

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of)
Missouri-American Water Company for an)
Accounting Order Concerning MAWC's)
Lead Service Line Replacement Program)

File No. WU-2017-0296

POST HEARING BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Post Hearing Brief*, states as follows:

Missouri-American Water Company (“MAWC”) filed this request for accounting authority order (“AAO”) to collect an estimated \$8.9 million in costs to fully replace lead service lines, including the customer-owned portion of the line. MAWC’s total lead service line replacement program results from a shift in national best practices from partial lead service line replacements, as a way to best protect human health from the serious consequences of lead leaching into drinking water. Due to the underlying policy rationale supporting total lead service line replacement, and because MAWC has met the extraordinary and significant standard used for evaluating AAOs, Staff supports an AAO for MAWC’s expenses in replacing lead service lines from January 2017 until May 2018, and utilizing the short-term debt rate of MAWC’s parent company’s, American Water Works Company (“AWWC”), for carrying costs.

ARGUMENT

I. Should the Commission grant MAWC the Accounting Authority Order it has requested in this case?

Yes, MAWC should be granted the AAO requested in this case. This

question can be answered as a two-pronged test. First, is MAWC's action of replacing total lead service lines, including the customer owned portion, a justifiable course of action, supported by policy and other considerations? Second, if this action is justifiable, is it a non-reoccurring, extraordinary activity that would have a significant impact on MAWC's earnings if not approved?¹ The answer to both questions is yes.

Policy Considerations

The most important decision before the Commission is whether it is good public policy to grant an AAO for MAWC's proposed lead line replacements that have so far occurred. One way to evaluate this is whether the public benefit of reducing the risk of lead exposure outweighs the monetary cost of MAWC replacing customer owned service lines. In Staff's view, research on the negative health effects of lead is well established, as are the benefits of total lead service line replacements.² Moreover, MAWC's plan to mitigate negative impacts is reasonable and beneficial to customers. Therefore, benefits to the customers outweigh costs associated with the replacements, and thus granting the AAO is good public policy.

Research regarding the health risks of lead and the how to address lead infiltration in drinking water from lead service lines is largely consistent.³ After reviewing this research, MAWC has concluded that lead in water service lines is a risk they wish to limit. Staff witness James Merciel and MAWC witness Gary A. Naumick testified at

¹ State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm'n of Missouri, 858 S.W.2d 806, 810 (Mo. Ct. App. 1993).

² See Ex. 1, Direct Testimony of Gary A. Naumick, Ex. 2, Rebuttal Testimony of Gary A. Naumick, Ex. 3, Surrebuttal Testimony of Gary A. Naumick, Ex. 7, Direct Testimony of Bruce W. Aiton, Ex. 10, Direct Testimony of Martin R. Hyman, Ex. 13, Rebuttal Testimony of James A. Merciel, Jr., and Ex. 15, Rebuttal Testimony of Geoff Marke.

³ See Schedule JAM-r3 and JAM-r4. Though regulations for the removal of all LSL have not been enacted, the dangers of lead in drinking water have been confirmed.

the hearing and attached to their rebuttal testimony extensive documentation of resources, research, and advisory opinions regarding the deleterious health effects of lead and the best practices to limit lead exposure via drinking water, which support MAWC's conclusion and their replacement activities.⁴ Utility regulatory agencies, health agencies, the Environmental Protection Agency, non-governmental organizations, and utilities have all contributed and collaborated to this large body of research.⁵ Lead is dangerous to human health, and full replacement of a lead service line, including the customer-owned portion of the service line, is the best practice when necessary removal or repair to any part of a lead service line is considered.⁶ Because total replacement of a lead service line, including the customer-owned portion, is considered the best practice to reduce risk of exposure to lead in drinking water, replacing the total lead service line is good public policy for a utility.

Nevertheless, OPC witness Dr. Geoff Marke testified that more information is needed to establish the health risks of lead from various sources other than water service lines and to gain a better estimate on the number of lead service lines in Missouri. OPC further argued that this information would then have to be analyzed by an advisory committee of elected officials, MAWC, Staff, OPC, universities, non-profits, and others—similar stakeholders to those entities that have already conducted research on the topic and cited by Staff and MAWC.⁷

⁴ See Ex. 2, Rebuttal Testimony of Gary A. Naumick, Schedule GAN RT-4 and Ex. 13, Rebuttal Testimony of James A. Merciel, Jr., Schedules JAM r-1-5.

⁵ Tr. II; 112:1-21.

⁶ Ex. 13, Rebuttal Testimony of James A. Merciel, Jr..

⁷ See Sec. III *Proposed Lead Line Replacement Study* Ex.14, Direct Testimony of Geoff Marke.

As a member of the Lead Service Line Replacement Collaborative⁸ and expert witness for MAWC, Mr. Naumick testified that OPC's pilot program is largely redundant in scale and therefore not a best use of MAWC ratepayer money.⁹ Similarly, Division of Energy witness Martin Hyman expressed concerns about MAWC ratepayers funding a study that, one, would not be limited to MAWC's service territory, and, two, would consider lead-related issues that are unrelated to the water system and outside of MAWC's control, which is "lead in the water."¹⁰

Redundancy and cost control are not the only red flags surrounding OPC's pilot proposal. OPC witness Dr. Marke states in his rebuttal testimony, "[t]o be clear, OPC acknowledges that MAWC's current practice of partial lead line replacement is most likely flawed."¹¹ OPC admits that partial lead line replacement is flawed. The weight of the evidence provided in testimony and at hearing by the licensed engineers, based on their expert knowledge and the growing body of evidence produced by the EPA, advisory groups, and lead service line focused collaboratives, supported that partial lead service line replacements increase the risk of lead leeching into the water, causing direct negative impacts to human health and welfare. Yet, even with that admission, in the very next sentence, OPC states it is inappropriate to move forward without a study of the confounding variables, assumedly the ones outlined in their proposal.¹² Any study that requires MAWC ratepayers to fund statewide research, or issues outside of the Public Service Commission's jurisdiction and control, such as lead paint and real

⁸ See Ex. 1, Direct Testimony of Gary A. Naumick, pg.2 lines 20-22.

⁹ Tr.II; 116:7-19.

¹⁰ *Id.*

¹¹ See Ex. 14, Direct Testimony of Geoff Marke, pg. 5, lines 1-2.

¹² *Id.*

estate implications,¹³ is prima facie beyond the purview of the Commission or MAWC.

After admitting partial lead service line replacement is flawed, but stating it is inappropriate to move forward without OPC's study, OPC's witness further muddies the water by stating in the surrebuttal, "[t]o be clear, OPC is not saying no to full lead service line replacements. Instead, we are saying "we don't know."¹⁴ OPC proposes removing lead service lines, as MAWC is already doing, but only if MAWC agrees to extensive study parameters such as raw data about the number of pipes and the necessity of a communication plan.¹⁵ The resulting implication is that OPC believes the primary benefit to ratepayers is the results of their pilot proposal, not the human health benefits of preventing lead exposure.

As an alternative to total lead service line replacement, OPC suggests water filters.¹⁶ MAWC witness Gary Naumick discussed these options. One option, a filter within a pitcher,¹⁷ is similar to products many consumers already have in their homes. However, to successfully reduce or eliminate lead consumption, water would need to be filtered through the pitcher before cooking, carried to bathrooms for use when brushing teeth, and the filter would have to be replaced after a number of gallons had run through it. Another option is a filter which can be placed on a tap; the same issues arise with this filter option.¹⁸ Though they can initially be inexpensive, the use of these filters places a burden on customers to track their use and replace them when necessary, in

¹³ *Id.* pg. 9, lines 12-13 – pg. 10, lines 1-2.

¹⁴ See Ex. 16, Surrebuttal Testimony of Geoff Marke, pg. 6, lines 2-3.

¹⁵ See Ex. 14, Direct Testimony of Geoff Marke, pg. 8, line 10, pg. 9, line 22.

¹⁶ See Ex. 16, Surrebuttal Testimony of Geoff Marke, pg. 15-16.

¹⁷ Tr. 135:20-137:12.

¹⁸ Tr. II, 150:23-152:9.

accordance with manufacturers' instructions; in Staff's view, this is not a viable long-term solution.

Although it is the impetus behind much of the current research regarding lead service lines, the lead crisis in Flint, Michigan, has been controversial in this case. Staff views Flint as a prime example of why lead service lines should be proactively replaced, when possible, to avoid future costs and impacts to health.¹⁹ OPC has a different perspective on the lead contamination in Flint, Michigan; their conclusion seems to be that since MAWC plans to continue treating their water as it has in the past, the events of Flint are unlikely to be replayed in Missouri. However, as OPC's witness admitted, past compliance does not guarantee future compliance.²⁰ Staff is also concerned about unforeseen events that can change water chemistry or disturb pipes. Staff witness James Merciel testified that pipes can be disrupted by vibrations and these vibrations can cause the protective scaling to break off, increasing the risk of lead contamination.²¹ Vibrations, which could be caused by unexpected events such as natural disasters or roadwork, are not a hazard that can be predicted. MAWC's proposal would help reduce unanticipated health risks associated with lead service lines.

MAWC has met the standard for an Account Authority Order ("AAO")

At the outset, Commission guidance regarding AAOs suggests any cost deferral to be booked under Account 186 must be extraordinary and significant. MAWC's request is both extraordinary and significant, as those terms are used in Missouri

¹⁹ Ex. 13, Direct Testimony of James A. Merciel, Jr., pages 4:18-5:1.

²⁰ Tr. II, 271:22-24.

²¹ Tr. II, 292:22-293:3.

precedent and case law.²²

The Uniform System of Accounts (“USOA”) for Class A Water Utilities, Instruction 7 states:

Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. Commission approval must be obtained to treat an item as extraordinary.²³

In simpler terms, to qualify for deferral, an event or transaction should be non-reoccurring as well as not a business activity of a type that the company regularly or often engages in. Replacing the customer-owned portion of a lead service line is not a typical, reoccurring business activity for MAWC. In fact, it has only been in the last few years, due to the emerging research about the hazards of partial lead service line replacements as discussed above, that any utility nationwide has started the process of removing customer-owned lead service lines, making it a non-typical, non-reoccurring business activity for the water utility industry as a whole.²⁴ Replacing the customer-owned portion of a lead service line is also non-reoccurring on its face, since a lead service pipe only needs one replacement to resolve the risk of lead leaching.

Prior Commission decisions support this view, as safety-related replacements have often been given AAO treatment. In GR-99-315, *In the Matter of Laclede Gas Company’s Tariff to Revise Natural Gas Rate Schedules*, the parties stipulated to, and the Commission approved, a request to defer costs relating to the replacement of

²² State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm’n of Missouri, 858 S.W.2d 806, 810 (Mo. Ct. App. 1993).

²³ See Uniform System of Accounts for Class A Water Utilities, National Association of Regulatory Utility Commissioners, pg. 16 (1996).

²⁴ See Ex. 2, Rebuttal Testimony of Gary A. Naumick, Schedule GAN-4.

pipeline, including cast iron mains, for safety. Similarly, in response to safety concerns, the Commission granted Missouri Gas Energy an AAO for the deferral of costs relating to pipeline replacement.²⁵ A series of explosions for one utility led to all utilities replacing the potentially dangerous material in certain pipelines. The service line replacement program (“SLRP”) for gas utilities, for which the gas utilities received AAOs, is in many ways very analogous to the replacement program MAWC proposes. In response to a safety risk to human health and welfare, a utility began replacing pipelines made of certain materials that had a greater potential for risk, including customer-owned portions of service lines. Although eventually system replacements for gas utilities were codified in rule,²⁶ the approval by the Commission, and reaffirmation by the Missouri Courts,²⁷ supports the proposition that safety-related replacements are appropriate for AAOs.

The impact on MAWC’s earnings if this AAO is not approved is significant under the 5% guideline set out in the USOA definition of extraordinary items.²⁸ The Commission has stated that materiality is a factor for consideration, but it is not determinative.²⁹ “In other words, while the magnitude of the item proposed for deferral

²⁵ *In the Matter of Missouri Gas Energy’s Tariff Sheets Designed to Increase Rates for Gas Service in the Company’s Missouri Service Area*, Case No. GR-98-140.

²⁶ 4 CSR 240-40.030.

²⁷ Missouri Gas Energy v. Pub. Serv. Comm’n, State of Mo., 978 S.W.2d 434, 436 (Mo. Ct. App. 1998).

²⁸ “[A]n item should be more than approximately 5 percent of income...Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary” State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm’n of Missouri, 858 S.W.2d 806, 810 (Mo. Ct. App. 1993).

²⁹ *In the Matter of the Joint Application of Missouri-American Water Company, St. Louis County Water Company, d/b/a Missouri-American Water Company, and Jefferson City Water Works Company, d/b/a Missouri-American Water Company for an Accounting Authority Order Relating to Security Costs*, Case No. WO-2002-273, *Report and Order*, filed November 10, 2004.

must be considered, that factor alone does not drive the decision.”³⁰ In this case, the magnitude of the expense weighs in favor of granting an AAO. From January 2017 to May 2018, MAWC expects to spend \$8.9 million replacing lead service lines, including the customer-owned portion.³¹ This amounts to 11.5% of annual net income,³² over double the 5% rule of thumb. Granting the AAO allows MAWC a reasonable opportunity to earn its authorized rate of return, while proactively guarding human health and safety by investing in replacing lead service lines instead of one of the numerous other infrastructure projects MAWC could be undertaking.³³

2. If the Commission grants an AAO, what carrying costs should be utilized in regard to the balance of the costs deferred?

Having answered yes to the two determinative questions as to whether an AAO should be granted, the Commission must next decide what level of carrying costs any deferred costs should receive. The Commission should utilize carrying costs calculated using MAWC’s parent company’s, AWWC, ongoing short-term debt rate. On this point, Staff is in agreement with OPC and Missouri Energy Consumers Group (“MECG”).³⁴ A short-term debt rate has been used for AAOs regarding pipeline replacement programs before. The Western District affirmed the Commission’s decision to use a short-term debt rate to determine carrying costs for a pipeline replacement project in Missouri Gas Energy v. Pub. Serv. Comm’n, State of Mo.³⁵ The Commission had determined the use

³⁰ *Id.*

³¹ See Ex. 4, Direct Testimony of Brian LaGrand, pg. 8, lines 3-4.

³² *Id.*

³³ Tr. II, 135:4-19.

³⁴ See Joint Statement of Positions, filed September 9, 2017; Tr. II 58:12-14, 97:13-15.

³⁵ 978 S.W.2d 434, 436 (Mo. Ct. App. 1998)

of a short-term debt rate for this purpose was generally consistent with the calculation of Allowance for Funds Used During Construction (“AFUDC”) for plant projects under construction and not eligible for inclusion in rate base.³⁶ Staff recommends the same outcome in this replacement project. MAWC states that it would go forward with the full lead service line replacements if the short-term debt rate is ordered,³⁷ so ordering the short-term debt appropriately balances the interests of the ratepayers and the Company.

Criteria for Determination of Recovery

Prior cases regarding AAOs have made clear that:

the AAO technique protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs. However, AAOs are not a guarantee of an ultimate recovery of a certain amount by the utility.³⁸

AAO decisions are not ratemaking, nor a guarantee of a return of all, or even any, of the amount deferred. An AAO simply allows a utility to defer costs and later, as part of a rate case that examines all relevant factors, argue that the deferred costs should be considered by the Commission in the determination of new rates.³⁹ At that point, the Commission should evaluate deferred costs like any other expense item in a rate case. At that point in time, the courts have recommended consideration of issues such as the prudence of any expenditures, the amount of recovery, if any, whether carrying costs should be recovered, and if there are any offsets to recovery can be considered in

³⁶ *Id.*

³⁷ Tr.II, 158:3-5.

³⁸ Missouri Gas Energy v. Pub. Serv. Comm'n, State of Mo., 978 S.W.2d 434, 436 (Mo. Ct. App. 1998).

³⁹ State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm'n of Missouri, 858 S.W.2d 806, 813 (Mo. Ct. App. 1993).

determining what, if any, deferred amount is recovered in rates.⁴⁰

Additional Issues Identified by OPC

3. Does MAWC's tariff permit the company to replace customer-owned service lines?

OPC has raised the concern that MAWC's LSL replacement program is a violation of the Company's tariff.⁴¹ The purpose of a tariff is to establish expectations of a company's customers.⁴² It plainly sets out what is required of them: how the bills they are to pay are calculated, how to qualify for various programs, what portions of the utility service line they own, etc. OPC argues that, because MAWC's proposed program is not set out in tariffs, replacing customer-owned lines is a clear violation of the tariff.

The distinction is not that clear though; a program or project is not an automatic tariff violation if the utility repairs or replaces customer-owned property. As Staff expert Jonathan Dallas and MAWC witness Brian LaGrand wrote in testimony, often a part of the customer-owned portion of a service line is repaired or replaced during normal main work.⁴³ OPC witness Dr. Marke could not recall if OPC had ever filed a complaint regarding this practice, nor could he say if it was a violation of MAWC's tariff.⁴⁴ In Staff's view, a tariff violation would occur if a company were, outside of its Commission approved tariff, to require a customer to take some sort of action that is not authorized by the tariff, such as replacing a properly functioning LSL. MAWC is not asking its

⁴⁰ *Id.*

⁴¹ Ex. 16, Surrebuttal Testimony of Geoff Marke, pg. 45:20-46:1.

⁴² 4 CSR 240-13.010(4).

⁴³ See Ex. 11, Rebuttal Testimony of Jonathan Dallas and Ex. 4, Direct Testimony of Brian W. LaGrand.

⁴⁴ Tr. II, 273:2-9, 15.

customers to take any sort of action under this proposal other than agreeing to have their LSL replaced, both company and customer-owned portions, by MAWC. The role of a tariff is to protect customers; in this instance, Staff does not think additional language is necessary since no new expectations are being placed on MAWC's customers.

Furthermore, Staff does not see how MAWC's proposal to replace the customer-owned portion of a lead service line can be a violation of MAWC's tariff, while OPC's pilot proposal is not. As OPC witness Dr. Marke stated:

A. I want to be perfectly clear on this.

Q. Sure.

A. Okay? **Our proposal is replacing the full lead service lines.**⁴⁵

Nowhere in OPC's testimony is there proposed tariff language that, following their own argument, would make their program "legal."⁴⁶ The entire proposal outlines responsibilities for MAWC in minutia, including request for proposals, potential job creation, soil abatement, proposals for addressing the costs of garbage days, trees, and finished basement, as well as literature review surrounding toys.⁴⁷ If OPC believed that tariff language was absolutely necessary, it is startling that OPC would neglect to propose new tariff language to address the legality of their own proposal, or even to recommend that MAWC be responsible for proposing changes. Even more befuddling is that the witness that designed the pilot proposal and spent three rounds of testimony and approximately 35 pages of testimony describing and defending it, cannot answer if

⁴⁵ *Id.* 274: 6-9.

⁴⁶ *Id.* 279:21.

⁴⁷ See Ex. 14, Direct Testimony of Geoff Marke.

his proposal is a tariff violation or not.⁴⁸ A review of his attached case participation history shows Dr. Marke has worked on numerous cases in which he has proposed tariff language, a recent example being the KCPL rate case, Case No. ER-2016-0285, where he proposed customer disclaimer language regarding rooftop solar.⁴⁹ In that case, he was able to testify to appropriate tariff language. Dr. Marke also seemed to still have the ability to write testimony regarding tariffs, including alleged violations in his surrebuttal testimony, where he states, “MAWC is acting in conflict with their existing tariff and replacing customer-owned property.”⁵⁰ Only in this hearing was the witness unable to testify about tariffs and alleged violations, or whether OPC’s proposed pilot program was a violation. OPC has not made a showing that MAWC’s lead service line replacements are a violation of their tariff.

Conclusion

In conclusion, Staff recommends that the Commission grant MAWC an AAO to defer costs expended from January 2017 to May 2018 relating to total lead service line replacements. Staff also recommends that AWWC’s short-term debt rate be utilized for calculating carrying costs.

WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law as recommended by the Staff herein; and granting such other and further relief as is just in the circumstances.

⁴⁸ Tr. II, 280:5.

⁴⁹ *In the Matter of Kansas City Power & Light Company’s Request for Authority to Implement A General Rate Increase for Electric Service*, Case No. ER-2016-0285, Ex. 308, Direct Testimony of Geoff Marke.

⁵⁰ Ex. 16, Surrebuttal Testimony of Geoff Marke, pg. 45, line 21-pg. 46, line 1.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 19th day of October 2017 to all counsel of record.

/s/ Nicole Mers