ISSUE NO. 19

The Montana Administrative Register (MAR or Register), a twice-monthly publication, has three sections. The Proposal Notice Section contains state agencies' proposed new, amended, or repealed rules; the rationale for the change; date and address of public hearing; and where written comments may be submitted. The Rule Adoption Section contains final rule notices which show any changes made since the proposal stage. All rule actions are effective the day after print publication of the adoption notice unless otherwise specified in the final notice. The Interpretation Section contains the Attorney General's opinions and state declaratory rulings. Special notices and tables are found at the end of each Register.

Inquiries regarding the rulemaking process, including material found in the Montana Administrative Register and the Administrative Rules of Montana, may be made by calling the Secretary of State's Office, Administrative Rules Services, at (406) 444-2055.

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BEFORE THE DEPARTMENT OF ADMINISTRATION
OF THE STATE OF MONTANA

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TO: All Concerned Persons

1. On November 3, 2011, at 2:00 p.m., the Department of Administration will hold a public hearing in Room 136 of the Mitchell Building, at 125 N. Roberts, Helena, Montana, to consider the proposed repeal of the above-stated rules.

2. The Department of Administration 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 Administration no later than 5:00 p.m. on October 28, 2011, to advise us of the nature of the accommodation needed. Please contact Marjorie Thomas, Department of Administration, P.O. Box 200127, 125 N. Roberts, Helena, Montana 59620; telephone (406) 444-3982; fax (406) 444-0703; Montana Relay Service/TDD 711; or e-mail mthomas2@mt.gov.

3. The department proposes to repeal the following rules:

2.21.901 SHORT TITLE found at page 2-731 of the Administrative Rules of Montana (ARM).

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.902 POLICY AND OBJECTIVES found at ARM page 2-731.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.903 DEFINITIONS found at ARM page 2-731.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.906 APPROVAL OF LEAVE found at ARM page 2-737.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.907 MEDICAL CERTIFICATION found at ARM page 2-737.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.908 MATERNITY LEAVE found at ARM page 2-738.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

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AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

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AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.913 DISABILITY RETIREMENT found at ARM page 2-741.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.920 CLOSING found at ARM page 2-747.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

STATEMENT OF REASONABLE NECESSITY: Montana law requires that the department (1) develop and issue personnel policies and (2) adopt rules to implement the state's personnel administration statutes. 2-18-102 et seq., MCA. The definition of "rule" in 2-4-102(11)(a) and (b), MCA, excludes "statements concerning only the internal management of an agency or state government and not affecting private rights or procedures available to the public." This language was enacted by the 2003 Legislature, and, since June 2004, the State Human Resources Division has been removing its internal administrative policies from the Administrative Rules of Montana as part of its policy review process while retaining those rules in ARM that affect the public.

This proposed repeal addresses the disability and maternity leave rules. The disability rules have been replaced by the new Reasonable Accommodations and Equal Access rules, found in ARM Title 2, chapter 21, subchapter 41, effective

August 25, 2011. Since these rules go beyond the internal management of state government, it is appropriate that they are included in ARM.

In contrast, the maternity leave rules address the internal management of state government employees. The department is proposing that the maternity leave rules be combined with the existing parental leave policy into one internal policy for state employees. If adopted, the new policy will become effective on the same date as the repeal of these rules and will be included in the Montana Operations Manual (MOM), a document that addresses the internal management of state government. MOM human resources policies may be found at http://hr.mt.gov/hrpp/policies.mcpx.

Employees may comment on the proposed maternity and parental leave policy when it is posted on or about October 13, 2011, at http://hr.mt.gov/hrpp/policyproposals.mcpx. A notice of the new policy will also be posted on the MINE web page, an internal site for state employees. Employees may also offer their comments on the policy at the November 3, 2011, public hearing.

The department has taken the repeal approach because the department believes the alternatives to repeal lack merit. Regarding the disability rules, the alternative was to leave these rules in place. However, given that the new Reasonable Accommodations and Equal Access rules cover the same subject matter, leaving the disability rules in place would be duplicative and would create confusion. Regarding the maternity leave rules, the alternative was to leave these rules in the ARM. The department, however, believes that since these rules address the internal management of state government, they are not "rules" as defined in statute and, therefore, do not belong in the ARM.

It is important to reiterate that the department is required by law to adopt personnel policies that agencies are expected to follow. Moving a statement from rule to policy does not mean that the agencies may ignore the policy.

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 Marjorie Thomas, Department of Administration, P.O. Box 200127, 125 N. Roberts, Helena, Montana 59620; telephone (406) 444-3982; fax (406) 444-0703; or e-mail mthomas2@mt.gov, and must be received no later than 5:00 p.m., November 10, 2011.

5. Marjorie Thomas, an attorney with the Department of Administration, has been designated to preside over and conduct this 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 mailing list shall make a written request which includes the name and mailing address or e-mail address of the person to receive notices and specifies that the person wishes to receive notices regarding State Human Resources Division rulemaking actions. 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 department's web site at http://doa.mt.gov/administrativerules.mcpx. The department 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 if a discrepancy exists 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 department 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.

By: /s/ Janet R. Kelly
Janet R. Kelly, Director
Department of Administration

By: /s/ Michael P. Manion
Michael P. Manion, Rule Reviewer
Department of Administration

Certified to the Secretary of State October 3, 2011.

BEFORE THE DEPARTMENT OF ADMINISTRATION
OF THE STATE OF MONTANA

In the matter of the repeal of ARM 2.21.6401, 2.21.6403, and 2.21.6422 pertaining to performance management and evaluation	))))	NOTICE OF PUBLIC HEARING ON PROPOSED REPEAL

TO: All Concerned Persons

1. On November 3, 2011, at 3:00 p.m., the Department of Administration will hold a public hearing in Room 136 of the Mitchell Building, at 125 N. Roberts, Helena, Montana, to consider the proposed repeal of the above-stated rules.

2. The Department of Administration 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 Administration no later than 5:00 p.m. on October 28, 2011, to advise us of the nature of the accommodation needed. Please contact Marjorie Thomas, Department of Administration, P.O. Box 200127, 125 N. Roberts, Helena, Montana 59620; telephone (406) 444-3982; fax (406) 444-0703; Montana Relay Service/TDD 711; or e-mail mthomas2@mt.gov.

3. The department proposes to repeal the following rules:

2.21.6401 SHORT TITLE found at page 2-1461 of the Administrative Rules of Montana (ARM).

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.6403 POLICY AND OBJECTIVES found at ARM page 2-1461.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

2.21.6422 CLOSING found at ARM page 2-1462.

AUTH: 2-18-102, MCA
IMP: 2-18-102, MCA

STATEMENT OF REASONABLE NECESSITY: Montana law requires that the department (1) develop and issue personnel policies and (2) adopt rules to implement the state's personnel administration statutes. 2-18-102 et seq., MCA. The definition of "rule" in 2-4-102(11)(a) and (b), MCA, excludes "statements concerning only the internal management of an agency or state government and not affecting private rights or procedures available to the public." This language was

enacted by the 2003 Legislature, and, since June 2004, the State Human Resources Division has been removing its internal administrative policies from the Administrative Rules of Montana as part of its policy review process while retaining those rules in ARM that affect the public.

This proposed repeal addresses the performance management and evaluation rules. The performance management and evaluation rules address the internal management of state government employees. These rules will be rewritten in a new performance management and evaluation policy. If adopted, the new policy will become effective on the same date as the repeal of these rules and will be included in the Montana Operations Manual (MOM), a document that addresses the internal management of state government. MOM human resources policies may be found at http://hr.mt.gov/hrpp/policies.mcpx.

Employees may comment on the proposed performance management and evaluation policy when it is posted on or about October 13, 2011, at http://hr.mt.gov/hrpp/policyproposals.mcpx. A notice of the new policy will also be posted on the MINE web page, an internal site for state employees. Employees may also offer their comments on the policy at the November 3, 2011, public hearing.

The department has taken the repeal approach because the department believes the alternatives to repeal lack merit. The alternative is to leave these rules in the ARM. The department, however, believes that since these rules address the internal management of state government, they are not "rules" as defined in statute and, therefore, do not belong in the ARM.

It is important to reiterate that the department is required by law to adopt personnel policies that agencies are expected to follow. Moving a statement from rule to policy does not mean that the agencies may ignore the policy.

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 Marjorie Thomas, Department of Administration, P.O. Box 200127, 125 N. Roberts, Helena, Montana 59620; telephone (406) 444-3982; fax (406) 444-0703; or e-mail mthomas2@mt.gov, and must be received no later than 5:00 p.m., November 10, 2011.

5. Marjorie Thomas, an attorney with the Department of Administration, has been designated to preside over and conduct this 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 mailing list shall make a written request which includes the name and mailing address or e-mail address of the person to receive notices and specifies that the person wishes to receive notices regarding State Human Resources Division rulemaking actions. 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 department's web site at http://doa.mt.gov/administrativerules.mcpx. The department 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 if a discrepancy exists 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 department 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.

By: /s/ Janet R. Kelly
Janet R. Kelly, Director
Department of Administration

By: /s/ Michael P. Manion
Michael P. Manion, Rule Reviewer
Department of Administration

Certified to the Secretary of State October 3, 2011.

BEFORE THE DEPARTMENT OF ADMINISTRATION
OF THE STATE OF MONTANA

In the matter of the adoption of New Rules I through IV pertaining to financial responsibility of mortgage loan originators and control persons and ultimate equity owners of mortgage entities	))))))	NOTICE OF PUBLIC HEARING ON PROPOSED ADOPTION

TO: All Concerned Persons

1. On November 3, 2011, at 10:00 a.m., a public hearing will be held in Room 342 of the Park Avenue Building, 301 S. Park, Helena, Montana, to consider the proposed adoption of the above-stated rules.

2. The Department of Administration will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, contact the Department of Administration no later than 5:00 p.m. on October 26, 2011, to advise us of the nature of the accommodation that you need. Please contact Wayne Johnston, Division of Banking and Financial Institutions, P.O. Box 200546, Helena, Montana 59620-0546; telephone (406) 841-2918; TDD (406) 444-1421; facsimile (406) 841-2930; or e-mail to banking@mt.gov.

3. GENERAL STATEMENT OF REASONABLE NECESSITY: Section 32-9-120(1)(c), MCA, requires the department to deny a license application if an applicant for a mortgage loan originator license has not demonstrated financial responsibility, character, and general fitness to command the confidence of the community and warrant a determination that the mortgage broker, mortgage lender, or mortgage loan originator will operate honestly, fairly, and efficiently within the purposes of the Montana Mortgage Act (Act). The control persons and ultimate equity owners of entities are held to the same standard pursuant to 32-9-113, MCA.

On August 29, 2011, the U.S. Department of Housing and Urban Development (HUD) adopted final rules to implement the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, 12 USC 5101, et seq. (SAFE Act). Those proposed rules provide, in relevant part:

> § 3400.105 Minimum loan originator license requirements. For an individual to be eligible for a loan originator license required under § 3400.103(a) and (d), a State must require and find, at a minimum, that an individual:
>
> (2)(c) Has demonstrated financial responsibility, character, and general fitness, such as to command the confidence of the community and to warrant a determination that the loan originator will operate

honestly, fairly, and efficiently, under reasonable standards established by the individual State.

HUD has required that the state develop reasonable standards to determine whether an applicant has demonstrated financial responsibility and will operate honestly, fairly, and efficiently. The state must develop those standards and enforce them in order to comply with the SAFE Act.

The department initially proposed a rule to implement 32-9-120(1)(c) and 32-9-127, MCA, on August 13, 2009, in MAR Notice 2-59-414 published in 2009 Montana Administrative Register, Issue Number 15 at page 1292. In response to the comments received in that rulemaking, the department is proposing a new rule.

The comments received in response to the new rule proposed in MAR Notice 2-59-414 were largely that the mortgage industry, like the country as a whole, has fallen on hard times. The commenters were concerned that the state of the economy could prevent a mortgage loan originator from becoming licensed. Several people commented that business is way down, and the people who are still in the mortgage broker or lender industry are having economic difficulties. They commented that a person who lost a home due to being unable to afford the payments should not be prevented from being a mortgage loan originator.

Some people commented that the department should not adopt a rule implementing 32-9-120(1)(c) and 32-9-127, MCA. The department does not have that option. The SAFE Act and the Act mandate the department to determine whether an applicant has demonstrated financial responsibility and will operate honestly, fairly, and efficiently within the purposes of the law.

In order to license individuals as mortgage loan originators and control persons or ultimate equity owners of entities, the department must comply with 32-9-120(1)(c), MCA. In fairness to applicants who may have unpaid tax liens or other government liens, foreclosures, or unpaid debts, the department must define the standard and give guidance to applicants as to how that standard will be applied and what the effect of financial issues will be on licensure.

In drafting this rule, the department reviewed the financial responsibility rules of several other states and ultimately decided to pattern its financial responsibility after the Idaho policy because it seems closest in line with the attitudes and influences in Montana. It is a reasonable policy that allows the individual to explain the adverse information on a credit report and rehabilitate the individual by entering into repayment agreements and faithfully paying toward debts owed.

The department will review the credit history of an applicant and, based on the totality of the credit history and the surrounding circumstances, including the explanation of the individual, if any, make the required determination as to whether the individual has demonstrated financial responsibility and will operate honestly, fairly, and efficiently within the purposes of the SAFE Act.

The history of and the reason(s) for unpaid debts are critical to this analysis, as well as what the individual is doing to satisfy the debt. For instance, if an individual has unpaid tax liens but that person has entered into a repayment agreement with the government, and has faithfully performed the obligations that have become due under the repayment agreement to date, that fact alone would not justify denial of a license.

In exercising its discretion under 32-9-120(1)(c), MCA, the department will consider the totality of the credit history, as well as any explanation or supporting documentation that the applicant submits to the department.

4. The new rules proposed to be adopted provide as follows:

NEW RULE I APPLICATION OF FINANCIAL STANDARDS (1) Section 32-9-120(1)(c) and 32-9-113, MCA, require mortgage loan originators, as well as ultimate equity owners and control persons of entities, to meet financial responsibility standards. These persons are referenced in [NEW RULES I though IV] as "individuals."

(2) Financial responsibility, character, and general fitness are continuing requirements for individuals and must be met at all times including upon initial licensure and renewal.

AUTH: 32-9-130, MCA
IMP: 32-9-113, 32-9-117, 32-9-120, 32-9-166, MCA

STATEMENT OF REASONABLE NECESSITY: The Act makes the standards of financial responsibility, character, and general fitness a requirement for licensure and for renewal of licenses. 32-9-120, MCA. In addition, the Act requires the control persons and ultimate equity owners of entities to meet the same standards in order for the entity to become licensed. 32-9-113, MCA. The purpose of (1) is to define "individuals" as used in the remainder of these rules.

Section (2) provides that the financial standards, character, and general fitness standards are continuing standards the applicant must meet at the time of the application, at the time of renewal, and at all times in between. See 32-9-113, 32-9-117, and 32-9-120, MCA. The standards are the subject of several disclosure questions that applicants must answer on the Nationwide Mortgage Licensing System (NMLS). The NMLS requires applicants and licensees to update their responses to disclosure questions and keep them current, accurate, and complete under penalty of perjury and unsworn falsification to authorities. In addition, 32-9-166, MCA, provides that a licensee shall file a written report with the department within 30 business days of any material change to the information provided in a licensee's application. Therefore, the financial, character, and general fitness standards are continuing ones.

NEW RULE II STANDARDS FOR DETERMINING FINANCIAL RESPONSIBILITY (1) The department shall find an individual lacks the required financial responsibility if a pattern of disregard is shown regarding the management of the individual's personal financial affairs.

(2) In determining whether an individual has shown a pattern of disregard regarding their own personal financial affairs, the department shall consider the following factors:

(a) the existence of outstanding judgment(s), excluding judgments resulting solely from medical expenses;

(b) the existence of outstanding tax liens or other government liens or filings;

(c) a pattern of delinquency in child support or student loan payments;

(d) the existence of outstanding collection actions against the individual unless solely as a result of medical expenses;

(e) the existence of outstanding charged-off accounts with a remaining past due balance owed unless solely as a result of medical expenses;

(f) the existence of three or more accounts currently 90 days or more past due; and

(g) a foreclosure within the past three years.

(3) The department may not consider a bankruptcy as the sole basis for a finding that an individual lacks the required financial responsibility; however, the department may consider the factors that lead to the bankruptcy.

AUTH: 32-9-130, MCA
IMP: 32-9-113, 32-9-117, 32-9-120, MCA

STATEMENT OF REASONABLE NECESSITY: The general standard, a pattern of disregard for the management of personal financial affairs, comes from the model law developed by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to implement the SAFE Act. The SAFE Act requires that a credit report be obtained from a consumer reporting agency for each applicant for a license as a mortgage loan originator. When the model act was developed, the drafters agreed that the purpose of requiring a credit report from applicants was to determine financial responsibility. Since this standard is the model law adopted by 44 states, the department feels it is appropriate to base its rules on the same standard. In addition, another goal of the SAFE Act was to promote uniformity, which is also furthered by this rule.

The model law is as follows:

> CHARACTER AND FITNESS—The applicant has demonstrated financial responsibility, character, and general fitness such as to command the confidence of the community and to warrant a determination that the mortgage loan originator will operate honestly, fairly, and efficiently within the purposes of this Act.
>
> (a) For purposes of this subsection a person has shown that he or she is not financially responsible when he or she has shown a disregard in the management of his or her own financial condition. A determination that an individual has not shown financial responsibility may include, but not be limited to:
>
> (i) Current outstanding judgments, except judgments solely as a result of medical expenses;
>
> (ii) Current outstanding tax liens or other government liens and filings;
>
> (iii) Foreclosures within the past three years;
>
> (iv) A pattern of seriously delinquent accounts within the past three years.

NEW RULE II(2)(a), (b), and (g) incorporate into factors (i), (ii), and (iii) listed in the model law. The appearance on credit reports of the factors in (2)(c), (d), (e), and (f) would cause the department concern regarding an individual's financial responsibility. The department views these matters as serious enough to warrant an inquiry of the individual as to what happened and why these debts have not been paid.

Federal law prohibits a bankruptcy from being the sole basis of a denial of licensure. 11 USC 525. However, the licensing entity may take into consideration the behavior underlying a bankruptcy in determining an applicant's past and future financial responsibility.

Since an individual has no control over medical issues that can result in overwhelming medical bills, any and all debt related to medical expenses is excluded from a financial responsibility analysis.

NEW RULE III PROCEDURES FOR DETERMINING FINANCIAL RESPONSIBILITY (1) If an individual's credit report or response to any application disclosure question contains adverse information, the department shall:

(a) notify the individual in writing of the specific items that must be addressed; and

(b) specify the documentation that must be provided for the department's consideration and review.

(2) Examples of the type of documentation that the department may request include, but are not limited to, the following:

(a) a written explanation of the circumstances surrounding the adverse information reported; and

(b) documents that the department finds necessary for its review of the adverse information including, but not limited to, copies of:

(i) satisfactions of judgment;

(ii) bankruptcy discharge orders, schedules, or dismissal documents;

(iii) satisfactions of outstanding tax liens or other governmental liens;

(iv) court documents showing the factual basis underlying the adverse information being reviewed by the department and how the matter was resolved or adjudicated; and

(v) account statements or letters from the individual's creditors, or lien or judgment holders, explaining and verifying the current status of any past due accounts, including documentation of any repayment plans and agreements, as well as any temporary or permanent modifications to such accounts.

(3) Any document provided must be legible and complete. Incomplete documents may not be accepted.

(4) If the individual is unable to obtain the documents the department requests, the individual shall support that fact with documentation from the source of the unavailable documents consisting of a written statement from the agency or creditor who holds or held the records. The statement must be:

(a) written on the agency's or creditor's letterhead indicating that:

(i) the agency or creditor does not have any record of the matter;

(ii) the record was lost, damaged, or destroyed, or cannot otherwise be produced; and

(iii) the reason why the information is not available;

(b) signed by the agency's or creditor's records custodian; and

(c) include contact information such as phone number, mailing address, or e-mail address.

(4) Applications must be deemed withdrawn or abandoned if the applicant fails to provide the information requested by the department within 60 days of notification to the applicant by the department of deficiencies in the application or December 31, whichever comes first.

AUTH: 32-9-130, MCA
IMP: 32-9-113, 32-9-117, 32-9-120, MCA

STATEMENT OF REASONABLE NECESSITY: If the department finds one or more matters on a credit report or a disclosure question that raises concerns regarding financial responsibility, the department will notify the individual as to which matters are cause for regulatory concern and request that the individual explain what happened and why the debts are unpaid or provide evidence that the debts have been paid or that the individual has entered into a repayment agreement with the creditor and is making a good faith effort to meet the terms of the repayment agreement. The reason for this is that the individual must be given notice of the matters that raise concerns for the department and be given the chance to explain those matters. Credit reports can be wrong, or simply outdated, and the applicant must be given the opportunity to provide to the department any additional information the applicant would like to provide relevant to the matters of concern.

If the debt has been paid or discharged, the department requires documentary evidence of that. The rule lists the type of documentary evidence which will be required. The department requires actual documentary evidence, not simply a statement from the individual that the debt has been paid, in order to assure that the debtor and creditor agree on the current status of the debt.

If the individual cannot produce the records requested by the department, (4) sets forth the types of documents which must be produced to evidence that fact. A letter from an applicant saying that the creditor cannot locate the debt is not sufficient; the letter must come from the creditor and have sufficient evidence of reliability to be acceptable. The department requires documentation from the creditor, not the applicant, in order to ensure accurate and correct information.

Sometimes, after the department requests additional information, the individual does not respond or provide additional information. Then the department has to make repeated efforts to contact the individual in an effort to determine what the person intends to do. In an effort to avoid this situation, the department is proposing to deem an application withdrawn or abandoned for failure to provide the requested information to the department within 60 days of the request or December 31, whichever comes first. December 31 is the date that all licenses expire. Applications are rarely submitted from November 1 to December 31 because that is the dedicated period of license renewal. Any applicant that submits an initial application for licensure during the renewal period must also renew the license by December 31, provided that the license is issued by that date. This does not penalize the applicant for failing to respond; the applicant is free to reapply at any

time in the future with no negative consequence from the withdrawn application. It will allow the applicant to work to improve their financial responsibility without a negative sanction attaching to their license.

The other option for the department would be to deny the license because the factors required to issue a license under 32-9-120, MCA, cannot be found in the application provided by the individual. This is an unnecessarily harsh result for an applicant who filed an application and failed to complete it. A denial of a license would have to be reported on all subsequent applications and explained. This result should be reserved for more egregious conduct than failing to complete an application.

NEW RULE IV REVIEWING ADVERSE CREDIT HISTORY AND OTHER INFORMATION (1) In making a determination whether an applicant has demonstrated financial responsibility, character, and general fitness, the department shall consider the following:

(a) the individual's credit history reflected in a credit report;

(b) supplemental information and documentation requested from and provided by the individual as determined necessary by the department;

(c) responses and information contained in the individual's application filings;

(d) previous and current license history with the department, to include any regulatory actions that have occurred;

(e) other information that reflects upon the financial responsibility, character, and general fitness, whether favorably or adversely;

(f) the timing and context of the information reviewed;

(g) patterns of conduct; and

(h) factors indicating that financially adverse information may be the result of the involuntary loss of job or income, divorce, or health issues. Under such circumstances, the individual shall provide documents showing attempted workout arrangements with creditors or other factors indicating the individual has made an attempt to correct his or her financial difficulties.

(2) The department may not base a license application denial solely on a license applicant's credit score.

(3) In determining financial responsibility, the department shall consider the totality of the applicant's credit history, and surrounding circumstances, in exercising its discretion under 32-9-120(1)(c), MCA.

(4) Although the following is not an exclusive list, the department may consider the following factors, or a combination thereof, in determining whether to deny, condition, suspend, or revoke a license. The individual:

(a) has failed to fully provide any documentation required by the department;

(b) has made a false attestation associated with a filing related to an application for a license or a license renewal;

(c) has failed to pay in full any past due account, lien, judgment, or charged-off balance either as of the date of the issuance of a credit report to the department, or at time of initial licensure, designation as a control person or ultimate equity owner, or at renewal of any license. In reviewing this factor, the department shall make an exception for any account, lien, judgment, or charged-off balance that is solely due to medical expenses;

(d) is in arrears or has failed to comply with the terms of a repayment plan or agreement entered into with a creditor;

(e) has failed to make timely payments under a plan or agreement with any state or federal tax or other regulatory agency; and

(f) has any of the factors listed in [NEW RULE II(2)].

AUTH: 32-9-130, MCA
IMP: 32-9-113, 32-9-117, 32-9-120, MCA

STATEMENT OF REASONABLE NECESSITY: The decision whether to issue, deny, condition, suspend, or revoke a license based on financial responsibility is grounded on the totality of the circumstances. It is not susceptible to a bright line test; however, the factors that will and will not be considered are listed. As a matter of fairness, the department must consider all the factors before it in making a licensing decision, including aggravating and mitigating factors for the behavior in question. Each case must be decided on its own merits within the framework established by statutes and rules. In so doing, the department has determined that the factors listed in NEW RULE IV(1) are indicative of the factors which, if they exist, may be relevant to the licensing decision. The factors will not be viewed in isolation but will be viewed as a whole.

Credit scores alone are not a factor in the decision; however, the behavior that led to a particular credit score can be a factor in determining financial responsibility. Many loan originators believe that the department bases licensing decisions on credit scores. This is not so. The credit score is simply a number and cannot be used to determine whether the individual in question has demonstrated financial responsibility. The crux of the matter is an analysis of what is going on in the individual's life that may provide extenuating circumstances for a pattern of unpaid debts or not, as the case may be. That requires the department to define the factors that will be considered, or not considered, in making a licensing determination.

The factors listed in this new rule are designed to give the applicant notice of the types of factors that will be considered by regulators in assessing financial responsibility. The department will review the individual's credit history as revealed in the credit report since that is required by the SAFE Act. In addition, the department will consider the additional information and documentation received from the individual in response to an inquiry from the department. Obviously, the individual's explanation will be very important in determining extenuating factors or aggravating factors in any credit issues. The department will review all other answers and information provided by the individual in the application for licensure. Specifically the department will look at financial disclosure questions included within the application for licensure. Any affirmative responses provided by the applicants on the financial disclosure questions require the applicants to provide additional documentation. Any false or misleading responses or failure to disclose information in response to financial disclosure questions will be viewed negatively.

In addition, the department will consider the individual's prior and current regulatory history with the department as a factor in the licensing decision. For instance, an individual who has a history of noncompliance with the Act will be dealt

with more harshly than someone who has no prior regulatory history. In fairness, the department will consider any other information it has that reflects either positively or negatively on the individual's financial responsibility, character, and general fitness. The department will take into account the age and repetitive nature of any conduct at issue. A remote unpaid debt does not raise the same regulatory concern as a new unpaid debt. A single unpaid debt generally, although not always, is not of the same degree of regulatory concern as a pattern of unpaid debts. However, a large unpaid debt may rise to a significant level of regulatory concern.

If an individual provides a reasonable explanation for how the financial difficulties occurred, such as job loss, divorce, or health issues, the department will then look for a repayment agreement and evidence that it is being met in determining whether the individual is making a good faith effort to pay the debts despite difficult financial conditions. The department realizes that things happen in an individual's life that can lead to financial difficulties. The intent of this rule is not to penalize an individual because something unfortunate has happened. The intent of the rule is to distinguish between someone who falls on hard times but still makes an effort to pay their debts, who should be licensed, and someone who has a willful pattern of nonpayments of debts, who should not.

As noted, the department will not base its decision to deny a license solely on a credit score. A credit score is an arbitrary number assigned by a credit rating agency. It is not helpful to the regulatory analysis of financial responsibility which requires an analysis of the reasons for an individual's financial condition, and bona fide attempts to meet financial responsibilities in spite of hardships, or conversely, a willful pattern of unpaid debts. Every licensing decision is fundamentally a discretionary decision based on the totality of the circumstances that each separate application presents.

In determining whether to deny, condition, suspend, or revoke a license, the department will take into account all the factors present in the particular license application including any failure to fully provide any documentation required by the department or false attestation associated with a filing related to an application for a license or a license renewal. The department will view these two factors extremely negatively. In fact, the financial responsibility issue becomes secondary to character and fitness when an applicant makes a false attestation or fails to fully provide documents to the department.

The department will also consider whether the individual has failed to pay in full any past due account, lien, judgment, or charged-off balance either as of the date of the issuance of a credit report to the department, or at time of initial licensure, designation as a control person or ultimate equity owner, or at renewal of any license. The failure to pay a legitimate debt will be viewed negatively. In reviewing this factor, the department will make an exception for any account, lien, judgment, or charged-off balance that is solely due to medical expenses. The language regarding medical expenses is from the model law. The rationale is that an individual is able to control their spending but medical expenses cannot be controlled by an individual. The department agrees with this rationale.

The department will view negatively any individual who is in arrears or has failed to comply with the terms of a repayment plan or agreement entered into with a creditor or has failed to make timely payments under a plan or agreement with any

state or federal tax or other regulatory agency, unless a reasonable explanation is given for such failure. The department believes that these failures show a lack of financial responsibility, thus justifying the negative viewpoint.

In addition, the department will consider the factors set forth in NEW RULE II(2) for the same reasons as are listed in the statement of reasonable necessity under NEW RULE II.

5. Concerned persons may present their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to Kelly O'Sullivan, Legal Counsel, Division of Banking and Financial Institutions, P.O. Box 200546, Helena, Montana 59620-0546; faxed to the office at (406) 841-2930; or e-mailed to banking@mt.gov. The data, views, or arguments must be received no later than 5:00 p.m., November 14, 2011.

6. Kelly O'Sullivan, Legal Counsel, Division of Banking and Financial Institutions, has been designated to preside over and conduct the hearing.

7. An electronic copy of this Proposal Notice is available through the department's web site at http://doa.mt.gov/administrativerules.mcpx. The department 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 if a discrepancy exists 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 department 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 Division of Banking and Financial Institutions maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this division. Persons who wish to have their name added to the mailing list shall make a written request which includes the name, mailing address, and e-mail address of the person to receive notices and specifies that the person wishes to receive notices regarding division rulemaking actions. Notices will be sent by e-mail unless a mailing preference is noted in the request. Such written requests may be mailed or delivered to Wayne Johnston, Division of Banking and Financial Institutions, 301 S. Park, Ste. 316, P.O. Box 200546, Helena, Montana 59620-0546; faxed to the office at (406) 841-2930; e-mailed to banking@mt.gov, or may be made by completing a request form at any rules hearing held by the department.

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

By: /s/ Janet R. Kelly
Janet R. Kelly, Director
Department of Administration

By: /s/ Michael P. Manion
Michael P. Manion, Rule Reviewer
Department of Administration

Certified to the Secretary of State October 3, 2011.

BEFORE THE STATE AUDITOR AND COMMISSIONER OF INSURANCE
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 6.6.6802, 6.6.6804, 6.6.6805, 6.6.6806, 6.6.6811, 6.6.6815, 6.6.6820, and 6.6.6821, and the repeal of 6.6.6810, pertaining to Formation and Regulation of Captive Insurance Companies	)))))))	NOTICE OF PUBLIC HEARING ON PROPOSED AMENDMENT AND REPEAL

TO: All Concerned Persons

1. On November 2, 2011, at 10:30 a.m., the office of the State Auditor and Commissioner of Insurance, Monica J. Lindeen, (State Auditor's Office) will hold a public hearing in the 2nd floor conference room, at the State Auditor's Office, 840 Helena Ave., Helena, Montana, to consider the proposed amendment and repeal of the above-stated rules.

2. The State Auditor's Office will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing, or need an alternative accessible format of this notice. If you require an accommodation, contact the department no later than 5:00 p.m., October 26, 2011, to advise us of the nature of the accommodation that you need. Please contact Darla Sautter, State Auditor's Office, 840 Helena Avenue, Helena, Montana, 59601; telephone (406) 444-2726; TDD (406) 444-3246; fax (406) 444-3497; or e-mail dsautter@mt.gov.

3. The rules as proposed to be amended provide as follows, stricken matter interlined, new matter underlined:

6.6.6802 DEFINITIONS For purposes of these rules:
(1) remains the same.
(2) "Commissioner" means the State Auditor and Commissioner of Insurance.

AUTH: 33-28-206, MCA
IMP: 33-28-101, MCA

6.6.6804 ADDITIONAL SECURITY (1) If the commissioner deems that the financial condition of the company warrants additional security, ~~he~~ the commissioner may require the company to deposit through the ~~office of the Montana~~ State Auditor's Office in the manner described in 33-2-604, MCA, cash or securities approved by the commissioner or, alternatively, to furnish the commissioner a clean irrevocable letter of credit issued by a bank chartered by the state of Montana or by a member of the bank of the federal reserve system and approved by the commissioner.
(2) and (3) remain the same.

AUTH: 33-28-206, MCA
IMP: 33-28-104, MCA

6.6.6805 PERMITTED REINSURANCE (1) through (1)(d) remain the same.

(2) Credit for reinsurance of captive risk retention groups shall be permitted if reinsurer complies with 33-2-1216, MCA.

(3) If a captive risk retention group does not qualify for reinsurance under (2), credit for reinsurance may still be permitted if the reinsurer:

(a) maintains an A- or higher A.M. Best rating, or other comparable rating from a nationally recognized statistical rating organization;

(b) maintains a minimum surplus as regards policyholders in an amount acceptable to the commissioner based upon a review of the reinsurer's most recent audited financial statements; and

(c) is licensed and domiciled in a jurisdiction acceptable to the commissioner.

(4) If a captive risk retention group does not qualify for reinsurance under (2) or (3), credit for reinsurance may still be permitted if the reinsurer satisfies all of the following requirements and any other requirements deemed necessary by the commissioner:

(a) the risk retention group licensed as a captive insurer shall file the reinsurer's audited financial statements. The commissioner shall analyze these statements for appropriateness of the reserve credit, and the initial and continued financial condition of the reinsurer. The statements shall be filed:

(i) annually;

(ii) at the request of the commissioner; or

(iii) if the risk retention group thinks it appropriate, more often.

(b) the reinsurer shall demonstrate to the satisfaction of the commissioner that it maintains a ratio of net written premium, wherever written, to surplus as regards policyholders of not more than 3 to 1;

(c) the affiliated reinsurer shall not write third-party business without obtaining prior written approval from the commissioner;

(d) the reinsurer shall not use cell arrangements without obtaining approval from the commissioner;

(e) the reinsurer shall be licensed and domiciled in a jurisdiction acceptable to the commissioner; and

(f) the reinsurer shall submit to the examination authority of the commissioner.

(5) Risk retention groups shall not receive statement credit if:

(a) all policies are ceded through 100% reinsurance arrangements; or

(b) the commissioner requires a maximum ceded reinsurance percentage of less than 100% and the risk retention group exceeds the approved percentage. The portion within the approved amount may still qualify for state credit if the reinsurer is eligible under (2), (3), or (4).

(6) The commissioner shall require:

(a) a reinsurer not domiciled in the U.S. to include language in the reinsurance agreement that states that in the event of the reinsurer's failure to perform its obligations under the terms of its reinsurance agreement, it shall submit to the jurisdiction of any court of competent jurisdiction in the U.S.; or

(b) for credit for reinsurance and solvency regulatory purposes, the commissioner may require any of the following collateral:

(i) an approved funds-held agreement;

(ii) letter of credit; or

(iii) trust or other acceptable collateral based on paid losses, unearned premium, and LAE reserves.

(7) Upon application, the commissioner may waive the reinsurance requirements of (4)(b) in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the commissioner that the reinsurer:

(a) is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements;

(b) the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the commissioner; and

(c) the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be included in the plan of operation, or any subsequent revision or amendment of the plan, pursuant to Section 3902(d)(1) of the Federal Liability Risk Retention Act of 1986, and the plan must be submitted by the risk retention group licensed as a captive insurer to the commissioner of its state of domicile and each state in which the risk retention group licensed as a captive insurer intends to do business, or is currently registered. Any such waiver of (4) requirement constitutes a change in the risk retention group's plan of operation in each of those states.

(8) Upon application, the commissioner may waive either of the reinsurance requirements in (6) in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the commissioner that:

(a) the reinsurer is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements;

(b) the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the commissioner, and

(c) the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be disclosed in Note 1 of the risk retention group's annual statutory financial statement.

(9) Each approved risk retention group licensed as a captive insurer shall assess its reinsurance program and within 60 days of the effective date of these guidelines, submit a written report to the commissioner indicating whether such risk retention group licensed as a captive is in compliance with these guidelines. All risk retention groups licensed as captive insurers that fail to submit the report in a timely manner may be examined, at the risk retention group's expense, to determine compliance with these guidelines.

(10) These guidelines are effective December 9, 2011, and apply to risk retention groups licensed as captive insurers. Risk retention groups licensed as captive insurers who require additional time to comply with these guidelines shall be permitted to take credit for reinsurance for risks ceded to reinsurers not in compliance with these guidelines for a period not to exceed 12 months from the effective date of these guidelines upon satisfactory demonstration to the commissioner that such delay of implementation will not cause a hazardous financial condition or potential harm to its member policyholders.

AUTH: 33-2-121, 33-2-217, 33-28-102, 33-28-206, MCA
IMP: 33-28-203, MCA

6.6.6806 INSURANCE MANAGERS AND INTERMEDIARIES (1) No person shall, within the state of Montana, act as a manager, broker, agent, salesperson, or reinsurance intermediary for a company without the authorization of the commissioner. Application for such authorization must be in ~~the~~ a form prescribed by the commissioner.

AUTH: 33-28-206, MCA
IMP: 33-28-102, MCA

6.6.6811 ANNUAL AUDIT (1) through (4)(d) remain the same.

(5) A risk retention group licensed as a captive insurer shall utilize the Model Audit Rule as defined in ARM 6.6.3501 - 6.6.3521.

AUTH: 33-28-206, MCA
IMP: 33-28-107, MCA

6.6.6815 FINANCIAL STATEMENTS (1) through (2)(b) remain the same.

~~(3) Any pure captive insurance company, branch captive insurance company, industrial insured captive insurance company, or association captive insurance company may make written application for filing the required report on a fiscal year-end basis. if a fiscal year-end reporting date is granted:~~

~~(a) the required report is due 60 days after the fiscal year-end; and~~

~~(b) in order to provide sufficient information to support the premium tax return, the captive insurance company shall file, prior to march 1 of each year for the prior calendar year-end, a report acceptable to the commissioner.~~

AUTH: 33-28-206, MCA
IMP: 33-28-107, MCA

6.6.6820 REVOCATION OF THE COMPANY'S LICENSE (1) The commissioner may revoke the license of a company in accordance with 33-28-108, MCA, including, but not limited to, the following reasons:

(1)(a) through (2) remain the same.

AUTH: 33-28-206, MCA
IMP: 33-28-109, MCA

6.6.6821 LIMIT OF RISK -- CAPTIVE RISK RETENTION GROUPS (1) ~~The provisions of 33-2-1202, MCA, do not apply to a captive insurance company that is a risk retention group.~~ A captive risk retention group shall not retain any risk on any one occurrence in an amount exceeding 10% of its surplus as regards policyholders.

(2) The maximum retained risk on any one occurrence pursuant to (1) may be increased by the commissioner after considering all relevant aspects of a captive risk retention group's business plan and/or operational history including, but not limited to, the following:

(a) the financial strength of the captive risk retention group;

(b) the ability of the risk retention group to raise capital;

(c) quality of corporate governance and captive management;
(d) rating and pricing methodologies; and
(e) loss prevention and risk management programs.
(3) Increases in the maximum retained risk granted by the commissioner pursuant to (2) shall be by policy, or by program, and shall not apply to a captive risk retention group's other policies or programs without specific approval of the commissioner.
(4) The commissioner may revoke an increase in the maximum retained risk granted to a captive risk retention group pursuant to (2) when the commissioner becomes aware of any adverse change to one or more of the factors used in granting the increase, or when the commissioner becomes aware of any other information meriting a reduction in the maximum retained risk.
(5) Any captive risk retention group licensed and operating prior to the effective date of this rule that has a maximum retained risk higher than the limit in (1) is considered to have been approved for an increase in the maximum retained risk pursuant to (2). The commissioner's authority to revoke an increase in the maximum retained risk pursuant to (4) is applicable to captive risk retention groups.

AUTH: 33-28-206, MCA
IMP: 33-28-207, MCA

4. The State Auditor's Office proposes to repeal the following rule:

6.6.6810 CHANGE IN BUSINESS AND OTHER INFORMATION found at page 6-1883 of the Administrative Rules of Montana.

AUTH: 33-28-206, MCA
IMP: 33-28-102, MCA

5. REASONABLE NECESSITY STATEMENT: The State Auditor and Commissioner of Insurance, Monica J. Lindeen (commissioner), is the statewide elected official responsible for administering the Montana Insurance Department and regulating the business of insurance including the transaction of surplus lines insurance.

The commissioner is a member of the National Association of Insurance Commissioners (NAIC). The NAIC is an organization of insurance regulators from the 50 states, the District of Columbia, and the U.S. territories. The NAIC provides a forum for the development of uniform policy and regulation when uniformity is appropriate. For the Montana Insurance Department to remain accredited, the NAIC has requested the rules regarding captive insurers and risk retention groups licensed as captive insurers be modified in order to comply with national standards.

ARM 6.6.6804 is proposed to be amended for grammatical reasons. It is necessary to remove any gender specific language.

Similarly, ARM 6.6.6806 is also proposed to be amended for grammatical reasons. The change is necessary to reflect the concept that the commissioner may prescribe any form for an authorization application.

Amending ARM 6.6.6805 enables the commissioner to regulate reinsurance agreements between captive insurers and reinsurers when reinsurance carriers do not meet the usual credit for reinsurance standards of 33-2-1216, MCA. The rule is necessary because certain acceptable reinsurance carriers are not addressed within the statutory standards. By utilizing A.M. Best ratings, examinations and audited financial statements, the commissioner can allow these reinsurance carriers to do business in the state.

Furthermore, in instances when the commissioner is comfortable that a reinsurance carrier is domiciled in a state with strong insurance regulation, these rules grant the commissioner discretionary authority to approve a reinsurance carrier. This is necessary to facilitate captive insurance business for Montana-domiciled companies and provide access to legitimate reinsurance carriers in order to reduce total costs.

Another proposed amendment to ARM 6.6.6805 requires a self-reporting requirement. This rule is necessary to ensure existing reinsurance programs are in compliance with the amended rules. For reinsurance programs not in compliance, an extended time frame for achieving compliance is necessary because the negotiation of reinsurance agreements is complex and time consuming. Therefore, it is necessary to allow captive insurers to receive credit for reinsurance ceded within noncompliant reinsurance programs, but only for a limited extended time frame.

ARM 6.6.6811 is proposed to be amended in order to make captive risk retention groups subject to the same audit rules as traditional insurers, which is necessary pursuant to NAIC accreditation requirements.

The purpose of the proposed amendment to ARM 6.6.6815 is to delete misplaced references to the annual financial report. This is necessary because the purpose of this rule is to provide guidance with regard to audited financial statements, not the annual financial report.

The proposed amendment to ARM 6.6.6821 concerns the commissioner's authority to set standards and limitations on risk. This rule is necessary to set standards for captive insurers, as a comparable law exists for traditional insurers. The proposed amendment to the rule grants the commissioner authority to limit risk to maintain solvency and sets standards accordingly.

It is also necessary that the proposed amendment to the rule allows currently licensed captive risk retention groups to be considered approved under the new limitation of risk standards. This "grandfathering" is warranted because the department has already been using similar limitation of risk standards in its review of licensing applications previously submitted by captive risk retention groups.

The proposed repeal of ARM 6.6.6810 is necessary because the current rule diminishes the statute. Section 33-28-102(3)(b), MCA, addresses any changes in the business plan. It is necessary to repeal the rule to make the complete rules harmonious with the standards set forth in statute.

6. Concerned persons may submit their data, views, or arguments concerning the proposed actions either orally or in writing at the hearing. Written data, views, or arguments may also be submitted to Steve Matthews, Examinations Bureau Chief, State Auditor's Office, 840 Helena Ave., Helena, Montana, 59601; telephone (406) 444-2040; fax (406) 444-3499; or e-mail smatthews@mt.gov, and must be received no later than 5:00 p.m., November 10, 2011.

7. Brett O'Neil, Staff Attorney, has been designated to preside over and conduct this hearing.

8. The department maintains a list of concerned 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 and mailing address of the person to receive notices and specifies for which program the person wishes to receive notices. Such written request may be mailed or delivered to Darla Sautter, at the State Auditor's Office, 840 Helena Ave., Helena, Montana, 59601; telephone (406) 444-2726; fax (406) 444-3499; or e-mail dsautter@mt.gov or may be made by completing a request form at any rules hearing held by the department.

9. 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.

10. Pursuant to 2-4-302, MCA, the bill sponsor contact requirements do not apply.

/s/ Brett O'Neil	/s/ Jesse Laslovich
Brett O'Neil	Jesse Laslovich
Rule Reviewer	Chief Legal Counsel

Certified to the Secretary of State October 3, 2011.

BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

In the matter of the amendment of 42.23.801 and 42.26.233 relating to net operating losses and consistency in reporting with respect to property	)))))	NOTICE OF PROPOSED AMENDMENT NO PUBLIC HEARING CONTEMPLATED

TO: All Concerned Persons

1. On December 9, 2011, the department proposes to amend the above-stated rules.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in the rulemaking process and need an alternative accessible format of this notice. If you require an accommodation, contact the Department of Revenue no later than 5:00 p.m. on October 21, 2011, to advise us of the nature of the accommodation that you need. Please contact Cleo Anderson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-5825; fax (406) 444-4375; e-mail canderson@mt.gov.

3. The rules proposed to be amended provide as follows, stricken matter interlined, new matter underlined:

42.23.801 NET OPERATING LOSSES (1) The net operating loss deduction is allowed in accordance with the IRC (1954), as amended, for taxable periods ending on or before December 3, 1970. For taxable periods which begin on and after January 1, 1971, the net operating loss deduction is allowed as provided in ~~ARM 42.23.412 through 42.23.415~~ the rules contained in this subchapter.

(2) remains the same.

AUTH: 15-31-501, MCA
IMP: 15-31-114, MCA

REASONABLE NECESSITY: The department proposes to amend ARM 42.23.801 to update the internal ARM references that were inadvertently not updated when transferring ARM 42.23.412 to ARM 42.23.801. The transfer, as found in MAR Notice Number 42-2-863, at page 2053 of the 2011 Montana Administrative Register, Issue No. 18, became effective on September 23, 2011.

42.26.233 CONSISTENCY IN REPORTING WITH RESPECT TO PROPERTY (1) and (2) remain the same.

AUTH: 15-1-201, 15-31-313, 15-31-501, MCA

IMP: 15-1-601, ~~and Title 15, chapter 31, part 3~~ 15-31-301, 15-31-302, 15-31-303, 15-31-304, 15-31-305, 15-31-306, 15-31-307, 15-31-308, 15-31-309, 15-31-310, 15-31-311, 15-31-312, 15-31-321, 15-31-322, 15-31-323, 15-31-324, 15-31-325, 15-31-326, MCA

REASONABLE NECESSITY: The department proposes to amend ARM 42.26.233 to update the implementing citations.

4. Concerned persons may submit their data, views, or arguments in writing. Written data, views, or arguments may be submitted to: Cleo Anderson, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-5828; fax (406) 444-4375; or e-mail canderson@mt.gov and must be received no later than 5:00 p.m., November 10, 2011.

5. If persons who are directly affected by the proposed action wish to express their data, views, and arguments orally or in writing they must make written request for a hearing and submit this request along with any written comments they have to Cleo Anderson at the above address no later than 5:00 p.m., November 10, 2011.

6. If the agency receives requests for a public hearing on the proposed action from either 10 percent or 25, whichever is less, of the persons who are directly affected by the proposed action; from the appropriate administrative rule review committee; from a governmental subdivision or agency; or from an association having no less than 25 members who will be directly affected, a hearing will be held at a later date. Notice of the hearing will be published in the Montana Administrative Register. Ten percent of those persons directly affected has been determined to be approximately 1526 based on approximately 15,262 corporation taxpayers in Montana, as of September 30, 2011.

7. The Department of Revenue 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, which includes the name and e-mail or mailing address of the person to receive notices and specifies that the person wishes to receive notice regarding particular subject matter or matters. 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 person in number 4 above or faxed to the office at (406) 444-4375, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

8. An electronic copy of this notice is available on the department's web site at www.revenue.mt.gov. Locate "Legal Resources" in the left hand column, select the "Rules" link and view the options under the "Notice of Proposed Rulemaking" heading. The department strives to make the electronic copy of this 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 department

strives 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.

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

/s/ Cleo Anderson
CLEO ANDERSON
Rule Reviewer

/s/ Dan R. Bucks
DAN R. BUCKS
Director of Revenue

Certified to Secretary of State October 3, 2011

BEFORE THE SECRETARY OF STATE
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 1.2.419 regarding the scheduled dates for the 2012 Montana Administrative Register	))))	NOTICE OF PUBLIC HEARING ON PROPOSED AMENDMENT

TO: All Concerned Persons

1. On November 3, 2011, a public hearing will be held at 10:30 a.m. in the Secretary of State's Office Conference Room, Room 260, State Capitol Building, Helena, Montana, to consider the proposed amendment of the above-stated rule.

2. The Secretary of State will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, contact the Secretary of State no later than 5:00 p.m. on October 28, 2011, to advise us of the nature of the accommodation that you need. Please contact Jorge Quintana, Secretary of State's Office, P.O. Box 202801, Helena, MT 59620-2801; telephone (406) 461-5173; fax (406) 444-4249; TDD/Montana Relay Service (406) 444-9068; or e-mail jquintana@mt.gov.

3. The rule proposed to be amended provides as follows, stricken matter interlined, new matter underlined:

1.2.419 FILING AND PUBLICATION SCHEDULE FOR THE MONTANA ADMINISTRATIVE REGISTER (1) The scheduled filing dates, time deadline, and publication dates for material to be published in the Montana Administrative Register are listed below:

~~2011 Schedule~~

~~Filing~~	~~Publication~~
~~January 3~~	~~January 13~~
~~January 18~~	~~January 27~~
~~January 31~~	~~February 10~~
~~February 14~~	~~February 24~~
~~February 28~~	~~March 10~~
~~March 14~~	~~March 24~~
~~April 4~~	~~April 14~~
~~April 18~~	~~April 28~~
~~May 2~~	~~May 12~~
~~May 16~~	~~May 26~~
~~May 31~~	~~June 9~~
~~June 13~~	~~June 23~~
~~July 5~~	~~July 14~~

~~July 18~~	~~July 28~~
~~August 1~~	~~August 11~~
~~August 15~~	~~August 25~~
~~August 29~~	~~September 8~~
~~September 12~~	~~September 22~~
~~October 3~~	~~October 13~~
~~October 17~~	~~October 27~~
~~October 31~~	~~November 10~~
~~November 14~~	~~November 25~~
~~November 28~~	~~December 8~~
~~December 12~~	~~December 22~~

2012 Register Publication Schedule

Issue	Filing (due by noon)	Publication
1	January 3	January 12
2	January 17	January 26
3	January 30	February 9
4	February 13	February 23
5	February 27	March 8
6	March 12	March 22
7	April 2	April 12
8	April 16	April 26
9	April 30	May 10
10	May 14	May 24
11	May 29	June 7
12	June 11	June 21
13	July 2	July 12
14	July 16	July 26
15	July 30	August 9
16	August 13	August 23
17	August 27	September 6
18	September 10	September 20
19	October 1	October 11
20	October 15	October 25
21	October 29	November 8
22	November 13	November 23
23	November 26	December 6
24	December 10	December 20

(2) remains the same.

AUTH: 2-4-312, MCA

IMP: 2-4-312, MCA

4. ARM 1.2.419 is proposed to be amended to set dates pertinent to the publication of the Montana Administrative Register during 2012. The schedule is proposed during the month of October in order that it may be adopted during November to allow state agencies the opportunity to plan their rulemaking schedule to meet program needs for the upcoming year.

5. Concerned persons may present their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to Jorge Quintana, Secretary of State's Office, P.O. Box 202801, Helena, Montana 59620-2801, or by e-mailing jquintana@mt.gov, and must be received no later than 5:00 p.m., November 10, 2011.

6. Jorge Quintana, Secretary of State's Office, P.O. Box 202801, Helena, Montana 59620-2801, has been designated to preside over and conduct the hearing.

7. The Secretary of State 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 which includes the name and mailing address of the person to receive notices and specifies that the person wishes to receive notices regarding administrative rules, corporations, elections, notaries, records, uniform commercial code, or combination thereof. Such written request may be mailed or delivered to the Secretary of State's Office, Administrative Rules Services, 1236 Sixth Avenue, P.O. Box 202801, Helena, MT 59620-2801, faxed to the office at (406) 444-4263, or may be made by completing a request form at any rules hearing held by the Secretary of State's Office.

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

/s/ Jorge Quintana
JORGE QUINTANA
Rule Reviewer

/s/ Linda McCulloch
LINDA MCCULLOCH
Secretary of State

Dated this 3rd day of October, 2011.

BEFORE THE BOARD OF ENVIRONMENTAL REVIEW
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 17.30.1201, 17.30.1202, 17.30.1203, 17.30.1206, and 17.30.1207; the adoption of new rules I through V; and the repeal of ARM 17.30.1208 and 17.30.1209 pertaining to Montana pollutant discharge elimination system effluent limitations and standards, standards of performance, and treatment requirements	NOTICE OF AMENDMENT, ADOPTION, AND REPEAL (WATER QUALITY)

TO: All Concerned Persons

1. On May 26, 2011, the Board of Environmental Review published MAR Notice No. 17-322 regarding a notice of public hearing on the proposed amendment, adoption, and repeal of the above-stated rules at page 771, 2011 Montana Administrative Register, issue number 10.

2. The board has amended ARM 17.30.1201, 17.30.1202, 17.30.1203, 17.30.1206, and 17.30.1207, adopted New Rules I (17.30.1210), II (17.30.1211), III (17.30.1212), IV (17.30.1213), and V (17.30.1214), and repealed ARM 17.30.1208 and 17.30.1209 exactly as proposed.

3. The following comments were received and appear with the board's responses:

COMMENT NO. 1: The board should incorporate as much of the federal rule by reference into ARM 17.30.1202 and 17.30.1203 that specifically applies to those rules and only provide detail where the board rules and federal rules differ or provide explanation of how they are connected within the different rules. This should prevent any inadvertent disconnection between subchapter 12 and the federal rules and potential errors.

RESPONSE: The board is proposing to adopt the text of the federal rule establishing minimum treatment requirements into ARM 17.30.1203 to provide ease of access to the regulated community regarding federal minimum treatment requirements that apply to all MPDES permits. The board is also adopting the text of certain federal definitions into ARM 17.30.1202 to assist the regulated community in understanding the technical terms used throughout subchapter 12. The definitions and minimum treatment requirements proposed for adoption in ARM 17.30.1202 and 17.30.1203 do not differ from the federal regulations, because the text of the federal rules - with minor adjustments for style - is being adopted without any changes. Finally, the board is adopting by reference the federal rules that, when combined with all of the other federal regulations establishing treatment requirements, are too cumbersome to adopt into state rules.

COMMENT NO. 2: EPA has recently proposed new 316(b) rules requiring impingement and entrainment reductions at new and existing facilities which are the subject of New Rules II and III and some of the definitions in ARM 17.30.1202. We believe it would be prudent for the board to postpone the new rules and applicable definitions until the EPA has finalized its 316(b) rule. There could be differences in the EPA rule that would require the board to reopen New Rules II and III and the applicable definitions.

RESPONSE: The board is proposing to adopt the existing federal regulations pertaining to new cooling water intake structures that were first adopted by the U.S. Environmental Protection Agency (EPA) in 2001 and later amended in 2003. The board is also proposing to adopt EPA's current requirements for existing cooling water intake structures in New Rule V. Although EPA has recently proposed new rules that would make substantial changes to the requirements for existing facilities and make minor modifications to the current rules for new facilities, the board does not agree that it should postpone adopting the federal regulations that are currently in effect for these facilities. As the comment points out, if EPA actually adopts the proposed rules, then the board may simply amend the rules it is currently adopting to reflect any changes that EPA's new rules may require.

COMMENT NO. 3: Montana-Dakota appreciates that New Rule IV allows for alternative compliance requirements at cooling water intake structures if initial compliance costs are determined to be wholly disproportionate to other factors or results in impact to other resources. We recommend that the board remove the reference in New Rule IV to comparing the cost of this determination to the costs EPA considered since technology costs will change in the future and this should be up to the department's discretion.

RESPONSE: New Rule IV adopts into state rule the decision criteria in 40 CFR 125.85(a) for granting alternative requirements to new facilities that are less stringent than New Rule II requires. Since 40 CFR 125.85(a) allows an alternative (i.e., less stringent) requirement only if the cost of compliance with the requirement is "wholly out of proportion to the costs EPA considered" when establishing the requirements for new facilities, the board declines to remove the reference to the costs EPA considered in order to be consistent with, and no less stringent than, the federal regulation.

COMMENT NO. 4: The board should expand the text in New Rule IV to specifically include the consideration of a result where the cost of compliance would be wholly disproportionate from the actual benefit of implementation controls.

RESPONSE: The board declines to expand the criteria in New Rule IV to include a consideration of costs that are "wholly disproportionate" to the benefit of implementing the controls, because expanding the criteria from the list provided in 40 CFR 125.85 may result in permit requirements that are less stringent than required by the federal rule.

COMMENT NO. 5: We agree that best professional judgment in New Rule V is appropriate for determining impingement and entrainment reductions at cooling water intakes at existing facilities on a case-by-case, region, site, or waterway

segment basis. We also believe that the wholly disproportionate cost analysis included in New Rule IV would be appropriate to reference in New Rule V, unless that is universally understood to be already considered under a case-by-case determination in New Rule V.

RESPONSE: Permit limits for existing facilities subject to the Section 316(b) requirements under New Rule V will be based on a cost benefit determination using the best professional judgment (BPJ) of the permit writer. Since existing facilities are not expected to meet the impingement and entrainment criteria required for new facilities, the wholly disproportionate criterion is not applicable.

COMMENT NO. 6: The board should extend the comment period on the proposed rules, because Montana Dakota Utilities Co. has not had much time to review the rules in order to provide more accurate comments on the proposed rules relating to cooling water intake structures.

RESPONSE: In response to this comment, the department contacted the person who had submitted the comment on behalf of Montana Dakota Utilities Co. to ascertain whether an extension was necessary to accommodate the request for more accurate comments. The department was informed that the company no longer believed that an extension of time was necessary, since the board's proposed rules did not differ from EPA's existing rules governing cooling water intake structures.

Reviewed by: BOARD OF ENVIRONMENTAL REVIEW

/s/ James M. Madden By: */s/ Joseph W. Russell*
JAMES M. MADDEN JOSEPH W. RUSSELL, M.P.H.
Rule Reviewer Chairman

Certified to the Secretary of State, October 3, 2011.

BEFORE THE BOARD OF ENVIRONMENTAL REVIEW
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 17.8.801, 17.8.804, 17.8.818, 17.8.820, 17.8.822, 17.8.825, 17.8.901, 17.8.904, and 17.8.1007 pertaining to definitions, ambient air increments, major stationary sources, source impact analysis, source information, sources impacting federal class I areas, definitions, when air quality permit required, baseline for determining credit for emissions and air quality offsets	NOTICE OF AMENDMENT (AIR QUALITY)

TO: All Concerned Persons

1. On May 26, 2011, the Board of Environmental Review published MAR Notice No. 17-323 regarding a notice of public hearing on proposed amendment of the above-stated rules at page 799, 2011 Montana Administrative Register, issue number 10.

2. The board has amended ARM 17.8.820 and 17.8.822 exactly as proposed and has amended ARM 17.8.801, 17.8.804, 17.8.818, 17.8.825, 17.8.901, 17.8.904, and 17.8.1007 as proposed, but with the following changes, new matter underlined, stricken matter interlined:

17.8.801 DEFINITIONS (1) through (20)(b)(vii) remain as proposed.

(21) The following apply to the definitions of the terms "major source baseline date" and "minor source baseline date":

(a) "major source baseline date" means:

(i) in the case of PM-10 and sulfur dioxide (SO_2), January 6, 1975;

(ii) in the case of nitrogen dioxide (NO_2), February 8, 1988; and

(iii) remains as proposed.

(b) "Minor source baseline date" means the earliest date after the trigger date on which a major stationary source or a major modification subject to 40 CFR 52.21 or to regulations approved pursuant to 40 CFR 51.166 submits a complete application under the relevant regulation. The trigger date is:

(i) in the case of PM-10 and sulfur dioxide (SO_2), August 7, 1977;

(ii) in the case of nitrogen dioxide (NO_2), February 8, 1988; and

(iii) through (26) remain as proposed.

(27) The following apply to the definition of the term "significant":

(a) "significant" means, in reference to a net emissions increase or the potential of a source to emit any of the following pollutants, a rate of emissions that would equal or exceed any of the following rates:

Pollutant and Emissions Rate

Carbon monoxide: 100 tons per year (tpy)
Nitrogen oxides: 40 tpy
Sulfur dioxide (SO_2): 40 tpy
Particulate matter: 25 tpy of particulate matter emissions
15 tpy of PM-10 emissions
PM-2.5: 10 tpy of direct PM-2.5 emissions, 40 tpy of sulfur dioxide (SO_2) emissions, or 40 tpy of nitrogen dioxide (NO_2) emissions unless demonstrated not to be a PM-2.5 precursor
Ozone: 40 tpy of volatile organic compounds
Lead: 0.6 tpy
Fluorides: 3 tpy
Sulfuric acid mist: 7 tpy
Hydrogen sulfide (H_2S): 10 tpy
Total reduced sulfur (including H_2S): 10 tpy
Reduced sulfur compounds (including H_2S): 10 tpy
Municipal waste combustor organics (measured as total tetra- through octa-chlorinated dibenzo-p-dioxins and dibenzofurans): $3.2 * 10^{-6}$ megagrams per year ($3.5 * 10^{-6}$ tpy)
Municipal waste combustor metals (measured as particulate matter): 14 megagrams per year (15 tpy)
Municipal waste combustor acid gases (measured as sulfur dioxide (SO_2) and hydrogen chloride): 36 megagrams per year (40 tpy)

(b) through (29) remain as proposed.

17.8.804 AMBIENT AIR INCREMENTS (1) In areas designated as Class I, II, or III, increases in pollutant concentration over the baseline concentration shall be limited to the following:

Pollutant	Maximum allowable increase (micrograms per cubic meter)
CLASS I	
Particulate matter:	
PM-2.5, annual arithmetic mean	1
PM-2.5, 24-hr maximum	2
PM-10, annual arithmetic mean	4
PM-10, 24-hr maximum	8
Sulfur dioxide (SO_2):	
Annual arithmetic mean	2
24-hr maximum	5
3-hr maximum	25
Nitrogen dioxide (NO_2):	
Annual arithmetic mean	2.5
CLASS II	
Particulate matter:	
PM-2.5, annual arithmetic mean	4

PM-2.5, 24-hr maximum	9
PM-10, annual arithmetic mean	17
PM-10, 24-hr maximum	30
Sulfur dioxide (SO_2):	
Annual arithmetic mean	20
24-hr maximum	91
3-hr maximum	512
Nitrogen dioxide (NO_2):	
Annual arithmetic mean	25

CLASS III	
Particulate matter:	
PM-2.5, annual arithmetic mean	8
PM-2.5, 24-hr maximum	18
PM-10, annual arithmetic mean	34
PM-10, 24-hr maximum	60
Sulfur dioxide (SO_2):	
Annual arithmetic mean	40
24-hr maximum	182
3-hr maximum.	700
Nitrogen dioxide (NO_2):	
Annual arithmetic mean	50

(2) remains as proposed.

17.8.818 REVIEW OF MAJOR STATIONARY SOURCES AND MAJOR MODIFICATIONS--SOURCE APPLICABILITY AND EXEMPTIONS (1) through (6) remain as proposed.

(7) The department may exempt a proposed major stationary source or major modification from the requirements of ARM 17.8.822, with respect to monitoring for a particular pollutant, if:

(a) the emissions increase of the pollutant from a new stationary source or the net emissions increase of the pollutant from a modification would cause, in any area, air quality impacts less than the following amounts:

(i) remains as proposed.

(ii) nitrogen dioxide (NO_2): 14 µg/m^3, annual average;

(iii) and (iv) remain as proposed.

(v) sulfur dioxide (SO_2): 13 µg/m^3, 24-hour average;

(vi) through (c) remain as proposed.

17.8.825 SOURCES IMPACTING FEDERAL CLASS I AREAS--ADDITIONAL REQUIREMENTS (1) through (3) remain as proposed.

(4) The owner or operator of a proposed source or modification may demonstrate to the federal land manager that the emissions from such source would have no adverse impact on the air quality-related values of such lands (including visibility), notwithstanding that the change in air quality resulting from emissions from

such source or modification would cause or contribute to concentrations which would exceed the maximum allowable increases for a Class I area. If the federal land manager concurs with such demonstration and so certifies to the department, the department may, provided that applicable requirements are otherwise met, issue the permit with such emission limitations as may be necessary to assure that emissions of sulfur dioxide (SO_2), particulate matter, and nitrogen oxides would not exceed the following maximum allowable increases over the minor source baseline concentration for such pollutants:

Pollutant	Maximum allowable increase (micrograms per cubic meter)
PM-2.5	
annual arithmetic mean	4
24-hr maximum	9
Particulate matter:	
PM-10, annual arithmetic mean	17
PM-10, 24-hr maximum	30
Sulfur dioxide (SO_2):	
annual arithmetic mean	20
24-hr maximum	91
3-hr maximum	325
Nitrogen dioxide (NO_2):	
annual arithmetic mean	25

(5) through (6) remain as proposed.

17.8.901 DEFINITIONS (1) through (15) remain as proposed.

(16) "Precursor" means:

(a) remains as proposed.

(b) sulfur dioxide (SO_2) in PM-2.5 nonattainment areas.

(17) and (18) remain as proposed.

(19) "Significant" means, in reference to a net emissions increase or the potential of a source to emit any of the following pollutants, a rate of emissions that would equal or exceed any of the following rates:

	Pollutant Emission Rate
Carbon monoxide:	100 tons per year (tpy)
Nitrogen oxides:	40 tpy
Sulfur dioxide (SO_2):	40 tpy
Particulate matter:	25 tpy of particulate matter emissions or 15 tpy of PM-10 emissions
PM-2.5	10 tpy of direct PM-2.5 emissions, 40 tpy of sulfur dioxide (SO_2) emissions, or 40 tpy of nitrogen oxide emissions unless demonstrated not to be a PM-2.5 precursor
Lead:	0.6 tpy

(20) and (21) remain as proposed.

17.8.904 WHEN MONTANA AIR QUALITY PERMIT REQUIRED (1) and (2) remain as proposed.

(3) Sulfur dioxide (SO_2) is a precursor to PM-2.5 in a PM-2.5 nonattainment area.

(4) through (7) remain as proposed.

17.8.1007 BASELINE FOR DETERMINING CREDIT FOR EMISSIONS AND AIR QUALITY OFFSETS (1) For the purposes of this subchapter, the following requirements apply:

(a) through (d) remain as proposed.

(e) In the case of emission offsets involving sulfur dioxide (SO_2), particulates, and carbon monoxide, areawide mass emission offsets are not acceptable, and the applicant shall perform atmospheric simulation modeling to ensure that emission offsets provide a positive net air quality benefit. The department may exempt the applicant from the atmospheric simulation modeling requirement if the emission offsets provide a positive net air quality benefit, are obtained from an existing source on the same premises or in the immediate vicinity of the new source, and the pollutants disperse from substantially the same effective stack height; and

(f) remains as proposed.

3. In order to make the rules more understandable, the board is making nonsubstantive revisions to the chemical nomenclature for sulfur dioxide and nitrogen dioxide as they appear in ARM 17.8.801, 17.8.804, 17.8.818, 17.8.825, 17.8.901, 17.8.904, and 17.8.1007. The board has inserted names of these chemical compounds with their shorthand chemical designations following in parentheses. The final rules will reflect these changes.

4. No public comments or testimony were received.

Reviewed by: BOARD OF ENVIRONMENTAL REVIEW

/s/ John F. North By: */s/ Joseph W. Russell*

JOHN F. NORTH
Rule Reviewer

JOSEPH W. RUSSELL, M.P.H.
Chairman

Certified to the Secretary of State, October 3, 2011.

BEFORE THE DEPARTMENT OF ENVIRONMENTAL QUALITY
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 17.56.308 through 17.56.310 and the adoption of New Rules I and II pertaining to operating tags and delivery prohibition	)))))	NOTICE OF AMENDMENT AND ADOPTION (UNDERGROUND STORAGE TANKS)

TO: All Concerned Persons

1. On June 23, 2011, the Department of Environmental Quality published MAR Notice No. 17-325 regarding a notice of public hearing on the proposed amendment and adoption of the above-stated rules at page 1048, 2011 Montana Administrative Register, issue number 12.

2. The department has amended ARM 17.56.308, 17.56.309, and 17.56.310 and adopted New Rule I (ARM 17.56.311) exactly as proposed, and has adopted New Rule II (17.56.312) as proposed, but with the following changes, new matter underlined, stricken matter interlined:

NEW RULE II (17.56.312) DELIVERY PROHIBITION (1) For purposes of meeting the delivery prohibition requirements of The Energy Policy Act of 2005, whenever the department finds that there has been significant noncompliance with Title 75, chapter 11, part 5, MCA, or with rules, permits, or orders issued pursuant to part 5, and the department has suspended, revoked, or determined not to renew an operating permit pursuant to ARM 17.56.308(7), or determined not to issue, or determined not to renew an operating permit pursuant to 75-11-509(9), MCA, the department will classify such underground storage tank(s) as ineligible for delivery, deposit, or acceptance of product.

(2) The department shall:

(a) make every reasonable effort to notify tank owners, operators, or both prior to prohibiting the delivery, deposit, or acceptance of product;

(b) notify product deliverers when an underground storage tank is ineligible for delivery, deposit, or acceptance of product;

(c) issue a certificate that clearly identifies the ineligible underground storage tank classified in (1); and

(d) issue an operating permit to the owner or operator within ten business days to reclassify an ineligible underground storage tank as eligible following correction of violations identified as significant noncompliance based on a follow-up inspection report submitted to the department in accordance with ARM 17.56.309(8).

(3) The certificate issued in (2)(c) must be conspicuously displayed at the facility until the underground storage tank is reclassified as eligible for delivery, deposit, or acceptance of product.

3. The following comments were received and appear with the department's responses:

COMMENT NO. 1: One commentor suggested that dispensing with the current operating tag system will make it more difficult for delivery drivers to determine if it is legal to dispense fuel into a particular tank, since the driver would have to check inside the facility office under the proposed rules, and the facility office may not even be open at the time product is delivered.

RESPONSE: Since the "tag" system was adopted in 2001, there are many instances of bulk fuel delivery drivers ignoring an operating tag on an underground storage tank (UST) system. This may occur because owners/operators often fail to remove an operating tag when the status of a tank has changed from active to inactive, or alternatively, because the owner/operator fails to properly install an operating tag when received from the department. Additionally, delivery drivers may be confused by the collection of operating tags that have accumulated on some UST systems over the past ten years and ignore them altogether. Finally, department personnel have personally observed UST fuel deliveries and have noted that drivers do not routinely check for an operating tag.

It is the department's experience that many bulk fuel delivery drivers prefer not to depend on owners/operators to properly place or remove an operating tag on the access pipe, but prefer instead to rely on the department's web site listing of the current status of all regulated UST systems in the state. This procedure removes the uncertainty of reliance on owner/operator actions with regard to a tank status and allows the delivery drivers to rely on the department's more accurate and up-to-date web site listings. Accordingly, the department has determined that the current operating tag system is ineffective and a waste of department resources and declines to reconsider the proposed rules in response to the comment.

COMMENT NO. 2: One commentor stated the department should have discretion to consider unique military missions.

RESPONSE: The department concurs with the commentor; however, no change to the proposed rules is required. ARM 17.56.310(6) allows the department to issue an emergency operating permit for USTs that do not have a current operating permit. This administrative rule specifically allows for the issuance of an operating permit when it determines that national security issues outweigh the risks to human health or the environment that could result from operation of the UST.

COMMENT NO. 3: The department should make significant noncompliance findings in accordance with MCA administrative enforcement provisions. A commentor stated that New Rule II Delivery Prohibition does not specify how the department determines a finding of significant noncompliance and recommends adding language that significance criteria be in accordance with 75-1-512, MCA. Additionally, the commentor suggests that the proposed rule does not state if the owner/operator has the opportunity to contest a finding before a delivery prohibition is effective.

RESPONSE: The department agrees that the proposed rule as written appears to allow the department to issue a delivery prohibition without providing any recourse for the owner or operator to challenge the prohibition, which was not the department's intent. Accordingly, the department is modifying the proposed rule to clarify that a delivery prohibition only occurs when the department suspends,

revokes, determines not to issue, or determines not to renew an operating permit, each of which actions may be challenged by requesting a hearing before the Board of Environmental Review. The department, therefore, is amending (1) as shown above.

Reviewed by: DEPARTMENT OF ENVIRONMENTAL QUALITY

/s/ James M. Madden By: */s/ Richard H. Opper*
JAMES M. MADDEN RICHARD H. OPPER, DIRECTOR
Rule Reviewer

Certified to the Secretary of State, October 3, 2010.

BEFORE THE DEPARTMENT OF ENVIRONMENTAL QUALITY
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 17.50.203 pertaining to completion of shielding	)	NOTICE OF AMENDMENT
	)	(MOTOR VEHICLE RECYCLING AND DISPOSAL)

TO: All Concerned Persons

1. On August 11, 2011, the Department of Environmental Quality published MAR Notice No. 17-326 regarding a notice of proposed amendment of the above-stated rule at page 1442, 2011 Montana Administrative Register, issue number 15.

2. The department has amended the rule exactly as proposed.

3. No public comments or testimony were received.

Reviewed by: DEPARTMENT OF ENVIRONMENTAL QUALITY

/s/ James M. Madden By: */s/ Richard H. Opper*
JAMES M. MADDEN RICHARD H. OPPER, DIRECTOR
Rule Reviewer

Certified to the Secretary of State, October 3, 2011.

BEFORE THE DEPARTMENT OF JUSTICE
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 23.15.306, concerning mental health therapists	)))	NOTICE OF AMENDMENT

TO: All Concerned Persons

1. On August 25, 2011, the Department of Justice published MAR Notice No. 23-15-222, pertaining to the proposed amendment of the above-stated rule at page 1585 of the 2011 Montana Administrative Register, Issue Number 16.

2. The department has amended the above-stated rule as proposed.

3. No comments or testimony were received.

By: /s/ Steve Bullock
STEVE BULLOCK
Attorney General
Department of Justice

/s/ J. Stuart Segrest
J. STUART SEGREST
Rule Reviewer

Certified to the Secretary of State October 3, 2011.

BEFORE THE BOARD OF NURSING
DEPARTMENT OF LABOR AND INDUSTRY
STATE OF MONTANA

In the matter of the amendment of ARM 24.159.301 definitions, 24.159.401 fees, 24.159.662 faculty for practical nursing programs, 24.159.901, 24.159.903, 24.159.905, 24.159.910, and 24.159.915 medication aides, 24.159.1011 prohibited intravenous therapies, 24.159.1024 and 24.159.1224 licensure by examination, the adoption of NEW RULES I through V medication aides, and the repeal of ARM 24.159.1025 and 24.159.1225 nurse reexamination	)))))))))))))	NOTICE OF AMENDMENT, ADOPTION, AND REPEAL

TO: All Concerned Persons

1. On July 28, 2011, the Board of Nursing (board) published MAR notice no. 24-159-75 regarding the public hearing on the proposed amendment, adoption, and repeal of the above-stated rules, at page 1350 of the 2011 Montana Administrative Register, issue no. 14.

2. On August 18, 2011, a public hearing was held in Helena on the proposed amendment, adoption, and repeal of the above-stated rules. Several comments were received by the August 26, 2011, deadline.

3. The board has thoroughly considered the comments received. A summary of the comments received and the board's responses are as follows:

GENERAL COMMENT: Some comments were received in general support of the rule notice or in support of various specific rules.

GENERAL RESPONSE: The board appreciates all comments made during the rulemaking process.

COMMENT 1: Two commenters suggested that the board add the requirement of a high school diploma or equivalent for Medication Aides I in ARM 24.159.901(3)(b) to be consistent with the qualifications of Medication Aides II.

RESPONSE 1: The board points out that the suggested change falls outside the scope of this notice, but has noted the recommendation for possible future action.

COMMENT 2: One commenter suggested the board rewrite and reorganize (4) of the Medication Aide II definition at ARM 24.159.901 for clarity to the reader.

RESPONSE 2: The board believes that the commenter's suggestion is not intended to change the meaning of the definition, but the board concluded that the rewrite would not provide any more clarity than the rule language as proposed, and is amending (4) exactly as proposed.

COMMENT 3: Two commenters suggested that the board delete "preset or," and leave the words "labeled and predrawn insulin delivery device" in ARM 24.159.915, New Rule I(2), and New Rule III(1)(c), to allow medication aides to set the dosage on insulin pens. The commenter opined that it is inappropriate to preclude a trained, licensed medication aide from doing that which an unlicensed and untrained person can do through self-administration, and likened the procedure to the administration of one pill versus two.

RESPONSE 3: The board disagrees with this comment. The suggested changes would expand the practice of medication aides beyond what the Legislature intended. The board believes that the administration of insulin is a matter of public health and safety, and that the proposed rules adequately protect the public while meeting the intent of the legislation.

COMMENT 4: One commenter opposed allowing anyone but LPNs or RNs to administer insulin.

RESPONSE 4: The board disagrees with this comment and notes that the suggested restricts the practice of medication aides beyond what the Legislature intended. The board believes that the administration of insulin is a matter of public health and safety, and that the proposed rules adequately protect the public while meeting the intent of the legislation.

COMMENT 5: One commenter supported the amendments to ARM 24.159.915 to allow a Medication Aides I to administer insulin only from labeled and preset or predrawn insulin delivery devices, stating that insulin is the number one drug associated with harmful medication errors. The commenter stated that insulin is listed as an ISMP high alert medication and opined that, when given in error, insulin has a heightened risk of causing patent harm.

RESPONSE 5: The board agrees with this comment and believes that the administration of insulin is a matter of public health and safety and that the proposed rules adequately protect the public while meeting the intent of the legislation.

COMMENT 6: One commenter suggested that the board delete "Cardio-Pulmonary Resuscitation Certification (CPR)" from ARM 24.159.901(4)(d) and New Rule II(1)(e), stating that the language is inconsistent with the American Heart Association's definition pertaining to successful completion of the program. The commenter asserted that the language would prevent holders of a Red Cross "basic

life support for healthcare providers card" from qualifying, and instead suggested amending the rule to "holds a current basic life support for healthcare providers' card."

RESPONSE 6: The board does not believe that the proposed language would disqualify holders of a Red Cross basic life support for healthcare providers card. However, the board is amending ARM 24.159.901(4)(d) to maintain consistency with the language of the legislation, while clarifying for the reader that a Red Cross "basic life support for healthcare providers card" would be sufficient.

COMMENT 7: One commenter suggested replacing the term "board-specified" with "board-approved" in ARM 24.159.901(4)(e) and New Rule II(1)(h), to be consistent with ARM 24.159.905. The commenter stated that if the intent is for the board to no longer approve each program, then the stakeholders should have more discussion before moving in this direction.

RESPONSE 7: The board disagrees with this comment and notes that the language of these rules directly reflects the language of House Bill 377, the implemented legislation, and is consistent with the board's intent. The board does not approve Medication Aide II programs, it specifies program curricula. The board also notes that ARM 24.159.905 addresses Medication Aide I training programs, while the other rules deal with Medication Aides II.

COMMENT 8: One commenter suggested deleting ARM 24.159.901(4)(a), in its entirety, because it can be required as a prerequisite to a board-approved medication program.

RESPONSE 8: The board notes that the language in this rule directly reflects the language of House Bill 377, the implemented legislation, and is consistent with the board's intent. The board does not approve Medication Aide II programs, it specifies program curricula.

COMMENT 9: One commenter suggested that "requirements for application" be changed to "requirements for licensure" in New Rule II(2) , to be consistent with actual licensure process, and because completed applications are always required for licensure.

RESPONSE 9: The board disagrees with this comment and points out that application must be made before licensure and it is the failure to complete the application process that is meant to cause the expiration of a license application, not the failure to become licensed.

COMMENT 10: One commenter suggested that the word "normal" be deleted from New Rule III(1)(d), so that a Medication Aide II would be required to report any changes in a patient's condition.

RESPONSE 10: The board agrees that Medication Aides II are not qualified to determine which changes are significant. The board concluded that Medication Aides II should report changes in a patient's physical or mental condition as is already required of Medication Aides I, and is amending New Rule III accordingly.

COMMENT 11: One commenter suggested that the language "take verbal orders" be amended to "accept and process medication order changes" in New Rule III(2)(c), to specify the actual process of taking a medication change order from an authorized prescriber, etc.

RESPONSE 11: The board agrees that Medication Aides II should not process any change orders, verbal or otherwise, and is amending this rule accordingly.

COMMENT 12: One commenter stated that only LPNs and RNs should address patient questions about medications, because only they can appropriately assess their understanding of the information provided and any need to follow up with the provider. The medication aide should notify the supervising nurse that the patient has questions about the patient's medications.

RESPONSE 12: Having carefully considered this particular topic, the board determined that it is appropriate, logical, and safe for the Medication Aide II to provide patient education in this manner and to the degree provided in New Rule III. The board is adopting New Rule III(2)(d) exactly as proposed.

COMMENT 13: One commenter specifically supported the language in New Rule III(2)(d) that restricts Medication Aides II from providing information or education to patients beyond basic knowledge of medications and medication administration.

RESPONSE 13: Having carefully considered this particular topic, the board determined that it is appropriate, logical, and safe for Medication Aides II to provide patient education in the manner and to the degree provided in this rule. The board is adopting New Rule III(2)(d) exactly as proposed.

4. The board has amended ARM 24.159.301, 24.159.401, 24.159.662, 24.159.903, 24.159.905, 24.159.910, 24.159.915, 24.159.1011, 24.159.1024, and 24.159.1224 exactly as proposed.

5. The board has adopted NEW RULE I (24.159.906), NEW RULE II (24.159.911), NEW RULE IV (24.159.912), and NEW RULE V (24.159.1207) exactly as proposed.

6. The board has repealed ARM 24.159.1025 and 24.159.1225 exactly as proposed.

7. The board has amended ARM 24.159.901 with the following changes, stricken matter interlined, new matter underlined:

24.159.901 DEFINITIONS (1) through (4)(c) remain as proposed.

(d) maintains a current ~~Cardio-Pulmonary Resuscitation Certification (CPR)~~ valid certificate in cardiopulmonary resuscitation; and

(4)(e) and (5) remain as proposed.

8. The board has adopted NEW RULE III (24.159.916) with the following changes, stricken matter interlined, new matter underlined:

NEW RULE III STANDARDS RELATED TO THE RESPONSIBILITIES OF A MEDICATION AIDE II (1) through (1)(c) remain as proposed.

(d) notify the supervising nurse if the medication aide II has observed a change in the ~~normal~~ patient's physical or mental condition ~~of the patient~~; and

(e) through (2)(b) remain as proposed.

(c) ~~take verbal orders related to changes in medications or dosages~~ accept and process medication order changes; or

(d) remains as proposed.

BOARD OF NURSING
KATHY HAYDEN, LPN

/s/ DARCEE L. MOE
Darcee L. Moe
Alternate Rule Reviewer

/s/ KEITH KELLY
Keith Kelly, Commissioner
DEPARTMENT OF LABOR AND INDUSTRY

Certified to the Secretary of State October 3, 2011

BEFORE THE BOARD OF OUTFITTERS
DEPARTMENT OF LABOR AND INDUSTRY
STATE OF MONTANA

In the matter of the amendment of ARM 24.171.401 fees, 24.171.408 outfitter records, 24.171.412 safety provisions, 24.171.512 inactive license, 24.171.602 guide license, 24.171.701 determination of client hunter use, 24.171.2101 renewals, and the adoption of NEW RULES I and II web site posting and successorship	))))))))))	NOTICE OF AMENDMENT AND ADOPTION

TO: All Concerned Persons

1. On July 14, 2011, the Board of Outfitters (board) published MAR notice no. 24-171-31 regarding the public hearing on the proposed amendment and adoption of the above-stated rules, at page 1265 of the 2011 Montana Administrative Register, issue no. 13.

2. On August 8, 2011, a public hearing was held on the proposed amendment and adoption of the above-stated rules in Helena. Several comments were received by the August 16, 2011, deadline.

3. The board has thoroughly considered the comments received. A summary of the comments received and the board's responses are as follows:

GENERAL COMMENT: A few commenters offered general support of the rule notice or regarding various rules.

GENERAL RESPONSE: The board appreciates all comments made during the rulemaking process.

COMMENT 1: Two commenters emphasized that the proposed fee increases in ARM 24.171.401 are intended as one-time increases. The commenters asked that the board thoroughly review and discuss costs and fees in the upcoming year.

RESPONSE 1: The board continues to review and discuss ways to control costs and avoid unnecessary fee increases. The board confirms that this change will implement a one-time fee increase.

COMMENT 2: Two commenters supported the proposed amendment of ARM 24.171.408 to allow fishing outfitters to omit client addresses from client logs. One commenter also suggested that the board take steps to coordinate with other involved entities to repeal this requirement for hunting outfitters as well.

RESPONSE 2: The board will consider the request for a similar amendment for hunting outfitters in a future action, but notes that this request falls outside the scope of this rulemaking notice.

COMMENT 3: Two commenters stated that renaming category 2 NCHU and category 3 NCHU in ARM 24.171.701 will cause confusion. The commenters suggested instead that the board simply omit category 1 NCHU and leave the other two categories as they are.

RESPONSE 3: The board agrees with this suggestion and is amending this rule accordingly.

COMMENT 4: One commenter stated that the proposed amendments to ARM 24.171.701 will change how licensees account for NCHU when serving bird hunters who are also served pursuing big game under a combination license. The commenter stated that this is likely an unintentional consequence of the amendments and suggested specific language to address the problem.

RESPONSE 4: The board discussed at length how one should account for NCHU in relation to a client pursuing upland game birds, incidental to the pursuit of big game, under a combination license. Currently, an incidental upland bird hunt done in conjunction with a big game hunt under a combination license only, requires an outfitter to use one NCHU in category 2. Meanwhile, an outfitter who serves a client in the pursuit of upland birds under a combination license, without pursuing big game, uses no NCHU at all.

The board notes that the proposed amendments to this rule should not change how NCHU has been accounted for in the past, except that if an outfitter serves a client who pursues upland birds only, the outfitter must hold and use a category 3 NCHU. The board is therefore amending ARM 24.171.701 to clarify and ensure that clients served in the pursuit of big game and birds under a combination license are category 2 NCHU clients, while clients served in the pursuit of only birds under a combination license are category 3 NCHU clients.

COMMENT 5: One commenter generally supported New Rule II, but requested clarification of the phrase "certain licensure requirements" in (2) and the application of New Rule II to long-existing successorships.

RESPONSE 5: The board is also concerned with how New Rule II will apply to existing successorships. Because each existing successorship is reviewed for continuing approval on an annual basis, the board understands that those successors will not need to comply with this new rule until after their successorships have been approved under the terms of this new rule at an annual review.

The board is amending New Rule II to clarify how it will apply to existing successorships. Also, the board is deleting the word "certain" from (2) to clarify that a successorship may be conditionally granted, pending documentation of meeting

any licensure requirements, not just some unknown particular licensure requirements.

4. The board has amended ARM 24.171.401, 24.171.408, 24.171.412, 24.171.512, 24.171.602, and 24.171.2101 exactly as proposed.

5. The board has adopted NEW RULE I (24.171.2305) exactly as proposed.

6. The board has amended ARM 24.171.701 with the following changes, stricken matter interlined, new matter underlined:

24.171.701 NCHU CATEGORIES, TRANSFERS, AND RECORDS

(1) remains as proposed.

(a) Category ~~1~~ 2, consisting of all clients served in the pursuit of upland game birds and big game under combination licenses or in the pursuit of big game; and

(b) Category ~~2~~ 3, consisting of all clients served in the pursuit of upland game birds, water fowl, and turkeys.

~~(2) Category 1 NCHU is accounted for and established on the basis of the hunting licenses held by clients served. Category 2 NCHU is accounted for and established on the basis of the individual clients served, regardless of licenses held. For example, a client having a deer/elk/upland game bird combination license requires one Category 1 NCHU of the outfitter, regardless of whether one or both big game species are pursued under that license, and the same client requires one Category 2 NCHU when the upland game bird is pursued.~~

(3) through (12) remain as proposed, but are renumbered (2) through (11).

7. The board has adopted NEW RULE II (24.171.504) with the following changes, stricken matter interlined, new matter underlined:

NEW RULE II SUCCESSORSHIP (1) remains as proposed.

(2) Prior to approval, a successor must meet all qualifications for licensure aside from the experience and testing requirements. Among other conditions, approval may be granted upon the condition that documentation of ~~certain~~ licensure requirements will be received by the board no later than a specified date. If the documentation of licensure requirements is not received in a timely manner, board staff shall immediately place the license on inactive status until the board is able to reconsider the conditional approval.

(3) through (5) remain as proposed.

(6) A successor seeking licensure must meet all the qualifications of an outfitter, successfully complete the required examination, and submit to the board all required applications, fees, and other documents and information no later than the date that is three years from the date the successorship was approved under this rule. If a successor obtains licensure, the NCHU is transferred to the successor as a newly licensed outfitter.

(7) through (9) remain as proposed.

BOARD OF OUTFITTERS
TIM LINEHAN, CHAIRPERSON

/s/ DARCEE L. MOE
Darcee L. Moe
Alternate Rule Reviewer

/s/ KEITH KELLY
Keith Kelly, Commissioner
DEPARTMENT OF LABOR AND INDUSTRY

Certified to the Secretary of State October 3, 2011

BEFORE THE BOARD OF SOCIAL WORK EXAMINERS
AND PROFESSIONAL COUNSELORS
DEPARTMENT OF LABOR AND INDUSTRY
STATE OF MONTANA

In the matter of the adoption of NEW RULES I through XII qualification of social workers and professional counselors to perform psychological testing, evaluation, and assessment	)))))	NOTICE OF ADOPTION

TO: All Concerned Persons

1. On April 14, 2011, the Board of Social Work Examiners and Professional Counselors (board) published MAR notice no. 24-219-22 regarding the public hearing on the proposed adoption of the above-stated rules, at page 533 of the 2011 Montana Administrative Register, issue no. 7.

2. On May 5, 2011, a public hearing was held on the proposed adoption of the above-stated rules in Helena. Several comments were received by the May 13, 2011, deadline.

3. The board has thoroughly considered the comments received. A summary of the comments received and the board's responses are as follows:

Support MAR Notice 24-219-22

COMMENT 1: Numerous commenters responded favorably to the proposed new rules regarding psychological evaluations.

RESPONSE 1: The board appreciates all comments received during the rulemaking process.

COMMENT 2: One commenter observed that some tests can be administered by LCPCs/LCSWs without additional training beyond what is specifically necessary for the test.

RESPONSE 2: The board believes that licensees should only perform evaluations if they have been trained so that they are familiar with the reliability, validity, related standardization, error of measurement, and proper application of the chosen assessment technique.

COMMENT 3: One commenter stated that the board should require specific training in the specific assessment being administered.

RESPONSE 3: The board agrees that it will usually be necessary to have test-specific training, and this is contemplated by the rules as proposed.

Oppose MAR Notice 24-219-22

COMMENT 4: Some commenters stated that the proposed rules do not provide a method to ensure competence to do psychological evaluations.

RESPONSE 4: The board disagrees with this comment. The board researched other states' and professional associations' rules regarding competence to perform psychological assessments and based these rules on such research. The board advises that postgraduate education will often be required to obtain competence.

COMMENT 5: Some commenters asserted that there have been complaints made regarding LCPCs/LCSWs performing psychological evaluations.

RESPONSE 5: The board was not aware of complaints involving its licensees performing such testing. However, the board will always consider such complaints on an individual case-by-case basis.

COMMENT 6: Several commenters suggested the board adopt Wisconsin's rules.

RESPONSE 6: The board did consider the Wisconsin model, but preferred the Ohio rules, and found them to be consistent with the requirements of 37-17-104, MCA.

COMMENT 7: A few commenters objected that the proposed rules are not consistent with the governor's amendatory veto.

RESPONSE 7: The board disagrees with this comment. The bill, as amended, required that the rules be consistent with national associations' guidelines. The board received input from counseling and social work associations that indicated the proposed rules are consistent with the requirements.

COMMENT 8: Numerous commenters stated that the psychological evaluation rules are not sufficient to ensure public protection.

RESPONSE 8: The board acknowledges that it is impossible to monitor every psychological evaluation performed, but has determined that the proposed rules are the best method to guide licensees and protect the public.

COMMENT 9: Many commenters objected to licensees performing psychological evaluations, because it is not taught in masters social work and counselor programs. The commenters suggested that the board specify additional qualifications to ensure competence.

RESPONSE 9: The board acknowledges the commenters' concerns. The board believes it will usually be necessary for licensees to obtain additional postgraduate education in psychological evaluations.

COMMENT 10: Several commenters complained that the proposed rules do not prescribe specific education and experience requirements, and opined that additional training will be necessary to ensure licensee competence.

RESPONSE 10: The board agrees that licensees could not ordinarily rely on their undergraduate or masters-level survey courses in testing to demonstrate competence, but the board concluded that it is not appropriate to dictate a specific level of training due to the wide array of testing methods and instruments available. The proposed rules state the required level of understanding necessary to competently perform evaluations. Licensees must use that guidance to determine whether they have reached the requisite level of competence before performing evaluations. The board notes that each test and testing situation is different, and a licensee must assess his or her competence, based upon the specific circumstances of each case.

COMMENT 11: One commenter observed that training in individual assessments will not ensure competence.

RESPONSE 11: The board agrees that only training in an individual test, without broader knowledge regarding psychological testing in general, will likely not ensure licensee competence.

COMMENT 12: Some commenters alleged that the rules do not provide a means to evaluate whether a licensee is competent to perform psychological evaluations.

RESPONSE 12: The board believes that the standards proposed in the rules are sufficient to put licensees on notice that they must be knowledgeable about the performance of psychological evaluations in general, and familiar with the use of each instrument in particular. Some evaluation methods specify unique standards for competence, and it would be impossible to cover all standards in specific rules.

COMMENT 13: A few commenters stated that the board should not wait until a problem arises in the complaint/compliance process to review competence.

RESPONSE 13: The board believes it should not attempt to preemptively specify the level of expertise required for each method of evaluation. Just as the board does not determine which clinical methods a therapist may be competent to use, it should not attempt to define one particular standard of competence for all evaluations. Each licensee must assess whether he or she is able to competently provide services and refrain from providing services where there is any doubt as to his or her ability to provide such services. Should a licensee fail to meet these proposed standards, the disciplinary process would compensate and protect the public.

COMMENT 14: One commenter stated that the board should specify discipline for conduct in psychological evaluations.

RESPONSE 14: The board disagrees with this comment, because the consequences for a violation of professional standards are unique in every case. The board also notes that the sanctions imposed should reflect the particular circumstances, conduct, and violations involved in each case.

COMMENT 15: A commenter suggested that the board should have a method to verify qualifications for psychological testing.

RESPONSE 15: The board reiterates that these rules do not preemptively verify qualifications for any particular specialization that a licensee might have. Licensees must assess their own knowledge and abilities before employing any technique, whether it is a therapeutic skill or a method of psychological evaluation. The proposed rules are consistent with the board's approach in other areas, which has always proven adequate to protect the public.

COMMENT 16: One commenter noted that the final rules will be completed later than the October 1, 2010 date described in the statute.

RESPONSE 16: The board began working on the proposed rules immediately after the bill became law. The board met with other licensing boards, held committee meetings, and conducted research into standards promulgated by national associations and enacted in other states. As a result of the thoroughness of the board's efforts to come up with the best standards for psychological evaluations, consistent with the new law, the board was not able to meet the deadline. With the adoption of these rules, qualified licensees will now be permitted to describe their methods of assessment as psychological evaluations.

COMMENT 17: One commenter opined that the board did not discuss the matter sufficiently.

RESPONSE 17: The board notes that the proposed rules were discussed at numerous committee meetings, multiple board meetings, and at meetings of another licensing board. During that process, the board heard from individuals and associations representing consumers, counselors, marriage and family therapists, social workers, psychologists, and others involved in providing mental health services. The board then responded to each comment and concern raised.

COMMENT 18: One commenter opined that the board does not have the expertise to determine whether a person is competent to do assessments.

RESPONSE 18: Board members cannot possess the highest level of skill and knowledge in every discipline in the field. Therefore, the board solicited feedback from the public and from experts in the field to help the board develop appropriate standards. In addition, the board researched the evaluation standards used by other states and based its proposal on the best standards, which were determined to be consistent with the guidelines of the counseling and social work professions.

COMMENT 19: One commenter recommended that the board use the Standards for Education and Training in Psychological Assessment.

RESPONSE 19: The board did previously consider and rejected this model while the board was researching and writing the proposed rules. The board concluded that the proposed rules are better suited to the needs of the public and consistent with the mandate of 37-17-104, MCA.

4. The board has adopted NEW RULE I (24.219.1001), NEW RULE II (24.219.1005), NEW RULE III (24.219.1011), NEW RULE IV (24.219.1014), NEW RULE V (24.219.1017), NEW RULE VI (24.219.1020), NEW RULE VII (24.219.1023), NEW RULE VIII (24.219.1026), NEW RULE IX (24.219.1029), NEW RULE X (24.219.1032), NEW RULE XI (24.219.1035), and NEW RULE XII (24.219.1038) exactly as proposed.

BOARD OF SOCIAL WORK EXAMINERS
AND PROFESSIONAL COUNSELORS
LINDA CRUMMETT, LCSW, PRESIDENT

/s/ DARCEE L. MOE
Darcee L. Moe
Alternate Rule Reviewer

/s/ KEITH KELLY
Keith Kelly, Commissioner
DEPARTMENT OF LABOR AND INDUSTRY

Certified to the Secretary of State October 3, 2011

BEFORE THE DEPARTMENT OF LABOR AND INDUSTRY
AND THE BOARD OF SOCIAL WORK EXAMINERS
AND PROFESSIONAL COUNSELORS
STATE OF MONTANA

In the matter of the amendment of ARM 24.101.413 renewal dates and requirements, and the adoption of New Rules I through XIII licensure and regulation of marriage and family therapists	))))))	NOTICE OF AMENDMENT AND ADOPTION

TO: All Concerned Persons

1. On April 14, 2011, the Board of Social Work Examiners and Professional Counselors (board) published MAR notice no. 24-219-24 regarding the public hearing on the proposed amendment and adoption of the above-stated rules, at page 550 of the 2011 Montana Administrative Register, issue no. 7.

2. On May 5, 2011, a public hearing was held on the proposed amendment and adoption of the above-stated rules in Helena. Several comments were received by the May 13, 2011, deadline.

3. The board has thoroughly considered the comments received. A summary of the comments received and the board's responses are as follows:

COMMENT 1: Numerous commenters supported the adoption of the new rules regarding marriage and family therapy.

RESPONSE 1: The board appreciates all the public input in the drafting of these rules and for all comments received in the rulemaking processes.

COMMENT 2: One commenter requested clarification regarding the scope of practice for licensed marriage and family therapists (LMFTs).

RESPONSE 2: The scope of practice of LMFTs is defined in 37-37-102(4) and (5), MCA. While it is inappropriate for the board to make a legal determination regarding the scope of practice for LMFTs, in the context of this rulemaking process, psychological testing and evaluation is not clearly described in the statute defining marriage and family therapists' practice areas.

COMMENT 3: One commenter inquired as to whether LMFTs can perform psychological evaluations and child custody evaluations.

RESPONSE 3: Senate Bill 235 (2009), codified at 37-17-104(3), MCA, specifically provides, "The board of social work examiners and professional counselors shall adopt rules that qualify a licensee under Title 37, chapter 22 or 23, to perform

psychological testing, evaluation, and assessment. The rules for licensed clinical social workers and professional counselors must be consistent with the guidelines of their respective national associations." The plain language of this statute does not give the board authority to address the scope of practice of marriage and family therapists.

4. The department has amended ARM 24.101.413 exactly as proposed.

5. The board has adopted NEW RULE I (24.219.409), NEW RULE II (24.219.701), NEW RULE III (24.219.704), NEW RULE IV (24.219.707), NEW RULE V (24.219.709), NEW RULE VI (24.219.712), NEW RULE VII (24.219.715), NEW RULE VIII (24.219.807), NEW RULE IX (24.219.2001), NEW RULE X (24.219.2004), NEW RULE XI (24.219.2007), NEW RULE XII (24.219.2010), and NEW RULE XIII (24.219.2309) exactly as proposed.

BOARD OF SOCIAL WORK EXAMINERS
AND PROFESSIONAL COUNSELORS
LINDA CRUMMETT, LCSW, PRESIDENT

/s/ DARCEE L. MOE
Darcee L. Moe
Alternate Rule Reviewer

/s/ KEITH KELLY
Keith Kelly, Commissioner
DEPARTMENT OF LABOR AND INDUSTRY

Certified to the Secretary of State October 3, 2011

VOLUME NO. 54 OPINION NO. 3

PRIVACY - Even if state retirees have constitutionally protected rights to privacy, when balanced against the public's right to know, those rights to privacy do not clearly exceed the merits of public disclosure;
RIGHT TO KNOW - Information such as public employees' names, addresses, salaries, job titles, merit pay, vacation and sick leave, dates of employment, and hours worked is crucial to fostering the public's trust in government;
RIGHT TO KNOW - State retirees' privacy interests in their names and benefit amounts does not "clearly exceed" the public's right to know;
MONTANA CODE ANNOTATED - Sections 2-6-101, (1);
MONTANA CONSTITUTION OF 1972 - Article II, sections 9, 10;
OPINIONS OF THE ATTORNEY GENERAL - 44 Op. Att'y Gen. No. 32 (1992), 43 Op. Att'y Gen. No. 6 (1989), 41 Op. Att'y Gen. No. 35 (1985), 38 Op. Att'y Gen. No. 109 (1980).

HELD: Retirees of the Teachers' Retirement System of the State of Montana do not have individual rights of privacy in the amounts of their retirement benefits that clearly exceed the public's right to know.

September 16, 2011

Ms. Denise Pizzini
Chief Legal Counsel
Teachers' Retirement System
1500 East Sixth Avenue
P.O. Box 200139
Helena, MT 59620-0139

Dear Ms. Pizzini:

You have requested my opinion on the following question:

> Whether a retiree of the Teachers' Retirement System of the State of Montana has an individual right of privacy in the amount of his or her retirement benefit that clearly exceeds the public's right to know.

According to your letter, in August, 2010, the State Administration and Veterans' Affairs Legislative Interim Committee (SAVA Committee) requested information from the Legislative Audit Division on the 100 highest annual retirement benefit amounts paid by the Montana Teachers' Retirement System (TRS) and the Montana Public Employees' Retirement System. The Legislative Audit Division provided the requested information to the SAVA Committee as a ranked listing of the 100 highest annual benefit amounts paid by each retirement system. The information provided by the Legislative Audit Division did not include any information by which individual retirees could be identified.

On August 24, 2010, the executive director of TRS received a written request via email from a media outlet, which stated in part:

> Last week I was at a SAVA meeting and members reviewed a list of the top 100 annual retirement benefits to retirees. I am looking into the story a little deeper. I would like the names, job titles, government agency for the top 10 TRS retirees.

According to your letter, TRS does not gather job title information on its members and therefore could not provide that information. Otherwise, if granted, the request would match individual retirees' benefit amounts with their names and agencies.

TRS then sent written notices to the retirees at issue, inquiring whether they would be willing to waive any privacy interests they may have in the requested information and authorize TRS to disclose the information pursuant to the media request. Each TRS retiree was informed that his information would be provided pursuant to the request only if he returned a signed and notarized authorization form. TRS further indicated that a retiree's failure to respond would be construed as the individual having declined to waive his or her privacy rights and therefore declining to authorize TRS to disclose the information.

Of the ten retirees whose information was at issue, only one returned the signed and notarized authorization. That individual's information was therefore disclosed pursuant to the request. Another retiree provided a written statement to TRS specifically asserting a privacy interest. Another called TRS asserting a privacy interest. The other seven retirees provided no response. Accordingly, TRS construed their silence as declining to waive their privacy interests and authorize TRS to disclose the information.

Resolution of this question requires the balancing of two rights enshrined in Montana's constitution: the right of individual privacy and the right of the public to know and understand the workings of its government.

Article II, section 9 of the Montana Constitution grants the public's right to know:

> No person shall be deprived of the right to examine documents or to observe the deliberations of all public bodies or agencies of state government and its subdivisions, except in cases in which the demand of individual privacy clearly exceeds the merits of public disclosure.

Describing the Framer's intent in adopting this section, the Court has noted, "the theme was that except as it may be limited by the right of the individual to personal privacy, there is to be in Montana a broad-based, pervasive and absolute right of citizens to know what is going on in their government and a right to participate in government untrammeled by the government itself." Bryan v. Yellowstone County Elem. Sch. Dist. No. 2, 2002 MT 264, ¶ 39, 312 Mont. 257, 60 P.3d 381.

Various statutes, such as Mont. Code Ann. § 2-6-101, specifically provide public access to government documents. Montana Code Annotated § 2-6-101(1) states, "Every citizen has a right to inspect and take a copy of any public writings of this state. . . ." The Montana Supreme Court has held that the public right to know includes the media and that the constitutional right of inspection may not be hindered based upon the gatekeeper or, in other words, the governmental record keeper's interpretation of the need or basis underlying the request. See Jefferson County v. Montana Std., 2003 MT 304, ¶ 13, 318 Mont. 173, 79 P.3d 805 and Associated Press v. Montana Department of Revenue, 2000 MT 160, ¶ 85, 300 Mont. 233, 4 P.3d 5.

Montana's right to privacy is found at article II, section 10 of the Montana Constitution, and provides, "The right of individual privacy is essential to the well-being of a free society and shall not be infringed without the showing of a compelling state interest." The right extends to informational privacy, that is, the right of individuals to control the disclosure and circulation of personal information. Montana Shooting Sports Ass'n v. State, 2010 MT 8, ¶ 14, 355 Mont. 49, 224 P.3d 1240, (citing) St. James Community Hosp. v. District Court, 2003 MT 261, ¶ 8, 317 Mont. 419, 77 P.3d 534; Gryczan v. State, 283 Mont. 433, 449, 942 P.2d 112, 122 (1997).

It is "well established" that Montana's constitutional right to know is not absolute. Yellowstone County v. Billings Gazette, 2006 MT 218, ¶ 19, 333 Mont. 390, 143 P.3d 135 (citations omitted). The Court has recognized that the public's constitutional right to know must be weighed against any individual privacy rights that may be present.

In order to balance these interests, the Court has established a three-step process:

> First, we consider whether the provision applies to the particular political subdivision against whom enforcement is sought. Second, we determine whether the documents in question are "documents of public bodies" subject to public inspection. Finally, if the first two requirements are satisfied, we decide whether a privacy interest is present, and if so, whether the demand of individual privacy clearly exceeds the merits of public disclosure.

Becky v. Butte-Silver Bow Sch. Dist. No. 1, 274 Mont. 131, 136, 906 P.2d 193, 196 (1995).

Here it is uncontested that article II, section 9 of the Montana Constitution applies to TRS. It is further conceded that the information requested constitutes "documents of public bodies" subject to public inspection.

The question presented instead turns on whether a privacy interest is present and, if so, "whether the demand of individual privacy clearly exceeds the merits of public disclosure." Becky, 274 Mont. at 136, 906 P.2d at 196. If the demand for individual privacy clearly exceeds the public's right to know public disclosure is not required.

Yellowstone Co., ¶ 19, citing Bryan v. Yellowstone Co. Elem. Sch. Dist. No. 2, 2002 MT 264, ¶ 33, 312 Mont. 257, 60 P.3d 381.

The Montana Supreme Court has established a two-part test to determine whether an individual has a protected privacy interest under article II, section 10 of the Montana Constitution. Jefferson County, ¶ 15 (citation omitted). A person has a constitutionally protected privacy interest when he or she has a subjective or actual expectation of privacy that society is willing to recognize as reasonable. Lincoln County Comm'n v. Nixon, 1998 MT 298, ¶ 16, 292 Mont. 42, 968 P.2d 1141 (citation omitted). Under this test, if it is determined that a constitutional right to privacy exists, it must then be balanced against the constitutional right to know. Montana Health Care Ass'n v. Montana Bd. of Directors, 256 Mont. 146, 150, 845 P.2d 113, 116 (1993). As stated above, only if the demand for individual privacy clearly exceeds the public's right to know is public disclosure not required. Yellowstone Co., ¶ 19 (citation omitted).

Good reason exists to conclude TRS retirees had some expectation of privacy in their retirement benefits. At least nine of the ten retirees either explicitly or implicitly asserted a privacy interest in the information sought. This suggests that they had at least a subjective expectation of privacy concerning their retirement benefits. Further, TRS's own policies may have created an actual expectation of privacy on the part of the retirees. As your letter points out, generally TRS does not publish or otherwise make publicly available the financial information and benefits of its members. Moreover, TRS's "Member's Retirement Plan Handbook" provides:

> RELEASE OF INFORMATION
>
> Most retirement and benefit information is confidential and may only be released to the member, benefit recipient, or an authorized person.
>
> The TRS receives many requests for information from banks, accountants, attorneys, spouses, and other interested parties. Even though most requests are made on behalf of the member or benefit recipient, state law prohibits the release of any confidential information unless the member consents in writing, or we are otherwise required to release the information. Information may be released directly to the member, benefit recipient, or to another person designated by the member in writing.

However, our analysis does not end there. While TRS members may have had an expectation of privacy, that expectation is only constitutionally protected if society recognizes it as reasonable. Lincoln County, ¶ 16. Whether society would recognize TRS members' expectation of privacy in their publicly funded retirement benefits is a more difficult question.

However, it is not necessary to reach that issue today, because I conclude that even if TRS members had constitutionally protected rights to privacy, when balanced

against the public's right to know, those rights to privacy do not "clearly exceed the merits of public disclosure." Yellowstone Co., ¶ 19.

It is well established through previous opinions of this office that public employees' names, addresses, salary, job titles, merit pay, vacation and sick leave, dates of employment, and hours worked may be subject to public disclosure. See 38 Op. Att'y Gen. No. 109 (1980), 41 Op. Att'y Gen. No. 35 (1985), 43 Op. Att'y Gen. No. 6 (1989), 44 Op. Att'y Gen. No. 32 (1992). Such information helps the public to understand how the state is using its tax dollars and what budget priorities the state has set for those dollars. Accordingly, such information is crucial to fostering the public's trust in government.

The present situation, involving retirees' names and retirement benefits, admittedly is somewhat different. However, it is not so different as to tip the scales to conclude that the retirees' rights to privacy now "clearly exceed[]" the public's right to know. This is particularly true in light of the fact that the Montana Supreme Court has indicated under article II, section 9 of the Montana Constitution, the public's right to know is essentially presumed. See Bryan, ¶ 39.

In considering this question, other jurisdictions have determined that public employees lack a reasonable expectation of privacy in their retirement benefits, a largely publicly financed benefit, that would trump the public's right to know. San Diego County Employees Retirement Ass'n v. The Superior Court of San Diego County, 127 Cal. Rptr. 3d 479, 489-90 (Cal App. 2011). See also Detroit Free Press v. City of Southfield 713 N.W.2d 28, 35 (Mich App. 2005); Pulitzer Publishing v. Missouri State Employees Retirement Sys., 927 S.W.2d 477 (Mo. App. 1996); Seattle Fire Fighters Union v. Hollister, 737 P.2d 1302 (Wash. App. 1987); Mergenthaler v. Commonwealth State Employees' Retirement Bd., 372 A.2d 944 (Pa. Cmmw. 1977).

In the San Diego County case, the court provided the following explanation of the balance between the retirees' privacy interests and the public's right to know:

> The names of [public] pension recipients combined with their pension amounts is not information of a personal nature. The information does not solely relate to private assets or personal decisions. Rather, the pension amounts reflect specific governmental decisions regarding retirees' continuing compensation for public service. Therefore, the pension amounts are more comparable to public salaries than to private assets. Retirees' publicly funded pensions--like their previous salaries--are of interest to the public, and only through disclosure can the public expect to prevent abuse.

San Diego County at 490 (citations omitted).

A party asserting a privacy interest in the question before me relied upon Rowland v. Commonwealth of Pennsylvania, 885 A.2d 621 (Pa. Commw. Ct. 2005) to support

his position that retirees hold a constitutionally protected privacy interest in the amount of retirement benefit received that trumps the public's constitutional right to know. That case, however, is distinguishable from the question presented in this Opinion. The challenge in Rowland was to release of address, date of birth and last employer. The retirement entity had already released the names of retirees, their dates of retirement, years of credited service and monthly annuities as public documents and that release was not challenged. The Rowland case therefore does not support the contention that retirees have a constitutionally protected privacy interest in the amount of retirement benefits paid which is the question I answer here.

Ultimately, I find the rationale of the court in the San Diego County case to be persuasive. TRS members' retirement benefits were earned while they were public employees and are subject to the same public disclosures as discussed above. Likewise, their retirement benefits are paid largely by public funds and, necessarily, subject to the public's same interest in understanding how pension funds are calculated and how the government is spending taxpayer funds.

THEREFORE IT IS MY OPINION:

> Retirees of the Teachers' Retirement System of the State of Montana do not have individual rights of privacy in the amounts of their retirement benefits that clearly exceed the public's right to know.

Sincerely,

/s/ Steve Bullock
STEVE BULLOCK
Attorney General

sb/zz/jym

BEFORE THE DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION OF THE STATE OF MONTANA

In the matter of the Petition of Ranck Oil Company for an administrative declaratory ruling upon the application of section 77-3-434, MCA, and ARM 36.25.210 as applied to State of Montana oil and gas leases nos. 11,526-69; 11,527-69; 13,030-71; 13,032-71; 15,453-73; 15,460-73; 15,919-74; 16,682-75; 17,533-76; 18,430-77; 19,581-78; 26,512-82; 27,293-84; 28,627-86; 28,757-86; 28,796-86; and 30,047-91 during the period from January 1, 2002 through December 31, 2006	)	DECLARATORY RULING

To: All Concerned Persons

1. Petitioner's name and address is: Ranck Oil Company, Inc., P.O. Box 548, Cut Bank, MT 59427.

2. The statute and administrative rule as to which petitioner requested a declaratory ruling is 77-3-434, MCA and ARM 36.25.210, as applied to state of Montana oil and gas lease numbers 11,526-69; 11,527-69; 13,030-71; 13,032-71; 15,453-73; 15460-73; 15,919-74; 16,682-75; 17,533-76; 18,430-77; 19,581-78; 26,512-82; 27,293-84; 28,627-86; 28,757-86; 28,796-86; and 30,047-91.

3. The question presented for declaratory ruling by the department is to whether lessees under Montana oil and gas leases could deduct any post-wellhead costs from the royalties to be paid to the state.

4. Declaratory Ruling

INTRODUCTION AND PROCEDURAL HISTORY

1. The Department initiated a royalty audit of eighteen State of Montana oil and gas leases held by Ranck Oil Company (Ranck) for the audit period of January 1, 2002 through December 31, 2006, under the authority granted to it by § 77-3-435(3), MCA. In response, Ranck filed a petition with the Department for an administrative declaratory ruling under § 2-4-501, MCA. Ranck requested that the Department render an opinion as to whether lessees under Montana oil and gas leases could deduct any post-wellhead costs from the royalties to be paid to the State.

2. The Department declined to issue a declaratory ruling, citing Ranck's failure to submit the gas purchase contracts by which Ranck and its affiliates sold the production to third party purchasers. The Department reasoned that absent

submission of the contracts, Ranck had failed to comply with Admin. R. M. 1.3.227(2)(b) and (c), which require that the petition for an administrative ruling contain "a detailed statement of facts upon which petitioner requests the agency to base its declaratory ruling" and "sufficient facts to show that petitioner will be affected by the ruling." The third party purchase contracts constituted—in the Department's view—the essential factual basis for a declaratory ruling.

3. Ranck sought judicial review of the Department's decision not to issue a declaratory ruling. The First Judicial District Court, Lewis and Clark County, granted Ranck's petition for judicial review. The court determined that "the question of whether Ranck is entitled to deduct development and transportation costs from the gas produced from State leases is a question that can be answered without particular reference to those actual expenses." The court rejected the Department's argument that the sales contracts were necessary for a declaratory ruling and determined that "Ranck is either entitled to deduct those costs and expenses or it is not." The court directed the Department to grant Ranck's petition for an administrative declaratory ruling.

SCOPE OF ADMINISTRATIVE RULING

4. The Department issues the following declaratory ruling in response to Ranck's Renewed Petition (Petition) dated August 9, 2010. The Petition requests a ruling as to the application of § 77-3-434, MCA, and Admin. R. M. 36.25.210 to sales of natural gas occurring between January 1, 2002 and December 31, 2006 under eighteen State of Montana oil and gas leases to which Ranck is a party. The Department has addressed the questions presented in the Petition based on an application of the specified statutory and administrative provisions of Montana law to the terms of these leases and to the facts described in the Petition. This Declaratory Ruling is restricted to the production and sale of natural gas and does not address sales of oil.

RELEVANT PROVISIONS OF LAW

5. Ranck requests an Administrative Declaratory Ruling as to how Admin. R. M. 36.25.210 and § 77-3-434, MCA, apply to the facts described in the Petition. These provisions are reproduced below.

a. 36.25.210 ROYALTIES

(1) The lessee shall pay in cash or deliver in kind to the lessor at its option, on all oil and gas produced and saved from the leased premises and not used for light, fuel and operation purposes on the leased premises, a royalty. The royalty shall be at the following rates unless, in regard to a particular lease, the department advertises in its lease sale notices that the royalty will be at a higher rate:

(a) On gas at the rate of 16.67%;

(b) On oil at the rate of 16.67%; and

(c) The royalty on gas, including casing-head gas and all gaseous substances, while the same is not sold or used off the premises shall be at the rate of $400 per well each year or the amount of the annual rental provided in the lease, in lieu of the per well rate, whichever is the greater, payable on or before the annual anniversary date of the lease. As long as the leased lands contain a well capable of

such production and such payment is made, the lease shall be considered a producing lease under the lease terms.

(2) The lessee shall pay royalties reserved to the state, in cash:

(a) on the reserved fraction of oil, the posted field price, or in lieu thereof, if no field price is posted, the fair market value in the field where produced on the day it is run into the pipeline or storage tanks; and

(b) on the reserved fraction of gas, the posted field price, or in lieu thereof, if no field price is posted, the fair market value at the well. In addition, the lessee shall pay to the state on the reserved fraction any bonus actually paid or agreed to be paid to the lessee for such oil or gas.

(3) All royalties, whether in money or in kind, shall be delivered to the state free of cost and deductions.

b. 77-3-434. Manner of making royalty payment. Such lease shall provide for the rendering of payment of such royalty on all oil and gas produced and saved and sold or used off the premises in the following manner and upon the following terms:

i. (1) the lessee shall pay to the state in cash, for all oil and gas royalty reserved, the posted field price existing on the day such oil or gas is run into any pipeline or storage tank to the credit of the lessee, plus any bonus actually paid or agreed to be paid to the lessee for such oil or gas; or

ii. (2) at the option of the state exercised in writing by the board not oftener than every 30 days, the lessee shall deliver the state's royalty oil or gas free of cost or deductions into the pipeline to which the wells of the lessee may be connected or into any storage designated by the state and connected with such wells.

QUESTIONS PRESENTED

6. A party may seek a declaratory ruling from an agency when "doubt exists as to how a statute or rule administered by an agency affects the party's legal rights." Admin. R. M. 1.3.226. In its Renewed Petition for Declaratory Ruling, Ranck presented the following questions to be resolved by the Department:

a. Whether the "wellhead jurisdiction" rule applies to the State leases and allows the lessee to deduct reasonable post-wellhead costs?

b. If the answer to the preceding question is that a version of the "marketable condition" rule—rather than the "wellhead jurisdiction" rule—applies to the State leases: (i) at what point does the State's royalty gas become "marketable" so as to allow post-wellhead/pre-transmission costs to be deducted; and (ii) specifically, whether actual post-wellhead gathering and compression costs are nonetheless deductible.

c. In respect to any post-wellhead costs allowed under either approach discussed above, the services for which are provided by an affiliate of the lessee: (i) whether the lessee is allowed to deduct an amount imputed from the affiliate's charges against third-parties for similar services, or whether the lessee is allowed to deduct only the affiliate's actual costs in providing the involved service, and (ii) if the latter, what element of the affiliate's actual costs are deductible?

ANALYSIS AND RULING
QUESTION ONE

7. Whether the "wellhead jurisdiction" rule applies to the State Leases and allows the lessee to deduct reasonable post-wellhead costs?

8. Summary of Ruling: Pursuant to Admin. R. M. 36.25.210(3), Ranck may not make deductions from the State's royalties for costs incurred in the production, storage, treatment, compression, marketing, or transportation of any gas production from the State leases. State royalties are payable upon the greater of: the gross proceeds obtained or obtainable by the lessee for the marketable production at the point of sale chosen by the lessee; or the fair market value of the marketable production at the wellhead. The State's royalties are not calculated upon the net profits of the lessee. Ranck is obligated to pay all royalties free of all costs and deductions.

9. Ranck erroneously requests that the Department employ a general "jurisdictional" interpretive methodology to determine Ranck's legal obligations without reference to the specific language of the very leases at issue. Without reference to lease language, it is impossible to describe the royalties due the lessor or to determine where gas is sold and royalties are calculated. To employ a blanket "jurisdictional" interpretive methodology is to circumvent the purpose for which the lease exists. The Department declines to adopt a jurisdictional approach without reference to the lease terms. For example, substantial variation exists in the wording of royalty clauses in State and private mineral leases; this variability results in differing legal obligations for lessees in the payment of oil and gas royalties to lessors.

10. An oil and gas lease represents a contract between a lessor and a lessee and must be construed according to established principles of contract interpretation. *See The Law of Oil and Gas*, 2 Summers (1959), Ch. 12, § 371, at 484, et seq.; *Edington v. Creek Oil Co.*, 213 Mont. 112, 121, 690 P.2d 970, 975 (1984); *Fey v. A. A. Oil Corp.*, 129 Mont. 300, 318-319, 285 P.2d 578, 587 (1955) ("Courts must interpret contracts as made by the parties, not make new ones for them, no matter how unreasonable the terms may appear."). The most fundamental rule governing oil and gas leases in Montana is that the terms of the lease are to be construed strictly against the lessee and in favor of the lessor. *See e.g. Schumacher v. Cole*, 131 Mont. 166, 172, 309 P.2d 311, 314 (1957).

11. The Department rejects Ranck's argument that a purely jurisdictional methodology should dictate how royalties are to be calculated without regard to the lease terms. Whether a mineral royalty is to be cost-free or cost-bearing depends on the wording of the royalty provisions in the lease. *See Wolfing v. Ralston*, 10 P.C.L.J. 11, 61 Cal. 288 (1882) (gross proceeds royalty distinguished from net proceeds royalty based on language of the royalty clauses). Royalties are calculated according to the language of the mineral lease; not solely upon any common-law definition of a royalty obligation. Where the lease terms are unclear, the Department will attempt to resolve questions by reference to the statutory provisions, administrative rules, implied covenants, and Montana caselaw. If no satisfactory resolution exists within the terms of Montana law, we will look to the caselaw of other jurisdictions.

12. Ranck's first question may be resolved by the application of Admin. R. M. 36.25.210(3), which is incorporated in every State oil & gas lease, and which mandates that: "All royalties, whether in money or in kind, shall be delivered to the

state free of cost and deductions." Likewise, § 77-3-432, MCA, provides that oil and gas royalties must be calculated based on the full market value of the oil or gas produced and saved from the leased land, and sets the minimum royalty for gas at 12 1/2%. That statute allows the State—at its option—to enter into a cost-sharing agreement for transportation expenses. Nothing in the statute requires the State to bear any portion of the costs incurred by a lessee prior to the point of sale of gas produced from a State lease.

13. Ranck requests that the Department declare the State's "royalty" to be a "net" share of produced minerals in their unmarketable condition at the site of the lease, and that the State should disregard the purchase price obtained by Ranck and its affiliates from the first arm's-length sale of the production. Ranck further requests that the Department declare that all royalties be paid at the wellhead, despite lease terms that grant the State a share of the gross proceeds from the actual sale of the production, regardless of where the sale occurs.

14. The lease terms, statutory provisions, and administrative rules dictate that State royalties are to be calculated upon actual gross proceeds obtained by the lessee of a marketable product at the point of sale of production, wherever that sale occurs—on or off the lease premises. The fair market value of the gas at the wellhead represents the minimum amount on which a royalty may be calculated. The lessee may not make self-serving determinations about the value of production or its costs of production, marketing, and transportation that bind the lessor. Such determinations constitute self-dealing and are prohibited. *See, Harding v. Cameron*, 220 F. Supp. 466 (W.D. Okla. 1963)

15. The implied covenant to market, which is present in every oil and gas lease in Montana, further imposes upon the lessee the legal obligation to: prepare the product for market; sell the production at the best available price; act as a reasonably prudent lessee to sell the production in the best mutual interests of the lessor and lessee; and refrain from any self-dealing. *Berthelote v. Loy Oil Co*., 95 Mont. 434, 28 P.2d 187 (1933) Finally, § 77-3-432, MCA, describes certain aspects of the lessee's obligation to pay royalties under State of Montana oil & gas leases:

a. 77-3-432. Royalty. In each oil and gas lease granted by the state under this part, there must be reserved to the state as consideration for the lease *a royalty in all oil and gas produced and saved from all lands covered by the lease and not used for light, fuel, and operation purposes on the leased premises, which must be equivalent to the full market value*, as ascertained by the board at the date of the lease, of the estate or interest of the state in the lands and oil and gas deposits disposed of under the lease. *The royalty reservation must be set by the board but may not be less than 12 1/2% on gas* and not less than 12 1/2% on oil or casinghead gasoline for each producing well for the calendar month. *The state may share the expense of transporting the oil to the nearest market on a basis proportional to the state's royalty interest in the oil and at a rate per mile acceptable to the department* (emphasis added.)

16. It is clear from the language of § 77-3-432, MCA, the lease terms read in the context of the implied covenant to market, and the relevant statutory and administrative provisions, that royalties under State of Montana oil and gas leases represent a share of the gross proceeds generated from the first arm's-length sale of

the lessor's share of production. Lessees of oil and gas on State lands must monthly report the oil and gas produced and saved from the lease: "[t]he report shall show the amount of oil or gas produced and saved during the preceding month, the price obtained, the total amount of all sales, and any additional information as may be required, and it shall be signed by the lessee or some responsible person having knowledge thereof." Section 77-3-431, MCA. Because the State's royalties depend upon the accuracy of royalty reports, criminal sanctions are available for any intentionally false statements in such reports. Section 77-3-410, MCA.

17. The State's reporting form has no provision for reporting "net volumes" of gas sold from State trust lands. Where, as here, the State has reserved the right to take its royalty oil or gas in kind "free of cost or deduction," and the lessee is obligated to report gross gas volumes, it is clear that the lessee is obligated to pay royalties based upon the gross proceeds received by the lessee without any deductions. *See Exxon Mobil Corp. v. Alabama Dept. of Conservation and Natural Resources*, 986 So.2d 1093, 1109-1110 (Ala. 2007).

18. In order to calculate a royalty based on the gross proceeds obtained, there must be a sale of the production. Where there are no proceeds or sale, as when gas is exchanged, gas royalties must be calculated based upon the fair market value of the gas. *See Lightcap v. Mobil Oil Corp*., 562 P.2d 1 (Kan. 1977), cert. denied, 434 U.S. 876 (1978); *Matzen v. Cities Serv. Oil Co.*, 667 P.2d 337 (Kan. 1983); *See also Phillips Petroleum Co. v. Johnson*, 155 F.2d 185 (5th Cir. 1946), cert. denied 329 U.S. 730 (1946); *Phillips Petroleum Co. v. Record*, 146 F.2d 485 (5th Cir. 1944).

19. A "gross proceeds" royalty clause imposes upon the lessee all costs incurred in exploring for, producing, marketing, and transporting the product to the point of sale. *Hanna Oil and Gas Co. v. Taylor*, 759 S.W.2d 563, 564-565 (Ark. 1988) ("Unless something in the context of an agreement provides otherwise, "proceeds" generally means total proceeds."). Where parties to a lease intend to allow for deductions, the lease must expressly provide for such deductions, as by a reference to "net royalties." *Id.* at 565.

20. Ambiguity in the lease language pertaining to allocation of costs has been held insufficient to permit the lessee to deduct costs incurred between the wellhead and the point of sale. *Estate of Tawney v. Columbia Natural Resources, L.L.C.*, 633 S.E.2d 22, 24 (W. Va. 2006). The construction and interpretation of an agreement, including whether the contract is ambiguous, is a question of law. *Sec. Abstract & Title Co. v. Smith Livestock, Inc.*, 334 Mont. 172, ¶¶ 16-17, 146 P.3d 732, ¶¶ 16-17 (2006). Ranck interprets its lease-imposed royalty obligation in the context of a "market value" rather than a "gross proceeds" approach. This construction is incorrect. Contracts are viewed as a whole "so as to give effect to every part if reasonably practicable, each clause helping to interpret the other." Section 28-3-202, MCA. In the construction of an agreement, a party may not isolate individual clauses or words, but instead must "grasp the instrument by its four corners and in the light of the entire instrument" ascertain the parties' intent. *K&R Partnership v. City of Whitefish*, 344 Mont. 336, 343, 189 P.3d 593, 600 - 601 (2008). If a particular clause in a State oil and gas lease conflicts with the remainder of the lease, the general intent of the lease should prevail. *See* § 28-3-307, MCA (When

interpreting the meaning of a contract: "[p]articular clauses of a contract are subordinate to its general intent.").

21. No ambiguity exists in these State oil and gas leases. The royalty payment obligations imposed by the eighteen leases to which Ranck is a party are substantively identical despite slight variations in language that reflect the fact that the leases were entered into over a period of twenty-two years. These variations may be grouped into one of four vintages or formulations that reflect amendments to the lease form made over time. We address these iterations in chronological order.

22. Lease Nos. 11,526-69 through 11,923-69 require a "flat" royalty of 12.5% to be paid on the actual price received by the lessee. A copy of Lease No. 11,526-69 is attached to this Ruling as Exhibit "A". These leases were drafted pursuant to the "terms and provisions of Chapter 17, Title 81 Revised Codes of Montana, 1947, and all acts amendatory thereof and supplementary thereto," anticipating subsequent statutory enactments, amendments, and rulemaking actions.

23. Paragraph five of these leases requires payment upon the "total amount produced and saved," except for oil and gas used directly on the lease premises. Paragraph six requires that the lessee remit royalties based upon the "posted field price therefor existing on the day such oil or gas was run into any pipe line or storage tank to the credit of the lessee *plus any bonus or other increase in price actually paid or agreed to be paid to the lessee.*" (emphasis added). For State of Montana oil and gas leases, a "bonus" is legally defined as that additional amount or payment for the sale of the production representing an increase in the purchase price over any posted field price. *State ex rel. Dickgraber v. Sheridan*, 126 Mont. 447, 254 P.2d 390 (1953). Where there is no posted field price, therefore, the entire purchase price is considered to be a "bonus" upon which royalty is payable. Paragraph six further provides that if the State opts to have its gas delivered in lieu of cash, the delivery shall be effected "free of cost or deductions into the pipeline." Paragraph seven stipulates that "payments in cash for the royalties payable hereunder *shall never be less than the price actually obtained therefore*." (emphasis added). Specifically, paragraphs four through seven of this vintage of State lease provide:

a. (4) *The lessee shall also pay in money or in kind to the said lessor at its option as hereinafter provided during the full term of this lease a royalty on the gas* produced from the wells under this lease whether the said wells produce oil and gas or gas alone, *a flat royalty of twelve and one-half per centum (12 1/2%)*.

b. (5) All wells under this lease shall be so drilled, maintained and operated as to produce the maximum amount of oil and/or gas which can be secured without injury to the wells and the aforesaid royalties shall be based and calculated on such full production of oil and/or gas; but the lessee shall have the right to apply to the State Board of Land Commissioners for permission to curtail production as provided in paragraph 12 of this lease. *All royalties shall be calculated upon the total amount produced and saved under this lease exclusive of oil or gas used for light, fuel or operating purposes in connection with the work on the lands under the lease*.

c. (6) *The lessee shall pay to the lessor in cash for such royalty oil and gas at the rate of the posted field price therefor existing on the day such oil or gas was run into any pipe line or storage tank to the credit of the lessee plus any bonus or other increase in price actually paid or agreed to be paid to the lessee; provided,*

however, that at the option of the lessor exercised not oftener than once every thirty days by notice in writing the lessee shall deliver the State's royalty oil or gas free of cost or deductions into the pipe line to which the wells of the lessee may be connected or into any storage designated by the State and connected with such wells. The lessee shall not be required to furnish storage for the State's royalty oil for more than thirty days following the date of production thereof when a market therefor is available.

d. (7) *In all cases where there is no posted field price for oil or gas produced under this lease, the payments in cash for the royalties payable hereunder shall never be less than the price actually obtained therefor* or the reasonable market value thereof at the wells produced at the time of the sale of the same; and if the price obtained appears to the State Board of Land Commissioners to be less than the actual reasonable market value, then such actual reasonable market value shall be fixed and determined by mutual agreement between the lessee and the said Board. This lease is granted upon the express condition that the value of the State's royalty gas shall not at any time be figured at less than five cents (5¢) per 1,000 cubic feet (emphasis added).

24. In *Clark v. Slick Oil Co.*, 211 P. 496 (Okla. 1922), the royalty clause in an oil and gas lease provided that the lessee was "to deliver to the credit of the lessor... free of cost, in the pipeline to which lessee…may connect the well or wells, the equal one-eighth part of all oil produced and saved from the leased premises." *Id*. at 497. Production was obtained, but the oil produced was "cut oil" contaminated with water and mud. In order to market the oil, the oil needed to be treated to remove the mud and water by being placed in settling tanks before a pipeline would accept the oil for purchase. When the treated oil sold for an amount above the posted field price, the lessor requested that royalties be paid on the higher price. The lessee refused to pay royalties above the posted field price, and it further refused to provide the Lessor with tanks to treat the lessor's royalty oil to render it marketable. The court held:

a. It was not necessary for the plaintiff [the Lessor] to treat his part of this oil and make it marketable so that the pipe line companies would receive it. Neither was he required to provide storage tanks in which to let the "cut oil" settle. It was just as much a part of the duty of the defendant [the Lessee] under the contract to prepare this oil for market so that it would be received by the pipe line company as it was its duty to pump the oil from the wells or drill the wells. The plaintiff had a right to demand his oil delivered in the pipe line, and the defendant's duty was not discharged until it was so delivered.

25. *Id.* at 501. Thus, to "deliver the State's royalty oil or gas free of cost or deductions into the pipe line to which the wells of the lessee may be connected," means that the lessee is obligated to place the production in marketable condition and pay royalties to the State upon the gross proceeds received or receivable by the Lessee at the point of sale of the production.

26. Lease Nos. 13,030-71 – 16,682-75 are substantially identical to the earlier iteration of the lease form. A copy of Lease No. 13,030-71 is attached to this Ruling as Exhibit "B". These leases contain an additional provision after paragraph 22, whereby the lessee expressly agrees to "comply with all applicable laws and regulations in effect at the date of this lease, or which may, from time, be adopted

and which do not impair the obligations of this contract and which do not deprive the lessee of an existing property right." This addition acknowledges the fact that the State Land Board and Department are empowered to make and amend administrative rules relating to oil and gas leases to ensure that the trust mandate is being fulfilled.

27. Lease Nos. 17,533-76 – 26,512-82 contain several amendments. A copy of Lease No. 17,533-76 is attached to this Ruling as Exhibit "C". Paragraph four of these leases states:

a. 4. The lessee shall also pay in money or in kind to the lessor at its option as hereinafter provided during the full term of this lease, free of costs and deductions, a royalty on the gas produced from the wells under this lease whether the wells produce oil and gas or gas alone, of twelve and one-half per centum (12 1/2%).

This iteration of the lease form also incorporates the clause pertaining to existing and new provisions of the law as paragraph 23.

28. The remaining lease forms are substantially identical. Lease Nos. 28,627-86 – 30,047-91 contain an amended oil royalty clause to establish a flat royalty (rather than a graduated royalty based on production) of 13%. The gas royalty provision is identical with earlier versions. A copy of Lease No. 28,627-86 is attached to this Ruling as Exhibit "D".

29. Each of these lease forms obligates the lessee to pay royalties upon the higher of: the gross proceeds obtained or obtainable at the point of sale; or the fair market value of the marketable gas at the wellhead. There are no deductions from the State's royalties prior to the point of sale, because each lease provides that royalties owed by the lessee are to be calculated based on the "total amount of production produced and saved," and the leases are issued in compliance with the Statutes and administrative rules in force at the time and to comport with future amendments.

30. In Montana, oil and gas leases are to be construed liberally in favor of the lessor and strictly against the lessee. *See e.g*. *Clawson v. Berklund*, 188 Mont. 48, 610 P.2d 1168 (1980); *Christian v. A.A. Oil Corp. and Byrne*, 161 Mont. 420, 506 P.2d 1369 (1973); *McDaniel v. Hagar-Stevenson Oil Co.*, 70 Mont. 156, 224 P. 870 (1924). This rule of construction is based on the recognition that the bargaining power between a lessor and lessee is unequal and that the lessor depends wholly upon the good faith of the lessee to operate the lease in the mutual best interests of the lessor and lessee. *Ladd v. Upham*, 58 S.W.2d 1037, 1039 (Tex.Civ.App. 1933). Montana law recognizes and attempts to redress this power imbalance by providing that in any contract between a public body and a private party, a court will presume that all uncertainty was caused by the private party, and will accordingly interpret the contract in favor of the public party. Section 28-3-206, MCA.

31. This presumption in favor of the public lessor is only strengthened where oil and gas leases are issued upon State school trust lands. Pursuant to Art. X, § 4 of the 1972 Montana Constitution, and § 77-1-202, MCA, the State Board of Land Commissioners is obligated to manage these lands as a fiduciary to secure the largest measure of legitimate and reasonable advantage to the State, and to provide for the long-term financial support of education. In keeping with this constitutional and statutory mandate, "[a] lease of school lands constitutes a contract between the

state and the lessee, which vitally affects the public interest, and should be construed liberally in favor of the public." *State v. Moncrief*, 720 P.2d 470, 475 (Wyo. 1986); *see also, Plateau Mining Co. v. Utah Division of State Lands and Forestry*, 802 P.2d 720 at 729 (Utah 1990) (The state has a duty not to act in the interest of a third party at the expense of school trust beneficiaries; the mineral lessees of such lands should have known that they were obligated to comply with the highest valuation of royalties under such leases).

32. Because oil and gas leases upon school trust lands in Montana are liberally construed in favor of the lessor and strictly against the lessee, the royalty clauses would have to expressly describe and authorize how those deductions were to take place in order for Ranck to take any such deductions. At a minimum, the leases themselves would need to mention "net royalties." No language is present in these leases that authorize the taking of deductions. No deductions may therefore be taken from the State's royalties under these agreements. *See West v. Alpar Res., Inc.,* 298 N.W.2d 484 (N.D. 1980) (lease that did not provide for allocation of costs was ambiguous, and must be construed against lessee and deductions by lessee were improper); *Savage v. Williams Production RMT Co.,* 140 P.3d 6, 69 (Colo. App. 2005). The variation in language displayed by the different lease forms does not undermine this basic premise.

33. Montana law provides that royalties for oil and gas leases on State lands "must be equivalent to the full market value" of the property interest represented by the lease. Section 77-3-432, MCA. The state "*may* share the expense of transporting the oil to the nearest market on a basis proportional to the state's royalty interest in the oil and at a rate per mile acceptable to the department." *Id.* (emphasis added). "The State may, also at its option, require the lessee to deliver the state's royalty oil or gas *free of cost or deductions* into the pipeline to which the wells of the lessee may be connected." Section 77-3-434(2), MCA (emphasis added). Admin. R. M. 36.25.210(3) requires that "[a]ll royalties, whether in money or in kind, shall be delivered to the state free of cost and deductions." All but four of the leases to which Ranck is a party expressly stipulate that "the lessee agrees to comply with all applicable laws and regulations in effect at the date of this lease, *or which may, from time to time, be adopted*." The other four leases (Leases 11,526-69; 11,527-69; 13,030-71; and 13,032-71) were expressly issued pursuant to the limitations in Montana's statutes "and all acts amendatory thereof and supplementary thereto."

34. Admin. R. M. 36.25.210, moreover, reflects a codification of the long-standing recognition that the State's royalty interest is to be paid free of all costs. In the context of federal mineral leases, the D.C. Circuit has determined that where a modified federal regulation pertaining to royalty calculations reflected historic department policy, it was not unreasonable and was properly applied retroactively to federal oil and gas lessees. *Independent Petroleum Ass'n of America v. DeWitt*, 279 F.3d 1036, 1041 (D.D.C. 2002).

35. Each of these provisions contemplates—either explicitly or implicitly—the State's receipt of its royalties free of costs or deductions by the lessee. The Alabama Supreme Court addressed an analogous situation in which the state had reserved the right to take its royalty oil or gas in kind "free of cost or deduction" and the lessee was obligated to report gross gas volumes. *Exxon Mobil Corp. v. Alabama Dept. of Conserv. and Nat. Res.*, 986 So.2d 1093, 1109-1110 (Ala. 2007).

The court determined that this language implicated a "gross proceeds" lease and triggered the lessee's duty to pay royalties to the state without deductions. *Id.* As discussed above, both the Montana Administrative Rules and the leases to which Ranck is a party stipulate that the State may claim its royalties "free of cost or deductions." *See* § 85-2-434(2), MCA; Amin. R. M. 36.25.210. Further, Montana lessees are required to provide a monthly report to the Department showing "the amount of oil or gas produced and saved during the preceding month, the price obtained, *the total amount of all sales*, and any additional information as may be required." Section 77-3-431, MCA. The State's oil and gas royalty reporting form effectuates this statutory mandate by requiring the lessee to report the total production and the total amount of all sales, with no provision for deductions. These production reporting requirements, viewed in light of the lease language and statutory provisions, represent a gross proceeds lease from which post-production costs are not deductible. *Exxon Mobil Corp.*, So.2d 1093, 1109-1110.

36. It is clear that Ranck may not make any deductions for the costs of preparing the production to make it marketable, or transporting the production to the point of sale from the State's royalties. Although the lease terms, statutes, and administrative rules provide clear support for the Department's ruling that a lessee's costs are not deductible from the State's royalty, this ruling is also supported by the implied covenants and rules of construction that govern the interpretation of oil and gas leases in Montana.

37. Further, the lessee's duty to market the production has been recognized in other jurisdictions to encompass the sole obligation to bear the costs associated with rendering the product marketable. Because the principle consideration for an oil and gas lease is the payment of royalties, all oil and gas leases in Montana impose upon the lessee an implied covenant to market the production. *Severson v. Barstow*, 103 Mont. 526, 63 P.2d 1022 (1936). In order to avoid lease cancellation for breach of this covenant, the burden of proof rests upon the lessee to establish that the lessee has acted with reasonable diligence. *Berthelote v. Loy Oil Co*., 95 Mont. 434, 28 P.2d 187 (1933). In judging whether a lessee has complied with the implied covenant to market, Courts will examine whether the lessee has acted as a reasonably prudent operator to market the production in the mutual best interests of both the lessor and lessee. *Fey*, 129 Mont. 300, 318, 285 P.2d 578, 587.

38. Under the implied covenant to market, moreover, a lessor has the right to be paid on the best price obtained or obtainable by the lessee. When a lessee is paying royalty based on one price but it is selling the gas for a higher price, the lessor is entitled to have its royalty payments calculated based on the higher price. *Howell v. Texaco Inc.*, 112 P.3d 1154, 1160 (Okla. 2004). Here, where Ranck obtained a higher price for itself through its affiliate, it should have remitted royalties to the Department based upon that higher price. The West Virginia Supreme Court held explicitly in *Estate of Tawney* that "at the wellhead" language in a lease was insufficient to overcome the general rule that "the lessee must bear all costs of marketing and transporting the product to the point of sale." *Id*. at 28.

39. Some courts have gone still further by adopting the view that leases containing "at the wellhead" language were completely silent as to allocation of costs. *See, Rogers v. Westerman Farm Co.*, 29 P.3d 887, 902 (Colo. 2001). Because of this silence, the court looked to the implied covenant to market to

determine the proper allocation of costs. *Id.* The implied covenant to market imposed upon the lessee the burden of any expenses incurred to render the gas marketable. *Id*. at 903. Any reasonable costs incurred to enhance the value of already marketable gas were to be shared to the extent that they actually resulted in increased royalty revenues. *Id.* The Colorado Supreme Court in *Rogers* declined to adopt a bright line rule with regard to transportation costs. The court reasoned that the distance required to transport the product to market was not relevant to a determination of how those costs should be allocated between lessor and lessee. Rather, the court held, "the determination of whether transportation costs (either short or long distance) are to be allocated between the parties is based on whether the gas is marketable before or after the transportation cost [sic] are incurred." *Id.* at 900.

40. The Supreme Court of Oklahoma similarly determined that the lessee's duty to market production from the lease includes bearing the costs of preparing the gas for market, especially where no cost sharing agreement between lessor and lessee dictates otherwise. *Wood v. TXO Production Corp.*, 854 P.2d 880, 881 (Okla. 1992). The Oklahoma Supreme Court further elaborated that the costs of compression, dehydration, and gathering under oil and gas leases on state trust lands were not chargeable to the state to the extent that these processes were necessary to render the product marketable at the point of delivery in the purchaser's pipeline. *TXO Production Corp. v. State ex rel. Com'rs of Land office*, 903 P.2d 259, 262 (Okla. 1994). The court's determination was predicated upon the lessee's implied duty to market the production and deliver the production to the point of sale. Because "gathering" costs were incurred prior to the point of sale, the Oklahoma Supreme Court held that gathering costs were not deductible from the State's gas royalties. *Id.*

41. In light of this line of precedent, Ranck's claim that "at the wellhead" language in the lease constitutes the beginning and end of the inquiry is a gross oversimplification. Neither the specific terms of the State leases nor the relevant provisions of Montana statutory and administrative law allow the deduction of expenses from the State royalty, and under the implied covenant to market, it is clear that a lessee may not deduct expenses necessary to render the gas marketable. Bearing in mind that oil and gas leases must be liberally construed in favor of the lessor and against the lessee, the Department concludes that Ranck is not entitled to take any deductions from the State's share of the gross proceeds obtained from the sale of the gas to the first arm's-length purchaser. *See West,* 298 N.W.2d 484 (N.D. 1980); *Savage v. Williams Production RMT Co.*, 140 P.3d 67, 69 (Colo. App. 2005).

42. Under the terms of the leases to which Ranck is a party, the Department concludes that neither § 77-3-434, MCA, nor Admin. R. M. 36.25.210 entitle Ranck to deduct any costs incurred prior to the gas being rendered marketable and sold. Ranck has the sole obligation to render the production marketable, and to deliver the product to the point of sale at which Ranck has chosen to sell the production.

QUESTION TWO

43. If the answer to the preceding question is that a version of the "marketable condition" rule – rather than the "wellhead jurisdiction" rule – applies to the State Leases:

a. (i) at what point does the State's royalty gas become "marketable" so as to allow post-wellhead/pre-transmission costs to be deducted; and

b. (ii) specifically, whether actual post-wellhead gathering and compression costs are nonetheless deductible.

44. Summary of Ruling: Under the terms of its leases with the State, Ranck is legally obligated to remit royalties due the State based upon the gross proceeds received or receivable by the lessee and its corporate affiliate from the first arm's-length sale of the production without any deductions for treatment, gathering, compression, transportation, or other charges. This determination is based upon the express terms of the above-captioned oil & gas leases, specific provisions of Montana statutory law and administrative rules, and fundamental principles of construction governing oil and gas agreements.

45. Ruling: State of Montana oil and gas law requires lessees to accurately report and pay royalties to the State upon the higher of:

a. 1) the purchase price received—calculated at the point of sale; or

b. 2) the purchase price receivable at the point of sale—calculated at the point of sale; or

c. 3) the fair market value of the production at the wellhead. Admin. R. M. 36.25.210; § 77-3-432, MCA.

46. Ranck fails to document how it and its corporate affiliates have determined the costs of marketing, treatment, and transportation that it seeks to deduct from the State's royalties. The creation of marketing affiliates, and the sale of production to those affiliates, allows a lessee to report lower prices for the calculation of royalties and severance taxes, which in turn allows the lessee and its corporate affiliate to capture additional profit at the expense of the lessor. The creation of marketing affiliates is often utilized by lessees seeking to unlawfully manipulate the price of production, and remit lower royalties to the lessor. Accordingly, courts have recognized that the price paid to a producer by its affiliate is not an "arms-length" sale and such sales are not a true measure of either the value of the product or the price actually received for its sale. See, *Howell*, 112 P.3d 1154 at 1158; *Beer v. XTO Energy, Inc*., 2010 WL 476715, 2 (W.D.Okla., Feb. 5, 2010).

47. The Department's determination that Ranck is required under the terms of its leases and Montana law to pay royalties based on the gross proceeds or fair market value free of costs and deductions answers in the negative Ranck's inquiry as to the deductibility of post-wellhead gathering and production costs. Ranck may not deduct any gathering or compression costs to the extent that they are incurred before the product is sold in an arm's-length transaction. As we have already stated, the lessee's duty to market the production encompasses the costs of rendering the product marketable. Marketability of production occurs at the point of the first arms-length sale to a third party purchaser. *See, Harding ,* 220 F. Supp. 466 (co-owner gas purchase contracts do not create a market); *Rogers*, 29 P.3d 887, 906 ("Gas is marketable when it is in the physical condition such that it is acceptable to be bought

and sold in a commercial marketplace, and in the location of a commercial marketplace, such that it is commercially saleable in the oil and gas marketplace.").

48. Because Ranck is not entitled—under the terms of the State leases—to deduct any costs incurred prior to the point of sale, the relevant question is when the first arms-length sale occurred. Ranck transferred the State's share of production to ROC Gathering, LLP, and Commercial Energy, both of which are wholly-controlled affiliates of Ranck, and based the State's royalties upon these purported sales. Ultimately, Commercial Energy sold the production in arm's-length sales to third-party purchasers. By this mechanism, Ranck sought to improperly deduct the costs of gathering, transportation, and fuel from the payments it received for the gas from these sales.

49. The State of Montana will not recognize a sale of production between wholly-controlled corporate affiliates for the purpose of calculating the royalties due the State upon State school trust lands. *See*, *Howell*, 112 P.3d 1154 at1158 (An intra-company contract is not an arm's-length transaction, and therefore not a legal basis on which lessee may calculate royalty payments); *Harding*, 220 F. Supp. 466 (A lessee cannot act in the dual capacity of a seller and buyer of gas production and set the Lessor's royalties based upon a self-devised purchase price).

50. As the Oklahoma Supreme Court stated in *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1275 (Okla. 1981):

a. Courts should take care not to allow lessors to be deprived or defrauded of their royalties by their lessees entering into illusory or collusive assignments or gas purchase contracts. Whenever a lessee or assignee is paying royalty on one price, but on resale a related entity is obtaining a higher price, the lessors are entitled to their royalty share of the higher price. *The key is common control of the two entities* (emphasis added).

51. The situation described by the court in *Tara Patrolium* equates precisely to the relationship of Ranck and its affiliate companies. The sale between Ranck and its wholly controlled affiliates does not provide a legal basis upon which lessees may calculate royalty payments and, therefore, must therefore be disregarded. Ranck may not use its affiliates to unfairly deprive the State of its royalties. *Id.* An oil company may not—where the terms of the lease dictate that royalties are never to be less than the price actually realized through the sale or fair market value—use another method of calculation that results in a royalty lower than one based on an arms-length transaction. *Shell Oil Co. v. Ross*, --- S.W.3d ----, 2010 WL 670549 (Tex. App. 2010). The first arms-length transaction occurred off the lease premises, and post-production costs up to that point of sale are not deductible by Ranck. *See Tyson v. Surf Oil Co.*, 196 So. 336 (La. 1940).

52. Because the costs that Ranck seeks to deduct were incurred prior to the first arms-length transaction, they represent costs necessary to render the gas marketable. As such, they are not deductible from the State's royalty. By deducting such costs, Ranck violated the lessee's implied covenant to market the production for the mutual benefit of lessor and lessee and failed to comply with the mandate of Admin. R. M. 36.25.210.

QUESTION THREE

53. In respect to any post-wellhead costs allowed under either approach discussed above, the services for which are provided by an affiliate of the lessee:

a. (i) whether the lessee is allowed to deduct an amount imputed from the affiliate's charges against third-parties for similar services, or whether the lessee is allowed to deduct only the affiliate's actual costs in providing the involved service, and

b. (ii) if the latter, what element of the affiliate's actual costs are deductible?

54. Summary of Ruling: Under the terms of the leases to which Ranck is a party, its royalty obligation must be calculated on the gross proceeds obtained or obtainable from the first arm's-length sale of the production. The lessee has an obligation imposed by the implied covenant to market to sell the gas produced at the best price available, and must operate the lease and market the production as if it were the lessee's only lease. No costs are deductible from the State's royalties calculated at the point of the first arm's-length sale, regardless of whether those costs were incurred by the lessee or a corporate affiliate of the lessee.

55. Ruling: Under the facts presented in the Petition, and as discussed above, the initial sale of gas from the lessee is a non-arm's length transfer of the gas production between two corporate affiliates. The Department will not recognize a transfer of production between corporate affiliates as a valid sale for the purposes of calculating oil and gas royalties due to State trust beneficiaries. *See Howell*, 112 P.3d 1154 at 1158.

56. In cases involving inter-affiliate transfers, royalties are calculated from the first arm's length sale of gas to a third-party purchaser. A lessee may not avoid its obligation to pay royalties to the state school trust by transferring production to an affiliate at a lower ostensible purchase price, who then sells the production to a third-party purchaser at a higher price. This constitutes self-dealing. The Department need not prove that the sale occurred as a scheme or subterfuge in order to disregard inter-affiliate sales for the purpose of calculating royalties. *Beer v. XTO Energy, Inc*., 2010 WL 476715, 2 (W.D. Okla. Feb. 5, 2010).

57. The implied covenant to reasonably market oil and gas serves to protect a lessor from the lessee's self-dealing or negligence. A lessee who receives seven-eighths of the proceeds from the sale of gas has a proper incentive to get the "best" price. A lessee who crafts sales transactions with a corporate affiliate to pass revenue to that affiliate has no incentive to obtain the best price. On the contrary, the lessee has every incentive to sell the production to its affiliate at below market value in order to reduce its royalty obligation. All revenue generated under an oil and gas lease must be shared strictly in accordance with the fractional division contemplated in the lease. The lessee may not engage in self-dealing or sales contract manipulation in order to secure more favorable terms to itself. *See Amoco Production Co. v. First Baptist Church of Pyote*, 611 S.W.2d 610, 610 (Tex. 1980) (breach of the implied covenant to market in good faith occurred where lessee sold the lessors' gas at rate substantially lower than market value, where by doing so the lessee was able to obtain for itself the collateral benefit of an increased price for gas from its other previously dedicated leases from third parties); *Amoco Production Co. v. First Baptist Church,* 579 S.W.2d 280 (Tex. Civ. App. 1979) (lessee must obtain best purchase for mutual benefit of lessor and lessee); *Klein v. Jones*, 980 F.2d 521,

532 (C.A.8 (Ark.) 1992) (oil and gas leases should be construed in manner so that lessee and the lessor split all economic benefits arising from the land).

58. Section 77-3-431, MCA, requires the royalty report to include the amount of "oil or gas produced and saved . . . and the price obtained." This statute does not mention any right of the lessee to take, or report, deductions from the gross proceeds royalty due the State. Because the State of Montana lease terms do not allow for any deductions from the lessor's royalties, the lessee has the sole obligation to place all production in marketable condition prior to the point of sale of that production. When transferring possession of the production to a commonly-controlled corporate affiliate, a lessee seeks to utilize such transactional schemes to:

a. 1) concoct a lower purchase price;

b. 2) render meaningless the implied covenant to market, and

c. 3) allow its corporate affiliate to charge against the royalty interest costs that normally would not be chargeable against the State's royalty interest under the terms of the lease contract, because those costs were incurred prior to the point of sale to a third-party purchaser. Under the facts Ranck has presented, the purchase prices and costs asserted by the corporate affiliates cannot be verified as arm's-length contracts with third-party purchasers in an open market. Therefore, the Department must ignore the inter-affiliate sales and to calculate its royalties based upon the first verifiable arms-length sale to a third-party purchaser. Schemes to manipulate the purchase price of production from State trust lands represent a violation of the implied covenant to market. By accepting royalties calculated under such methods, the Department would be remiss in its duty to enforce the express terms of these lease contracts. *Montanans for Responsible Use of School Trust v. State ex rel. Bd. of Land Comm'rs*, 296 Mont. 402, 407, 989 P.2d 800, 803 (1999); Art. X, §§ 1, 11 Mont. Const.

59. The department concludes that Ranck may not deduct costs incurred by either itself or its affiliates—ROC gathering and Commercial Energy—prior to the point of the first arms-length sale to a third party purchaser. No post-wellhead costs are deductible under the facts presented by Ranck in its Petition.

Effect of 2011 Legislation

60. Issuance of this Declaratory Ruling was delayed by consideration for possible legislative changes to the calculation of State oil and gas royalties. SB 415 by the 2011 Montana Legislature sought to revise the standard terms of State of Montana oil and gas leases so as to require royalties to be calculated at the wellhead regardless of where a State lessee sold the production, and to allow the State lessee to make certain deductions from the State's royalties.

61. SB 415 was vetoed by the Governor. A copy of the Governor's veto letter for SB 415 is attached hereto as Exhibit "E", and is incorporated herein by reference. Consequently, no enactments from the 2011 Legislature affect this Declaratory Ruling.

NOTICE

62. If all administrative remedies have been exhausted, this Administrative Declaratory Ruling may be appealed by a party in accordance with the Montana Administrative Procedure Act, Sections 2-4-501 and 2-4-701, et seq., MCA, by filing

a petition in the appropriate District Court within 30 days after service of this Final Decision upon you.

DATED this 4th day of August, 2011.

/s/ Mary Sexton
Mary Sexton, Director
Montana DNRC

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the fore-going ADMINISTRATIVE DECLARATORY RULING AND NOTICE OF OPPORTUNITY TO SEEK JUDICIAL REVIEW was served by mail, postage prepaid, upon the following on the 4th day of August, 2011:

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/s/ Tommy H. Butler

NOTICE OF FUNCTION OF ADMINISTRATIVE RULE REVIEW COMMITTEE

Interim Committees and the Environmental Quality Council

Administrative rule review is a function of interim committees and the Environmental Quality Council (EQC). These interim committees and the EQC have administrative rule review, program evaluation, and monitoring functions for the following executive branch agencies and the entities attached to agencies for administrative purposes.

Economic Affairs Interim Committee:

- Department of Agriculture;
- Department of Commerce;
- Department of Labor and Industry;
- Department of Livestock;
- Office of the State Auditor and Insurance Commissioner; and
- Office of Economic Development.

Education and Local Government Interim Committee:

- State Board of Education;
- Board of Public Education;
- Board of Regents of Higher Education; and
- Office of Public Instruction.

Children, Families, Health, and Human Services Interim Committee:

- Department of Public Health and Human Services.

Law and Justice Interim Committee:

- Department of Corrections; and
- Department of Justice.

Energy and Telecommunications Interim Committee:

- Department of Public Service Regulation.

Revenue and Transportation Interim Committee:

- Department of Revenue; and
- Department of Transportation.

State Administration and Veterans' Affairs Interim Committee:

- Department of Administration;
- Department of Military Affairs; and
- Office of the Secretary of State.

Environmental Quality Council:

- Department of Environmental Quality;
- Department of Fish, Wildlife, and Parks; and
- Department of Natural Resources and Conservation.

These interim committees and the EQC have the authority to make recommendations to an agency regarding the adoption, amendment, or repeal of a rule or to request that the agency prepare a statement of the estimated economic impact of a proposal. They also may poll the members of the Legislature to determine if a proposed rule is consistent with the intent of the Legislature or, during a legislative session, introduce a bill repealing a rule, or directing an agency to adopt or amend a rule, or a Joint Resolution recommending that an agency adopt, amend, or repeal a rule.

The interim committees and the EQC welcome comments and invite members of the public to appear before them or to send written statements in order to bring to their attention any difficulties with the existing or proposed rules. The mailing address is P.O. Box 201706, Helena, MT 59620-1706.

HOW TO USE THE ADMINISTRATIVE RULES OF MONTANA AND THE MONTANA ADMINISTRATIVE REGISTER

Definitions:

Administrative Rules of Montana (ARM) is a looseleaf compilation by department of all rules of state departments and attached boards presently in effect, except rules adopted up to three months previously.

Montana Administrative Register (MAR or Register) is a soft back, bound publication, issued twice-monthly, containing notices of rules proposed by agencies, notices of rules adopted by agencies, and interpretations of statutes and rules by the Attorney General (Attorney General's Opinions) and agencies (Declaratory Rulings) issued since publication of the preceding register.

Use of the Administrative Rules of Montana (ARM):

Known Subject

1. Consult ARM Topical Index.
   Update the rule by checking the accumulative table and the table of contents in the last Montana Administrative Register issued.

Statute

2. Go to cross reference table at end of each number and title which lists MCA section numbers and department corresponding ARM rule numbers.

ACCUMULATIVE TABLE

The Administrative Rules of Montana (ARM) is a compilation of existing permanent rules of those executive agencies that have been designated by the Montana Administrative Procedure Act for inclusion in the ARM. The ARM is updated through June 30, 2011. This table includes those rules adopted during the period July 1, 2011, through September 30, 2011, and any proposed rule action that was pending during the past 6-month period. (A notice of adoption must be published within six months of the published notice of the proposed rule.) This table does not include the contents of this issue of the Montana Administrative Register (MAR or Register).

To be current on proposed and adopted rulemaking, it is necessary to check the ARM updated through June 30, 2011, this table, and the table of contents of this issue of the MAR.

This table indicates the department name, title number, rule numbers in ascending order, catchphrase or the subject matter of the rule, and the page number at which the action is published in the 2011 Montana Administrative Register.

To aid the user, the Accumulative Table includes rulemaking actions of such entities as boards and commissions listed separately under their appropriate title number.

System - Video Gambling Machine - Hardware and Software Specifications - Prohibited Machines - Approval of Video Gambling Machines and/or Modifications to Approved Video Gambling Machines - Inspection and Seizure of Machines - Manufacturer of Illegal Gambling Devices – Department Contact Information - Combination of Video Poker, Keno, Bingo, and Video Line Games - Testing of Automated Accounting and Reporting Systems - Definitions - Prize Awards for Live Keno and Bingo Games, p. 1252, 1681

LABOR AND INDUSTRY, Department of, Title 24

Boards under the Business Standards Division are listed in alphabetical order following the department rules.

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24.11.2221 Unemployment Insurance Rates for Governmental Entities, p. 1002, 1371
24.17.103 and other rules - Prevailing Wage Rates for Public Works Projects - Building Construction Services - Heavy Construction Services - Highway Construction Services - Nonconstruction Services, p. 2681, 102, 747
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(Board of Barbers and Cosmetologists)
24.101.413 and other rule - Renewal Dates - Requirements - Fees, p. 812, 1683

(Board of Chiropractors)
24.126.510 and other rules - Endorsement - Inactive Status and Conversion - Minimum Requirements for Impairment Evaluators - Prepaid Treatment Plans, p. 2284, 380

(Board of Dentistry)

24.138.509 and other rules - Dental Hygiene Limited Access Permit - Medical Assistance Program Relapse - Dentist Administration of Anesthesia - Anesthesia Definitions - Committee - Permits, p. 1791

(State Electrical Board)

24.141.405 and other rule - Fee Schedule - Nonroutine Applications, p. 1347, 1588

(Board of Medical Examiners)

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