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

THE OFFICE OF THE PUBLIC COUNSEL'S REPLY BRIEF

COMES NOW the Office of the Public Counsel ("Public Counsel" or "OPC") and presents its reply brief to the Missouri Public Service Commission ("Commission") as follows[1]:

I. Introduction

1. Absent clear legal authority permitting it to continue replacing customer-owned service lines and a path to resolve the on-going tariff violations, the Commission cannot permit Missouri-American Water Company's ("MAWC" of "company") program to continue without modification. MAWC fails to offer either. The company chooses to dismiss the legal concerns and instead focus on gaining implicit approval for its program through an Accounting Authority Order ("AAO") to defer costs. Importantly, MAWC can already defer costs into NARUC USOA Account 186 and so the Commission should decline to issue the company's requested AAO.

2. Nothing in MAWC's or the Commission Staff's ("Staff") initial briefs persuaded OPC otherwise. Instead, MAWC and Staff write in broad generalities about the potential dangers of lead without demonstrating that "full" line replacement is legal, necessary, or any better at achieving either lower water lead levels or lower blood lead levels than the partial service line replacement the company has been doing for decades. Understanding the Commission may be interested in

[1] Any issue or argument treated in Public Counsel's Post-Hearing Brief not addressed specifically below is hereby adopted and incorporated as if set forth fully herein.

exploring the issue – especially as it relates to the putative health and safety concerns raised by MAWC – Public Counsel has worked to develop an outline for a pilot program as a legal way for the company to continue replacing customer-owned lead service lines while stakeholders address the issues. If the Commission does wish to explore the issue of customer-owned lead service line replacement, it should reject MAWC's AAO request and encourage the parties to pursue the pilot program outlined by OPC in MAWC's rate case.

II. Legal authority

3. Public Counsel suggested in its initial brief that MAWC is not merely seeking an AAO for deferral authority, but is instead seeking an AAO in an effort to gain implicit approval of the company's actions in violation of its tariff. It bears repeating that MAWC management alone chose to spend money it knew it could not collect from ratepayers. Importantly, MAWC itself describes its lead service line replacement program as "discretionary" (MAWC Br., p. 11).

4. The legal issues in this case relate to the company's ability to perform the action of replacing customer-owned lead service lines. There is no question the company has the engineering ability to replace pipes, however there are essentially two broad legal issues pertaining to its actions. First, whether the company is authorized to replace customer-owned service lines. Second, as argued by OPC, whether the company is violating its Commission-approved tariff.

5. In its initial brief, MAWC attempts to address both issues, but fails to demonstrate any legal authority for its program. Instead, the company asks the Commission to focus on accounting authority only (MAWC Br., p. 3). It is understandable that MAWC would rather the Commission focus on accounting authority because the company is unable to provide any authority authorizing

its actions. However an accounting authority order will not resolve questions on the legality of its actions.

6. As the Commission is aware, a reviewing court will examine if Commission orders are lawful in that the Commission acted within its statutory authority (*State* ex rel. *Atmos Energy Corp. v Pub. Serv. Comm'n*, 103 S.W.3d 753, 759 (Mo. banc 2003); *City of O'Fallon v. Union Elec. Co*., 462 S.W.3d, 442 (Mo. App. W.D. 2015)). The Commission must examine the legal authority in the cases it hears. However, the Commission's examination of authority before issuing an order is two-fold; (1) first examining its own authority and (2) second examining the authority of the applicant. For example, the Commission has authority to set rates to be charged for utility service (Sections 393.130 and 393.150 RSMo), but a single customer does not have authority to file a complaint as to the reasonableness of a utility's rates and charges (Sections 386.390 and 393.260 RSMo). Viewed through this two-part analysis it is clear the Commission must address the authority of the applicant to do the underlying action.

7. Here, if the question is focused on ability to issue an accounting order – Public Counsel does not dispute the Commission's statutory authority to do so (Section 393.140(8) RSMo). However the Commission does not need to issue an order for a utility to book costs into Account 186. The Commission should not issue this unnecessary order – thereby giving implicit approval to MAWC's actions – without examining the company's authority to replace customer-owned service lines. In this case, that authority is questionable.

8. At the hearing, OPC introduced into evidence an email from MAWC to certain members of the Office of the Commission (and Public Counsel) discussing legislation related to lead service line replacement (Ex. 26, Supplemental Response 2, Attachment 1). Public Counsel suggests the

email shows that the company believes its actions are not authorized by law. In its brief, MAWC attempts to explain that the referenced legislation was not about authority to replace the customer-owned property, but "was focused on cost recovery between rate cases" (MAWC Br., p. 6). To support its contention, MAWC compares its actions to (1) electric companies purchasing fuel or power and (2) utilities incurring costs to comply with environmental laws (MAWC Br., p. 6). MAWC's replacement is not similar to either situation. Purchasing fuel is a necessary aspect of providing electric service occurring long before the passage of the FAC statute referenced by MAWC. In contrast, replacing customer-owned service lines is described by the company itself as "discretionary" (MAWC Br., p. 11). Next, complying with environmental laws is required. The undisputed facts in the record show no legal or other regulatory requirement requiring Missouri-American to replace customer-owned service lines (Tr. Vol. 2, p. 166; Ex. 24).

9. Certainly, if the company could demonstrate that replacing customer-owned service lines was required by law or was otherwise necessary to provide safe and adequate service MAWC's authority to act may be different. However, the company has failed to demonstrate its program is necessary. The best rationale the company can offer is that "the physical disturbance of the lead service line have the potential to increase lead levels following replacement." (MAWC Br., p. 8). This putative justification by the company might make sense if "full" replacement was more effective at reducing that risk than partial replacement. However, the evidence in the record indicates no difference between partial and "full" replacement. Documents provided by the company confirm the foregoing conclusion (*See* Ex. 21C, Attachment p. 2 stating **

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Importantly, the evidence in this case shows the potential for temporarily elevated lead levels will subside relatively quickly. MAWC's Mr. Naumick testified that the predominating research is that partial replacements will return to a stable condition (Tr. Vol 2, p. 129). Moreover, Mr. Naumick testified that research shows a partial replacement returns to stable condition in hours or days (Tr. Vol. 2, p. 129).

10. Concerns about the increased risk of galvanic corrosion occurring if a partial replacement is performed are likely equally overstated by the company and the Staff. First, MAWC does not plan to go back and replace prior partial replacements because those pipes are stable. If MAWC or Staff believed there to be a risk, their current positions to ignore prior partial replacements would be irresponsible. Notably, MAWC states it would be "well within" its rights to refuse to replace customer-owned service lines, "refuse to replace any of the customer-owned service lines", and can "leave the customers on their own to discover the lead service lines, contract for replacement, pay for replacement, and decide what sampling and flushing protocols should be applied to the replacement." (MAWC Br., pp. 11-12). Again, if MAWC truly believed there to be a latent risk, such a posture would be irresponsible and dangerous. Second, MAWC's engineer Mr. Naumick testified that the company can address galvanic corrosion without a conducting a "full" service line replacement:

> **Q (by Mr. Opitz): So -- so you do agree there are instances where the full line is not replaced?**
> A (by Mr. Naumick): There may be.
> **Q: And based on the information in this DR, there are -- when that -- when there is some lead service line left in place, the company uses some kinds of coupling to make the connection; is that correct?**
> A: Correct.
> **Q: And is the purpose of that connection to reduce the galvanic corrosion?**
> A: Correct.

Q: And that's a way to, I guess, prevent lead from leeching in as a result from the different kinds of metals coming in contact?
A: Correct.

(Tr. Vol. 2, p. 123; Ex. 20). The evidence in the record shows there is no measurable benefit that results from replacing the customer-owned portion of a lead service line. However, Public Counsel's proposed pilot to occur in the rate case provides an opportunity to explore this question.

11. In response to OPC's charge that MAWC's program violates several provisions in its Commission-approved tariff, MAWC and Staff offer non-substantive responses. The Company stakes its legal position on an inapt analogy, arguing "MAWC's voluntary replacement of those lines, with implementation of flushing and sampling protocols, is not 'unlawful,' any more than if the newspaper company tossed you a newspaper for which they did not charge you." (MAWC Br., p. 12). MAWC further argues, in a footnote, that "almost every main replacement in St. Louis County, it is necessary to replace some portion of a Customer Water Service Line in order to complete the main replacement."(MAWC Br., p. 11). MAWC is not a newspaper company; it is a regulated monopoly offering public utility services. When MAWC voluntarily replaces and pays to replace customer-owned service lines it will seek to foist those "discretionary" costs onto all other customers – customers who cannot simply subscribe to another water company if they objected, as they could with a newspaper subscription. If MAWC wishes to continue replacing customer-owned service lines at shareholder expense, OPC will not object.[2] Furthermore, MAWC's argument in its footnote that its voluntary replacement of customer-owned service lines is authorized because it is sometimes "necessary to replace some portion" when doing main

[2] Of course, if MAWC chooses to pay for these replacements, it should not later complain its discretionary activities are a drag on its earnings and require an increased ROE.

replacement activities belies its own point (MAWC Br., p. 11). Replacing some portion of the line may be necessary, but "full" replacement is not.

12. In its brief Staff offers no legal authority authorizing the company's actions, but seems to argue that the company is not violating its tariff because Public Counsel did not propose any tariff sheets in this case (Staff Br., pp. 11-12). First, Staff again reveals its ignorance of the testimony in this case by failing to observe that OPC's proposed pilot would be considered in the company's pending rate case, not in the AAO docket.[3] Second, Public Counsel is under no obligation to propose tariffs even if the company decides to pursue a pilot in its rate case; the Commission requires *utilities* to keep tariffs on file, not Public Counsel. Staff then spills nearly two pages of ink discussing that Dr. Marke did not offer legal conclusions in his testimony (Staff Br., pp. 11-12). To be clear, Dr. Marke is not an attorney and so Staff's inquiry is totally useless. Nothing in the Staff's brief cites to any legal authority permitting MAWC to replace customer-owed lead service lines and require other customers to assume responsibility for those costs.

13. Additionally, neither MAWC nor Staff address Public Counsel's charges that the company's putative solution for resolving its tariff violations – a contract – creates more violations (See Ex. 9, Schedule BA-SR3). First, MAWC's tariff unambiguously requires that all "written agreements shall conform to these Rules and Regulations in accordance with the statutes of the

[3] Elsewhere in its initial brief, Staff feigns – as it did at the hearing – that it does not understand that OPC's proposal would permit the company to continue "full" replacement during the pilot (Staff Br., p. 5). OPC's proposal was explained to Staff informally prior to the hearing, formally in pre-filed testimony, in position statements, and during the hearing. To the extent Staff continues to be "befuddled" it is because of an affirmative decision to remain uninformed. Regardless of Staff's posture, OPC remains committed to working to help Staff understand the mechanics of the pilot program should the company pursue that course of action in its rate case.

State of Missouri and rules of the Commission." (PSC MO No. 13 1st Revised Sheet No. R 9, Rule 2.D). Furthermore, the general provisions of the company's tariff provide that "[n]o employee or agent of the Company shall have the right or authority to bind it by any promise, agreement or representation contrary to the letter or intent of these Rules and Regulations of law." (PSC MO No. 13 Original Sheet No. R 10, Rule 2.K). Second, the form agreements include language attempting to limit liability to the company when, in fact, the agreements expose the company to greater liability. MAWC tariff sheet PSC MO No. 13 Original Sheet No. R 11, Rule 3 defines the parameters surrounding MAWC's liability. Rule 3.F prohibits the company from entering agreements that assume or assign liability contrary to the parameters in the tariff (See PSC MO No. 13 Original Sheet No. R 11). When MAWC increases its liability it places a greater burden and risk on its customers from whom MAWC would seek to recover any payments made under the liability terms.

14. Public Counsel's pilot program outline provides a framework for the utility to continue replacing customer-owned service lines while stakeholders address the issues – including the necessity and efficacy of full lead service line replacement.[4] In a pilot proposed in a rate case, the Commission can approve new tariffs permitting the discrete program to explore the unanswered questions, including the necessity of the project, while assuring cost recovery of a defined budget.

15. Since January 2017 MAWC has been violating its Commission-approved tariff. As the Commission is aware, a tariff has the same force and effect as a statute and that it becomes state

[4] Including those state agencies tasked with addressing water quality and monitoring blood lead levels, the Department of Natural Resources and Department of Health and Senior Services respectively.

law when approved by the Commission (*See State* ex rel. *Union Elec. Co. v. Pub. Serv. Comm'n*, 399 S.W.3d 467, 477 (W.D. Ct. App. 2013). Furthermore, MAWC has not cited any legal authority to authorize its program. Given the outstanding question of the company's authority to replace customer-owned service lines and the clear violations of MAWC's Commission-approved tariff, the Commission should not grant an AAO to give implicit approval of the program.

III. Accounting Authority

16. Setting aside the legal considerations, there is no need for the Commission to issue an AAO. In its brief, MAWC invites the Commission to ignore all policy and legal issues and instead answer the question: "Should the Commission grant MAWC the accounting authority order ("AAO") requested by the Company?" (MAWC Br. p. 1). This seemingly simple question does not actually tell the Commission anything about what the company is requesting. **It is unclear, exactly, what order the company seeks**. Is it the order from the company's petition seeking rate treatment (Doc. No. 1, p. 5 seeking an order stating: "[t]his regulatory asset will remain in place until all eligible costs are amortized and recovered in rates.")? Maybe MAWC really wants the order in the company's pre-filed testimony also seeking rate treatment (Doc. No. 15, p. 9 stating "[t]his regulatory asset will remain in place until all eligible costs are amortized and recovered in rates.")? Perhaps the company wants the order from the company's internally inconsistent position statement (Doc. No. 36, p. 2 seeking an order "[t]hat this regulatory asset will remain in place until all eligible costs are amortized and recovered in rates" but later stating at p. 5 "[t]he Commission need not make a regulatory asset determination.")? Or, alternatively, is the company seeking the order described by MAWC counsel at the evidentiary hearing (*See* Tr. Vol. 2, p. 19 counsel for the company stating, in pertinent part, "MAWC … has agreed that recovery is a question that needs

to be addressed in the rate case and is dropping that aspect of its -- of its original request." Further stating MAWC "does not ask the Commission to make a GAAP regulatory asset determination.")? Perhaps the true order requested is in MAWC's initial brief (also containing internal inconsistencies) (MAWC Br. p. 2 asking for an order "[t]hat MAWC may defer and maintain this regulatory asset…", at p. 10 casually referring to the "regulatory asset associated with the requested AAO", but stating at p. 22 "[t]he Commission need not make a regulatory asset determination.")?

17. At every opportunity the company's position has been reversed, revised, and reversed again. Given this history Public Counsel would not be surprised to see the company asking for yet another different order in its reply brief. The only consistent foundation of the company's position is that it plans to foist these "discretionary" costs onto all other ratepayers (*See* MAWC Br. p. 11 wherein company admits these projects are "a discretionary investment").

18. Whether or not the company is still asking for an order explicitly granting approval for rate recovery by asking that the "regulatory asset will remain in place until all eligible costs are amortized and recovered in rates" the continued use of the term "regulatory asset" remains problematic. Outside of a rate case the Commission should never issue an order granting a "regulatory asset" because the defining characteristic of a "regulatory asset" under generally accepted accounting principles ("GAAP") is that the expenses deferred as a regulatory asset are "probable" of recovery in a rate case (Ex. 18, p. 1). While such a determination may be appropriate for company management to make if they believe the requirements of ASC 980-340-25-1 apply, the Commission cannot give ratemaking treatment without considering all relevant factors (*See*

State ex rel. *Util. Consumers' Council of Mo., Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41 (Mo. 1979).

19. Moreover, no Commission order is necessary for MAWC management to book costs to NARUC USOA Account 186 as the company requests. MAWC management can generally record revenues, expenses, gains and losses on its own determination without Commission approval or notification to all USOA accounts with a few exceptions (Ex. 18, p. 2).[5] Importantly, as to the language of any order in this case, NARUC USOA Account 186 is not a regulatory asset account; it is simply a "deferred debit" account (*Id*). Costs recorded in a deferred debit account have no association with rate recovery and should not be considered a regulatory asset (*Id*). No witness testified that MAWC requires permission from the Commission to book or to defer a cost to Account 186 (Tr. Vol. 2, p. 310 OPC's Hyneman; Tr. Vol. 2, p. 257 Staff's McMellen; Tr. Vol. 2, p. 179 MAWC's LaGrand). As a consequence, no order issued in this case should use the designation "regulatory asset".

20. In its brief Staff cites to USOA General Instruction No. 7, the definition for extraordinary items to support its position that the Commission should issue an order "grant[ing] MAWC an AAO to defer costs"[6] (Staff Br. p 6, 13). As explained in the testimony of Mr. Hyneman, although the Missouri Commission has often used the "Extraordinary Item" USOA language as a standard for approving utility requests to defer expenses, when the FASB created the Extraordinary Item

[5] Examples of instances when Commission approval or notification is necessary include certain transactions in Accounts 105, Property Held for Future Use, Account 106 Utility Plant Purchased or Sold, and Account 183 Extraordinary Property Losses (Ex. 18, p. 2).

[6] Public Counsel notes Staff's brief cites to the "Uniform System of Accounts for Class A Water Utilities, National Association of Regulatory Utility Commissioners, pg. 16 (1996)" when Commission rule 4 CSR 240-50.030(1) requires the 1973 version, as revised July 1976.

language and the FERC and NARUC adopted this language, it had no relationship with anything other than where on the income statement certain expenses would be reflected (Ex. 18. P. 7). Citing to the Accounting Principles Board ("APB") Opinion No. 9, *Reporting the Results of Operations*, issued in 1966, Mr. Hyneman explained the basis of his understanding about the concept of Extraordinary Items that:

> In that Opinion the APB concluded that net income for a period should reflect all items of profit and loss recognized during the period except for certain prior period adjustments. The Opinion further provided that extraordinary items should be segregated from the results of ordinary operations and shown separately in the income statement and that their nature and amounts should be disclosed.

(*Id*). The concept of extraordinary items was meant only to provide clarity and enhance the usefulness of the information on an income statement (*Id*. at 9). Whether or not an item qualifies as "extraordinary" has no impact on whether the utility can defer the cost or record the cost as a regulatory asset (*Id*). MAWC witness Mr. LaGrand agreed when he testified that he was unaware of anything in GAAP that requires a finding of extraordinary before a company can book costs to Account 186 (Tr. Vol. 2, p. 179). Mr. LaGrand further testified he did not believe anything in GAAP requires the company to seek approval to defer costs into Account 186 (Tr. Vol. 2, p. 179).

21. Ultimately, in the event the Commission determines an item to be extraordinary, the responsibility to decide how to record the costs for accounting purposes, whether it be for a regulatory asset or for deferral into Account 186, remains with utility management. Here, MAWC management can decide to book costs to NARUC USOA Account 186 if it chooses; no order from the Commission granting authority is necessary. As explained above, MAWC has not addressed

the outstanding question of the company's authority to replace customer-owned service lines or the clear violations of MAWC's Commission-approved tariff. The Commission should not use accounting authority orders as a means to endorse public policy positions and cannot inoculate the company from tariff violations by issuing an AAO, and so, should reject the company's petition for an AAO.

IV. Conclusion

22. MAWC can already defer costs into Account 186 without a Commission order. No witness testified otherwise. However, if the company wants to continue replacing customer-owned lead service lines, it must seek a legal basis to do so and provide the Commission with the policy and evidentiary support for such a program. MAWC has failed to do either. If the Commission wants to enable MAWC to continue replacing customer-owned lead service lines, it should encourage the company to pursue a pilot program in its pending rate case,

WHEREFORE Public Counsel submits its Reply Brief and asks the Commission to deny the company's AAO petition.

Respectfully,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 30th day of October 2017:

/s/ Tim Opitz