

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

In the matter of the adoption of New ) NOTICE OF PUBLIC HEARING ON  
Rules I through VII pertaining to ) PROPOSED ADOPTION  
simplified regulatory options for small )  
water and sewer utilities )

TO: All Concerned Persons

1. On October 1, 2013, at 1:30 p.m., the Department of Public Service Regulation will hold a public hearing in the Bollinger Room at 1701 Prospect Avenue, Helena, Montana, to consider the proposed adoption of the above-stated rules.

2. The Department of Public Service Regulation will make reasonable accommodations for persons with disabilities who wish to participate in this rulemaking process or need an alternative accessible format of this notice. If you require an accommodation, contact the Department of Public Service Regulation no later than 5:00 p.m. on September 24, 2013, to advise us of the nature of the accommodation that you need. Please contact Aleisha Solem, Department of Public Service Regulation, 1701 Prospect Avenue, Helena, Montana, 59620-2601; telephone (406) 444-6170; fax (406) 444-7618; TDD/Montana Relay Service (406) 444-4212; or e-mail asolem@mt.gov.

3. The rules as proposed to be adopted provide as follows:

NEW RULE I DEFINITIONS (1) "Contribution in aid of construction" means any money, services, or property received by a water or sewer utility to fund capital investments at no cost to the company with no obligation to repay.

(2) "Operating ratio" means the ratio of a utility's operating expenses to operating revenues. For purposes of [New Rule IV], a small water or sewer utility's operating ratio will be determined based on the expense and revenue information required to be submitted by the utility on the department's operating ratio methodology form referred to in [New Rule IV(2)].

(3) "Small water or sewer utility" means a water or sewer utility subject to the commission's jurisdiction that serves fewer than 500 customers.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA  
IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: The department proposes these definitions to clearly explain certain terms used in these rules.

NEW RULE II SIMPLIFIED REGULATORY TREATMENT OPTIONS

(1) Two simplified regulatory treatment options are available to a small water or sewer utility that allow it to establish or change its rates by a method other than

filing a rate application in accordance with the minimum rate case filing standards of ARM 38.5.101, et seq. The options are:

(a) adoption of the commission-approved standard rate tariff to establish initial rates as described in [New Rule III]; or

(b) filing a rate application in accordance with the operating ratio methodology as described in [New Rule IV].

(2) A small water or sewer utility is not required to establish or change its rates using the simplified regulatory treatment options. It may elect to file a rate application in accordance with ARM 38.5.101, et seq.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: The department proposes to simplify regulatory requirements for small water and sewer utilities because it is in the public interest to have a regulatory system that works efficiently to establish reasonable rates. All water and sewer utilities that are subject to department jurisdiction are currently required to submit comprehensive information required by the department's minimum rate case filing requirements if they want to establish initial rates or change existing rates. An attorney must be hired to represent the utility in the rate case and usually the services of an accounting professional are engaged as well. Small water and sewer utilities, with their limited financial and staff resources, typically struggle to meet the department's requirements for and expectations of an applicant in a rate case. These rules create two simplified regulatory treatment alternatives for water and sewer utilities with 500 or fewer customers that choose to avail themselves of one of the proposed alternatives rather than file conventional rate cases. The proposed rules will allow them to choose to set or revise rates using methods that still provide reasonable rates but are less burdensome and expensive for the utilities, ratepayers, and the department.

NEW RULE III STANDARD RATE TARIFF (1) A small water or sewer utility may establish its initial rates by adopting the commission's standard rates for small water or sewer utilities or by adopting its own rates if they are lower than the applicable standard rates. The standard rate tariff forms to be submitted for commission approval by the utility are available from the commission upon request or by obtaining them from the commission's web site at [www.psc.mt.gov](http://www.psc.mt.gov).

(2) The standard rates for small water and sewer utilities that choose to establish rates using this simplified regulatory option are:

(a) a flat charge of \$50 per connection per month for a water utility that provides water to its customers on an unmetered basis;

(b) a monthly service charge of \$40 per connection, plus a usage rate of \$2.00 per 1,000 gallons for customer usage in excess of 10,000 gallons, for a small water utility that provides water to its customers on a metered basis;

(c) a flat charge of \$30 per connection per month for a small sewer utility.

(3) Other terms and conditions of service are those provided in the commission's standard rate tariff forms and in ARM 38.5.2501, et seq.

(4) A person who seeks to challenge (2)(a), (b), or (c) may submit a complaint pursuant to ARM 38.2.2101, et seq.

(5) A small water or sewer utility that intends to adopt the standard rates must notify the commission and every customer in writing of its intention at least 30 days in advance of the proposed effective date of the standard rate tariff adoption.

(6) The customer notification must be mailed to each customer's billing address. The notification must inform customers of the standard rates, provide information that shows the typical bill impact of the application of the standard rates to the utility's average level of customer usage, and provide contact information for the utility, the Montana Consumer Counsel, and the commission.

(7) The commission notification must include the standard rates in tariff form, a copy of the notification provided to customers, and verification that all customers were mailed a notice of the proposed rate change. A small water or sewer utility must, if applicable, include in its commission notification a complete copy of the information regarding the utility's financial capacity that the utility provided to the Montana Department of Environmental Quality as part of that agency's public water system review process.

(8) The commission will act on the request to adopt the standard rate tariff no later than 45 days after it is received by the commission.

(9) The standard rate tariff adopted by a small water or sewer utility expires three years after its effective date, unless the commission approves an extension. At least three months prior to the expiration of the standard rate tariff, the utility must notify the commission whether it will file a rate application in accordance with the minimum rate case filing standards of ARM 38.5.101, et seq., or in accordance with the operating ratio methodology pursuant to [New Rule IV].

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: New Rule III establishes the standard rates that a small water or sewer utility may adopt as its initial rates for a limited three-year period if the utility chooses this simplified regulatory treatment option. This option is simple for a utility to implement and for the department to administer. The standard rates specified in the rule are set at levels that are similar to existing tariffed rates the department has approved for regulated small water and sewer utilities. This option will be especially helpful when a small water or sewer utility must establish initial rates because it is often the case that a small water or sewer utility that is new to regulation does not have the documentation and historical financial information that the department requires in order to determine the utility's rate base. When the standard rate tariff expires for a utility after three years of operation, the utility will have the operational experience and financial information required to establish rates according to either the operating ratio methodology or the department's minimum rate case filing requirements.

NEW RULE IV OPERATING RATIO METHODOLOGY (1) This option is available only to a small water or sewer utility that has been operating under commission-approved tariffed rates for at least three years. A small water or sewer

utility electing this simplified option must file a rate application with the commission using the operating ratio methodology to determine the appropriate rates to be charged by the utility.

(2) The commission will make available the forms and schedules to calculate the operating ratio which must be completed and included by the utility in the rate application. The forms are available upon request from the commission or by obtaining them from the commission's web site at [www.psc.mt.gov](http://www.psc.mt.gov).

(3) The commission will determine whether an increase or decrease in operating revenues is justified by dividing the utility's reasonable and legitimate operating expenses by the target operating ratio of 80 percent, and subtracting that amount from the operating revenues. A positive difference will result in a rate decrease; a negative difference will result in a rate increase.

(4) No later than ten days after filing the application, the utility must notify its customers in writing of the application and the proposed rate changes. The notice shall provide, at a minimum:

(a) the filing date of the rate application;

(b) a statement that the utility filed its application without the necessary costs of preparing for a hearing; however, a formal public hearing will be held if at least 20 percent of the utility's customers or the Montana Consumer Counsel submits a written request for hearing;

(c) the current rate, the proposed rate, and the percentage of the difference between the two;

(d) a statement that customers may contact the utility, the Montana Consumer Counsel, or the commission regarding the application and contact information for the utility, the Montana Consumer Counsel, and the commission.

(5) A copy of the notice and the mailing list of customers to whom the notice was, or will be mailed, must be submitted to the commission with the rate application.

(6) There will be no hearing on the application unless 20 percent or more of the utility's customers or the Montana Consumer Counsel request it, or the commission schedules a hearing on its own motion. Upon request for hearing, the commission will use a contested case procedure to conduct its review of the application. In any event, an individual commissioner may schedule a hearing to obtain public comment on the application.

(7) In the event a hearing is held, the utility may elect to designate its application to serve as its prefiled evidence; however, the utility is not precluded from filing additional evidence.

(8) Rates approved pursuant to the operating ratio methodology are subject to periodic review to ensure their continued justness and reasonableness.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: New Rule IV explains the operation of the operating ratio methodology, which is one of the simplified regulatory treatment options a small water or sewer utility may choose instead of the conventional ratemaking process. Like the standard rate tariff option in New Rule III, this option is simpler and less expensive

for a utility to implement than traditional ratemaking and for the department to administer.

NEW RULE V PURCHASED WATER COST PASS-THROUGH OPTION

(1) A small water or sewer utility may file an application for authorization to pass through price changes (increases and decreases) relating to the cost of purchased water obtained from a local municipality or from other entities which are not affiliated interests.

(2) Following commission approval of the establishment of a purchased water cost pass-through mechanism, the utility shall timely revise and refile its pass-through rate tariff as its costs of purchased water change.

(3) A purchased water cost pass-through tariff shall be revised and refiled within 60 days of a decrease in purchased water costs, and shall be designed to pass through to customers the entire reduction in purchased water costs from the date the reduction becomes effective. A purchased water cost pass-through tariff may be revised and refiled at any time after an increase in purchased water costs, and shall be designed to recover cost increases prospectively from the date of filing only.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: New Rule V will allow a small water or sewer utility that purchases water for use by its customers or for the operation of its utility to quickly reflect in rates any commodity price changes.

NEW RULE VI RESERVE ACCOUNT (1) The commission may authorize a small water or sewer utility to establish a reserve account. A reserve account is funded by customer contributions collected through rates for the purpose of making capital improvements to a utility plant pursuant to a long-range plan approved by the commission, or as required to assure compliance with state or federal safe drinking water statutes or regulations. The burden of demonstrating that actual or proposed expenditures are reasonable and in the public interest shall be borne by the utility.

(2) The amounts to be allocated to the reserve account will be determined by the commission after review of the utility's proposed capital budget and the justification for that budget.

(3) Funds in the reserve account shall be kept in a separate interest-bearing cash account. Interest accrued shall be credited to the reserve account and shall become part of the corpus of the reserve account.

(4) The utility must deposit all funds collected from customers for the reserve account at the close of each customer billing period and, in any event, no less frequently than quarterly.

(5) Funds from the account shall not be employed for a purpose other than those permitted under this section. Disbursements from the fund shall not be made without written authorization by the commission upon petition, shall be restricted to the uses in (1), and shall be made in accordance with a capital budget submitted with the initial rate filing or as modified with the consent of the commission.

(6) The utility shall report all disbursements from the reserve account by written notice to the commission and to other persons as the commission may direct within ten days of disbursement. In addition, the utility must provide by March 1 of each year a verified statement from the financial institution that houses the reserve account that shows all account transactions for the preceding calendar year. Disbursements from the reserve account which are found by the commission to have been made improperly, or in violation of any statute, regulation, or order of the commission shall be returned to the account or be refunded to ratepayers as the commission may direct. A person who makes, authorizes, or directs an improper or illegal disbursement of reserve funds shall be subject to the provisions of 69-3-209, MCA.

(7) Plant capitalized by means of the reserve account shall be accounted for as a contribution in aid of construction.

(8) In the event of a change of ownership of the small water or sewer utility, all funds in the reserve account must remain the property of the utility to be used for commission-approved purposes.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: The department is statutorily responsible for ensuring that regulated utilities provide adequate service. A small water or sewer utility will not provide adequate service to customers if it does not plan for and make necessary infrastructure improvements. The purpose of New Rule VI is to provide a funding source for a small water or sewer utility to undertake necessary system infrastructure improvements, subject to planning requirements, and strict safeguards to prevent improper use of the funds.

NEW RULE VII RATEBASE TREATMENT OF SUBDIVISION-RELATED WATER OR SEWER UTILITY ASSETS – PRESUMPTION OF RECOVERY

(1) When a small water or sewer utility that has been built in connection with a subdivision elects to file a rate application pursuant to the commission's minimum rate case filing standards, ARM 38.5.101, et seq., or pursuant to one of the simplified regulatory treatment options, there is a rebuttable presumption that the value of original utility plant and assets has been recovered in the sale of lots in a development to be served by the small water or sewer utility.

AUTH: 69-2-101, 69-3-103, 69-3-301, MCA

IMP: 69-2-101, 69-3-103, 69-3-301, MCA

REASON: When a small water or sewer utility files a traditional rate case, the department is often in the position of trying to determine the rate base for a utility that has been built and operated by the developer of the subdivision whose residents are being served by the utility. Often, the utility owner becomes aware of the fact that he or she is operating a regulated utility subject to department jurisdiction several years after the utility started providing service to customers. In proceedings to establish initial rates for these utilities, it is difficult to determine how

much of the cost of the utility system, if any, was included in the price of the lots purchased by homeowners and, therefore, should not be included in rate base. New Rule VII provides a clear statement of how the department will treat developer-owned utility assets for ratemaking purposes.

4. Concerned persons may submit their data, views, or arguments either orally or in writing at the hearing. Written data, views, or arguments may also be submitted to: Aleisha Solem, Department of Public Service Regulation, 1701 Prospect Avenue, Helena, Montana, 59620-2601; telephone (406) 444-6170; fax (406) 444-7618; or e-mail [asolem@mt.gov](mailto:asolem@mt.gov), and must be received no later than 5:00 p.m., October 4, 2013.

5. The commission, a commissioner, or a duly appointed presiding officer may preside over and conduct the hearing.

6. The department maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request that includes the name, e-mail, and mailing address of the person to receive notices and specifies for which program the person wishes to receive notices. Notices will be sent by e-mail unless a mailing preference is noted in the request. Such written request may be mailed or delivered to the contact person in 4 above or may be made by completing a request form at any rules hearing held by the department.

7. An electronic copy of this proposal notice is available through the Secretary of State's web site at <http://sos.mt.gov/ARM/Register>. The Secretary of State strives to make the electronic copy of the notice conform to the official version of the notice, as printed in the Montana Administrative Register, but advises all concerned persons that in the event of a discrepancy between the official printed text of the notice and the electronic version of the notice, only the official printed text will be considered. In addition, although the Secretary of State works to keep its web site accessible at all times, concerned persons should be aware that the web site may be unavailable during some periods, due to system maintenance or technical problems.

8. The bill sponsor contact requirements of 2-4-302, MCA, do not apply.

9. With regard to the requirements of Chapter 318, Section 1, Laws of 2013, the department has determined that the adoption of the above-referenced rules will significantly and directly impact small businesses. The small businesses that will be affected significantly and directly are the small water and sewer utilities that are subject to department jurisdiction. These small utility businesses will benefit from adoption of the proposed rules because the new rules provide simplified regulatory options that will reduce the burden and cost of the ratemaking process when compared to filing rate cases under existing department rules. Recent rate cases before the department involving small water and sewer utilities have resulted in rate case expenses for the utilities (that were passed through to ratepayers) of more than

\$30,000. The majority of the rate case expense in those cases was the cost of hiring legal and financial professionals in order for the utilities to present their cases. If the proposed rules are adopted and if a small water or sewer utility takes advantage of the new regulatory options and its election of one of the simplified methods is not challenged, it will not be necessary for the utility to engage professional services to support the ratemaking process. The department is unaware of any significant and direct adverse impacts that adoption of the proposed rules will have on other small businesses.

/s/ JUSTIN KRASKE  
Justin Kraske  
Rule Reviewer

/s/ W.A. (BILL) GALLAGHER  
W.A. (Bill) Gallagher  
Chairman  
Department of Public Service Regulation

Certified to the Secretary of State August 26, 2013.