

Service Date: February 8, 2012

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

IN THE MATTER OF the APPLICATION of) REGULATORY DIVISION
AQUAFLO, LLC for Authority to Increase)
Rates and Charges and Amend Tariff Rules) DOCKET NO. D2009.1.9
and Regulations for Water and Sewer Service)
to its Helena, Montana, Customers)

IN THE MATTER OF the APPLICATION of) REGULATORY DIVISION
AQUAFLO, LLC for Authority to Permanently)
Increase Rates and Charges and Amend Tariff) DOCKET NO. D2011.4.34
Rules and Regulations for Water and Sewer)
Service to its Helena, Montana, Customers)

NOTICE OF COMMISSION ACTION

1. On April 27, 2011, AquaFlo, LLC (AquaFlo) filed before the Montana Public Service Commission (PSC) pursuant to Order No. 6985b in Docket No. D2009.1.9, its application to permanently increase rates and charges for water and wastewater service to its Helena, Montana, customers and to continue to charge the interim rates presently in place until the final rates are established. The Montana Consumer Counsel (MCC) intervened, participated in an on-site audit, and issued data requests MCC-001 – MCC-022 to AquaFlo. The PSC also issued data requests to AquaFlo.

2. The PSC issued Procedural Order No. 7171 on August 19, 2011, which set a September 7, 2011, deadline for written discovery. Objections to data requests were due to be filed seven business days after the data requests were filed and responses were due on September 21, 2011. AquaFlo asked for an extension of time to respond to data requests, which the MCC did not oppose. PSC staff issued a Notice of Staff Action extending the deadline and temporarily suspending the procedural schedule. On November 16, 2011, AquaFlo provided responses and objections to the MCC and PSC data requests. AquaFlo objected to MCC data requests MCC-002, MCC-005 and PSC data requests PSC-019 (Audit Request PSC-012), PSC-021 (a) and (b), PSC-022, PSC-023, PSC-024, PSC-025, and PSC-026.

AquaFlo's Objections to Data Requests

3. On November 16, 2011, AquaFlo objected to MCC data requests MCC-002 and MCC-005. MCC-002 requested whether any individual providers of contracted services to AquaFlo personally or through ownership/membership of any legal entity have a direct or indirect interest in AquaSierra, LLC (AquaSierra). In response to MCC-002, AquaFlo requested that the data request be redirected from Mr. Maxness to Ms. Barrows. AquaFlo argued that information regarding whether any of the individual providers of contracted services to AquaFlo have a direct or indirect interest in AquaSierra is irrelevant to the pending proceeding, is unlikely to lead to discoverable evidence, and AquaSierra is not a public utility and is not a party to this proceeding.

4. MCC-005 asked for copies of any audit reports produced concerning AquaFlo or its parent AquaSierra since the inception of AquaFlo in 2007. In response to MCC-005, AquaFlo argued that it is not in possession of any audit reports that may have been produced by or from AquaSierra and further objects that the data request is irrelevant to the current proceeding. AquaFlo continues to argue that the request is outside the scope of the proceeding and AquaSierra is not a party to this proceeding or a public utility.

5. AquaFlo objected to PSC data requests PSC-019 (Audit Request PSC-012), PSC-021 (a) and (b), PSC-022, PSC-023, PSC-024, PSC-025, and PSC-026. PSC data request PSC-019 (Audit Request PSC-012) requested copies of the Montana and federal tax returns for AquaFlo and its parent company for 2009 and 2010. AquaFlo objected and stated that AquaFlo is not in possession of AquaSierra tax returns, that they are irrelevant to the proceeding, and would not lead to discoverable evidence.

6. PSC data requests PSC-021 (a) and (b), PSC-022, and PSC-024 requested copies of transfer of control documents, remuneration paid for the transfer, and percentages of ownership of all entities that AquaSierra has an interest in from 2007-2011. AquaFlo objected and argued that information regarding the ownership of AquaSierra is irrelevant to the current proceeding and would be unlikely to lead to discoverable evidence. In addition, AquaSierra is not a party to this proceeding and is not a public utility. AquaFlo argues that it has already indicated that AquaSierra has always held 100% of the membership shares of AquaFlo and the requested information has no bearing on the issue of whether AquaFlo should be allowed to adjust rates.

7. PSC data request PSC-023 requests the capital structure of AquaSierra for the years 2007 through 2010. AquaFlo objected and argued that information regarding the capital structure of AquaSierra is irrelevant to the current proceeding and would be unlikely to lead to discoverable evidence. In addition, AquaSierra is not a party to this proceeding and is not a public utility. Information regarding the capital structure of AquaSierra has no bearing on the rate adjustment application and is outside the scope of this proceeding.

8. PSC data request PSC-025 requests that since the accounting services contract would be considered a related party transaction, AquaFlo is required to provide copies of any and all competitive bids for accounting services. AquaFlo objected that the data request is based on an erroneous legal conclusion, but notwithstanding this objection, AquaFlo responds that no written competitive bids were received. In 2007 an oral bid with similar terms was tendered.

9. PSC data request PSC-026 requests that since the legal services contract would be considered a related party transaction, AquaFlo is to provide copies of all invoices for services rendered by Gallagher and Assoc., PLLC for 2008 through 2011. AquaFlo objected that the data request is based on an erroneous legal conclusion and argues since the invoices were for legal services; they are protected by attorney-client privilege and are therefore not subject to discovery.

MCC's Response Brief

10. On January 3, 2012, the MCC filed a Motion for Acceptance of Reply, Objection and Reply to Objections of AquaFlo, LLC, to Data Requests (MCC Motion and Brief). In the MCC Motion and Brief, the MCC moves the Commission to accept its reply brief to objections. MCC states that since the procedural order was suspended, there was no effective deadline for the MCC's objection and reply.

11. MCC-002 requested whether any individual providers of contracted services to AquaFlo personally or through ownership/membership of any legal entity have a direct or indirect interest in AquaSierra. MCC objected to a portion of the response to MCC-002, where AquaFlo asked that the data request be redirected to its witness Sandra Barrows. MCC argues that AquaFlo should not evade an answer and AquaFlo itself can redirect the data request to Ms. Barrows. In response to AquaFlo's objection to MCC-002, the MCC argued that the specter of a related party transaction calls into question the need for and the level of expense associated with

a service provided by a related party, expense that AquaFlo expects to recover from its ratepayers. In a related party transaction, additional Commission scrutiny is called for to protect consumers and the public interest. The MCC argues that this information is in the possession of the utility, subject to more intense scrutiny than normal, and is highly relevant to the issues in this rate case. The MCC states that the Commission should overrule the objection to MCC-002 and compel a response.

12. MCC-005 asked for copies of any audit reports produced concerning AquaFlo or its parent, AquaSierra since the inception of AquaFlo in 2007. The MCC argued that the audit reports, if they exist, should contain the audited financial statements which can be used to investigate the source of the funds used to finance the rate base. It is common to investigate the source of funds to determine what return the ratepayers should pay and the utility investors should recover. The MCC states that double leverage was historically a concern and in this case, there exists a heightened concern regarding the source and nature of the funds used to finance the rate base. The MCC expresses concerns that significant financial transactions are not fully reflected on the books of AquaFlo and that only partially unverifiable financial information is available for review. MCC argues that the information is not only relevant, but also directly related to the scope of this proceeding. The MCC states that the Commission should grant its motion, sustain MCC's objection to the response to MCC-002, overrule AquaFlo's objections to MCC-002 and MCC-005 and compel responses to MCC-002 and MCC-005.

AquaFlo's Reply Brief

13. On January 13, 2012, AquaFlo filed a Reply to MCC's Responses to AquaFlo's Objections to MCC's Data Requests (AquaFlo Reply). AquaFlo argued that while it can redirect MCC-002 to Ms. Barrows, AquaFlo wants to make sure the record is clear that Ms. Barrows is responding to the data request and Mr. Maxness is not at this point a witness in the proceeding. As to the remainder of the objection, AquaFlo continues to maintain that information regarding whether any of the individual providers of contracted services to AquaFlo have a direct or indirect interest in AquaSierra is irrelevant to the pending proceeding, is unlikely to lead to discoverable evidence, and AquaSierra is not a public utility and is not a party to this proceeding. AquaFlo argues that the *Montana-Dakota Utilities v. Bollinger* case that was quoted by the MCC can be distinguished from this proceeding on its facts because AquaFlo has not submitted

expenses to the PSC caused by transactions with a subsidiary company as was the case with Montana Dakota Utilities (MDU). *Montana-Dakota Utilities Co. v. Bollinger*, 193 Mont. 508, 513, 632 P.2d. 1086, 1089 (1981). AquaFlo argues that if some vendor with a contractual relationship with NorthWestern Energy (NWE) or MDU is also an owner of one or more shares of the parent of one of those companies, that interest would have no bearing on whether NWE was entitled to change their rates in a rate case proceeding. AquaFlo argues that no allegation has been made that AquaFlo's customers have been harmed by any of its vendor relationships.

14. In response to the MCC's Motion and Brief regarding MCC-005, AquaFlo argues that it is not in possession of the audit reports for AquaSierra and cannot obtain the audit reports. In addition, it indicates that decisions regarding expenditures on accounting and other professionals that would be routine at larger utilities are agonizing for a company with the very limited financial resources AquaFlo has.

Discussion and Decision

15. The PSC agrees with the arguments presented by the MCC and overrules AquaFlo's objections to MCC-002 and MCC-005. AquaFlo is required to redirect MCC-002 to Ms. Barrows and respond to MCC-002. The PSC has historically placed additional scrutiny on related party transactions in rate cases to protect consumers and the public interest in rate cases. *Montana-Dakota Utilities Co. v. Bollinger*, 193 Mont. 508, 513, 632 P.2d. 1086, 1089 (1981). When a utility expects to recover a related party transaction expense from its ratepayers, additional PSC scrutiny is called for to protect consumers and the public interest. The information requested is highly relevant to the issues in this rate case. AquaFlo spends a significant part of its revenue requirement on contracted services that ratepayers are responsible for paying and it is highly relevant information for both the MCC and the PSC to review to establish just and reasonable rates. The PSC requires AquaFlo to redirect MCC-002 to Ms. Barrows and the PSC overrules the objection to MCC-002.

16. The MCC argued that the audit reports, if they exist, should contain the audited financial statements which can be used to investigate the source of the funds used to finance the rate base. The PSC and the MCC investigates the source of funds to determine what return the ratepayers should pay and the utility investors should recover in a rate case. Pursuant to ARM 38.5.146, the utility is required to provide information with respect to debt capital and common

stock information on the parent company, if 50 percent or more of the public utility stock is owned by another corporation. In this case, AquaSierra owns 100 percent of AquaFlo, so that information is required by administrative rule to be provided to the PSC. In addition, double leverage was historically a concern and in this case, there exists a heightened concern regarding the source and nature of the funds used to finance the rate base. Therefore, the PSC overrules the objection to MCC-005 as the information requested is relevant and related to the scope of this proceeding.

17. PSC data request PSC-019 (Audit Request PSC-012) requested copies of the Montana and federal tax returns for AquaFlo and its parent company, AquaSierra for 2009 and 2010. Tax returns of a utility parent company are relevant to the proceeding and required for the PSC to help verify expenses, capital structure, and set just and reasonable rates. The PSC and the MCC have previously requested and reviewed the tax returns of the utility's parent company in the Mountain Water rate case and the Big Mountain Water rate case. (Docket Nos. D2010.4.41 and D2010.1.9). AquaFlo can file a Motion for Protective Order with the PSC to protect the tax returns from disclosure and the PSC has consistently protected tax returns in the past. Therefore, the PSC overrules the objection to PSC data request PSC-019 (Audit Request PSC-012).

18. PSC data requests PSC-021 (a) and (b), PSC-022, PSC- 023, and PSC-024 requested copies of transfer of control documents, remuneration paid for the transfer, the capital structure of AquaSierra, and percentages of ownership of all entities that AquaSierra has an interest in from 2007-2011. This requested information is relevant and will lead to discoverable evidence. The PSC has a long established history of reviewing transfers of ownership of public utilities, including most recently the transfer of Park Water to the Carlyle Group. (Docket No. D2011.1.8). Pursuant to ARM 38.5.146, the utility is required to provide information with respect to debt capital and common stock information on the parent company if 50 percent or more of the public utility stock is owned by another corporation. In this case, AquaSierra owns 100 percent of AquaFlo, so that information is required by administrative rule to be provided to the PSC. In addition, the PSC is required to determine the source and nature of the funds used to finance the rate base, which is the purpose of the data requests. Double leverage of utilities is an issue that is closely reviewed by the PSC when a parent company owns a regulated utility. The Montana Supreme Court upheld a PSC decision to scrutinize and make double leverage

adjustments to the capital structure of regulated utility based on evidence of the parent company's capital structure. *Mountain States Telephone v. PSC*, 191 Mont. 331, 624 P.2d 481, (1981). Therefore, the PSC overrules the objections to PSC data requests PSC-021 (a) and (b), PSC-022, PSC-023 and PSC-024.

19. PSC data request PSC-025 requests that AquaFlo provide copies of any and all competitive bids for accounting services. PSC data request PSC-026 requests that AquaFlo provide copies of all invoices for services rendered by Gallagher and Assoc., PLLC from 2008 through 2011. AquaFlo objected that the data requests are based on erroneous legal conclusions, and the PSC overrules those objections. PSC-025 has been sufficiently answered, so no further answer is compelled. With regards to PSC-026, AquaFlo argues that the invoices were for legal services and they are protected by attorney-client privilege and are therefore not subject to discovery. The PSC and the MCC have requested and reviewed similar copies of invoices for services in several past water rate cases including Salish Shores, Big Mountain Water, and Aquanet. AquaFlo spends a significant part of its revenue requirement on contracted services that ratepayers are responsible for paying and it is highly relevant information for both the MCC and the PSC to review to establish just and reasonable rates.

20. The PSC agrees that very specific information included on legal bills may be subject to attorney client privilege and can be redacted. However, providing copies of the invoices with billing hours, rates, dates, and a summary of legal work billed for, would not reach the level of attorney client privilege. The PSC has the public interest obligation to review and verify for accuracy all contracted services that ratepayers are responsible for paying for in utility rates. In addition, if confidential information is contained in the invoices, AquaFlo can file a Motion for Protective Order consistent with PSC rules. The objection to PSC-026 is overruled and AquaFlo is directed to provide a response.

21. The PSC grants the MCC's motion for acceptance of reply, sustains MCC's objection to the response to MCC-002, overrules AquaFlo's objections to MCC-002 and MCC-005 and compel responses to MCC-002 and MCC-005. AquaFlo's objections to the PSC's data requests PSC-019 (Audit Request PSC-012), PSC-021 (a) and (b), PSC-022, PSC-023, PSC-024, PSC-025, and PSC-026 are overruled and the PSC compels responses to these data requests except PSC-025, which has already been sufficiently answered. AquaFlo is directed to file the responses to the MCC and PSC data requests by February 17, 2012.

DONE AND DATED this 17th day of January 2012 by a vote of 4 to 0.

BY THE MONTANA PUBLIC SERVICE COMMISSION

TRAVIS KAVULLA, Chairman

GAIL GUTSCHE, Vice Chair

W. A. (BILL) GALLAGHER, Commissioner (Recused)

BRAD MOLNAR, Commissioner

JOHN VINCENT, Commissioner