

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

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

TO: All Concerned Persons

1. On September 5, 2013, the Department of Public Service Regulation published MAR Notice No. 38-5-219 pertaining to the public hearing on the proposed adoption of the above-stated rules at page 1583 of the 2013 Montana Administrative Register, Issue Number 17.

2. The department has adopted the following rules as proposed: New Rule IV 38.5.2529, New Rule V 38.5.2530, New Rule VI 38.5.2531, and New Rule VII 38.5.2532.

3. The department has adopted the following rules as proposed, but with the following changes from the original proposal, new matter underlined, deleted matter interlined:

NEW RULE I (38.5.2526) 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) "Customer" means any individual or entity supplied with water or sewer service by means of a water or sewer line that connects a single building or living unit to the utility's water or sewer system. For purposes of these rules, each single building or living unit connected to the utility's system is one customer.

(23) "Operating ratio" means the ratio of a utility's operating expenses to operating revenues. For purposes of ARM 38.5.2529, 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 ARM 38.5.2529(2).

(34) "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

NEW RULE II (38.5.2527) 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 ARM 38.5.2528; or

(b) filing a rate application in accordance with the operating ratio methodology as described in ARM 38.5.2529.

(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.

(3) If a utility's election of either of the two simplified regulatory options described in ARM 38.5.2527(1)(a) or (1)(b) would result in increased rates to customers, it may request, or the commission may require the utility to implement the rates in increments over a reasonable time period.

(4) An existing small water or sewer utility must be in compliance with 69-3-203, MCA (annual report requirement), in order to elect either of the simplified regulatory treatment options or to request authorization for a reserve account as provided in ARM 38.5.2531.

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

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

NEW RULE III (38.5.2528) 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.

(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 request for an extension of the standard rate tariff option, a rate application in accordance with the minimum rate case filing standards of ARM 38.5.101, et seq., or ~~in~~ an application in accordance with the operating ratio methodology pursuant to ARM 38.5.2529.

(10) The commission may deny the adoption of the standard rate tariff by a small water or sewer utility if the utility has been operating pursuant to commission-approved rates and the commission determines it would be unjust and unreasonable to approve adoption of the standard rate tariff for the utility.

(11) Nothing contained in these rules shall be construed to limit the statutory and constitutional authority of the Montana Consumer Counsel to participate and represent the interests of the utility ratepayers in these proceedings.

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

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

4. The department has thoroughly considered the comments and testimony received. A summary of the comments received and the department's responses are as follows:

COMMENT 1: One commenter suggested that to be consistent with the rest of the rule and for ease of regulation the rule should be changed from defining a small utility on a customer basis to a connection basis. In the alternative, the commenter suggested a definition of customers be added.

RESPONSE 1: The commission appreciates the comment and has defined customer in New Rule I (38.5.2526). The commission decided on using customer because that is consistent with the language used in the commission's other rules involving water utilities.

COMMENT 2: One commenter applauded the commission for its efforts to simplify the process of filing rate cases for small water utilities. The commenter stated that the proposed changes will allow it to prepare a rate case at a significant savings by preparing the filing and documents in-house and avoiding contracting with specialized accounting and legal firms.

RESPONSE 2: The commission appreciates the comment. One factor the commission considered when initiating this rulemaking was to simplify the process of

filing for rates and to minimize the regulatory costs that ratepayers are ultimately responsible for.

COMMENT 3: A commenter supported the use of a standard, tariffed rate in the rule. The commenter stated that there are benefits to systems and consumers in having a reasonable, affordable, and streamlined system for charging rates, which outweighs any potential benefits achieved by a more expensive, burdensome, and granular case-by-case ratemaking process intended for large utilities. The commenter supported having the standard rate subject to rate examination in rulemaking instead of by an individual basis during a rate case. The simplified standard rate also decreases the demand for agency services and is a more productive use of limited agency resources.

RESPONSE 3: The commission agrees and appreciates the comment.

COMMENT 4: One commenter suggested the standard tariffed rate should be tied to an economic indicator such as the Consumer Price Index. Therefore, the rate would rise or fall on an annual basis with the overall economy and this would prevent rate shock.

RESPONSE 4: The commission disagrees with the implementation of an automatic adjustment mechanism to the standard tariff rate. The commission determines that a preferred practice would be for the commission to reevaluate the standard tariff as necessary during future rulemaking proceedings. Reviewing the tariff during subsequent rulemaking proceedings will allow the commission to receive public comment before making any adjustment to the standard rate.

COMMENT 5: A commenter recommended that the commission consider allowing extensions of the three-year period for standard rates pursuant to New Rule III (38.5.2528). The commenter stated that the extension makes sense if notice is provided at least three months prior to the end of the three-year period.

RESPONSE 5: The commission agrees with the comment and has amended the rule to allow extensions of the three-year period.

COMMENT 6: In response to New Rule VI (38.5.2531), one commenter suggested that the commission could establish a target reserve amount based on a per-hookup calculation to replace or repair some percentage of the system. The per-hookup amount could be established based on recommendations from water associations or home insurance groups. The commenter also stated that the entire amount of the replacement of the system should not be required as a reserve. Finally the commenter suggested that the utility could appoint an independent trustee to manage the trust account instead of the utility relying on the commission.

RESPONSE 6: The commission disagrees that a target reserve amount per-hookup should be established in the rule. The commission determines that it should maintain flexibility on the amount of the reserve account. As stated in New Rule VI

(38.5.2531), the burden of demonstrating that actual and proposed expenditures are reasonable and in the public interest shall be borne by the utility.

COMMENT 7: One commenter stated that they understand the rule is trying to obtain efficiency in the administrative process while also providing proper due process for utilities and ratepayers. The commenter further stated they appreciate and share the commission's concern for rate-making efficiencies, but that the proposed rules shouldn't be adopted at this time. The commenter also states that the number of small water and sewer filings is not unmanageable at this time, and once it becomes unmanageable then the commission should revisit these proposals. Further, the current commission practice of setting initial rates by allowing the utility to use existing rates or to rely on operating information protects customers because interim rates are subject to refund. Setting initial rates on a standard rate is arbitrary.

RESPONSE 7: The commission disagrees with the commenter. The commission is aware that there may be a substantial number of water utilities that are currently operating without commission-approved rates that need to establish rates. Under the current regulatory regime, small water utilities have an incentive to avoid establishing commission-approved rates because of the substantial regulatory cost. The rules are being established to reduce the regulatory cost to establish rates. The commission needs to establish initial rates in some manner when utilities first start serving customers. Utilities generally have limited financial information available when they first start operating so standard rates are the best way to establish initial rates until complete financial information is available.

COMMENT 8: One commenter stated that after three years, the proposed rules would allow utilities to choose between traditional cost of service rates or rates based on an operating ratio of 80%. The operating ratio method is less accurate than the commission's current practice of cost of service approach, because the operating ratio only focuses on certain elements of operation, which is a disadvantage to ratepayers. Utilities could analyze the two approaches available and choose the one that generates more revenue. There are often disagreements with regard to expenses and revenues which may require a traditional cost of service analysis in addition to the operating ratio calculations. The commenter also stated that the commission has expressed concerns about the availability of rate consultants and regulatory legal assistance; however, they believe the initial need for financial analysis would still exist and may be increased under the proposed rules.

RESPONSE 8: The commission generally disagrees with the commenter. While it is correct that the rules allow a utility to choose between two options, most utilities will likely not want to undertake a traditional cost of service rate case based on the substantial cost for rate consultants and legal assistance. That consultant cost must be paid for up front by the utility and can only be recovered over a number of years by the utility and would likely limit interest in traditional rate cases. The commenter's

own analysis included with its comments show that the operating ratio, in most cases, results in lower rates than the traditional cost of service approach.

COMMENT 9: One commenter stated that the commission should consider under the operating ratio methodology the inclusion of depreciation expense.

RESPONSE 9: The commission appreciates this comment; however, this expense is not addressed by the rules but the operating ratio forms that the commission has prepared for rate applications. The commission will consider this change in the operating ratio forms.

COMMENT 10: One commenter stated that they did not favor the operating ratio approach because utilities could game the regulatory paradigm. The commenter feels that one concern would be that a utility would have an incentive to inflate or "gold plate" expenses as expenses have become the rate base. The commenter further states, income taxes actually paid by the utility should be an expense that is recoverable only on a dollar for dollar basis, and over time other expenses may emerge as candidates to receive only dollar for dollar recovery.

RESPONSE 10: The commission generally disagrees with the commenter. A utility can attempt to game any regulatory paradigm. Even under current cost of service regulation, a water utility has an incentive to inflate expenses. The operating ratio attempts to standardize some of the expenses, such as management expenses, to avoid inflation of these expenses. The commission shares the concerns of the commenter about only allowing income taxes actually paid by the utility. The commission will consider this change in the operating ratio forms.

COMMENT 11: One commenter stated that a number of small water and sewer utilities may experience significant rate shock. The commenter suggested that the commission consider allowing for a stair-stepped implementation of new rates if the increase exceeds a certain dollar and/or percentage amount.

RESPONSE 11: The commission agrees with the concerns of the commenter and has added a requirement to New Rule II (38.5.2527) which requires that if either of the two simplified regulatory options result in increased rates, the commission may require the utility to implement the rates in increments over a reasonable time period.

COMMENT 12: One commenter stated that New Rule IV (38.5.2529) provides that a formal hearing may be held if 20 percent of the utility's customers or the Montana Consumer Counsel submits a written request for hearing. The rule should be clarified that if a hearing is requested, the burden of proof is not shifted to the customers or the MCC, but remains with the filing utility.

RESPONSE 12: The commission determines that specific language in the rules are unnecessary as the burden of proof is always on the utility in a rate proceeding;

however, based on this comment the commission has added language to New Rule III (38.5.2528).

COMMENT 13: One commenter stated that New Rule VI (38.5.2531) provides for the establishment of a reserve account approved by the commission and funded by customer contributions collected through rates for the purpose of making capital improvements in relation to long-range planning. The commenter stated that they felt this provision was unnecessary as well as the complicated processes it would require. Further, the commenter felt that it is clear that utility management, not the commission, is the manager of the utility. The commenter also expressed concern that there appears to be no public involvement in considering and approving the proposed long-range plan or decisions on how the funds could be spent.

RESPONSE 13: The commission generally disagrees with the commenter. The commission believes this is one possible tool for the commission to establish for a utility. The commission may allow a reserve account to be established but is not required to grant the utility's request. The burden of demonstrating that actual and proposed expenditures are reasonable and in the public interest shall be borne by the utility. The commission determines that a reserve account will not unnecessarily complicate the regulatory process and may likely provide long-term stability and benefit to the ratepayers through a properly maintained water utility. The commission intends to establish a procedure prior to approving a reserve account request that would include public comment and involvement of any interested persons.

/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 February 18, 2014.