modifications To The Company's Proposal That Result in a Plan That Is Consistent With Fundamental Ratemaking Principles. R.D. at 1-2, 34; PAWC Exc. at 10-11.

In its first Exception, the Company interprets the Recommended Decision as a mandate to undertake the Replacement Plan pursuant to the modifications made by the ALJ. PAWC Exc. at 10. The Company asserts that the Commission cannot direct the Company to replace customer-owned lead service lines unless it receives the ratemaking and accounting treatment it requests. Moreover, the Company argues that it will not implement the Replacement Plan if the Commission adopts the Recommended Decision. PAWC Exc. at 11.

The OCA is concerned with the Company's position for several reasons. First, the Company has repeatedly criticized the statutory advocates for characterizing the Company's proposal as a profit-making venture in light of the significant public health risks associated with lead service lines, but now attempts to withhold the program for lack of it. See PAWC M.B. at 10, PAWC R.B. at 8. Failure to continue with the program subject to the Recommended Decision's modifications would confirm exactly that, *i.e.*, "the Company is proposing to turn a customer's health risk into a profit center, at the expense of all other customers." OCA St. 1 at 16.

Second, the Company has repeatedly stressed the public health effects of lead service lines. As stated by the Company's witness:

Lead is a naturally occurring metal that is harmful if inhaled or swallowed, particularly to children and pregnant women. Lead exposure can cause a variety of adverse health effects. For example, lead exposure can cause developmental delays in babies and toddlers and deficits in the attention span, hearing and

learning abilities of children. Lead exposure can also cause hypertension, cardiovascular disease and decreased kidney function in adults. The most common sources of lead exposure are paint and dust, but lead can also be found in drinking water. Recent events, including those in Flint, Michigan, have heightened PAWC customers' concern about the presence of lead in drinking water.

PAWC St. 1 at 5. Moreover, the Company has discussed the need to avoid partial lead service line replacements. As stated by the Company in its Main Brief:

[A] relatively recent and growing body of research indicates that a "partial" replacement, which physically disturbs, but leaves in place, the customer's segment of a service connection, may potentially increase the risk of lead exposure through drinking water for two principal reasons. First, removing and replacing the Service Line and curb box connection may disturb the "scale" or protective coating that builds up naturally inside of the Service Pipe over its years of service and, in that way, could promote the release of lead and other accumulated material in the scales. Second, if a lead Service Line is replaced with a line made of another metal, conditions are created for bimetallic corrosion, which affects the interior wall of the LSP and accelerates the leaching of lead into the water passing through the pipe. Significantly, LSPs largely remain in neighborhoods that face economic constraints making it unlikely that affected customers would be willing or able to bear the cost of replacing their LSPs and, thereby, avoid the risks that may be posed by partial replacements.

PAWC M.B. at 12-13.

As a result, failure to replace customer-owned lead service lines in conjunction with its ongoing main and Company-owned service line replacement program will result in many partial lead service line replacements and likely increase lead exposure, possibly creating violations of 66 Pa. C.S. § 1501 and the requirements of the Environmental Protection Agency/Department of Environmental Protection's lead and copper rule. It is incumbent upon the Company to minimize these health effects and ensure that its service is safe and adequate.

Third, as stated by the ALJ, deferred regulatory accounting treatment "will still ensure that PAWC can earn full recovery of the costs and will be able to continue providing safe and

reliable service to its customers.” R.D. at 25; see also OCA St. 1SR at 6-7. While the Company cannot earn a profit on the costs, such an arrangement ensures that the Company recovers its expense for the program. While the OCA suggests that the Company forego carrying charges on the amortization of this expense, that issue is left to the base rate case. Recovering expenses without carrying charges is common practice in Pennsylvania ratemaking. In this case it would result in a modest sharing of these public health costs. As discussed below, cost-sharing has been utilized in other states as it concerns lead pipe replacement. In no state was a utility allowed to earn a return on 100 percent of the costs associated with replacing customer-owned lead service lines. See pg. 18, infra, see also R.D. at 20, OCA M.B. at 19-21, OCA R.B. at 14-15.

Moreover, when compared to other American Water subsidiaries, PAWC’s unwillingness to shoulder some of the risk in replacing customer-owned lead service lines demonstrates the unreasonableness of the Company’s Exception. See e.g. Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York American Water Co. for Water Service, Case No. 16-W-0259, Order (NY PSC May 18, 2017) (agreeing to defer and amortize the costs with no carrying charge) (NYAWC LSL), In the Matter of Missouri-American Water Company’s Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas, WR-2017-0285, et al., Report and Order at 22-23 (May 28, 2018) (denying the Company’s proposal to earn a return on the costs of replacing customer-owned lead service lines). (MAWC LSL)

For these reasons, the Commission should deny the Company’s Exception.

**Reply to PAWC Exception No. 2:** The ALJ Did Not Treat the Decision in York Water as Precedent. R.D. at 14-15, 21, 23, 29; PAWC Exc. at 11-13; OCA R.B. at 7-8.

The Company claims that the ALJ improperly treated the settlement for York Water as binding precedent to support her recommendations. PAWC Exc. at 11; see also Petition of The York Water Company for an Expedited Order Authorizing Limited Waivers of Certain Tariff Provisions and Granting Accounting Approval to Record Costs of Certain Customer-Owned Service Line Replacements to the Company's Service Account, Docket No. P-2016-2577404, Order (Mar. 8, 2017) (York Water). PAWC argues that the ALJ compared the instant proceeding to York Water and uses York Water to establish the holding in the Recommended Decision regarding the amortization period of the regulatory asset and the partial compensation plan. PAWC Exc. at 11, see also R.D. at 11. PAWC also claims that the ALJ examined evidence outside the record in this case by examining the consequences to York Water if capital accounting treatment were permitted. PAWC Exc. at 11-12.

The OCA submits, however, that the ALJ did not treat York Water as precedential in this proceeding. Rather, the ALJ used York Water as an example of how a Pennsylvania water utility is treating the costs of customer-owned lead service line replacements. The ALJ has determined that such an approach is a prudent and reasonable means to replacing customer property based on the record here. Moreover, as discussed in more detail below, the ALJ applies general ratemaking principles and existing case law to come to a reasonable and fair decision. The ALJ does not rely on York Water to the extent the Company claims. See pgs. 8-20, infra.

With respect to PAWC's last claim regarding record evidence, the York Water decision and settlement were included in the record attached to the Direct Testimony of OCA witness

Scott Rubin. OCA Sch. SJR-5. The Company did not object to its inclusion. Therefore, the ALJ properly examined the record evidence. Moreover, the ALJ can properly examine the effects of this proceeding on the water industry at large, including the effect to the York Water Company.

For these reasons, the Commission should deny the Company's Exception.

**Reply to PAWC Exception No. 3:** The ALJ Properly Determined that the Company Cannot Capitalize and Earn a Return Of and a Return On the Costs of Replacing Customer-Owned Lead Service Lines. R.D. at 13-25; PAWC Exc. at 13-23; OCA M.B. at 18-24; OCA R.B. at 3-12.

In the Recommended Decision, the ALJ determined that PAWC should not be able to capitalize the costs associated with replacing customer-owned lead service lines. R.D. at 24. Moreover, the ALJ determined that the Company should not be able to include these costs in rate base, earn a return on it, or include such costs in its DSIC. R.D. at 18, 24. As a basis for this decision, the ALJ properly determined that a utility is only allowed to earn a return on property devoted to the public use.

In general, utilities are entitled to earn a return only on property devoted to the public use. *Keystone Water Co. v. Pa. Pub. Util. Comm'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 customer specific costs not for the public use. *Klossman v. Duquesne Light Co.*, C-00945802 (Final Order entered July 24, 1996).

R.D. at 13-14.

Rather than disallow recovery of all expenses, the ALJ determined that the cost of replacing customer-owned lead service pipes is an extraordinary, non-recurring, one-time expense applicable to a few thousand properties. R.D. at 22. Accordingly, the ALJ recommended

that the Company track and record the incurred cost as a deferred regulatory asset. R.D. at 21. The ALJ stated that the amortization period should be established in the next base rate proceeding. R.D. at 21.

The ALJ noted that there are multiple benefits to deferred regulatory accounting treatment. R.D. at 24. The Company would still have financial incentive to replace customer-owned lead service pipes with full recoupment of the costs over a potential five-year period. R.D. at 24. The Company would have no profit motive and have more incentive to use lower-cost approaches, such as coating or lining, where appropriate. R.D. at 24. Furthermore, the Company would have incentive to seek potential funding from the state and federal government, which can offset the amount included in the regulatory asset. R.D. at 24. Additionally, by denying DSIC recovery, the Company would not be subject to a DSIC cap. R.D. at 24. Lastly, treatment as a regulatory asset will reduce costs for customers when compared to rate base treatment. R.D. at 24.

The Company generally objects to the ALJ's determination that the Commission should deny PAWC's request to include in rate base and the DSIC, and thereby earn a return on, the costs associated with replacing customer-owned lead service lines. PAWC Exc. at 13-14, R.D. at 13-25. To advance its position, PAWC makes several arguments within the Company's Exception No. 3. The OCA will address and rebut each one separately.

A. Commission Precedent Establishes That the Company Cannot Earn a Return on Customer Property

The Company first asserts that Commission precedent undercuts the notion that the Company should not be able to earn a return on customer-owned property. PAWC Exc. at 14.

The Company attempts to compare its request to that of the gas companies, which the Commission previously allowed to capitalize the costs of replacing customer-owned gas service lines and recover those costs, with a return, in base rates and through the DSIC between base rate cases. PAWC Exc. at 15. Specifically, the Company states that replacing these lead service lines will provide system-wide benefits to all customers of the utility, as did the gas service lines, and that both water service lines and gas service lines only benefit one customer. The Company also argues that the reasons the ALJ relied upon in distinguishing its request from the gas service line cases was improper.

The ALJ's Decision, however, presents an in-depth analysis of the Commission's decisions regarding the proposals of Columbia Gas and Peoples to replace customer-owned gas service lines. R.D. at 15-19, see Petition of Peoples Natural Gas Co., LLC for Approval of Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement, Docket No. P-2013-2346161, *et al.*, 2013 Pa. PUC LEXIS 543 (May 23, 2013) (Peoples), Petition of Columbia Gas of Pennsylvania, Inc. for Limited Waivers of Certain Tariff Rules Related to Customer Service Line Replacement, Docket No. P-00072337, 2008 Pa. PUC LEXIS 344 (May 19, 2008) (Columbia). After comparing the facts in the instant proceeding to the gas service line cases, the ALJ determined that PAWC's request is materially different with respect to ratemaking and accounting issues. R.D. at 18. The OCA agrees.

In the Columbia and Peoples proceedings, the Commission granted each request to capitalize the costs of replacing customer-owned gas service lines because replacing those service lines was physically necessary for replacing its own gas mains and such replacements would have overall benefits to all customers. See Columbia Gas, 2008 Pa. PUC LEXIS 344, at



\*4, Peoples, 2013 Pa. PUC LEXIS 543, at \*9, 14; see also OCA R.B. at 4-6. Had those customers refused to replace their portion of the gas service line they would have faced termination of service because their gas lines would have been unable to handle the increased pressures that the utility could now operate its distribution system at due to replacing its unprotected bare steel and cast iron mains. Columbia Gas, 2008 Pa. PUC LEXIS 344, at \*2, 4; see also OCA R.B. at 4-5. Moreover, natural gas distribution companies (NGDCs) may, in certain areas, own and maintain the entire service line from the main to the customers' premises, thereby already having a reasonable basis to capitalize the entire gas service line to the customers' premises.<sup>2</sup> See Columbia Gas, 2008 Pa. PUC LEXIS 344, at \*3, Peoples, 2013 Pa. PUC LEXIS 543, at \*8; see also OCA R.B. at 6.

These facts are not present in PAWC's request and the ALJ recognized both distinctions in the Recommended Decision. R.D. at 18-19. First, replacement of lead service lines is not physically necessary. As stated by the ALJ:

[T]hese two cases involved emergency replacement of vulnerable customer-owned bare steel service lines...Unlike Columbia and Peoples, PAWC's customers are not facing termination of service for failure to replace a customer-owned lead service line.

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<sup>2</sup> The Commission also based its decision on Section 1510 of the Public Utility Code, which states:

When connecting the premises of the customer with the gas utility distribution mains, the public utility shall furnish, install and maintain the service line or connection according to the rules and regulations of the filed tariff. A public utility shall not be authorized or required to acquire or assume ownership of any customer's service line. A public utility shall not be authorized or required to acquire or assume ownership of any pipe or appurtenances installed after the effective date of this section between its main and the meter unless the utility would have been authorized or required to do so according to the rules and regulations of its filed tariff if the pipe or appurtenances had been installed on or before the effective date of this section. Maintenance of service lines shall be the responsibility of the owner of the service line.

66 Pa. C.S. §1510; see also Columbia Gas, 2008 Pa. PUC LEXIS 344, at \*7-8. The water utility industry does not have a similar statutory provision

R.D. at 19 (citations omitted). While the Company claims that replacement of customer-owned lead service lines is necessary to avoid partial replacements of lead service lines, it has made assurances that it will install a dielectric coupling between the Company-owned portion and the customer-owned portion if the customer refuses to have their lead service line replaced. OCA R.B. at 6. Secondly, the Company has provided no evidence that there is system-wide benefits to the Replacement Plan. Replacing customer-owned lead service lines only benefit the homeowner whose line is replaced and the ALJ has affirmed that this Replacement Plan would only affect a small subset of customers. R.D. at 14, 23-24. Third, the Company does not own any service line on the customer premises, rather, the maintenance and ownership of the line on the customer premises is the responsibility of the customer currently and after replacement. OCA R.B. at 6. As stated by the ALJ, “[t]he instant case is distinguishable because no service lines from the curb to the dwellings are currently included in PAWC’s rate base or the water industry at large.” R.D. at 19.

Additionally, vulnerable gas service lines have unique dangers, which can result in possible injury and damage to homeowners of an adjacent property. As succinctly stated by the ALJ:

Additionally, a vulnerable natural gas line represents a clear and present danger to not only the consumer/customers but also to his/her neighbors; whereas, a lead customer-owned service pipe is less of an immediate threat to public health and safety as it affects only the consumers at the dwelling.

R.D. at 19 (citations omitted). If a customer were to leave a vulnerable gas service line in use that could not handle the increased pressure it could result in a leak and an explosion harming individuals outside the home. This type of concern is not present in the instant proceeding.

The Company further argues that it routinely spends money on equipment that benefits a narrow subset of customers that it can include in rate base and earn a return on, such as booster pumping stations. PAWC Exc. at 15-16. Additionally, it argues that Company-owned service lines also serve only one customer, rather than the public generally, but still qualifies for capitalization and inclusion in rate base. PAWC Exc. at 16.

The OCA disagrees with the Company's comparison. The Company provides multiple examples of *utility* property that routinely benefit a smaller subset of customers. This can be argued of any piece of equipment in operation, *i.e.* a main will only benefit customers attached to that main. The crux of this analysis and the basis for the ALJ's decision, however, is whether the Commission should allow the Company to capitalize and earn a return on customer-owned property.

The Commission has made it clear in past decisions that a utility may not earn a return on property devoted to a customer-specific use.

If the Commission reasonably finds that a particular class or property is not used and useful in serving the public, it may exclude the value of the property from rate base and thus disallow the utility's return on that property.

Pa. PUC v. Pennsylvania Power and Light Co., Docket No. R-842651, 1985 Pa. PUC LEXIS 56, at \*25 (Apr. 26, 1985) (citing Bell Teleph. Co. v. Pa. PUC, 408 A.2d 917, 925 (Pa. Commw. Ct. 1979)) (holding that excess generating capacity was not used and useful in rendering service to the public thereby disallowing inclusion in rate base); see also OCA M.B. at 18-19. Moreover, the Commission has affirmed that:

Costs incurred at the request of an individual customer which are beyond the standard service supplied to other customers, in the same rate class, are considered to be customer-specific. Such non-standard service requests include private property service line extensions...

Klossman v. Duquesne Light Co., Docket No. C-00945802, 1995 Pa. PUC LEXIS 136, at \*20, Initial Decision (Dec. 22, 1995), aff'd 1996 Pa. PUC LEXIS 112, at \*43-44, Order (July 24, 1996); see also OCA M.B. at 18-19. A Replacement Plan that will install customer-owned property at the utility's sole cost benefitting a small subset of customers falls squarely within this definition. R.D. at 22.

Lastly, the Company argues that the Replacement Plan will benefit individuals who do not own the lead service pipes, claiming that the Replacement Plan is not limited to only residential customers. PAWC Exc. at 16. It claims that it may undergo replacement to reduce lead exposure to daycares, schools, or restaurants. PAWC Exc. at 16.

Regardless of whether the customer benefitting from the Replacement Plan is a business or a residential homeowner, any costs incurred would still classify as customer-specific costs on customer property ineligible for rate base recovery. Moreover, the Company has not provided evidence or made assurances that any of those facilities listed above have lead service lines that will need to be replaced as part of this program. As stated by the ALJ:

As PAWC offered no actual number of customer-owned lead-service lines within its service territory, it is difficult to assess the annual projected cost of replacement of these customer-owned lead service pipes.

R.D. at 20.

B. Customer-Owned Lead Service Line Replacement Costs Are Not Akin to Roadway Restoration Costs

As further argument for its position, the Company attempts to compare customer-owned lead service line replacement costs to roadway restoration costs. PAWC Exc. at 19. The Company argues that it routinely capitalizes and recovers in rate base costs to restore roadways and customer premises to original condition because of an underlying capital project even though

it does not own the roadways and customer premises. PAWC Exc. at 19-20. Similarly, the Company states that replacing the Company-owned service line impacts the adjacent customer-owned lead service line such that it is appropriate to replace the customer-owned lead service line and recover the costs as a rate base item. PAWC Exc. at 20.

The above comparison is inapposite. As stated in the OCA's Main Brief, the Commission allows utilities to capitalize restoration costs because such costs arise out of necessity in order to access the utility's *own* property, *i.e.* mains, services, and appurtenances. OCA M.B. at 23; see also OCA St. 1SR at 5. As OCA witness Scott Rubin stated:

PAWC has the legal right to occupy public rights-of-way and, in particular, to bury its water mains underneath public roads. Opening and then repairing a roadway is absolutely essential in order for PAWC to use the right-of-way and to install or access its property. That is, it is physically impossible for PAWC to use its rights and to access Company-owned property without damaging a publicly owned road surface. Thus roadway opening and repair costs are an essential, unavoidable cost that is directly associated with the installation, repair, or replacement of Company-owned property.

OCA M.B. at 23; see also OCA St. 1SR at 5. With respect to customer-owned lead service lines, however, the Company has no legal right of way over the customer's premises. OCA M.B. at 9; see also PAWC St. 1 at 14. Moreover, it need not access the customer portion of the service line beyond the point at which the two portions connect. As previously stated, the Company can replace its portion of the line and install a dielectric coupling to separate the two pipes if a customer refuses to have their portion replaced. See pg. 7, supra.

Additionally, it would be improper for the Company to depreciate property it does not own. The National Association of Regulatory Utility Commissioners (NARUC) defines depreciation as:

‘Depreciation,’ as applied to depreciable *utility plant*, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of *utility plant* in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand, and requirements of public authority.

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, PUBLIC UTILITY DEPRECIATION PRACTICES 13 (1996) (emphasis added). The Federal Energy Regulatory Commission has adopted a definition for the electric and gas industry that is essentially the same. Id. Based upon its analysis, NARUC recognizes that a utility can only depreciate utility plant. The Company, however, has made it clear that it will not own or maintain the customer portion of the service line after replacement. PAWC M.B. at 5. Accordingly, the Company cannot depreciate this property.

C. The Deferred Regulatory Accounting Method Fairly Remunerates the Company and its Investors

The Company next argues that the amortization method under the deferred regulatory accounting method will not compensate the Company for committing its capital for lead service line replacements. PAWC Exc. at 21. The Company asserts that if it were to expend \$6 million dollars in a single year, amortization over a period of five years or ten years would result in time value losses of approximately \$1.5 million and \$2.34 million respectively. PAWC Exc. at 22. PAWC believes this would violate the principles of ratemaking embodied in the cash working capital allowance. PAWC Exc. at 22.

As the ALJ points out in the Recommended Decision, the Company’s claims are overstated. R.D. at 20, 23-24. The Company relies on the assumption that it will use the full extent of its Replacement Plan budget each year. R.D. at 23. The Company, however, has not

offered actual numbers regarding the number of customers with a lead service line. R.D. at 20. Accordingly, the ALJ relies on the “credible testimony of Mr. Rubin who testified that there may be a few thousand pipes replaced in the total project.” R.D. at 23-24. Therefore, the “total cost could be closer to ten percent of what is being advocated by PAWC, or \$6 million in its entirety.” R.D. at 24.

Furthermore, the Company recently filed a base rate case on April 28, 2017, where it sought a revenue increase of \$107.9 million, or 16.4 percent, based on a fully projected future test year (FPFTY) of 2018. Pa. PUC v. Pennsylvania-American Water Company, Docket No. R-2017-2595853, Statement of Reasons at 1 (April 28, 2017) (2017 PAWC Rate Proceeding). OCA St. 1SR at 6. As part of its general rate proceeding, the Company had the opportunity to claim these expenses, but chose not to do so. OCA St. 1SR at 6. As with other expenses that arise in between base rate proceedings, the Company would not have the ability to recover these expenses at all. OCA St. 1SR at 7. As stated by the OCA’s witness Scott Rubin:

In April 2017, PAWC filed a base rate case with a calendar year 2018 projected test year (Docket No. R-2017-2595853). PAWC, however, did not include costs associated with customer-owned service lines in its rate-case projections, and it never updated its case to include such costs. Thus, we have a situation where a utility is proposing to incur an on-going expense beginning in the projected test year that it did not include in the test year projections in the rate case. The typical ratemaking treatment for such an expenditure would be to ignore it until the next base rate case. Many things change between cases -- some costs increase, others decrease; new projects are implemented, others are terminated; and so on. Base rates are set based on an overall level of projected costs synchronized with projected levels of sales, customer counts, investment levels, and other costs. Base rates are not meant to track each particular project or specific expenditure amounts. Recovery is not dollar-for-dollar.

As such, the normal approach to this program would be to require the Company to expense the cost and treat it as one of those items that changes between rate cases. Because of the important public-health implications of the project, however, I am proposing special ratemaking treatment that provides the

Company with the opportunity to recover most of its costs from customers. My proposed deferral and amortization would enable the Company to eventually recover from customers the costs it otherwise would be required to expense immediately. While Mr. Cox views this as a "glass half empty" because it does not provide perfect compensation to the Company, I view it as a "glass half full" because it provides the Company with compensation that it otherwise would not be entitled to receive.

OCA St. 1SR at 6-7.

The Company also argues that these costs are not atypical and irregular costs that would qualify for deferred regulatory accounting treatment because it will require regular annual expenditures of \$6 million for a period of ten years. PAWC Exc. at 23. Although the replacement project may be over a period of time, the Company will never again have to replace lead service lines. The ALJ properly recognized these expenses as meeting the criteria for a deferred regulatory asset, noting that it had substantial benefits as compared to capital treatment. R.D. at 22, 24-25; see also OCA M.B. at 14-18, OCA R.B. at 12-15. As stated in the Recommended Decision:

In the instant case, the cost of replacing customer-owned lead service pipes is an extraordinary, non-recurring, one-time expense applicable to a few thousand properties, a relatively small number of PAWC's approximately 700,000 customers. Once work is complete, the health hazard will have been removed and it is not a recurring cost.

\* \* \*

Regulatory assets are "recovered over a period of time through rates, and therefore, represent a compromise between immediately expensing a cost (and an immediate loss to shareholders) and an immediate charge to ratepayers (and an immediate spike in rates)," which represents a fair balance of both interests. 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 to earn a return on those lines, it promotes the Company's minimization of pertinent costs. Conversely, this ratemaking treatment will still ensure that PAWC can earn full recovery of the costs and will be able to continue providing safe and reliable service to its customers.

R.D. at 22, 24-25. Accordingly, the ALJ denied the Company's request to capitalize the costs of replacing customer-owned lead service lines.

Lastly, where similar programs have been approved there has been some sharing of the costs between investors and ratepayers. As stated by the OCA's witness:

The three other cases that have been decided recognize that the removal of customer owned lead service lines is an extraordinary event that is essential for public health protection, and that the utility's actions to replace only its portion of the service line could harm the customer. As a result, the utilities (and the regulatory commissions) recognized that there should be some sharing of responsibility. In the York Water case, that sharing occurs by deferring and amortizing costs with no carrying charge. In the New York American case, the utility agreed to shoulder the entire cost burden for approximately one year, with future actions to be determined. In Halifax, the cost sharing occurs through the utility paying approximately 25% of the cost of work on the customer-owned line. In this case, however, PAWC is not proposing any type of cost-sharing mechanism. PAWC is asking that this extraordinary expenditure for customer-owned property should be treated like any other routine spending on property, plant, or equipment, such that the expenditure would be booked to a plant account, depreciated over a period of more than 50 years, and earn a full return on the undepreciated balance for that entire time period. I do not consider that to be an equitable or reasonable approach to the extraordinary investment needed to protect public health.

OCA St. 1 at 15-16; see also NYAWC LSL, In the Matter of an Application by Halifax Regional Water Commission for an Order Approving Amendments to its Regulations to Provide for the Repair and Replacement of Lead Service Pipes in the Provision of Water Service, Matter No. M07891, 2017 NSUARB 138, Decision (Nova Scotia Utility and Review Board Aug. 22, 2017).

As a further example, the Missouri Public Service Commission (Missouri PSC) recently approved Missouri-American Water Company's request to replace customer-owned lead service lines stating, "[w]hile MAWC should be commended and even made whole for its efforts, MAWC is not entitled to a profit from its initiative." MAWC LSL, at 22 (May 28, 2018).

In addition, the Company has not provided any evidence of other State Commissions allowing a return on 100 percent of the costs. R.D. at 20. Therefore, the ALJ's decision is a fair balancing of investor and ratepayer interests consistent with other state programs.

D. Summary

The Company has presented several arguments supporting its position that replacing customer-owned lead service lines should be capitalized and earn a return on the capitalized amount either in base rates or the DSIC. These arguments do not have merit. Commission precedent establishes that utilities are not entitled to earn a return on customer property. See pgs. 12-13, supra. Moreover, the Company had the ability to include these costs in base rates during its general rate proceeding, but did not do so. Accordingly, the OCA's regulatory asset recommendation and the Recommended Decision's adoption of that approach represents a fair balance of risk between investors and ratepayers to ensure that the significant public harm of lead pipes is dealt with effectively and efficiently. See pgs. 19-20, supra.

**Reply to PAWC Exception No. 5:** The ALJ Did Not Err in Recommending that the Company Provide a Partial Compensation Plan for Customers that Recently Replaced a Lead Service Line Prior to the Replacement Plan. R.D. at 27-29; PAWC Exc. at 26; OCA M.B. at 26-27; OCA R.B. at 16-17.

In the Recommended Decision, the ALJ adopted the OCA's partial compensation plan directing the Company to provide a sliding scale of partial reimbursement to customers that replaced their lead service pipe at their own expense in the four years prior to the Company's Petition. R.D. at 27-29. In her decision citing to 66 Pa. C.S. § 1304, the ALJ determined that failure to provide partial reimbursement for customers would create equitable concerns and possible discrimination in rates if it now required all ratepayers to pay for customer-owned lead service line replacements on a going forward basis. R.D. at 27-28.

In its Exceptions, the Company asserts that the budget cap of \$6 million per year will mitigate any impact of the Replacement Plan on customer rates because, assuming it uses the entire \$6 million budget in each year, customer rates would increase by only \$1.24 per year per customer. PAWC Exc. at 26. In addition, the Company believes that the proper focus of the \$6 million budget should be on customer-owned lead service pipes that remain in service. PAWC Exc. at 26. The Company further argues that any reimbursement program would further add complexity to the administration of this Replacement Plan and would exclude individuals that replaced their lead service pipe prior to the four-year period. PAWC Exc. at 26.

As stated in the OCA's Main Brief, it would be unfair for customers that have recently replaced their lead service line at their sole cost to pay for future replacements on behalf of other customers, as stated by Mr. Rubin:

I agree that the focus of the program is on the removal of lead from the distribution system, but that must be done in a way that is fair to all customers. Reimbursing customers who recently replaced a lead service line is fair and will help avoid customers feeling that they are being disadvantaged by the new program -- they recently paid for their own service line replacement and they are now being asked to subsidize line replacements for other customers, too.

OCA St. 1SR at 3-4; see also R.D. at 28, OCA M.B. at 26-27, OCA R.B. at 16-17. If the Company expects all ratepayers to pay these expenses, ratepayers who have had a lead service line replaced in recent years should also have the opportunity to recover some of their costs. OCA M.B. at 27. Further, the Company's argument that the Replacement Plan budget would mitigate customer rates increases to a mere \$1.24 per year per customer is unavailing. PAWC Exc. at 26. Section 1304 of the Public Utility Code does not have a monetary minimum. 66 Pa. C.S. § 1304. Even the most minor increase in rates can be discriminatory.

Moreover, there is little evidence to suggest that this reimbursement program would be administratively complex. R.D. at 28, see also OCA M.B. at 26-27, OCA R.B. at 17. The Company stated that it "anticipates a small number of customers would qualify for reimbursement." OCA M.B. at 26, see also PAWC St. 1R at 18. Additionally, the four-year limitation on reimbursement is "consistent with the general limitation on refunds of customer bills under the Public Utility Code (Section 1312(a))." OCA M.B. at 26-27, see also OCA St. 1SR at 4. The administration of this program, therefore, should not pose a burden to PAWC.

Additionally, the OCA's recommendation provides sufficient protection for the Company. The Company would verify the customer's lead service line replacement by visiting the customer site to confirm, as well as require a paid invoice, a certification from a licensed plumber, and other documentation as determined by the Company. OCA M.B. at 27, see also OCA St. 1 at 23-24.

Accordingly, the Commission should deny the Company's Exception with respect to the partial compensation plan.

### III. CONCLUSION

For the reasons set forth in the Recommended Decision and supported above, the Office of Consumer Advocate respectfully requests that the Pennsylvania Public Utility Commission deny the Exceptions of Pennsylvania-American Water Company and adopt the Recommended Decision of Administrative Law Judge Barnes.

Respectfully submitted,



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