

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the Consolidated)	REGULATORY DIVISION
Petition by Mountain Water Company for)	
Declaratory Rulings and Application for)	DOCKET NO. D2011.1.8
Approval of Sale and Transfer of Stock)	
in Park Water Company)	ORDER NO. 7149d
)	

FINAL ORDER

Appearances

FOR THE APPLICANTS:

Mountain Water Co.
John Alke, 40 W. Lawrence, Suite A, PO Box 1166, Helena, MT, 59624-1166

Carlyle Infrastructure Partners, LP
Thorvald Nelson, Holland & Hart LLP, 6380 S. Fiddlers Green Circle, Suite 500,
Greenwood Village, CO 80111

FOR THE INTERVENORS:

Montana Consumer Counsel
Mary Wright, 111 N. Last Chance Gulch, Suite 1B, Box 201703, Helena MT 59620-1703

City of Missoula
Jim Nugent, Missoula City Attorney, 435 Ryman St., Missoula MT 59802

Clark Fork Coalition
Barbara Hall, 140 S. 4th St. W., Unit 1, PO Box 7593, Missoula MT 59801

BEFORE:

Travis Kavulla, Chairman
Gail Gutsche, Vice Chair
W.A. Gallagher, Commissioner
Brad Molnar, Commissioner
John Vincent, Commissioner

COMMISSION STAFF:

Leroy Beeby, Rate Analyst
Justin Kraske, Staff Attorney
Dennis Lopach, Chief Legal Counsel
Kate Whitney, Administrator, Regulatory Division

Summary of the Final Order

1. In this case, the Montana Public Service Commission (Commission) has heard from hundreds of customers of Mountain Water (Mountain) regarding the proposed sale of Mountain's parent company, Park Water (Park), to the Carlyle Group (Carlyle). Missoula residents are passionate about this issue, and they have freely shared their views. Public comments have focused on a variety of issues, but particularly on the importance to Missoula of its water supply, the interest of the public in owning and controlling the water system, and the belief that the proposed buyer of Park will not have the best interests of Mountain's customers and Missoula at heart.

2. The Montana Consumer Counsel (MCC), which represents residential and small business customers before the Commission, has been a strong proponent of a principle called "ring-fencing." Ring-fencing is a series of organizational and financial measures to protect a subsidiary utility company from potential harm that could otherwise result from activities of a utility's parent company or affiliated companies. The parties in this docket have presented an agreement that contains a series of strong ring-fencing measures. These ring-fencing measures are an important benefit to Mountain ratepayers as no ring-fencing measures now exist between Mountain and Park. With this agreement, the MCC and other parties either support the sale or do not oppose the sale.

3. Clark Fork Coalition (CFC) advocated for the preservation of the Rattlesnake watershed and of Mountain's water rights. CFC sought assurances from Carlyle that the Rattlesnake watershed would be used only for emergency backup water supply and that Missoula water would be kept in the Missoula-area watershed. The parties have presented an agreement that does not allow Mountain to transfer, sell, lease, or otherwise dispose of any of Mountain's water rights, without Commission approval, with the exception of transfers that facilitate service to Mountain's customers. This prohibition on transfers of water rights is a significant benefit to Mountain's customers as no specific prohibition on transfers now exists.

4. The City of Missoula (City), acting through its elected leaders, supports the sale in the hope that Carlyle will work with it in the future to transfer the Mountain system to public ownership. The City has reached a written agreement with Carlyle which provides the City an absolute right of first refusal (ROFR) to purchase Mountain if Mountain itself is sold as a stand-alone entity. The City can also submit an offer to purchase Mountain at any time. Finally, if Mountain's holding company, Park, is sold in the future, the City has a minimum of 120 days to make an offer to purchase Mountain. The Missoula City Council supported this agreement by a vote of 11-1. Mayor Engen emphasized "the clear advantages to a community of having its water utility owned by local ratepayers who are affected by operations every day..." City of Missoula response to PSC-037(c). The City has, through the Letter Agreement, obtained a binding ROFR that this Commission lacks the statutory power to order.

5. The Commission's jurisdiction in this case rests on its power to protect customers from harmful consequences of a purchase in the form of rate increases or deterioration of service. This decision is required by law to be based on the record of evidence offered by the parties. As discussed below, the MCC, the City and the CFC have presented no evidence that the sale will have adverse future consequences on rates or service. The PSC's own staff has investigated the transaction thoroughly and has found no reason to believe that service or rates would be different if Carlyle acquires Park from its present owners. Given the primary focus of this Commission on rate and service impacts, and given the evidentiary record and the support of the parties for the transaction, the Commission approves the stipulated ring-fencing agreement and the sale for the reasons discussed below. The decision is the outcome that is required by Montana law and the extensive body of evidence that the Commission has carefully analyzed.

6. The stipulated Commission-approved ring-fencing agreement, which closely follows the ring-fencing provisions recommended by the MCC; provides important structural and financial protections for Mountain assets and limits subsequent negative impacts on ratepayers from activities of Carlyle and its other companies. The approved provisions ensure that the Commission can review and scrutinize the expenses and revenue of Mountain at any time and requires that those accounts are kept separate from other Carlyle-owned companies. Mountain is restricted in its borrowing and is required to use all proceeds for utility purposes in Montana. Commission notification is required before Mountain can issue dividends to investors, and is limited on the amount of profit that it can distribute to investors. Mountain is prohibited from

transferring significant utility property or any of its water rights without prior authorization from the Commission.

7. Rates will not increase as a result of the approval of this transaction. It is certainly possible that rates will increase as the company's costs increase and old water mains are replaced, but that will be the case no matter who owns the system. Such investment is subject to future Commission proceedings and review prior to any rate changes being authorized. The ratepayers of Mountain shall not pay, directly or indirectly, for any transaction costs or other liabilities or obligations arising from the approval of this transaction.

8. The California Public Utilities Commission (California PUC), which regulates Park (owner of Mountain) and its California water systems, conducted its own review of this sale. The Town of Apple Valley (Apple Valley), whose residents receive water service from another Park-owned company, recently filed comments with the California PUC. After reviewing the agreement reached by the City of Missoula with Carlyle, Apple Valley requested that it be granted the same right of first refusal in the Letter Agreement that the City negotiated with Carlyle. Apple Valley was unsuccessful in reaching an agreement with Carlyle, and the California PUC approved the sale anyway, without any option for a right of first refusal for Apple Valley.

9. The Commission is requiring that Carlyle must file with the Commission a specific plan for the future disposition of Park Water and Mountain at least 18 months before Carlyle is dissolved or otherwise terminated or modified. The Commission would review any future transfer of Mountain to the City or any other entity under the same standards that govern its decision in this case.

10. As Robert Dove, of the Carlyle Group, indicated in his testimony during the hearing, Carlyle is interested in establishing an ongoing dialogue with the MCC, CFC, City, and other stakeholders. The Commission advises Carlyle and Mountain to work actively with its stakeholders and Mountain's customers to understand their priorities for the water system and to provide the best service possible at the lowest cost. To fulfill these goals, the Commission advises Mountain to establish a stakeholder or citizen's advisory committee to conduct ongoing dialogue.

Introduction and Procedural History

11. On January 24, 2011, Mountain submitted to the Commission a Consolidated Petition for Declaratory Ruling and Application for Approval of Sale and Transfer of Stock in Park Water Company. In the filing, Mountain requested the Commission issue declaratory rulings that there is no basis for the Commission to claim implied power to review the sale and transfer of Park stock to Carlyle Infrastructure Partners, LP (Carlyle) and that, even if it has the power to review and approve the sale and transfer, the Commission decline to exercise its jurisdiction. Mountain further requested, if the Commission asserts jurisdiction over the sale and transfer of Park stock to Carlyle, that the Commission approve the transaction.

12. A Notice of Application and Intervention Deadline was issued by the Commission on February 1, 2011. The Commission subsequently granted intervention to the MCC, Carlyle, CFC, and the City.

13. The Commission declined to issue the requested declaratory rulings on June 28, 2011. (See Order No. 7149c, Order on Petition for Declaratory Ruling, issued September 14, 2011.)

14. On May 17, 2011, the Commission issued Procedural Order No. 7149 establishing a schedule for consideration of the application. On June 30, 2011, the Commission granted MCC's and CFC's joint request for an extension of the deadline for filing intervenor response testimony due to discovery delays and established July 29, 2011, as the new deadline. The procedural schedule was further amended by the Notice of Commission Action issued July 20, 2011. The Commission issued Amended Procedural Order No. 7149b on August 3, 2011, which amended the deadline for identification of additional issues and set a hearing date of September 26, 2011. On August 11, 2011, the Commission issued a Notice of Additional Issues and Procedural Schedule. A Notice of Public Hearing was issued September 2, 2011.

15. On September 22, 2011, Carlyle, CFC, and the City submitted a Letter Agreement (Attachment A to this Order).

16. A public hearing was held September 26-27 in Missoula, Montana.

17. On October 31, 2011, Mountain, Carlyle, MCC, and the City submitted a Stipulation regarding implementation of ring-fencing conditions and approval of the transaction. (Attachment B to this Order).

18. Carlyle and CFC submitted post-hearing briefs on November 1, 2011.

Summary of Applicant's Petition

19. Mountain has owned and operated the Missoula water utility since Mountain was formed to acquire the utility from the Montana Power Company in 1978. The petition described Mountain as a closely-held Montana corporation wholly-owned by Park, which is a closely-held California corporation almost entirely owned by Henry Wheeler and his family and subject to the jurisdiction of the California Public Utilities Commission. According to the petition, on December 21, 2010, Park entered into a merger agreement pursuant to which a wholly-owned subsidiary of Western Water Holdings, LLC, a Delaware limited liability company, controlled by Carlyle Infrastructure Partners Western Water, LP, will merge with and into Park. Park will continue as the surviving corporation as a wholly-owned subsidiary of Western Water. Carlyle Infrastructure Partners, LP, owns Carlyle Infrastructure Partners Western Water, LP. The Carlyle Group, a large privately-owned investment firm, created and manages the entities comprising Carlyle Infrastructure. Mountain maintained that the sale of Park's stock to Carlyle does not affect the ownership of Mountain or of Mountain's utility assets because, after the merger, Mountain will still be owned by Park.

20. Mountain attached to its filing a copy of the joint application for approval of the sale that the merging companies filed with the California PUC (California Application). The merger agreement was included with the application as Exhibit A. The merger agreement calls for Western Water Holdings to acquire 100 percent of Park's outstanding stock for a total purchase price of \$102 million, plus an estimated \$1.5 million in closing costs. Park's outstanding debt of approximately \$53 million will remain on Park's balance sheet. Western Water Holdings is set to expire no later than September 2021. In response to a data request regarding Carlyle's plans for recovering its investment, Carlyle responded that it does not intend to seek rate recovery of any acquisition premium from Park's customers, including the customers of Mountain. According to Carlyle, the acquisition premium may be wholly or partly recovered in a future sale of Park stock to another owner. (Carlyle Response to DR PSC-8e.)

21. According to the California Application, the proposed transaction will have no adverse impact on utility operations or rates. Carlyle has a few existing infrastructure investments (waste/wastewater recycling in Texas, operation of highway service plazas in Connecticut, a lift-on/lift-off container operation for trucks and trains, and school bus transportation in Illinois), but none is a regulated public water utility. In Mountain's application, the utility asserted that the

proposed Carlyle/Park transaction will have no impact on the ownership of Mountain, on Mountain's facilities, service or operations, on the Commission's jurisdiction, or on rates. Mountain asserted that Park's access to the capital markets could be enhanced by its access to Carlyle's resources.

Summary of Applicant's Pre-filed Testimony

Robert Dove (Carlyle)

22. Robert Dove is a managing director of the Carlyle Group, co-head of Carlyle Infrastructure Partners, LP, and board chairman of Western Water. He testified that Carlyle intends for Mountain and its management team to continue as they are today, resulting in no change to the service received by customers. He said Carlyle will not sell water from the Mountain system to any persons other than Mountain customers and added that Mountain's water rights will not be diverted elsewhere.

23. According to Dove, Carlyle intends to retain Park and its subsidiaries, including Mountain, for a long period of time and invest capital into the system as necessary. However, during the hearing, Dove testified to a relatively short ownership period, which is discussed further below in paragraph 76. He explained that Carlyle will not try to quickly increase the value of the assets by increasing revenues or cutting expenses in order to sell the company for a large profit. Rather, he said Carlyle's investors expect to acquire low-risk assets that offer steady, predictable returns.

24. Dove identified Mountain's water main leakage problem as an area of concern that Carlyle will address in consultation with the Commission, customers and other stakeholders. He acknowledged that infrastructure replacement will affect rates, but said Carlyle is aware of the need to balance infrastructure improvements with reasonable rates. Dove said Carlyle will perform cost-benefit analyses of any plans to improve Mountain's infrastructure.

25. Dove said Carlyle will also work with the Commission to promote rate designs and educational efforts that could accelerate the migration of existing flat-rate customers to metered service.

26. Regarding Carlyle's commitment to Missoula, Dove said Carlyle would protect the quality of Missoula's water, strive to keep rates reasonable, and be an active member of the community.

Summary of Intervenors' Pre-Filed Response Testimony

Dr. John Wilson (MCC)

27. MCC consultant and economist Dr. John Wilson said the Commission should not be overly concerned about Carlyle's lack of experience in the water utility industry because Carlyle intends to retain Park's and Mountain's existing management and operate the utility without significant changes. However, Wilson did identify several concerns. One MCC concern is that Carlyle's business plan for Mountain apparently is to increase the utility's investment in infrastructure improvements/replacement, which will increase rate base and lead to rate increases. Wilson referred to an October 2010 internal Carlyle memo, provided in Carlyle's response to data request MCC-004, that summarizes the financial analysis that led to Carlyle's acquisition of Park.¹ The memo includes information about Carlyle's eventual exit from its investment in Park and the expected annual internal rate of return, a confidential number which Wilson termed "very large." Wilson said the memo does not indicate that Carlyle plans to recover the acquisition premium through dividend payouts, but rather that Carlyle intends to increase the utility's investment in infrastructure. According to Wilson, more rate base investment may not be a concern if the investments are justified by a benefit/cost analysis; however, he advised the Commission to monitor the utility closely if the transaction is approved. He recalled that leaky water mains were an issue in the last Mountain rate case, and Mountain's testimony in that case was that the estimated cost of the water loss in 2009 was \$366,000, but to replace all of Mountain's water mains over 40 years old would cost \$128.6 million.

28. Wilson questioned Carlyle's assertion that it intends to be a long-term owner of Mountain because the Carlyle memo indicates that Carlyle will build up the utility's rate base and market value and then exit this investment after five years. Wilson said Carlyle, in any case, is a limited-life entity that is scheduled to expire in 2019, which could be extended to 2021. (See Carlyle response to PSC-014(e).)

29. Wilson was also skeptical of the value of the ROFR that Park promised to the City of Missoula in a 1997 letter (City DR-008, Ex. A), since reaffirmed by Carlyle, in the event Mountain is for sale. He referred again to the Carlyle internal memo, which advises that the

¹ The "Investment Committee Memo," dated October 7, 2010, was initially provided on an entirely confidential basis in Carlyle's response to MCC-004(b), but a redacted version of the memo was subsequently submitted in Carlyle's 3rd Supplemental Response to MCC-004(b) on September 16, 2011.

letter clearly states the ROFR would apply only if Mountain were proposed to be sold on its own, separate from Park.

30. Wilson proposed several provisions to “ring-fence” Mountain’s finances and operations, which he argued are needed to protect Mountain’s ratepayers in light of Carlyle’s apparent growth plans and potential inter-corporate transactions and financing. He said the major credit rating agencies support utility ring-fencing provisions, especially limits on dividend payments, affiliate loans, and capital structure, to strengthen utilities’ financial ratings. Wilson’s recommended ring-fencing provisions closely follow those contained in the ring-fencing Stipulation, which is ultimately adopted as discussed later in this order. Wilson recommended the Commission require implementation of the following ring-fencing conditions:

- a. The Commission or its agents may audit the accounts of Mountain, its parent and its subsidiaries and affiliates which are the basis for charges to, or transfers from Mountain or its parent. Mountain shall cooperate fully with such Commission audits.
- b. Mountain and its parent shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between Mountain or its parent and its affiliated interests.
- c. Mountain shall maintain its own financial and business operating accounts, separate from its parent’s and its affiliates’ accounts. All financial and operating books and records of Mountain and those of its parent and subsidiaries shall be completely and immediately accessible at Missoula, Montana.
- d. There is no provision that Mountain shall maintain its own debt, in recognition of the historic practice of Mountain’s parent (Park) issuing debt on a consolidated basis. If these financing circumstances change or if debt is to be incurred for acquisition purposes, appropriate debt ring-fencing conditions may be required. If, at any time, Mountain’s parent or affiliates intend to issue debt for the purpose of acquiring other companies, those financing intentions must be filed with the Commission at least 120 days in advance of any such financing so that the Commission may implement appropriate debt ring-fencing provisions.
- e. Mountain shall not make any distribution to its parent or to any affiliates that would cause Mountain’s equity capital to fall below 45 percent of Mountain’s net utility plant balance (utility plant in service less accumulated depreciation and amortization) without Commission approval. Also, Park shall maintain a capital structure equity percentage of at least 45 percent, on a Park-and-subsiaries-consolidated basis, except to the extent that the Commission imputes a lower equity percentage for ratemaking purposes. The Commission may re-examine these minimum common equity percentages as financial conditions change, and may determine that they be adjusted.

f. Mountain and its parent shall provide the Commission unrestricted access to all written information provided to common stock, bond, or bond rating analysts, that directly or indirectly pertains to Mountain, its parent, or any affiliate that exercises influence or control over Mountain. Such information includes, but is not limited to, reports provided to, and presentations made to, common stock analysts and bond rating analysts. For purposes of this condition, “written” information includes but is not limited to any written and printed material, audio and video tapes, computer disks and electronically stored information. Nothing in this condition shall be deemed to be a waiver of Mountain’s right to seek protection of the information.

g. Unless such a disclosure is determined to be unlawful in an opinion of counsel provided to the Commission, Mountain shall notify the Commission of:

1. Its intention to transfer more than 5 percent of Mountain’s retained earnings to its parent or subsidiaries or affiliates (or any combination thereof) over a six-month period, at least 60 days before such a transfer begins.
2. Its intention to declare a special cash dividend from Mountain, at least 30 days before declaring such dividend.
3. Its most recent regular common stock cash dividend from Mountain within 10 days after declaring such dividend.

h. Mountain’s parent, subsidiaries and affiliates shall not allocate to or directly charge Mountain with expenses not specifically authorized by the Commission to be so allocated or directly charged.

i. Without the prior and specific authorization of the Commission, neither Mountain nor Park shall transfer, merge, sell, lease, encumber or otherwise dispose of Mountain’s utility property which (a) has a net book value in excess of \$1 million, which is included in Montana rate base, and (b) has costs recovered through rates regulated by the Commission.

j. The following principles shall apply to any new financing involving utility property of Mountain which (a) is included in Montana rate base, or (b) has costs recovered through Commission-regulated rates:

1. Proceeds of debt that is secured by utility assets must be used for utility purposes only;
2. If any utility assets that are pledged or encumbered to secure debt issuances are divested, the debt must “follow” the assets and be divested as well;
3. If utility assets financed by unsecured debt are divested to another entity, then a proportionate share of the debt must also be divested;

4. If assets financed with unsecured debt are divested, the associated unsecured debt must follow those assets. Specifically, if any of the proceeds from unsecured debt are used for non-utility purposes, the debt likewise must “follow” the non-utility assets and if the non-utility assets are divested, then a proportionate share of the debt must follow the associated non-utility assets by being divested as well. The term “divested” in this context includes moving assets to both affiliated and non-affiliated corporations.

k. If Mountain or its parent participates in a “cash management pool” or “treasury pool” arrangement, or otherwise engages in intra-corporate financing with affiliates, Mountain shall file for Commission approval a cash management plan incorporating best practices for protecting Mountain’s and its parent’s credit from the risks associated with participating in a shared money pool with such affiliates.

31. Wilson suggested the Commission may also want to adopt, in addition to his ring-fencing conditions, the California approval conditions that Carlyle agreed to in the California PUC proceeding. (Ex. MCC-1, Attached Exhibit __JW-1)

John Engen (City)

32. John Engen, Mayor of Missoula, testified on behalf of the City that the City would like to purchase, own and operate Mountain. Engen commented that clean, safe drinking water is a fundamental resource and should be provided by a municipally-owned public utility. He said the City has decades of experience owning public utilities such as its wastewater treatment facility.

33. According to Engen, reasons for City ownership include providing more accountability and accessibility. He said there is a higher level of accountability to consumers when utilities are publicly owned. He asserted that municipal utilities are not profit-motivated and, therefore, typically cost less to operate and maintain, are more interested in conservation than a private utility, and are less likely to be sold. Engen stated that the City has some knowledge of Mountain’s operations because the City works cooperatively with Mountain in several areas. Engen concluded by stating that the City has the financial capability and political will to purchase, operate and maintain Mountain. He recommended that, if the proposed Carlyle-Park transaction is approved, the City should be afforded an opportunity to negotiate an agreement with Carlyle to purchase Mountain at the time Carlyle decides to sell either Mountain or Park.

Charles Rial (CFC)

34. The pre-filed response testimony of CFC witness Charles Rial was not admitted into the record at hearing.

Summary of Applicant's Pre-Filed Rebuttal TestimonyJohn Kappes (Mountain)

35. John Kappes, Co-CEO of Mountain, emphasized that the City's and CFC's advocacy of public ownership of Mountain is misplaced because the Commission does not have the authority to decide that Mountain should be transferred from private ownership by Park to City ownership. He said that, no matter who owns the stock of Mountain's corporate parent Park, Mountain's status as a privately-owned, regulated utility is unchanged. Kappes asserted that Park's stock transaction with Carlyle is subject to the jurisdiction of the California PUC, and that Mountain, which is subject to Montana PSC regulation, is not proposing an action of any kind.

36. In response to Engen's testimony on behalf of the City, Kappes argued that, if the City wants to own or acquire Mountain against the utility's wishes, the City must initiate and win an eminent domain proceeding. He recalled that the City tried to do just that in the 1980s, but its efforts were rejected by Montana courts. Kappes also disagreed with the City's contention that it would serve and protect consumers better than Mountain does under the Commission's regulatory oversight. He said that Commission regulation is rigorous, consumer-oriented, and provides incentives for private utilities to ensure they provide service in a cost-effective manner. He added that the MCC protects consumer interests so long as Mountain is PSC-regulated.

37. According to Kappes, the Commission should clearly and frankly tell both CFC and the City that the Commission has no authority to provide the relief they have requested in this case.

38. In response to MCC witness Wilson's concern that Carlyle plans to invest aggressively in main replacements, which will increase rates, Kappes said he agreed with Wilson that water mains should be replaced only when it is cost-effective to do so and that he had discussed with Carlyle the need to moderate its main replacement plans. Kappes pledged that Mountain will not conduct a main replacement program that is not cost-effective for customers and not fully supported by the Commission. He noted that when a former Commission pressed Mountain to more aggressively pursue main replacement, it was Mountain that urged moderation because of the rate impact.

39. Regarding Wilson's ring-fencing recommendations, Kappes responded that the proposed transaction between Park and Carlyle is a sale of stock of a non-jurisdictional entity (Park), not the acquisition of a jurisdictional utility by a non-jurisdictional entity. Therefore, he argued, the ring-fencing provisions proposed by Wilson might appropriately be considered by the California PUC as the regulator of Park, but not by this Commission. Kappes argued that the jurisdictional utility, Mountain, has been owned by a non-jurisdictional entity, Park, for many years, and the Commission has successfully regulated Mountain without any ring-fencing provisions for many years.

40. Kappes further argued that some of Wilson's ring-fencing proposals, such as specifying a mandatory capital structure for Park and requiring Commission approval of Park's debt issuances, are actually attempts to directly regulate Park. He observed that the debt issuance restriction is not within the Commission's authority in any case when it concerns a water utility.

41. Kappes included his proposed revisions to Wilson's ring-fencing conditions. Kappes' proposed revisions to Wilson's recommended conditions are summarized below:

Proposed Conditions (a) and (b) – revise to ensure that the auditing and access to books provisions do not extend to unregulated Carlyle.

Proposed Condition (c) – eliminate requirement that Park's accounting records and systems be available in Missoula, which is contrary to current practice of auditing Park's records at its California location and Mountain's records in Missoula.

Proposed Condition (d) – eliminate entirely this proposed condition regarding debt issuances because the Commission has no authority to regulate them for water utilities.

Proposed Condition (e) – eliminate the parts that specify a mandatory capital structure for Park.

Proposed Condition (f) – eliminate entirely this proposed condition requiring access to information provided by Park and/or Mountain to stock and bond analysts because neither company is publicly traded.

Proposed Condition (g) – revise the provision to maintain its intent of providing the Commission with advance notice of any upstream dividends from Mountain to Park, while ensuring it does not apply to cash management agreements as well.

Proposed Condition (h) – eliminate entirely this provision that prohibits Mountain's parent or affiliates from allocating any of Mountain's expenses in a way that was not specifically authorized by the PSC. Kappes argued the Commission has never prescribed

a system of cost allocation for any regulated utility, but rather the Commission and MCC examine all cost allocations in rate cases.

Proposed Condition (i) – revise to delete portions that apply to non-jurisdictional Park or that improperly allow Commission to authorize water utility security issues.

Proposed Condition (j) – eliminate entirely this provision because, with the recent exception of the federal stimulus-financed main replacement, all debt capital is raised by Park, not Mountain.

Proposed Condition (k) – revise to reflect there is an existing cash management agreement between Mountain and Park and focus the provision on changes to that agreement.

Summary of Applicant's Pre-Filed Additional Issues Testimony

Robert Dove (Carlyle)

42. Dove addressed the additional issues that were identified by the Commission as follows:

Issue (a)(i) – Local control and security of Missoula's drinking water. Dove said that because Carlyle intends for Mountain and its management team to continue unchanged, there will be no changes in local control, water rights or security of the resource.

Issue (a)(ii) – Carlyle's qualifications to own and operate a regulated public utility. Dove reiterated that the same qualified and experienced people who are managing and operating Mountain and Park today will continue to do so. Carlyle will not be directly involved in Mountain's daily operations, but the three Carlyle members of Park's board of directors will provide strategic guidance to Park.

Issue (a)(iii) - Balancing Carlyle's objective of maximizing returns with the requirement that rates must be just and reasonable. Dove testified that Park and Mountain have always been for-profit, regulated utilities providing reasonably-priced service while trying to earn a reasonable return for investors. He said a change in Mountain's upstream owner will not change how it operates as a regulated investor-owned utility.

Issue (a)(iv) – Ensuring access to clean, safe drinking water and preservation of water rights. Dove referred to his direct testimony in which he said Mountain's water will not be sold off-system and Mountain's water rights will not be diverted for use elsewhere.

Issue (a)(v) – Carlyle's ethics policies, investigations. Dove said Carlyle conducts its business in accordance with investment guidelines developed in consultation with an environmental, social and governmental expert and drawing on internationally recognized norms, including the U.N. Principles for Responsible Investment and the U.N. Global Compact. He attached to his testimony a copy of Carlyle's 2010 report on its corporate citizenship. (Ex. RD-1.) Dove added that Carlyle, as a signatory to the Public Pension Fund Code of Conduct, provides on its website information regarding backgrounds of

key Carlyle personnel, corporate political contributions, and certain investment fund fees and expenses. He said Carlyle received two corporate citizenship awards in 2010. Finally, according to Dove, Carlyle is not aware of any material violations of federal, state or local laws by Carlyle Infrastructure or any of its portfolio companies (except for minor notices of environmental violations assessed to Synagro Technologies, the incidence of which he said Carlyle is attempting to reduce).

Issue (b)(ii) – Carlyle’s position on ROFR. Dove responded that the Commission has no legal authority to require Park or Carlyle to sell Mountain to the City or to establish a sale condition to that effect. He reiterated that Carlyle will honor the August 1997 letter from Mountain to the City.

Issue (c) – Appropriate standard for review of the transaction. Dove argued this is a legal issue that will be addressed in either a legal pleading or brief in this docket.

Issue (d) – Impact of Carlyle’s business plan on customers. According to Dove, because Carlyle’s investors seek low-risk investments that produce a predictable rate of return, maintaining reasonable rates and adequate service is a key part of the business plan. He said Carlyle plans to consult with the Commission, customers and other stakeholders to develop ways to address Mountain’s leaking infrastructure and how and when to invest capital to fix the problem. Dove testified Carlyle is aware that infrastructure improvements must be balanced with keeping rates reasonable and affordable and, to that end, will analyze the long-term benefits of infrastructure investment compared to short- and long-term rate impacts.

Summary of CFC’s Pre-Filed Additional Issues Testimony

Karen Knudsen (CFC)

43. Karen Knudsen, executive director of CFC, said the additional issues identified by the Commission highlight the issues CFC is concerned about in this proceeding, such as the perceived remoteness and inaccessibility of Carlyle, the question of local control, and Carlyle’s motivation and intentions. However, during the hearing, Knudsen testified in favor of the sale.

44. Regarding the issue of local control, Knudsen said that, despite Carlyle’s stated intention to retain Mountain’s current management, it is unclear whether any Mountain representative will serve on the Park board post-merger. She said CFC is also concerned about the effect on local control of Carlyle’s recently announced plan for an initial public offering, Carlyle’s short investment horizon, and Mountain’s “outlier” status as the only Park-owned utility regulated in a different jurisdiction. Knudsen said the lack of Commission parent-level management oversight jeopardizes the security of Missoula’s drinking water resources, a concern that she claimed is heightened by Carlyle’s lack of experience in Montana or in the water utility industry.

45. Knudsen testified that CFC is concerned that Carlyle has not provided any assurance that Mountain will not add large-scale commercial users, such as bottling companies, to the system, which Knudsen said is a way Carlyle could increase Mountain's rate base.

46. According to Knudsen, CFC opposes approval of the transaction unless Carlyle provides these assurances: (1) designation of the Rattlesnake Creek watershed as an emergency backup water supply only; (2) commitment to keep Missoula water in the Missoula-area watershed; and (3) granting of a ROFR to the City to purchase Mountain and/or any other assets of Mountain.

Summary of Carlyle/City/CFC Letter Agreement

47. Under the terms of the Letter Agreement (Ex. Carlyle-3), the City and CFC agreed to support approval of the proposed transaction. Key elements of the agreement include:

- If Mountain's upstream owner receives an offer to buy Mountain independent of its parent and the parent, having received the offer, decides to sell Mountain, the City will be notified of the decision prior to any sale. The City will have 120 days to submit its own proposal to purchase Mountain. If the City's offer meets or exceeds the third-party's purchase price in Carlyle's reasonable judgment, Carlyle will accept the City's proposal.
- If Mountain, Park, or Western Water is proposed to be sold, Carlyle will notify the City prior to the sale. The City will have at least 120 days after notice of Carlyle's intention to sell to determine whether to submit an offer to purchase Mountain and, during that time, Carlyle will not sell the company to a third party and will consider in good faith any offer from the City to purchase Mountain.
- Carlyle will consider in good faith any offer from the City at any time to purchase Mountain.
- Disputes regarding the provisions of the Letter Agreement will be settled by a 3-member arbitration panel in Missoula. The arbitrators, one each selected by Carlyle and Mountain and the third by mutual agreement, will have the power to award damages, injunctive relief, and attorneys' fees and expenses to any party. The arbitration decision will be final and binding on the parties.
- The Commission should not adopt a condition on the sale regarding the future use of Mountain's water rights. If the Commission approves the transaction, Mountain's Rattlesnake drainage infrastructure will continue to be beneficially used as a backup water supply for Missoula and not diverted elsewhere and, prior to Mountain using its water rights for a different use, Mountain will discuss those plans with the City and CFC at least 90 days prior to the planned change of use.

Summary of Stipulation Regarding Ring-Fencing Conditions

48. MCC, the City, Carlyle and Mountain proposed in their Stipulation a set of ring-fencing conditions as a resolution of the remaining issues in this docket that were not addressed in the Letter Agreement (Attachment A). The conditions are summarized below:

- a. PSC may audit Park's and Mountain's accounts and have access to affiliates' records regarding transactions that are the basis of charges to or transfers from Mountain.
- b. Mountain will maintain its own separate financial and business operating accounts and they will be accessible in Missoula.
- c. Mountain's utility assets will not be encumbered to raise debt capital for non-utility purposes or non-Montana utility purposes without PSC approval. If Park or Western Water pledges the ownership of Mountain as security for non-Montana utility financing purposes, Park or Western will immediately provide the Montana PSC a copy of the financial filing that Park or Western Water submitted to the California PUC for approval.
- d. Mountain will not make any distribution to Park or its affiliates that results in Mountain's equity falling below 45% of its rate base without PSC approval.
- e. If Mountain, Park or Western Water is the subject of an initial public offering, Mountain will notify the PSC and, upon PSC request, will provide all related information provided to rating analysts and the Securities & Exchange Commission (subject to federal limitations).
- f. Mountain will notify the PSC 30 days in advance of any declaration of dividends or other transfer that exceeds 5% of Mountain's equity (unless a legal opinion provided to the PSC determines such disclosure is unlawful).
- g. Allocations of expense or direct charges to Mountain from Park or an affiliate which is included in Mountain's cost of service will be scrutinized closely in Mountain's rate cases.
- h. PSC authorization is required prior to Mountain transferring, selling or otherwise disposing of any of Mountain's water rights or any Montana rate-based utility property with a net book value in excess of \$1 million.
- i. If a material amount of Mountain utility assets that are encumbered to secure debt issuances are divested, the net proceeds of the sale must be used to pay down the debt, or be reinvested in utility assets in accordance with the security agreement under which the debt was issued.
- j. If Mountain wants to change its current cash management agreement with Park, Mountain will incorporate best practices for protecting Mountain's credit from the risks

associated with participating in such an agreement and will notify the PSC 30 days in advance of the change.

Commission Authority to Review Transaction

49. The Commission's duty is to supervise and regulate the operations of public utilities in conformity with Title 69, MCA. § 69-1-102, MCA. The Commission is invested with the full power of supervision, regulation, and control of public utilities. § 69-3-102, MCA. In addition to normally implied powers, the Commission is expressly granted the power to do all things necessary and convenient in the exercise of the powers conferred by Title 69, Chapter 3, excluding judicial powers. § 69-3-103(1), MCA.

50. The Commission has consistently exercised authority over mergers, sales, and transfers of utilities and utility property for many years covering a significant number of transactions. (See Docket No. D2011.1.8, Order No. 7149c, ¶ 19 (Order on Petition for Declaratory Ruling)) and (In the Matter of the Joint Application of NorthWestern Corp. to Babcock & Brown Infrastructure Limited, Docket No. D2006.6.82, Order No. 6754e, ¶ 19)

51. In Order No. 7149c, the Order on Petition for Declaratory Ruling, in this Mountain Water docket, the Commission set out its authority to review the sale and transfer of stock in Park Water. “Pursuant to its authority, the Commission has jurisdiction over and must approve any sale or transfer of a public utility, its assets, or utility obligations in order to assure generally that utility customers will receive adequate service and facilities, that utility rates will not increase as a result of the sale or transfer, and that the acquiring entity is fit, willing, and able to assume the service responsibilities of a public utility.” (In the Matter of the Joint Application of Energy West Incorporated and Cut Bank Gas Company, Docket No. D2008.3.27, Order No. 6907b, Conclusions of Law ¶ 6 (November 2, 2009) The jurisdiction of the Commission over the sale and transfer of Park stock is based on Mountain Water’s status as a regulated subsidiary of Park and its public utility status in Montana. (Docket No. D2011.1.8, Order No. 7149c, ¶ 30)

Standard of Review for Transaction

52. Carlyle, in its post hearing brief argues that the “Commission should review the application in this docket under a no-harm to consumers standard of review.” (Carlyle Reply Br., p.3) The City, CFC, MCC, and Mountain did not argue for a specific standard of review.

53. Generally, there are three standards that regulatory commissions employ: the public interest standard, the no-harm-to-consumers standard, or the net-benefit-to-consumers standard. (*Joint Application of NorthWestern Corp. to Babcock & Brown Infrastructure Limited*, Docket D2006.6.82, Order No. 6754e, ¶ 35) In the Northwestern Corporation and Babcock and Brown Infrastructure Limited Joint Application for approval of the sale and transfer of Northwestern to BBI, this Commission chose to apply a no-harm-to-consumers standard. (Docket No. D2006.6.82, Order No. 6754e, ¶ 36) More recently, in the sale of Qwest Communications to CenturyLink, the Commission also used the no-harm-to-consumers standard. (*Joint Application of Qwest Communications International, Inc and CenturyLink, Inc.*, Docket No. D2010.5.55, Order No. 7096e, ¶ 106) “In prior orders, the Commission has based its authority on the duty to ensure adequate service at just and reasonable rates, but has not enunciated a specific standard. It may be impossible to enunciate a general standard that is applicable in all cases. For example, if the Commission were faced with the sale of a public utility that was not providing adequate service, it would be appropriate for the Commission to apply a net benefit standard that assured customers would receive adequate service. In another case, a utility may be providing adequate service but just rates for the potential acquirer may be higher than currently charged. In such a situation, it would be appropriate for the Commission to apply a no-harm-to-consumers standard.” (Docket No. D2006.6.82, Order No. 6754e, ¶ 35)

54. Mountain has consistently provided adequate service in the past and none of the parties testified to the contrary. ¶ 35) Since service inadequacy is not at issue with Mountain, the Commission determines that the net-benefit standard is not the appropriate standard to use here. Rather, consistent with its past orders, the Commission will review the transaction using the no-harm-to-consumers standard.

Discussion and Findings of Fact

55. Two of the three intervenors in the docket -- the City and CFC -- support Commission approval of the proposed transaction and the third intervenor -- MCC -- does not oppose it. The City and CFC initially opposed the transaction; MCC initially took no position, but recommended that any Commission approval include conditions. All three intervenors resolved their concerns through successful negotiations with Carlyle and Mountain that produced the Letter Agreement and the ring-fencing Stipulation.

56. As discussed above, the Commission must determine that the proposed transaction will not result in harm, or risk of harm, to ratepayers. As part of making that determination, the Commission's task includes "... [assuring] generally that utility customers will receive adequate service and facilities, that utility rates will not increase as a result of the sale or transfer, and that the acquiring entity is fit, willing, and able to assume the service responsibilities of a public utility." (See *In the Matter of the Joint Application of Energy West Incorporated and Cut Bank Gas Company*, Docket No. D2008.3.27, Order No. 6907b, Conclusions of Law ¶ 6 (November 2, 2009))

57. The Commission approves the proposed transaction, conditioned upon implementation of the ring-fencing measures in the Stipulation, plus one additional condition regarding a disposition plan, which is explained below in paragraph 70, because the record demonstrates that approval of the transaction with conditions will not harm, or risk harm to, Mountain's ratepayers and is consistent with the public interest. Reasons for Commission approval are discussed below.

Ring-fencing

58. Implementation of the Stipulation's ring-fencing provisions is essential to the Commission's finding that the transaction will not harm ratepayers. "Ring-fencing" refers to structural and financial measures undertaken to isolate a utility from the risks of other entities and operations. To protect the public interest and the ability of the utility to provide adequate service at just and reasonable rates, the Commission may impose appropriate ring-fencing requirements as a condition of approval of a transaction such as are proposed in this proceeding.

59. In this case, as pointed out by MCC, Carlyle's plans for Park's growth, such as those regarding "tuck-in" acquisitions in California, indicate the need for ring-fencing Mountain's finances and operations.² (Ex. MCC-1, p. 16) Other factors contributing to the need for ring-fencing were noted by MCC, including the fact that Carlyle is a private investment firm and not a public utility, it has vast interests that extend far beyond Mountain and Missoula, and Mountain's utility assets should not be put at risk by the financial ventures of its upstream owner and its affiliates. (Tr. at 180-181)

² Carlyle indicated in response to data request MCC-004 that it has already targeted possible acquisitions of (additional) companies by Park. See Appendix IV, page 21 of the response to MCC-004.

60. The ring-fencing provisions agreed to by the parties to the Stipulation are very similar to those initially proposed by MCC's Wilson, and cover all the same main issues. Where there are differences, for the most part they reflect reasonable concerns that were discussed by Mountain witness Kappes in his rebuttal testimony. (Ex. MWC-1, pp. 12-21) The ring-fencing Stipulation conditions are explained in the following paragraphs.

61. Condition (a) effectively combines Wilson's provisions regarding Commission access to information and auditing. Condition (b) requires Mountain to maintain its own accounts and books separate from Park's, but does not require that Park's records be available in Missoula as Wilson initially had proposed. As Kappes pointed out, the existing practice is that Commission and MCC staff examines Mountain's books in Missoula and examine Park's books at the Park office in California. (Ex. MWC-1, p. 15)

62. Condition (c) ensures that neither Mountain nor its affiliates will use Mountain's utility assets as security for non-utility or out-of-state purposes without Commission approval and that, if Park or Western Water plans to use their ownership of Mountain to secure debt or other financing, they must provide the Commission a copy of their California PUC filing for approval of the financing. This condition provides Mountain more specific protection against its assets being encumbered by affiliates' debt issuances than Wilson's initial proposal, which would have merely required advance notice of debt issuances so that the Commission would have the opportunity to implement appropriate debt ring-fencing provisions.

63. The Stipulation imposes limits on Mountain's capital structure and on its ability to pay dividends to its parent. Condition (d) requires prior Commission approval of any upstream distribution that would cause Mountain's equity capital to fall below 45 percent of its rate base. Wilson had initially proposed that Park, maintain the same minimum equity capital percentage, but Kappes correctly pointed out that it would be inappropriate for the Commission to attempt to mandate a capital structure for a company it does not regulate. (Ex. MWC-1, p. 17) However, the order issued by the California PUC, approving the transaction, included a requirement that Park maintain an equity percentage of at least 45 percent, on a Park-and-subsidaries-consolidated basis, except to the extent the California PUC imputes a lower equity percentage for

ratemaking purposes.³ Therefore, Wilson's concern about the Park capital structure is resolved by the California PUC order. Condition (f) is substantially the same as Wilson's proposed requirement that Mountain notify the Commission in advance if it intends to declare dividends or otherwise transfer more than 5 percent of its retained earnings.

64. Since Mountain, Park and Western Water are not publicly traded companies, Wilson's initial proposed condition to require Mountain to provide the Commission with information it or Park provided to rating analysts was changed in Condition (e) to require Mountain to notify the Commission if Mountain, Park or Western Water is the subject of an initial public offering and to provide related information to the Commission upon request and as might be limited by law.

65. Condition (g) provides that any Park or Park affiliate expenses charged to Mountain and included in Mountain's cost of service will be scrutinized by the Commission in rate cases. This condition corresponds to Wilson's proposal to prohibit allocation of Park expenses to Mountain without Commission approval.

66. Mountain may not dispose of any rate-based utility property that exceeds \$1 million in net book value without prior Commission approval as a result of Condition (h). This condition is important because it ensures that there will be no disputes regarding the Commission's authority concerning disposition of utility property of significant value. When asked at hearing if the \$1 million figure should be reduced because none of Mountain's assets appears to exceed that number, Wilson replied that his proposed condition contemplated a sale of a segment of Mountain's operations, not an individual asset. (Tr. at 178) This condition is expanded from Wilson's original proposal to also require prior Commission approval of the sale or transfer of any of Mountain's water rights, excluding certain transfers for permitting purposes that are within the jurisdiction of the state Department of Natural Resources and Conservation and/or the Montana Water Court.

67. Condition (i) is a pared-down version of Wilson's proposal regarding divestiture of Mountain assets that have been pledged to secure debt. The original proposal would have applied comprehensively to divestitures of secured and unsecured debt and utility assets while the Stipulation condition simply requires that if a material amount of Mountain's utility assets that secure debt issuances are divested, the sale proceeds must be used to pay down the debt or

³ *Decision Conditionally Approving the Application for Authority by Western Water Holdings, LLC, et al., to Acquire and Control Park Water Company and Apple Valley Ranchos Water Company*, California Public Utilities Commission, Application 11-01-019, December 1, 2011.

be reinvested in utility assets. Kappes had noted in his objection to Wilson's original proposal that Mountain, historically, has not issued its own debt; it is raised by Park, over which the Commission has no jurisdiction. (MWC-1, p. 21) However, the order issued by the California PUC, approving the transaction, included requirements that Park shall not issue long-term debt, guarantee any debt of any affiliates, or encumber any utility assets without California PUC approval.⁴

68. Regarding Mountain's cash management agreement with Park, Wilson's original proposal did not reflect the fact that there is an existing cash management agreement that governs that process. Condition (j) provides that if Mountain proposes changes to the current agreement, it will incorporate best practices for protecting Mountain's credit from the risks of participating in the agreement and will give 30 days' advance notice to the Commission of the changes.

69. Regarding enforcement of the ring-fencing requirements, if violations occur, no penalties will be automatically imposed, however, the Commission will have its full legal and ratemaking remedies available.

70. Commission approval of the Carlyle/Park transaction is contingent on one more item that is not included in the Stipulation. Carlyle Infrastructure Partners, LLC, is a limited-life entity that will expire no later than September 28, 2021. (DR PSC-14(e)) The dissolution of Carlyle will result in the transfer of control of Mountain's parent to a new owner or to a new Carlyle investment fund. In the California PUC's order approving the California Application, the California PUC addressed this issue by conditioning approval of the transaction on the requirement that Western Water Holdings LLC., Carlyle Infrastructure Partners Western Water L.P., and Carlyle Infrastructure Partners, L.P., as owners of Park and Apple Valley Ranchos Water Company (Apple Valley) must file an application with a proposed plan for an orderly transition of Park and Apple Valley no later than 18 months before dissolution of the company.⁵ The Commission agrees with the California PUC that such a requirement will ensure a timely and orderly transfer of control. The Commission imposes the same requirement on Carlyle as a condition of approval of this transaction. In the event that ownership of Mountain, or its parent, Park, has not already been transferred to an entity other than Western Water before September

⁴ Id.

⁵ Id.

28, 2021, Carlyle must file with the Commission the same proposed plan for the future disposition of Park that it must file in California and in the same time frame.

Additional factors

71. While appropriate ring-fencing is important to the Commission's determination that the Carlyle/Park transaction will not result in harm to consumers, there are other factors that contribute to that determination as well. Carlyle and Mountain demonstrated that Mountain will continue to provide adequate service because the sale of Park's stock to Carlyle's subsidiary, Western Water, will not change Mountain's regulatory status or significantly affect Mountain's operations. Mountain will remain a regulated utility subject to the same Commission jurisdiction, which means any proposed rate changes will be subject to the same regulatory oversight as before. Park will remain Mountain's owner. Carlyle's internal investment committee memo indicated to Carlyle that Park that Mountain and Park are well-managed companies whose management teams should be retained. (DR MCC-004(b)) Retention of key management personnel was a condition of the Carlyle offer to acquire Park, dated October 8, 2010. (DR City-016) Carlyle's witness Dove repeatedly stated that, under Carlyle ownership, Mountain will continue to be managed by the same team that is managing the utility today with little or no difference in rates or in service reliability and water quality. (Ex. Carlyle-1, pp. 3-4; Ex. Carlyle-2, pp. 1-2) Carlyle made a commitment to Mountain's rank-and-file employees that nothing would change for them regarding their salaries, benefits, and job responsibilities. (Tr. at 127)

72. The rate of leakage on Mountain's system is a service-related issue that will continue to be addressed in rate cases. Carlyle clearly recognizes the infrastructure issue, as well as the issue of converting flat-rate customers to metered service, and has expressed its willingness to work on alleviating these problems with input from stakeholders. The Commission emphasizes that addition of infrastructure investments into rate base will be allowed only when Mountain is able to demonstrate the prudence of the investment. Carlyle, Mountain and MCC all agree on this point. (Tr. at 159; Ex. Carlyle-1, p. 11; Ex. MWC-1, pp. 10-11)

73. Rates will not increase as a result of the approval of this transaction. The ratepayers of Mountain will not pay, directly or indirectly, any transaction costs or other liabilities or obligations arising from the transaction. Any expenses incurred by Mountain due to the

transaction or the Commission proceeding shall be accounted for as non-utility expense and shall not be included in the calculation of the revenue requirement for future rate cases. The ratepayers of Mountain shall not incur financial obligations due to any premium paid by Carlyle for the acquisition of Park Water and Mountain.

74. Carlyle witness Dove testified frankly that Carlyle's plan for recovery of its investment is a future sale of Park to a new owner. (Tr. at 122) Wilson had speculated in his response testimony that, based on his review of incomplete financial modeling information initially provided by Carlyle, Carlyle's business plan was to increase Mountain's rate base, and therefore its rates, with uneconomic infrastructure investments, specifically water main replacement. (Ex. MCC-1, pp. 7-11) However, at hearing, Wilson testified that Carlyle's model, once he was able to analyze it in full, did not reflect a dramatic rate impact, but only modest increases. (Tr. at 187) He said the model indicated Carlyle's plans for infrastructure investment were assumed to be funded by internal cash flow rather than by additional financing by Carlyle. (DR PSC-44)

75. Carlyle's lack of utility experience in general and its lack of regulated water utility experience in particular is a concern when assessing the firm's fitness as a buyer. Carlyle is an infrastructure investment company owned by one of the world's largest private equity firms. As Wilson indicated, Carlyle's interests go far beyond the operation of a local water utility. (Tr. at 181) However, as discussed above, the concern about Carlyle's lack of utility experience is mitigated because Carlyle intends to retain both Park's and Mountain's current managers to operate the utilities.

76. Of more concern is what the Commission considers to be the relatively short-term nature of Carlyle's intended ownership of Mountain and the loss of stability for the utility that could result. Carlyle's claim that it will be a long-term owner of Mountain and Park is not credible since the evidence shows Carlyle plans to exit its investment within five to seven years. (Ex. MCC-1, p. 6) It is conceivable that Carlyle could be just the first in a series of short-term owners of Mountain, an outcome that would be detrimental to the utility and would not be welcomed by the Commission. That said, the Commission cannot dictate how many years the purchaser of a utility must own and operate it. The Commission can, as it does in this case, condition its approval of a sale on the implementation of rigorous financial and structural ring-fencing measures that protect the regulated utility and its ratepayers from the risks of its parent's ventures. Those conditions include one that ensures the Commission will fully evaluate any

future proposal by Carlyle to sell, transfer or otherwise dispose of Mountain. (Stipulation, Condition (h))

Benefits resulting from transaction

77. The Commission finds that approval of the Carlyle/Park transaction with conditions not only satisfies the no-harm-to-consumers standard but also provides very real benefits to Mountain, its ratepayers, and other stakeholders that would not be possible under the status quo. Ring-fencing is an obvious benefit compared to the current absence of any ring-fencing. Additional benefits are found in the provisions of the Letter Agreement that concern Mountain's water rights and use of the water. (Ex. Carlyle-3) These provisions document and solidify what previously had been informal understandings regarding water use.

Local control/water resource security

78. Besides its support of the City's position in this case, CFC advocated for the preservation of the Rattlesnake watershed and of Mountain's water rights and sought assurances from Carlyle that the Rattlesnake watershed would be used only for emergency backup water supply and that Missoula water would be kept in the Missoula-area watershed. (Ex. CFC-1, p. 3)

79. The Letter Agreement contains Carlyle's agreements that Mountain's facilities in the Rattlesnake drainage will continue to be used as a backup water supply and that Mountain's water rights will not be diverted outside of Missoula for use elsewhere. In addition, Carlyle agreed that Mountain's Rattlesnake drainage water rights will be used to benefit Missoula and, if any change in use is planned, Mountain will notify the City and CFC of those plans, and discuss them as well, at least 90 days prior to the proposed change. In return for the Carlyle assurances, CFC dropped its opposition to the transaction and testified in support of it. As CFC witness Knudsen said:

... In fact, we believe that the letter of agreement secures from Carlyle assurances that the Rattlesnake is safe, the Missoula water stays home, and that the people of Missoula have a legitimate shot at becoming the next owner of Mountain Water. As a result, we believe that the sale is in the public interest, and we are asking the Commission to approve the sale. (Tr. at 252.)

80. The Commission is satisfied that the provisions of the Letter Agreement and the Stipulation's Proposed Condition (h), which requires the PSC's prior authorization of any

transfer or Mountain's water rights, resolve the important concern of keeping Missoula's drinking water safe and secure for Mountain's customers.

81. As Dove indicated in his testimony during the hearing, Carlyle is interested in establishing ongoing dialogue with the MCC, CFC, City, and other stakeholders. (Tr. at 79 and 83) Carlyle and Mountain will work actively with the stakeholders and Mountain's customers to understand their priorities for the water system and to provide the best service possible at the lowest cost. The establishment of a stakeholder or citizen's advisory committee will ensure the ongoing dialogue that Mr. Dove endorsed.

Opportunity for City to purchase Mountain

82. The City's advocacy centered on its desire to purchase, own and operate Mountain. The City's initial testimony was that it wanted an opportunity to negotiate an agreement with Carlyle to purchase Mountain at the time Carlyle decides to sell either Mountain or Park. (Ex. City-1, p. 4) CFC supported the City's position. (Ex. CFC-1, p. 3) Mountain objected to the City's and CFC's attempts to include the question of City ownership in this proceeding and argued that Commission consideration of the issue in this docket would exceed the lawful scope of its authority. (Ex. MWC-1, pp. 2-3) The issue became moot because, upon execution of the Letter Agreement, the City and CFC changed their positions from opposing the Carlyle/Park transaction to one of support.

83. The Letter Agreement executed by the City, CFC and Carlyle provides the City with a better chance of acquiring Mountain than it currently has under the terms of the August 1997 letter. At hearing, Mayor Engen acknowledged the Letter Agreement the City and CFC negotiated with Carlyle is not airtight, but he testified that the City is satisfied with its terms. He said:

I know what the status quo is. This letter gets us past the status quo. The status quo today, I believe, is the City of Missoula has no opportunity to own this utility. I think with the sale to Carlyle and this agreement in some place, the City of Missoula will have an opportunity. This is our shot. It is not perfect. It is not as secure as I or many of the folks I serve might have liked it to be. I suspect it's not as secure as some of you think it ought to be. I think it's the best we are going to do. I think it's closer than we've ever been. I think it would be irresponsible at this point, with this agreement, not to support the sale, because I do think this is our opportunity. (Tr. at 231-232.)

84. The subject of this docket is whether Carlyle's proposed acquisition of Mountain's parent, Park, should be approved. The question of whether the City should acquire Mountain is not one that can or should be answered here. It is possible that the Commission will consider City ownership in a future proceeding, given the City's longstanding interest in purchasing the utility and the improved opportunity provided by the Letter Agreement. (Ex. Carlyle-3) If and when that occurs, the City will bear the burden of demonstrating that its acquisition of Mountain will not harm ratepayers.

Conclusions of Law

1. The Commission has provided adequate public notice of all proceedings, and an opportunity to be heard to all interested parties in this docket. § 69-3-104, MCA.
2. The Commission supervises, regulates, and controls public utilities pursuant to Title 69, Chapter 3, MCA. § 69-3-102, MCA.
3. The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it and to regulate the mode and manner of all investigations and hearings before it. § 69-3-103, MCA.
4. Public utilities are required to provide reasonably adequate service and facilities at just and reasonable rates. § 69-3-201, MCA.
5. Pursuant to its authority, the Commission has jurisdiction over any sale or transfer of a public utility; acquisition of its stock, assets or utility obligations, in order to assure that utility customers will receive adequate service and facilities, that utility rates will not increase as a result of the sale or transfer, and that the acquiring entity is fit, willing, and able to assume the service responsibilities of a public utility.
6. Mountain Water Company is a public utility subject to the jurisdiction of the Commission.
7. The Commission concludes that the ring-fencing stipulation is reasonable in light of the record evidence, is consistent with the law, and is in the public interest.
8. The Commission concludes that the sales transaction, with the additional conditions adopted in this decision, is consistent with the law and in the public interest.
9. All findings of fact that are properly conclusions of law are incorporated herein and adopted as such.

Order

1. The application of Mountain and Carlyle for approval of the sale and transfer of stock in Park Water Co. is approved, contingent on implementation of the ring-fencing provisions in the Stipulation and plan described in the following sentence. In the event that ownership of Mountain, or its parent, Park, has not already been transferred to an entity other than Western Water before September 28, 2021, Western Water Holdings LLC., Carlyle Infrastructure Partners Western Water L.P., and Carlyle Infrastructure Partners, L.P., as owners of Park and Mountain, must file with the Commission the same proposed plan for the future disposition of Park and Mountain that it must file in California and in the same time frame.

2. The Stipulation submitted by MCC, Mountain, Carlyle and the City is approved.

DONE AND DATED this ?? day of December, 2011 by a vote of ?? to ??.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

TRAVIS KAVULLA, Chairman

GAIL GUTSCHE, Vice Chair

W. A. GALLAGHER, Commissioner

BRAD MOLNAR, Commissioner

JOHN VINCENT, Commissioner

ATTEST:

Aleisha Solem
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.