

## Program Evaluation

# Small Water and Sewer Utility Regulation in Montana

Montana Public Service Commission



## ENERGY AND TELECOMMUNICATIONS INTERIM COMMITTEE

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Authored by: Sonja Nowakowski

## Introduction

The Energy and Telecommunications Interim Committee’s statutory duties allow for an in-depth overview of programs, budget, and implementation of programs administered by the Montana Public Service Commission (PSC). The committee may focus more specifically on a subject the PSC administers, pursuant to 5-5-230, MCA. That law provides the ETIC with “administrative rule review, draft legislation review, program evaluation, and monitoring functions for the department of public service regulation and the public service commission.”

The ETIC allocated time for a programmatic review of the PSC’s regulation of small water and sewer utilities in Montana. At the March 15-16 ETIC meeting, the committee will hear from the PSC concerning its rate regulation responsibilities and problems with fulfilling its statutory duties. The ETIC also will hear from the Montana Department of Environmental Quality about its role in regulating small water and sewer utilities. In addition, the committee will hear from the Montana Consumer Counsel, which has statutory and constitutional authority to participate and represent the interests of utility ratepayers in rate proceedings.

At this time, only a handful of small, privately owned public water and sewer utilities have filed rate schedules with the PSC, which has regulatory authority over them. The PSC also has not identified the water and sewer utilities that should be subject to PSC rate regulation and has struggled to implement a strategy to bring those utilities into compliance. While the PSC may hear complaints against public utilities and investigate rates at any time, utilities are statutorily required to file tariffs with the PSC, creating a shared responsibility. The PSC is not generally in the business of seeking out entities to enforce compliance with the law.

Montana law, however, makes the PSC responsible for regulating small water and sewer utilities in Montana. This includes corporations, companies, individuals, or associations of individuals that own, operate, or control any plant, equipment, or water right that furnishes water or sewer service to other persons or associations.<sup>1</sup> A public utility regulated by the PSC also is required to furnish reasonably adequate service and facilities. In addition, any charges for service must be reasonable and just.<sup>2</sup> The PSC regulates utilities in part to ensure that rates for essential public services, like water and electricity, are just and reasonable. Montana law also requires each public utility to file a schedule showing its rates. The information must be available to the public.<sup>3</sup> Multiple small water and sewer utilities in Montana do not comply with the requirement to file rate schedules with the PSC.

The exemptions to the existing laws above also provide a critical component in terms of regulation related to water and sewer utilities. Water and sewer utilities that are privately owned and operated and do not serve the public, county or consolidated city and county water or sewer districts, and municipal sewer or water systems established by a municipality are exempt from PSC regulation.<sup>4</sup> Montana case law further clarifies and extends the exemptions. In *Lockwood Water Users Association v. Anderson*, the Lockwood Water Users Association provided water service to its members on a nonprofit cost-share basis.<sup>5</sup> Members received water by joining an association and agreeing to its rules. The defendant argued that the water service was subject to PSC regulation. The Montana Supreme Court, however, upheld a trial court finding that the association’s service, only available to members who shared in the cost of the operation and not open to the public, was provided by customer permission through contract, and the association was not subject to PSC regulation. For example, water systems owned by an HOA are not subject to PSC rate regulation.

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<sup>1</sup> 69-3-101(1), MCA.

<sup>2</sup> 69-3-201, MCA.

<sup>3</sup> 69-3-301, MCA.

<sup>4</sup> 69-3-101(2), MCA.

<sup>5</sup> *Lockwood Water Users Association v. Anderson*, 168 Mont. 303, 308, 542 P.2d 1217, 1220 (1975).

To oversimplify, if a water or sewer system is open by right—not by permission—to serve the entire public where the facilities are located, and if the private entity serves the public and profits or intends to profit from the service, the system is a public utility subject to PSC jurisdiction.

Because of the complexity of the issue, the PSC to date does not have a complete working inventory of known water and sewer systems subject to its jurisdiction. Multiple utilities also are likely unaware that they are subject to regulation. The PSC indicates these are obstacles to effectively regulating small water and sewer utilities. To that end, the PSC requested the ETIC review the subject and provide guidance on addressing the regulatory deficiency.

## Inventory

To implement the law, the PSC adopted a series of rules establishing a regulatory strategy. Pages five through eight of this report discuss the rules in detail. The regulatory strategy outlined in the rules, however, is based on the PSC regulating an unknown number of water and sewer utilities in Montana.

A single list of public utilities does not exist, and there is no single source in the state for compiling the information. The PSC has not identified system names, locations, operators, or the number of customers served by public utilities or ultimately composed a complete list of utilities potentially subject to regulation. Even with a basic list of utilities potentially subject to regulation, the PSC also may need to determine annual sales, revenues, and expenses to move forward with a decision concerning whether the public utility is attempting to provide service at a profit.

The Montana DEQ tracks all public water supplies in the state and ensures that public water supplies meet state and federal requirements. The DEQ defines "public water supply system" as a system for the provision of water for human consumption from any community well, water hauler for cisterns, water bottling plants, water dispenser, or other water supply that has at least 15 service connections or that regularly serves at least 25 persons daily for any 60 or more days in a calendar year.<sup>6</sup> There also are three types of public water supplies:

- "Community" means a public water supply system which serves at least 15 service connections used by year-round residents or that regularly serves at least 25 year-round residents. Examples include cities, towns, nursing homes and prisons.
- "Non-transient non-community" means a public water supply system that is not a community water system and that regularly serves at least 25 of the same persons over 6 months a year. Examples include workplaces and schools.
- "Transient non-community" means a public water supply system that is not a community water system and that does not regularly serve at least 25 of the same persons for at least 6 months a year. Examples include restaurants, cafes, bars, campgrounds and motels.

For the purposes of PSC authority, "community" public water supplies are potentially subject to PSC rate regulation. Using DEQ information, the PSC estimates that the number of privately owned water utilities has substantially grown, largely based on subdivision growth. The only large water or sewer utility the PSC recently regulated was Mountain Water Company in Missoula, but Missoula took ownership in 2017, meaning it is no longer subject to PSC jurisdiction. Currently, the PSC regulates 21 private water and sewer utilities. Using DEQ documents, the PSC estimates it should be regulating about 220 small water and sewer utilities.

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<sup>6</sup> "Drinking Water Regulations Summary/ Community and Non-Transient Non-Community Water Systems", Montana DEQ, June 2016, page 1.

An overview of potential utilities subject to regulation as compiled by the PSC is included in **Table 1**. The PSC compiled it using the DEQ’s community water supply database. However, it may be incomplete. Some utilities, for example, have different names in the databases. The PSC currently regulates Flathead Utility Co. In the DEQ database, Flathead Utility Co. appears as Country Estates Water Supply or Hilltop Terrace Subdivision. The PSC regulates MT Moonlight Basin Water & Sewer, LLC. In the DEQ database, the utility appears as Spanish Peaks Mountain Club. The PSC also needs to determine if the utilities in the table and the DEQ database are privately owned. A search of business records through the Secretary of State’s business services search could provide some direction on private ownership. Currently, the summary includes entities that are corporations or LLC’s.

The PSC also broke out utilities in Table 1 that serve subdivisions, trailer/mobile home and RV parks, and water user associations. Some on the list may not be truly open to the public. For example, community water supplies on Hutterite colonies likely are not subject to PSC rate regulation and are not included, and some of the trailer and mobile home parks may render service to members who equally share the costs of operation. The service could be contractual, not public, and not subject to PSC jurisdiction.

**TABLE 1: PSC STAFF**

<b>Potential Systems Subject to PSC Regulation</b>		
<b>Type</b>	<b>Number</b>	<b>Reasoning</b>
Trailer, Mobile Home Park	121	Lot owners likely charge renters (through monthly lot rental or separate fee)
Subdivisions	66	Not identified in DEQ database as a Homeowner Association, Water User Association, Colony, or other category not subject to regulation
LLC’s	7	LLC indicates operating for profit
Inc.’s	7	Inc. indicates operating for profit
Systems	5	Not identified in DEQ database as a Homeowner Association, Water User Association, Colony, or other category not subject to regulation
Villages	15	Not identified in DEQ database as a Homeowner Association, Water User Association, Colony, or other category not subject to regulation
<b>Total</b>	<b>221</b>	

Compiling a proper inventory likely requires contacting each entity on the DEQ’s list to determine if the utility is subject to rate regulation. The PSC states that it does not send letters to a potential list of utilities because the PSC may not be equipped to provide rate regulation to those entities. The complexity of the issue also means many entities do not know they are public utilities and do not know they are failing to comply. Recent standard rate dockets, some of which have been lengthy and costly, also may be a deterrent to self-reporting.

The National Regulatory Research Institute, a research entity serving utility regulatory commissions in the U.S., outlines an inventory as the first step in regulatory strategy. “Once the inventory of systems is complete, it could be made available on the commission website, accessible to all or limited to those who demonstrate certain credentials as specified by the commission,” according to the institute’s recommendations.<sup>7</sup>

<sup>7</sup> Phillip S. Teumim and Frank W. Radigan, “The Small Water Company Dilemma: Processes and Techniques for Effective Regulation,” National Regulatory Research Institute, Oct. 2011, page 25.

## History

### Public Service Commission Authority

The Montana Legislature is not a stranger to changes in PSC regulation of water and sewer utilities in Montana. In 1981, legislation reduced PSC jurisdiction over municipal water and sewer utilities. Up until that time, the PSC reviewed and regulated water and sewer rates established by local governments. House Bill No. 765 substantially limited PSC regulation, unless a proposed increase was greater than a certain percentage of total annual revenues.

Local governments requested the legislation, arguing the time and cost of rate changes at the PSC was burdensome. Larry Herman, the mayor of Laurel at the time, told the House Local Government Committee that Laurel was spending \$10,000 to \$15,000 for hearings before the PSC. “Already the PSC is asking for more staff, more money to work with, and who will bear the cost but the state, the cities, and the consumers,” he said.

In general, local governments supported reducing or eliminating PSC oversight throughout the hearings. Opposition to the legislation included the Montana Consumer Counsel. The Counsel did not oppose the merits of the legislation but was concerned about how the office would track municipal meetings and properly represent consumers if requested as indicated in the legislation. The bill included language requiring municipalities to notify the Consumer Counsel of rate changes. The Consumer Counsel’s constitutional authority outlines the Counsel appearing before PSC hearings.<sup>8</sup> The 1981 legislation included a section, which remains the law today, that the Montana Consumer Counsel can be present and participate in a municipal rate hearing.<sup>9</sup>

The 1981 legislation passed the House 73 to 23 and passed the Senate 40 to nine.

In 1995, the Montana Legislature revisited PSC regulation of water and sewer utilities. While the 1981 legislation reduced municipal regulation based on the amount of an increase, the 1995 bill, House Bill 289, totally eliminated regulation of municipal utilities. Former Governor Marc Racicot’s Task Force to Renew Government requested the repeal. The task force examined government and made efficiency recommendations to reduce government costs.

Rep. Loren Soft sponsored the legislation and said local elected officials, rather than statewide elected officials, were in a better position to set rates and to respond to customer concerns. The fiscal note for the bill showed a reduction in the next biennium of about \$13,000 by eliminating PSC review, and the PSC testified that the requirements for municipal review, those in place since 1981, took PSC staff only about 150 hours a year. The 1995 records provide some guidance, absent municipal water and sewer facilities, about water and sewer facilities the PSC was to regulate. At a hearing before the Senate Local Government committee, the PSC testified that if House Bill 289 was passed and approved, the PSC in 1995 would regulate 32 private water utilities. At that time, the PSC’s budget was about \$2.1 million or \$3.4 million in 2018 dollars.

The PSC currently regulates privately owned small water and sewer utilities on a case-by-case basis. They most often act after receiving complaints about service or rates and learning that the utility is subject to its jurisdiction. However, Bill Gallagher, who was elected to the commission in 2010 and became chair, elevated the issue. Gallagher, an attorney and former owner of a small water utility, was experienced with the regulation of privately owned utilities. The PSC, led by Gallagher, also requested legislation in 2013 requiring developers, when submitting

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<sup>8</sup> Mont. Const. Art. XIII, § 2.

<sup>9</sup> 69-7-112, MCA.

a preliminary plat to a local planning and zoning authority, to state whether the utility is subject to PSC jurisdiction.<sup>10</sup> The legislation was intended to assist the PSC in better regulating small water and sewer utilities.

Since passage of the bill, one utility notified the PSC in accordance with the plat process. A review of some planning and zoning documents used in Montana indicate that the question is part of general forms used, for example, in Flathead, Jefferson, and Gallatin Counties. The law, however, doesn't require counties to notify the PSC if developers indicate a utility is subject to regulation, and the PSC doesn't check with counties to review the forms or to inquire about forms filled out by developers.

The PSC in 2014 also enacted rules, discussed below, establishing a regulatory strategy for small water and sewer utilities with the goal of those utilities coming to the PSC to establish commission-approved, tariffed rates.

## PSC Rulemaking

Following the legislature's first decision to reduce PSC oversight of municipal utilities in 1981, the PSC addressed its rules for water and sewer. The rules, established in 1982, speak to water service provisions, limits on the use of water mains, discontinuance of service, meter regulations, and some guidance on the use of flat rates or metered rates.<sup>11</sup> The early rules are predicated on a general cost-of-service rate case at the PSC to establish customer rates.

After passage of the 2013 legislation attempting to track increasing private sewer and water utilities in subdivisions, the PSC also initiated a rulemaking to implement new rules for simplified regulatory options for small water and sewer utilities.<sup>12</sup> The rules define a small water or sewer utility as a utility serving fewer than 500 customers. The intent was that simplified rules would encourage utilities to comply with regulation. Under the rules, which remain in place, a small water or sewer utility selects from two simplified regulatory options—a predetermined standard rate or a rate based on an operating ratio of annual expenses—that allow it to establish or change rates. Alternatively, a utility may file a regular rate case and request more than the standard rate or operating ratio. A utility also must comply with annual reporting requirements prior to being eligible for the simplified regulatory options.

The PSC offered the simplified options to streamline the regulatory process for both small water and sewer utilities and PSC staff. The PSC recognized that a traditional rate case can be expensive, depending on its complexity and whether it is contested, and that regulatory expenses are generally recoverable from ratepayers. Contested, small water utility rate cases can cost between \$15,000 and \$35,000 because of the need to hire attorneys and consultants and to prepare for hearings, according to the PSC.

The PSC also found that because new small utilities typically have limited financial information when they begin operation, offering options for standard rates was the best way to establish initial rates. In addition, the revised rules allow a small water or sewer utility to file an application to pass through increases and decreases relating to the cost of purchased water obtained from a local municipality or from other entities that are not affiliated interests.<sup>13</sup>

## Option One – Standard Rates

Under the first option, a utility requests the commission-approved standard rates. The rules set the standard water rates at \$50 per month per customer for nonmetered water service, \$40 per month per customer for metered customers using up to 10,000 gallons of water, and \$2 per 1,000 gallons after that. Standard sewer rates are \$30 per

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<sup>10</sup> 76-3-622(1)(b)(ii), MCA.

<sup>11</sup> Administrative Rules of Montana 38.5.2501-38.5.2514.

<sup>12</sup> Administrative Rules of Montana 38.5.2526-38.5.2531.

<sup>13</sup> Docket No. N2012.12.126, In the Matter of Proposed Rules Regarding Simplified Regulatory Treatment for Small Water/Wastewater Utilities, December 2012.

month per customer. The PSC established the standard rate rules after reviewing rates for municipalities and water utilities throughout Montana and other states and based on public comments.

In 2014, a Montana Statewide Water and Wastewater Rate Study conducted by the Rural Community Assistance Corporation provided a baseline for tariffs of systems serving less than 500 people. The Department of Natural Resources and Conservation updated the rate study in 2016 by surveying 229 municipalities and independent districts in Montana.<sup>14</sup> The study concluded utilities regulated by self-governing councils, which are not subject to PSC regulation, had a monthly water rate average of \$49.98 and a monthly average sewer rate of \$26.27.

A small water or sewer utility that seeks the standard rate notifies the PSC, the Montana Consumer Counsel, and all customers in writing at least 30 days before the proposed effective date of the intent to adopt standard rates. The PSC acts on the request within 45 days. The standard rate, if accepted by the PSC, expires after three years. Three months prior to the three-year expiration, the utility notifies the PSC to request an extension, make a rate application, or make a request to use the operating ratio methodology.

The PSC reports that of ten requests for standard rates, the PSC approved six at the standard rate and three on an interim basis. The PSC approved two of the three at a graduated rate. One request is pending. Five utility requests for an extension are pending, and three standard rates for those utilities remain in place on an interim basis.

## Option 2 – Operating Ratio Methodology

The second option is available to small utilities operating under a PSC-approved rate for at least three years. The operating ratio methodology allows the utility to propose rates by dividing its reasonable and legitimate operating expenses by a target-operating ratio of 80 percent—the equivalent to multiplying operating expenses by 1.25 percent.

Within 10 days of filing, a utility notifies its customers of the application and the proposed rate changes. There is not a hearing at the PSC 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. If a utility requests a hearing, the PSC uses a contested case procedure. Once approved, the rates are subject to periodic PSC review.

Since adoption of the rules, no utilities have formally requested this option.

## Montana Consumer Counsel Authority

During the 2014 rulemaking, the Montana Consumer Counsel opposed the standard rate options. The Counsel argued that before adopting standard rate options, the PSC needed to determine the number of utilities under PSC jurisdiction and whether that number was manageable. The Counsel also noted that the PSC was increasingly skeptical of settlements, creating an expensive process for applicants and the Counsel. “Until recently, the Montana PSC has typically approved settlements,” the Counsel wrote. “This recent skepticism toward settlements has taken away a tool to accomplish in part what these rules are designed to do.”<sup>15</sup> The Consumer Counsel also raised concerns about the standard rate option being an inadequate benchmark and potentially overcharging customers.

Since passage of the rules, the Consumer Counsel has taken an active role in requests for the simplified options, specifically standard rates. Article XIII, section 2, of the Montana Constitution requires the Legislature to provide an

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<sup>14</sup> <http://dnrc.mt.gov/divisions/cardd/docs/rate-study/RateSurveyInformation.pdf>

<sup>15</sup> Montana Consumer Counsel comments, in the matter of the adoption of new rules I through VII pertaining to simplified regulatory options for small water and sewer utilities, October 2013.

Office of Consumer Counsel to represent consumer interests in hearings before the PSC. The Consumer Counsel, in keeping with its constitutional and statutory duties, intervened in nearly all requests to date for standard rates or extension of standard rates. The Consumer Counsel, in general, requests more information to verify that the standard rate is the best option for customers. Examples of Consumer Counsel involvement are outlined in **Table 2**.

For additional example, in September 2016, Circle H Water Inc. requested that standard water rate tariffs. The Consumer Counsel requested the PSC set up a process to gain more information on the requested increase prior to taking action. The PSC approved Circle H Water's request but only on an interim basis. The PSC agreed to establish a limited process to ensure that the Consumer Counsel, and any other interested parties, could review the request. The process requires Circle H Water to respond to formal data requests, the primary means of discovery before the PSC. There are 38 water users on the system, which at buildout will serve 113 users. The case remains open.<sup>16</sup>

In 2014, Indian Springs Ranch Water and Sewer, LLC, filed an application to adopt the standard rates for nonmetered residential customers and metered commercial customers. The PSC approved the request. In 2017, the utility requested a three-year extension in the rates, as allowed in the rules. The Consumer Counsel objected to the request and asked the PSC to conduct a more meaningful review. The Consumer Counsel argues that to determine whether it would be just and reasonable to allow continued use of the standard rates, a contested case process that provides discovery and an opportunity for a hearing is necessary. The case remains open.<sup>17</sup>

However, even if the Consumer Counsel did not intervene in standard rate cases, the PSC indicates it has concerns about processing dockets on the large number of small utilities it estimates are subject to its regulatory authority.

## Attorney and Consultant Fees

The simplified regulatory options were originally introduced with the idea that a small utility would, in general, complete a checklist, file for standard rates, and implement the rates, according to the PSC. The rules, however, have not resulted in a checklist situation. The PSC also developed standard rates with the expectation that attorney and consultant fees would be reduced or unnecessary. The PSC often responds to requests by the Consumer Counsel for more information by initiating a partial contested case proceeding to determine rates. Utilities must then respond to data requests. Most utilities have responded directly to requests. Two utilities have hired a consultant and attorney to respond. No hearings have been held on standard rate requests.

The PSC states that if a small utility wishes to recover legal costs, the utility must file a regular cost-of-service case. The costs are not authorized in the simplified standard rate scenario and cannot be recovered in customer rates. One utility has appeared before the ETIC and indicated that the issue, along with the current complexity, discourages compliance. "Given the present hostile regulatory climate, I cannot, with any conscience, suggest to a company that they should be in compliance, even though they are legally obligated to," Leroy Beeby, a consultant working with Holmberg Estates, wrote to the ETIC in Sept. 2017. "The small water rules should be allowed to work as intended and not be the convoluted process that the Montana Consumer Counsel apparently desires and the PSC has encouraged."

In 2016, Holmberg Village Water Company requested a standard rate under the simplified regulatory options. More than half the customers contacted the Consumer Counsel about the rate increase, and the Counsel, as the entity

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<sup>16</sup> Docket No. D2016.9.70, In the Matter of the Standard Rate Tariff by Circle H Water, Inc.

<sup>17</sup> Docket No. N2014.7.66, In the Matter of Indian Springs Ranch Water and Sewer, LLC's Application for Extension of Standard Water Tariff.



established to represent ratepayers' interests in utility proceedings, participated in the proceedings, according to the Consumer Counsel.

In January 2017, Holmberg filed a separate request to recover its attorney's fees and consulting costs. The PSC authorized Holmberg Village Water Company to institute interim rates of \$35 per month, plus \$1.50 per 1,000 gallons for customer's usage in excess of 10,000 gallons—less than the full standard rate. The PSC, however, determined that Holmberg would need to withdraw its application for standard rates and file a full general rate case with supporting documentation to request recovery of expenses. Holmberg in late January 2018 requested further evaluation of the PSC's interim rates and is requesting the full standard rate.<sup>18</sup>

## New Rulemaking Underway

In September 2017, the Montana Consumer Counsel formally requested that the PSC amend or repeal the standard rate rules, or Option 1. The Counsel says the standard rate rules “do not necessarily serve their stated purpose, cause perverse incentives for utilities, and conflict with substantive and procedural statutes.”<sup>19</sup> The Counsel proposes replacing the standard rate with a simplified process based on minimum filing requirements to achieve the goal of the lowest reasonable rates for ratepayers. The PSC agreed to publish the Consumer Counsel's proposed rule and also published its own, alternative rule that preserves the standard rate option with amendments.

## Montana Consumer Counsel's Proposed Rule

The Consumer Counsel's proposed rule change removes the standard rate process, replacing it with a simplified rate application. The proposal sets out minimum filing requirements for rate applications to ensure there is sufficient information to consider if rates are just and reasonable for each utility based on unique, individual circumstances. A traditional rate case would involve more extensive minimum filing requirements.

Under this proposal, the minimum filing requirements replace the standard rate as a simplified option, but utilities remain able to request other options, like the operating ratio or a traditional rate case. The proposal eliminates the standard flat \$50 water connection and \$30 sewer connection options and instead allows utilities to propose whatever rate they can justify under the minimum filing requirements.

## PSC Proposed Rule and Amendments

The PSC proposed rule allows the commission to consider a prioritization of rate regulation and supervision based on consumer complaints. Because of the PSC's limited resources, the proposed rule clarifies that the commission may prioritize regulatory oversight based on consumer complaints.

The second track proposes three simplified regulatory options. A utility could file a standard rate application in accordance with minimum filing requirements. This track would limit the availability of the standard rate option to utilities without existing tariffs on file and would limit use of the standard rates to a period of three full calendar years. Additionally, a utility could also file a rate application in accordance with the operating ratio methodology or file a rate application requesting adoption of the Montana Department of Natural Resources and Conservation's most recent water and sewer rate study. A utility also could still request a full rate case. The proposal preserves the flat \$50 water connection and \$30 sewer connection options but builds in minimum filing requirements for that rate

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<sup>18</sup> Docket No. D2016.4.35, Holmberg's Request for Further Evaluation of Current Rates, In the Matter of the Adoption of the Standard Rate Tariff by Holmberg Village Water Company, LLC.

<sup>19</sup> Docket No. N2017.9.76, Petition of the Montana Consumer Counsel to Amend ARM 38.5.2527 through 38.5.2528.

application. On March 13, the PSC held a hearing on the proposed rule changes. The rules hearing occurs after the deadline for this publication, so stakeholders will update the ETIC during the March 16 meeting.

TABLE 2

<b>PSC Regulated Private Water and Sewer Utilities</b>			
<b>2014-Present</b>	<b>PSC Action Requested</b>	<b>Customers*</b>	<b>Consumer Counsel</b>
Holmberg Village Water Company, LLC April 2016 January 2018 - Open	Request for Standard Rate Request for Further Evaluation of Interim Rates D2016.4.35	111	Requests Further Review and Files Testimony
North Star Planned Unit Water and Sewer June 2010, June 2014 Oct. 2017 - Open	Request to Continue with Standard Rate D2010.6.60	326	Intervened in 2010
Alpine Public Utilities Sept. 2017 - Open	Request to Continue with Standard Rate N2014.9.80	80	No Action to Date
Williams Water Works July 2017 - Open	Request to Continue with Standard Rate N2014.8.77	49	Requests Further Review
Indian Springs Ranch Water & Sewer June 2017 - Open	Request to Continue with Standard Rate N2014.7.66	60	Requests Further Review
Glacier Point Water & Sewer April 2017 - Open	Request to Continue with Standard Rate D2014.6.57	84	Requests Further Review and Files Testimony
Flathead Utility Company Feb. 2017 - Open	Request for Standard Rate D2017.3.19	278	Intervened in 2017
TML Construction Jan. 2017 - Closed Granted, \$50 per connection.	Standard Rate and Sale and Transfer of Ownership of Fox Hill Estates D2017.1.5	47	Requests Further Review and Files Testimony
Circle H Water, Inc. Sept. 2016 - Open	Request for Standard Rate D2016.9.70	38	Requests Further Review and Files Testimony
Wettington Water District Oct. 2015 – Closed (Interim rate granted)	Request for Standard Rate N2015.10.82	90	Requests Further Review and Files Testimony

### PSC Regulated Private Water and Sewer Utilities

Pre-2014	PSC Action Requested	Connections*	Consumer Counsel
Landmark Water Company May 2005 – Closed Granted	Increase Rates N2015.4.33	238	Elects not to File Testimony
Big Mountain Sept. 2010 – Closed	Request to Increase Rates D2010.1.9	396	Stipulation Reached
Moonlight Basin Water and Sewer April 2012 – Closed Granted	Transfer of Assets D2012.4.39	319	Intervened
Wilder Resorts Dec. 2003 - Closed	Increase Rates D2003.12.173	35	Stipulation Reached
HLH Oct. 2008 - Closed	Increase Rates D2008.10.123	227	Stipulation Reached
AquaFlo Jan. 2009 - Closed	Interim Rates and Permanent Increase D2009.1.9	146	Stipulation Reached
Phantom Hills Water Company April 2004 – Closed Granted	Initial Rates D2004.4.61	168	Elects not to File Testimony
Salish Shores Utility Corp. Oct. 2006 – Closed	Initial Rates D2006.10.146	187	Stipulation Reached
Aquanet, Inc. Dec. 2009 - Closed	Initial Rates D2009.12.156	81	Stipulation Reached
Valley Water System May 2013 – Open Interim Rates Granted	Initial Rates D2013.3.18	35	Intervened in 2013
Utility Solutions April 2015, 2017 Transfer/Open	Application to Sell Water to Four Corners. 7406a Elk Grove Subdivision Remains Regulated. D2015.4.34	Not provided	Requests Further Review and Stipulation Reached

Information from PSC dockets.

\*Estimated customers generally supplied by utility. Taken from 2016 annual reports.

## Fiscal Overview

Of the 21 small water utilities currently in compliance or seeking compliance with regulatory obligations before the PSC, eight have pending applications before the commission and four of the eight pending applications have suffered delays attributable to insufficient staff resources, according to the PSC.

The PSC is funded primarily by a fee levied on regulated companies, based on funding appropriated by the legislature for a specific fiscal year. Fees are deposited directly into a state special revenue account and are based upon a percentage of the gross operating revenue from all activities regulated by the commission for the calendar quarter of operation. The agency's total annual budget is about \$4.4 million and includes about 35 FTE.

Revenues received from small water and sewer utilities in accordance with the fee are negligible. Using the estimated inventory discussed previously, the PSC developed a rough estimate of potential revenue generated if it fully regulated small water and sewer utilities. The PSC completed a regression analysis of estimated connections and operating revenues to develop a formula. A regression analysis explores relationships between independent variables and dependent variables. The estimates are also based on the assumption that the Legislature appropriates a similar amount as in the past, setting the benchmark for the fee.

PSC staff concluded the fee would generate about \$61,624 per year. The PSC does not find that amount sufficient to fund the FTE or FTEs they estimate necessary to proactively enforce utility compliance with the current law. If the PSC generated sufficient revenues to fund additional FTE required for a compliance effort, the revenue also would only result in increased funding if the Legislature provided the necessary authority in the form of an appropriation.

PSC staff indicated that the high-level fiscal analysis does involve significant uncertainty. The estimate of additional PSC revenue also assumed that the average size and water usage characteristics of these systems is similar to the currently compliant utility systems.

A comprehensive effort to determine the precise number of jurisdictional water utilities would involve making contact with water systems identified in the DEQ report in order to apply the statutory criteria for regulation to the particular organizational structure of each system. The PSC said existing resources and workload do not allow for that approach.

## Other States

Small water systems are different from the large investor owned electricity companies regulated by the PSC. For example, small utilities don't have paid staff, financial resources, or the expertise typically required to file a rate case. However, the law does not recognize these differences. The regulatory tools traditionally used by utility commissions, like the PSC, also can present some challenges when applied to small water and sewer utilities. The National Regulatory Research Institute finds "rate of return regulation, applied to small systems, is time-consuming, expensive, and overly complex and bureaucratic; so much so that small systems may be reluctant to file for rate increases. By the time they do, they may already be in financial crisis."<sup>20</sup>

Challenges in regulating small water and sewer utilities also are not unique to Montana. Some state regulators have responded to the challenge by creating simplified regulatory options, like standard rates; others have responded by

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<sup>20</sup> Melissa J. Stanford, "Small Water Systems: Challenges and Recommendations," National Regulatory Research Institute, Feb. 2008, page 11.

modifying certain regulatory procedures, like eliminating hearings. Legislative policies for regulating small water and sewer utilities also vary from state to state.

Between 1986 and 2013, a Texas Commission on Environmental Quality regulated between 600 and 700 investor-owned water utilities. In 2013, the Texas Legislature approved a transfer of those duties after determining a utility commission was best equipped to handle the process.<sup>21</sup> In 2014, the Public Utility Commission of Texas assumed regulatory responsibility for small water and sewer utilities.

Stakeholders testified that with the transfer, the Texas Office of the Public Utility Counsel, the entity that represents consumers, would take a much more active role in water and wastewater ratemaking before the commission. Most noted that the increased action would be welcome and would protect customers. The new law also established investor-owned utility classifications based on connection count to eliminate one-size-fits-all regulatory treatment. Class A utilities have 10,000 or more connections with rate setting similar to an electric utility. Class B utilities represent 500 to 10,000 connections and allow for an abbreviated rate-filing option. Class C utilities with 500 or fewer connections can request annual rate adjustments based on a predetermined index that doesn't exceed more than a 5% increase.<sup>22</sup>

Colorado grants "less comprehensive" regulatory treatment for utilities serving fewer than 1,500 customers.<sup>23</sup> The Colorado Public Utilities Commission regulates water utilities. The commission is required to balance reasonable regulatory oversight with the cost of regulation in relation to the benefit of the regulation.

Under Colorado's simplified regulatory treatment for small water utilities, five options are available to utilities:

- Annual rate adjustment allows an annual percentage change based on the United State Gross Domestic Product Chain-Type Price Index or a measure of productivity specified in U.S. Bureau of Labor Statistics.
- Resource cost pass-through allows price changes relating to the acquisition cost for wholesale water from a local municipality, other governmental entity, or other source as approved by the commission.
- Operating ratio methodology allows a utility to request the commission employ an operating ratio methodology in determining appropriate rates.
- A capital improvement reserve option allows utilities to implement a monthly surcharge to fund a reserve account for future capital improvement expenditures.
- The customized option requires a utility to prove that its proposal balances reasonable regulatory oversight with the costs and benefits of regulation, is not discriminatory, and is in the public interest, improves the quality of water service to customers, is financially compensatory, and promotes the development and maintenance of just and reasonable rates.<sup>24</sup>

The Office of Consumer Counsel in Colorado represents the public interest only in energy-related issues, not water or wastewater utility cases.

In Oregon, a utility that serves fewer than 500 customers is subject to service regulation if the commission determines that the utility has provided discriminatory service or the utility charges an average annual residential rate

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<sup>21</sup> Texas, 83<sup>rd</sup> Legislature, H.B. 1600 and S.B. 567, effective on September 1, 2013.

<sup>22</sup> Texas Water Code, Title 2, Subtitle B, Chapter 12, Subchapter A.

<sup>23</sup> Colorado Revised Statutes, 40-3-104.4. Simplified regulatory treatment for small, privately owned water companies.

<sup>24</sup> Code of Colorado Regulations, 4 CCR 723.5, 5112.

that exceeds \$24 per month.<sup>25</sup> Service regulation requires safe, adequate, and nondiscriminatory service. A water system is subject to rate regulation, versus service regulation, if it serves more than 500 customers or it provides water and wastewater services within the boundaries of a city, it requests rate regulation, or it charges or proposes to charge a rate or fee that exceeds certain thresholds. The thresholds are between \$42 and \$45 average monthly rates.<sup>26</sup>

To raise rates above the Oregon commission's established thresholds, a utility must send a 60-day notice to its customers, with a copy to the commission, explaining the reasons for the increase, state the annual increase in dollars, and show the old and new monthly rates for each customer class. The notice must also include specific language informing customers of their 45-day right to petition the commission for rate regulation. A petition from 20% or more of the customers is required before the commission initiates rate regulation.

In Florida, the regulation of water utilities is fragmented. The Florida Public Service Commission regulates investor-owned water and wastewater companies in 34 counties out of 67. The regulation is focused on rate base/economic regulation, competitive market oversight, and monitoring of safety, reliability, and service. County governments through the home-rule principle have the authority and responsibility to regulate the remaining investor-owned water and wastewater companies.<sup>27</sup>

In terms of tracking new public utilities, the Missouri Public Service Commission and the Missouri Department of Natural Resources provide an example. The agencies operate under a memorandum of understanding to provide guidance on the responsibilities of the respective agencies. The MOU includes an agreement to share copies of all reports regarding water and wastewater utilities to assist with proper recordkeeping. "Commission staff works closely with DNR staff to ensure that the entities regulated by the Commission provide safe and adequate service at rates that are just and reasonable," according to a recent report from the Missouri Public Service Commission.<sup>28</sup>

## Conclusion

Without a true inventory of how many small water and sewer utilities should be regulated by the Montana PSC, it may be difficult to determine the proper regulatory strategy. In a memo to the ETIC, the PSC indicated it has contemplated initiating a compliance process, but the commission is concerned that proper compliance, along with the Consumer Counsel's authority to represent consumer interests, could more than double the number of utilities regulated by the PSC and increase commission staff workload.

The National Regulatory Research Institute recommends that with an inventory in place, utility commissions are better positioned to develop streamlined commission regulation for small systems. The institute does not advocate for abandoning or reducing regulatory responsibility, but instead recommends considering simplified filing requirements, short time frames, and standard allowances for management and operations expenses and professional services.<sup>29</sup>

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<sup>25</sup> Oregon Administrative Rules (OAR) Chapter 860 Division 036.

<sup>26</sup> OAR 860-036-1910.

<sup>27</sup> Florida Statutes, Chapter 367.

<sup>28</sup> "Water: A Building Block of Life: A look at the Public Service Commission's Water and Sewer Unit," PSConnection, Missouri Public Service Commission Publication, Vol. 5, No. 9 – Summer 2015.

<sup>29</sup> Phillip S. Teumim and Frank W. Radigan, "The Small Water Company Dilemma: Processes and Techniques for Effective Regulation," National Regulatory Research Institute, Oct. 2011, page 17.