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March 26, 2009

Mr. Mike Jacobson
Water/Wastewater Treatment Plant Supervisor
City of Great Falls
P.O. Box 5021
Great Falls, MT 59403-5021

RE: Response to Request for Proposals for Consulting Services
Water Rights Review for Potential Purchase

Dear Mr. Jacobson:

Thank you for inviting Garlington, Lohn & Robinson, PLLP ("Garlington") to submit a proposal to the City of Great Falls (the "City") to assist with review and possible acquisition of municipal water rights. We are pleased to submit this proposal, and we would welcome the opportunity to assist the City on this project. We also are happy to meet with you at your convenience to discuss this proposal further.

We have structured this letter to respond to the specific items that you requested. We also are happy to provide any additional detail or to answer any questions that you might have about our response.

A. Profile of Firm and Principals.

Garlington is the second largest Montana-based law firm. We trace our roots to an 1870 law practice started by an early attorney in Missoula. Since 1955, the firm has continuously been known by its current name. Our practice always has focused on representations of various businesses, governmental entities and others in a wide variety of legal issues. Currently, we have about 30 attorneys and additional supporting staff. We assist clients throughout Montana, including several entities in the Great Falls area.

If we are selected, I will be the principal in charge of this project. I have enclosed a resume that lists my qualifications. I have had an environmental and natural resource focused practice for nearly 20 years since I graduated from law school. The first five years of my practice were for a large regional firm in Portland, Oregon. I have been with Garlington for the past 15 years.

For the entire time I have been in practice, a substantial amount of my work has involved water rights issues. Through this work, I am quite familiar with the nuances of Montana water law and some of the unique issues faced by municipalities. I have testified before both the Montana legislature and the interim water policy

committee on municipal water issues. I also have given several talks about municipal water rights issues. I enclose a copy of an outline I prepared for a seminar earlier this year.

If we are selected, I will be assisted in the project by my colleague, Elena Zlatnik. I have included Elena's resume for your information. Elena also maintains a natural resource practice with a particular focus on water rights issues.

Both Elena and I also have degrees in natural resource related disciplines. My degree is in geology and Elena's is in resource conservation with extensive coursework in hydrology. In addition, because we are a relatively large law firm for Montana, we have many staff and other attorneys available to assist us. We also have strong relationships with various engineers, hydrogeologists, and other consultants in the water resources field, whose assistance we can call on as needed.

B. Client List.

1. Mountain Water Company

Garlington has been counsel for Mountain Water Company ("MWC") for the entire time MWC has been in existence. Although MWC itself is not a municipality, it holds several dozen municipal water rights that it utilizes to provide municipal water service to the City of Missoula. We have assisted MWC in protecting and acquiring the water rights that allow it to serve the Missoula area. This work has included assisting MWC in acquiring several systems, permitting new rights, protecting existing rights, making changes to rights to respond to growth, and with general municipal water system operations. Through this work, we have gained a significant knowledge base about many of the unique aspects to municipal water rights and systems.

Client contact: Arvid Hiller or John Kappes
Mountain Water Company
Telephone: (406) 721-5570

2. Big Sky Area Resorts.

We have assisted several large self-contained resorts in the Big Sky area in acquiring municipal water rights necessary for development. Specifically, we recently assisted the Yellowstone Club in its acquisition and permitting of municipal water rights to serve a complex system in Big Sky. This involved designing and negotiating a far-reaching agreement with several entities and a large water and sewer district to obtain a secure source of water for the residential and commercial aspects of the resort. We also assisted these entities in evaluating water rights for purchase and in obtaining permits in a closed basin. This work also involved negotiating and drafting contracts for water utilization.

Client contact: Mike DuCuennois
Yellowstone Mountain Club
Telephone: (406) 995-3140

In addition to our work for Yellowstone Club, we also have been retained on a confidential basis by several large financial institutions to evaluate and provide opinions on the viability of water rights being acquired by another large resort in the Big Sky area. Although our confidentiality arrangement precludes us from identifying the client, we can disclose that this project included analyzing several options being proposed by the resort to acquire and protect quasi-municipal water rights to be used to satisfy anticipated future growth at the resort.

3. Lower Teton Water Users Association.

Although not directly related to the acquisition of municipal water rights, we have assisted many clients over the years in the Montana water rights adjudication process. Currently, we are assisting a group of water users who hold water rights in the lower Teton River Basin. As part of this work, we have been part of a team that has evaluated the viability of several hundred water rights in the Teton River basin. This work is relevant because any water rights being considered for acquisition must be carefully scrutinized to determine whether they will survive DNRC and potential objector scrutiny in a change of use proceeding.

Client contact: Monte Giese
Lower Teton Water Users Association, Inc.
Telephone: (406) 268-3029

4. Miscellaneous.

In addition to these specific projects, we regularly assist a variety of water right owners with obtaining new water rights and protecting existing water rights. This work has become much more complex in recent years as a result of several significant Montana Supreme Court decisions and legislative responses.

C. Fee Schedule.

We propose the following hourly fees for the duration of this project:

Stephen R. Brown	$195.00 per hour
Elena J. Zlatnik	$175.00 per hour
Paralegals	$95.00 per hour

Any travel time is billed at one-half the normal hourly rate. Mileage is charged at the IRS rate or actual cost if rental vehicles are used. Our approach is to minimize travel to what is necessary, and then to charge it at a rate that is most cost-effective to the client.

We also charge incidentals such as copying costs, postage, etc. at our actual cost. We do not charge additional fees for clerical staff assistance.

If we are selected for an interview, we are willing to travel to Great Falls for the interview at our cost.

D. Project Approach and Anticipated Schedule of Activities.

While the specific approach will be better defined after meeting to discuss the City's needs and goals, we can provide several general ideas as to anticipated approach.

1. Understand the City's current water budget, anticipated growth and existing water rights.

   While we do not view this task as involving a significant amount of work, we do believe it is important as background to understand the City's existing water system and planning documents it previously has prepared. For example, the water reservation application that the City prepared in 1988 makes reference to a 1981 Water System Master Plan. There may be other more recent documents that the City has developed to document its existing water and forecasted water needs for the foreseeable future. Because the approval of any potential water rights acquisition will require some showing of anticipated need, it will be important to start with a general understanding of these documents.

   In addition to any water system planning documents, we also believe it important to understand the City's existing water rights. From the information supplied in the City's Request for Proposals and from information available in available data bases, it appears that the City has a valid water reservation with a July 10, 1985, priority date for 9153.52 gallons per minute and 6489 acre feet. The reservation supplements several rights the City holds to divert water from the Missouri River. Much of the information about these rights is available online, but it will be important to understand how the City uses these rights, and how the water reservation fits into the City's long-term plans, especially with its relatively junior priority date.

2. Evaluate types of rights that can best fulfill the City's anticipated needs.

   Water rights have several components, including priority, type of use (i.e. irrigation, industrial, etc.), period of use, place of use, and volume. Any water right acquired will need to go through the DNRC change process to convert the rights to the City's anticipated use. Because each water right has unique characteristics, the available rights will have to be weighed based upon various factors to determine which are best to meet the City's needs. For example, water rights might be readily available for purchase with very junior priority dates, but it probably makes little sense to acquire these types of rights because of the risk they could be "called" by more senior users in times of shortage. Because Montana does not recognize preferences between different types of rights, a junior right held by a municipality may not provide adequate assurances necessary to meet future needs.

   Another aspect that must be evaluated in considering water rights acquisitions is the potential difficulty in obtaining a change approval. Before the City can use any acquired right, it must obtain approval from DNRC to use the right at a different place of use, for a different type of use, and probably from a different point of diversion. Based upon numerous recent interactions with the DNRC on municipal issues, we know that DNRC currently follows an approach that places serious constraints on the flexibility of municipal water systems. The DNRC currently only allows changes based upon the actual historical use of the right proposed for change.

As part of this task, we would anticipate examining the target water rights that may be available for the City to determine whether there are significant risks to obtaining change approval. Based upon the parameters of the target rights, evaluation of actual historical use, and consistency with the City's anticipated needs, we would anticipate providing the City with an analysis that ranks the rights in some fashion.

3. Pricing of the available water rights.

Montana does not yet have a mature water market, so the prices paid for water rights can vary wildly. This, in part, is a function of availability, along with the viability of rights to fulfill the needs of the acquiring entity. However, over the last few years, several water rights acquisitions have occurred, so there is pricing information available. The City will be in the best position to negotiate price by understanding some of this information in the context of the parameters of the rights that may be available for purchase.

4. Contract negotiations.

Assuming that the City does find a willing seller of rights that appear to meet the City's anticipated needs, a contract of purchase will need to be negotiated. We can assist the City in any way appropriate in drafting and negotiating this contract. Water purchase contracts do have certain unique provisions. For instance, because actual use of the water right will depend upon approval of the DNRC change, the contract should contain appropriate contingencies to protect the City in the event the change is not approved.

5. DNRC change issues.

Finally, if the City does proceed with the acquisition of any water rights, we can assist in preparing the necessary change application to allow the water to be used by the City, and to allow it sufficient time to perfect these changes.

E. Price Proposal.

The following table sets out a very general price proposal for the work described above. Please note, as suggested by your request, this estimate is very rough and can be significantly refined once we better understand the City's specific needs and work that might already have been accomplished.

Task	Description	Anticipated Cost
1	Understanding water budget and anticipated needs	$1,000.00
2	Evaluate viability of rights available to meet anticipated needs	$15,000.00
3	Evaluate pricing proposals for rights	$3,000.00
4	Negotiate and draft acquisition contracts	$5,000.00

Task	Description	Anticipated Cost
5	Assist with change application preparation	$5,000.00
	Miscellaneous costs	$1,000.00
TOTAL		**$30,000.00**

F. Disciplinary Proceedings.

Each of the attorneys who will perform work on this project are fully licensed and in good standing to practice law in the State of Montana. None of the attorneys listed in this proposal, or that we anticipate will provide services if we are selected, are or have been involved in any disciplinary proceedings. Also, although not specifically requested by your proposal, we do not believe that we will have any conflicts of interest that would prevent us from working for the City. All of our water rights work in the Missouri basin either involves clients in downstream tributary basins or has been completed.

We very much appreciate the invitation to submit this proposal. Please feel free to contact me if there is any other information that we can provide.

Thank you.

Very truly yours,

GARLINGTON, LOHN & ROBINSON, PLLP

Stephen R. Brown

SRB:kaw

Obtaining and Protecting Municipal Water Rights in Montana

Stephen R. Brown
Garlington, Lohn & Robinson PLLP

I. INTRODUCTION

Appropriating water for municipal needs is not like appropriating water to irrigate or to run an industrial operation. Municipal demand is a function of how many people choose to build their homes within a service area, and on how many commercial and industrial enterprises locate within that area. These numbers will only increase, especially in rapid growth counties such as Missoula, Gallatin and Ravalli. Municipal rights also are different because the water supplier must respond to instantaneous demand, but cannot control demand.

The "growing communities doctrine" is a body of case law and statutes that allow a municipal water supplier to hold a priority date for an unused block of rights to water in anticipation of future water needs. The general purpose of the doctrine is to allow municipalities to secure water rights for sources of water for construction of a properly scaled water system, rather than rely upon piecemeal short-term expansion of the system. The issue raised by the doctrine is whether it fits within the existing water law framework.

II. LEGAL BACKDROP

A. Montana Water Law Concepts.

Like most western states, Montana operates under a prior appropriation system. Under this system, beneficial use is the basis, the measure and the limit of a water right. Water is allocated on a priority system of "first in time, first in right." During times of water shortage, those persons with junior water rights must curtail use in favor of senior water users. There are a few important basic concepts built into western water law:

- **Beneficial Use.** There is a common saying in water law that "beneficial use is the basis, the measure, and the limit to those rights." The "basis" part means there are a number of different types of water rights, such as irrigation, industrial, stock watering, power generation, mining, and municipal.

- **Waste.** An appropriator who holds a water right may not waste it.

- **Abandonment.** Water rights cannot be held unused for a prolonged period of time without being used. At some point, extended nonuse of a water right will cause the right to be abandoned. In Montana, ten years of

nonuse generally raises a rebuttable presumption of abandonment. Mont. Code Ann. § 85-2-404.

- **Anti-Speculation.** Speculation is the act of acquiring a resource for future use or resale. The law of all western states, including Montana, prohibits speculation in water rights.

- **Preferences.** Montana water law does not expressly recognize preferential use of water rights. What this means is when water use is curtailed during a time of shortage, the priority scheme is blind to the type of water right. In other words, under the priority system, a municipal water right enjoys no special protection.

- **Acquisition.** Municipal appropriators (whether public or private), like any other water user, must apply to the DNRC for a permit to use a specified amount of water; from a particular source and point of diversion; at a particular time or season; at a specified location; and for specified purposes. Like any other water user, municipal users must "prove up" or "perfect" the right within a reasonable period of time. In Montana, new appropriations are subject to a complex set of permitting rules.

- **Change.** Implicit in the Montana water law scheme is the notion that various components of a water right can be changed, including the point of diversion and place of use. Like acquisition, changes also are subject to complex regulatory rules that require, among other things, a showing of actual historic use. Mont. Code Ann. § 85-2-402.

- **Basin Closures.** As a result of several court cases and statutes, the acquisition of new water rights in Montana is uncertain at best. Many basins are closed to new applications, with very limited exceptions. Closed basins include the upper Missouri, Jefferson, Madison, Teton, upper Clark Fork, Bitterroot and Musselshell. As the result of a decision issued in an administrative case involving Avista Utilities and the Thompson River Lumber Company, the remainder of the Clark Fork basin also has been closed to almost all new permitting.

B. The Growing Communities Doctrine

In its simplest form, the growing communities doctrine is something of a subset of the prior appropriation system. It generally provides municipal water suppliers more time to perfect their rights by construing some of the requirements more liberally. This allows municipal suppliers to hold rights in anticipation of future needs and to develop a water system gradually. The doctrine also completely or partially exempts a municipal supplier from loss for nonuse. Effectively it allows municipal suppliers to hold a priority date for rights in anticipation of future water uses in the community. The doctrine, however, varies from state to state.

A corollary to the growing communities doctrine is the so-called "progressive growth" doctrine. This doctrine allows claimants to establish a priority date by documenting their anticipated water needs. The Montana Supreme Court first recognized the progressive growth doctrine in 1926:

> It is not requisite that the use of water appropriated be made immediately to the full extent of the needs of the appropriator. It may be prospective and contemplated, provided there is a present ownership or possessory right to the lands upon which it is to be applied, coupled with a bona fide intention to use the water, and provided that the appropriator proceeds with due diligence to apply the water to his needs.

St. Onge v. Blakely (1926), 76 Mont. 1, 245 P. 532, 539.

C. Issues Raised by Growing Communities Doctrine

1. Establishing Quantities for Future Use. Public water suppliers serve dynamic and growing populations with potable and industrial water. As such, they must have the ability and flexibility to use and retain water rights that recognize the need to "grow into" a level of use. The physical features of a water system, the plan for financing the system and financing the physical improvements to it, the obligation to serve, and the current and planned service area, all need to be taken into account. Each of these factors creates uncertainty when it comes to proving up a municipal use water right.

2. Adequate Time to Use Water. Public water suppliers require a relatively long and flexible time horizon to put a water appropriation to full use. These time horizons can be 50 years or more. The challenge in managing water resources is to ensure that the system for allocating water recognizes and accommodates the dynamic character of the municipal and community use. Municipal suppliers are subject to barriers such as financing, regulatory approval and public interest criteria that do not apply to other users.

3. Place of Use Flexibility. Suppliers that serve growing communities need to have the flexibility of a growing or dynamic place of use. Montana water rights specify the quantity of water that may be used, and also state where water may be used. Changing the place of use requires a burdensome regulatory process. The Montana DNRC has taken the position that Montana law does not provide for place of use flexibility for municipal water rights. (See Exhibit A).

III. LAW IN OTHER STATES

A. Colorado

The roots of the growing communities doctrine generally are traced to *City and County of Denver v. Sheriff et al*, 105 Colo. 193, 96 P.2d 836 (Colo. 1939). In that case, the City and County of Denver were experiencing considerable growth and had invested millions of dollars in the construction of a tunnel to bring water over the divide to the west to the city of Denver. The lower court had decreed an appropriation less than the capacity of the tunnel and conditioned

additional appropriations on the actual use of the tunnel's capacity. The Supreme Court reversed and held that a municipal right includes a reasonable expectation of an increase in the number of consumers.

In 1979, the Colorado General Assembly modified the statutory definition of "appropriation" and recognized the need for a more flexible anti-speculation requirement that would allow government agencies planning flexibility for future water use. These modifications legislatively recognized a "great and growing cities" concept previously recognized by the Colorado Supreme Court. Colorado's Water Right Determination and Administration Act provides governmental agencies with a limited exception from certain requirements otherwise applicable to private water appropriators. "A governmental agency need not be certain of its future water needs; it may conditionally appropriate water to satisfy a projected normal increase in population within a reasonable planning period." Colo. Stat. § 37-92-103(3)(a)(II).

In *Pagosa Area Water and Sanitation District v. Trout Unlimited*, 170 P.3d 307 (2007), the Colorado Supreme Court reaffirmed the continued vitality of the doctrine, although it held that the period of time cannot be unlimited. The court ruled that a governmental water supply agency has the burden of demonstrating three elements in regard to its intent to make a non-speculative conditional appropriation of unappropriated water: (1) what is a reasonable water supply planning period; (2) what are the substantiated population projections based on a normal rate of growth for that period; and (3) what amount of available unappropriated water is reasonably necessary to serve that population for the planning period, above its current water supply. In addition, it must show under the "can and will" test that it can and will put the conditionally appropriated water to beneficial use within a reasonable period of time.

B. Washington

Washington's approach is in contrast to Colorado. Washington by statute exempts municipal users from abandonment through nonuse so long as there are certain conservation and planning measures in place. There has been significant and ongoing recent litigation in Washington over the doctrine.

1. *State Dept. of Ecology v. Theodoratus*. Case law in Washington indicates it will not allow a municipal water user to simply build a water system and then claim a water right based upon the capacity of the pumps and pipes associated with that system. *State Dept. of Ecology v. Theodoratus*, 135 Wash 2d 582 (1998). In *Theodoratus*, the Washington Supreme Court held that state statutory and common law did not allow the State Department of Ecology (the water permitting agency in Washington) to determine beneficial use or issue a vested water right based on water system capacity. The Court did recognize that under Washington's statutes there are significant differences between municipal and other water uses. At the same time, the Court created uncertainty by implying that municipal water suppliers could not rely on system capacity to validate inchoate (unperfected) water rights.

2. Municipal Water Law. In 2003, the Washington Legislature adopted efficiency requirements for municipal water suppliers. (HB 1338, Ch. 5, Laws of 2003) (www.ecy.wa.gov/programs/wr/rights/Images/pdf/2E2SHB_1338.pdf). The Washington

legislature enacted the Municipal Water Law ("MWL") in 2003 in part to resolve the uncertainty from the *Theodoratus* case. The MWL is significant legislation that directly governs water utilities that provide water supply to more than 80% of the states population. The purpose of the MWL is twofold. The MWL provides certainty and flexibility by clarifying long-standing ambiguities in the law governing water rights held by municipal water suppliers and resolving uncertainties created by the 1998 state Supreme Court decision in the *Theodoratus* case. Simultaneously, in exchange for the municipal water right protections under the law, the MWL also requires municipal water suppliers to implement water use efficiency and conservation measures.

The law was criticized as promoting irresponsible development at the expense of junior water rights holders and stream flows for fish. The law redefined "municipal water supplier" to include any private developer with connections for 15 or more homes and allows these developers to benefit from expanded rights granted retroactively to municipalities. It carried out these changes without the state Department of Ecology's usual review of the impacts of the expansion of a water right.

Several lawsuits have been filed challenging the MWL. These suits asserted the law violated the due process rights of water-rights holders. The challengers also argued the MWL also violated the separation of powers by retroactively overruling a decision of the Washington Supreme Court. The MWL's supporters argued it was intended to strike a balance between keeping water available for future growth and serving existing water rights users during periods of water scarcity by, in part, confirming that municipal water suppliers are exempt from Washington's "use it or lose it" relinquishment laws.

In June 2008, a King County (Seattle) judge ruled that the state legislature overreached by redefining developers as "municipal water suppliers." The Plaintiffs in the case, a number of Tribes and environmental groups, were challenging various provisions of the law on its face. In his split decision, Judge Rogers held that two of the challenged provisions were unconstitutional because they violated separation of powers, but rejected the constitutional challenges to the remaining provisions. Several parties have asked for direct review to the Washington Supreme Court. (The Seattle law firm GordonDerr (www.gordonderr.com) has put many of the pleadings in this case online under a link it maintains called **Municipal Water Law Case Update Center**).

C. Idaho

In Idaho, water supply utilities can secure water rights for "municipal purposes" in a quantity designed to serve "reasonably anticipated future needs." Idaho Code § 42-202(2). Those needs must pertain to a described "service area" in a "planning horizon" that is established for each user. Idaho Code § 42-202(B)(6). A municipality must support its reasonably anticipated future water needs with population and planning data, which is subject to review by the Idaho Department of Water Resources. Idaho Code § 42-202.

D. Oregon

Oregon has adopted legislation that makes several important distinctions between private water rights and municipal water rights. All cities and towns can obtain water rights for "future

reasonable and usual municipal purposes that may be anticipated by reasons of growth of population." Oregon Revised Statues (ORS) 540.610(4). Municipalities that perfect 25% of their water rights can keep the remainder of the permit for future development. ORS 237.260(4). A municipal appropriator may rebut a presumption of forfeiture that arises through nonuse of water by showing that the water right is for "reasonable and usual municipal purpose." ORS 540.610.

Oregon's water laws generally require water use permit holders to diligently develop their permitted use within a limited time period (usually no more than five years). For water uses not fully developed within this time, the permit holder must either seek an extension of the permit or face cancellation of the permit. Oregon's approach did not accommodate the long-term needs of municipal water suppliers, who need long-range water supplies to support future growth in demand. In 2002, Oregon adopted a specialized set of rules to govern permit extensions for municipal water providers.

Under the 2002 rules, long-term municipal permit extensions may be approved for a reasonable time necessary to complete water development or to apply all permitted water to beneficial use. Upon receiving the permit extension, the permit holder has the ability to develop water from identified sources in 20-year blocks. The amount of water available for development in the 20-year block is determined by a basic showing of need. Additional amounts of permitted water may be developed for use by updating water management and conservation plans, and analyzing alternative sources, including enhanced conservation measures.

Oregon's Municipal Water Management and Conservation Planning program provides a process for municipal water suppliers to develop plans to meet future water needs. Many municipal water suppliers are required to prepare plans under water right permit conditions. In addition, with the revision of the permit extension rules in fall 2002, communities seeking long-term permit extensions will be required to prepare plans. These plans will be used to demonstrate the communities' needs for increased diversions of water under the permits as their demands grow.

Oregon also has experienced litigation over the municipal water rights preferences. In *WaterWatch of Oregon v. Water Resources Commission*, 193 Or. App. 87, 88 P.3d 327 (2004), the Oregon Court of Appeals held that the Coos Bay North Bend Water Board could not obtain a permit because it could not show commencement of construction within five years, as was required by Oregon statute. The municipality had projected growth and water needs through 2050. The Oregon Supreme Court reversed in *Waterwatch of Oregon, Inc. v. Water Resources Commission*, 339 Or. 275, 119 P.3d 221 (2005) because the Oregon legislature passed a new statute that exempted water rights for municipal use from the requirement to commence and complete construction within a specified period of time.

IV. THE GROWING COMMUNITIES DOCTRINE IN MONTANA

A. Case Law

Montana does not have a clear case adopting the growing communities doctrine, which leads to a certain amount of uncertainty. There are arguments, however, that the doctrine does exist:

- As noted above, there is case law in Montana recognizing the concept of progressive growth. *St. Onge v. Blakely* (1926), 245 Mont. 532.

- Criteria for abandonment are more generous in Montana for municipal rights than for other rights. Mont. Code Ann. § 85-2-227.

B. Effect of HB 831

- Prior to the 2007 Montana Legislature, Montana exempted municipal use from the basin closure laws. This allowed municipal users to obtain a water right for new groundwater wells, even in a closed basin.

- The 2007 Legislature passed HB 2007 in an attempt to address some of the problems with permitting new water rights for groundwater in closed basins. The Montana Supreme Court's decision in *Montana Trout Unlimited v. Montana DNRC* (2006), 331 Mont. 483, 133 P.2d 224, established that a presumptive link exists between groundwater and surface water, essentially eliminating the groundwater exceptions to the basin closure laws. Under the system set out in HB 831, new groundwater appropriations are possible in closed basins if the applicant meets strict requirements, including a detailed hydrologic assessment, and a mitigation or aquifer recharge plan that demonstrates senior water rights are protected.

- HB 831 left open the possibility of a municipal exception by exempting the "use of surface water by or for a municipality" in certain closed basins. Mont. Code Ann. § 85-2-330(2)(c)(iii) (Teton River basin); Mont. Code Ann. § 85-2-341(2)(c)(iii) (Madison River basin); Mont. Code Ann. § 85-2-343(2)(c)(iii) (Upper Missouri River basin); Mont. Code Ann. § 85-2-344(2)(b) (Bitterroot River basin).

- The municipal exceptions leave open almost as many questions as they answer. For instance:

    - Under *Trout Unlimited,* does limiting the exception of "surface water" mean that municipal use also is exempt from groundwater?

    - Does the term "municipality" include service of water to unincorporated areas that surround cities and towns?

    - Does the exception apply the same way to change applications?

C. Other Cases

- *Lohmeier v. DNRC*, 2008 MT 307 (Sept. 3, 2008). *Lohmeier* involved the issue of whether the DNRC acted lawfully when it repealed the

administrative definition of "municipal use" formerly contained in ARM 36.12.101(39). The Water Use Act does not define the term municipal use even though, prior to HB 831, basin closure laws exempted municipal use from closures. DNRC adopted a rule that arguably exempted only a municipality or town. This left an open question whether a private utility company could appropriate water for public or municipal purposes in a closed basin. One year after adopting the rule, DNRC repealed it on the grounds that it was not in keeping with its historical interpretation of the Act. The district court held that DNRC lacked authority to repeal the rule because it conflicted with protections of senior water users implicit in the basin closure laws. The Supreme Court reversed, holding that DNRC's actions were to restore consistency with the long-standing interpretation that water can be appropriated for municipal use by public utilities in addition to cities and towns.

V. OPEN ISSUES

- Whether the doctrine even exists in Montana
- How to quantify "reasonably anticipated future needs."
- Whether municipal rights should be more broadly exempt from basin closures.
- How municipal rights should be calculated in water availability analyses.
- How best to define the community. Does every subdivision apply?
- Short of additional clarity, what planning constraints exist?

EXHIBIT A

garlington | lohn | robinson

glr

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December 26, 2007

Mr. Bill Schultz
1610 South 3rd Street West, Suite 103
P.O. Box 5004
Missoula, MT 59806-5004

RE: Mountain Water Company

Dear Mr. Schultz:

We represent Mountain Water Company ("MWC") in its efforts to obtain approval for a water right change application to allow additional wellheads as new points of diversion for existing rights. MWC owns sufficient municipal water rights to provide for its needs into the foreseeable future and would rather change the points of diversion on these rights to accommodate growth than acquire new rights. In considering this issue, you asked us to analyze the legal support for granting a change application that anticipates the future municipal use of water that is not currently actually used. We understand you are concerned that MWC could not meet the standard set out in Administrative Rules of Montana 36.12.1902(2), which provides that the amount of water changed cannot exceed historical use. This letter is our response to that inquiry.

SUMMARY

Although not fully developed in Montana, western water law generally recognizes what is known as the "growing communities doctrine" which allows municipal water rights owners to maintain more water rights than actually are being used without the threat of a claim for abandonment. Even though Montana has not expressly adopted the doctrine, it likewise has not been rejected or modified by statute. Because Montana water law is grounded on prior appropriation doctrine principles that are long established in the west, and because the growing communities doctrine is widely-recognized as a fundamental component of western water law, the doctrine is applicable in Montana. Accordingly the notion of historical use contained in the rules must be evaluated in light of this doctrine, which is implicit in MWC's water rights.

BACKGROUND

MWC holds 62 water rights associated with its greater Missoula municipal water supply and distribution system. These water rights include many groundwater wells, high lake storage, and surface rights from Rattlesnake Creek. Many of these water rights are statements of claim protecting pre-1973 priority dated water rights. These rights have been the subject of a preliminary, but not a final, Water Court decree. Several of the existing water rights are post-1973 permits that are currently not verified or completely perfected. As a result, it is difficult to determine the precise flow and volume associated with the company's water rights. However, the combined flow rate appears to be in the neighborhood of 226 cfs and the combined volume appears to be around 132,300 acre-feet. In comparison, actual peak diversion is in the 120-140 cfs range with a maximum annual volume in recent years of 28,000 acre-feet, in 2006.

In February 1998, MWC submitted a water right change application to the Department, under which eight wells were added as points of diversion to the existing Rattlesnake Creek surface water rights. Part of this application process entailed establishing to the Department's satisfaction that there was a connection between the surface waters in Rattlesnake Creek and the water appropriated by the eight wells located in the Missoula Valley. The Department approved this application.

In April 1999, MWC submitted a water right change application in an effort to more precisely define its projected long term service area. The application standardized all water rights to a uniform place of use, reflecting the integrated nature of MWC's system. It also identified the areas the rights would be extended to in the future. During the application review process, the Department did not question the combined flow rate or combined volume of the underlying water rights. The authorization to use those rights in additional areas was granted on December 1, 2003, with a completion date of 2024. Filings for extensions of time to complete the project are possible as long as the company can document efforts to expand the service area between 2003 and 2024.

MWC's 2003 service area place of use change authorization gives it the right to extend pipelines and provide water service connections, using its existing rights, within the clearly defined but very expansive area.

MWC's 1999 application lists the entire flow rate and volume for its existing rights. DNRC actually modified the flow rate and volume numbers listed on the application upward to reflect several additional water rights that Mountain Water had obtained between 1999 and 2003. MWC's intent to use its existing rights and their attendant flow rates and volumes for new hookups in new areas is made very clear in the application. The application establishes

that existing rights would be used in these new areas. DNRC did not question this intent at the time.

As a result of the 2003 authorization, we believe that MWC can serve any locations within the expanded place of use, including projects that serve infill or even projects that entail expansions into outlying areas, provided these can be served by the wellheads listed on the existing water rights. Further, MWC can complete extension projects and add connections without applying for new water rights as long as the total flow rate and volume protected by the existing water rights is not exceeded. None of those activities would require that an additional change application be submitted to DNRC.

However, the 2003 change authorization still begs several questions regarding what actions MWC can take pursuant to it. Arguably, the 2003 authorization suggests that new diversion points (wellheads) are a necessary, obvious, and logical step in the process of providing service to the outlying areas identified in the authorization. Much of the proposed place of use is far removed from any existing wellheads, so the need to add wellheads to fully perfect the authorization was quite apparent.

MWC believes the 2003 change authorization for an expanded service area should be used by DNRC as the frame of reference for processing MWC's point of diversion change application. Specifically, the water rights flow rates and volumes that were implicitly accepted by DNRC when approving an expanded service area in 2003 should also be accepted as the water rights basis for any new wellheads that might be needed to implement that change. DNRC's authority to make that determination rests in the so-called "growing communities" doctrine.

THE GROWING COMMUNITIES DOCTRINE

The growing communities doctrine enables a municipality to maintain the rights to more water than it is actually using at the present time, in seeming contravention of the general principle of water law that water must actually be put to a beneficial use. The roots of the so-called growing communities doctrine are traced to *City and County of Denver v. Sheriff, et al*, 105 Colo. 193, 96 P.2d 836 (Colo. 1939). In that case, the City and County of Denver were experiencing considerable growth and had invested millions of dollars in the construction of a tunnel to bring water over the divide to the west to Denver. The lower court decreed an appropriation less than the capacity of the tunnel and conditioned additional appropriations on the actual use of the tunnel's capacity. The city appealed, claiming that "the trial court, in giving the city its priorities from the Western Slope streams, made such priorities subject to unlawful and burdensome restrictive conditions."

The Colorado Supreme Court began its analysis by acknowledging the fundamental basis of western water law—that beneficial use defines the extent of a water right, and that unused water generally does not ripen into a defendable appropriation. But the court then addressed the peculiar difficulties faced by a municipality in fulfilling its obligations to anticipate future needs and provide for the public.

> In establishing a beneficial use of water under such circumstances the factors are not as simple and are more numerous than the application of water to 160 acres of land used for agricultural purposes. A specified tract of land does not increase in size, but populations do, and in short periods of time. With that flexibility in mind, it is not speculation but the highest prudence on the part of the city to obtain appropriations of water that will satisfy the needs resulting from a normal increase in population within a reasonable period of time.

City of Denver, 96 P.2d at 841.

The court further concluded that the concept of beneficial use must be adapted when applied to municipal uses as compared to irrigation uses. "All we now say is that the factors which enter into a determination of a beneficial use here, which is based upon a normal need, are more flexible than those relating to the use of water on agricultural land" *City of Denver*, 96 P.2d at 842.

Colorado recently affirmed the continuing viability of this doctrine in an expansive opinion written by noted water law attorney, and now Justice, Gregory Hobbs. *Pagosa Area Water and Sanitation District v. Trout Unlimited*, 170 P.3d 307 (2007). Other states and courts also have historically come to and elaborated this view that municipal water rights are of a separate nature from other types, and that flexibility in traditional water law is necessary when considering a city's development. For instance, in *Van Tassel Real Estate & Live Stock Co. v. City of Cheyenne*, 49 Wyo. 333, 54 P.2d 906 (1936), the Wyoming Supreme Court approved the City of Cheyenne's change in point of diversion, even though the City had shut down the plaintiff's headgate in the process. The plaintiff and the City both had rights from an 1888 decree, and the plaintiff asserted that the City had lost some of its rights by not using them. The Court held that Cheyenne had not lost its rights through "nonuser," and that moving the point of diversion, even to the detriment of the plaintiff, was appropriate. In its discussion, the court begins with the established doctrine of progressive use (not so named in the opinion); i.e., that so long as one is gradually developing one's capacity to use the water appropriated, one is entitled to the full amount. "The full enjoyment of the water attempted to be appropriated does not, of course, commence until the

works are finally completed and capable of conducting all of the water; but against all others, subsequently attempting an appropriation of the waters of the same stream, the right of the first appropriator to the use of the water dates or relates back, by what is known as the doctrine of relation." *Van Tassel*, 54 P.2d at 913. The court then extends the principle to municipal use, stating "In view of these facts, we cannot see why an analogous doctrine should not apply to municipal purposes, and indeed more so." The court, like the Colorado court above, addressed the specific challenge faced by a municipality in keeping up with its population growth. "We may say in that connection that it was confidently asserted by counsel for plaintiff in the case of *Holt v. City of Cheyenne* that the city would never have a population of more than 15,000. The facts in this case seem but to verify other facts showing that true prophets no longer traverse our land."

A consistent thread throughout these cases is the issue of nonuser, or, in the more modern parlance, abandonment, forfeiture, or relinquishment. In cases in which a right has not been used for some time, it could be considered abandoned. Most jurisdictions eventually passed a forfeiture statute, which set some amount of time after which a right was presumed abandoned. The distinction created by these municipal water use cases is to figure out how to protect the unused—but going to be used—water rights from abandonment or relinquishment.

Applied to more modern times, courts have sanctioned the principle that municipal water rights are protected from forfeiture for nonuse when they are held in anticipation of further growth. *See State ex rel. Reynolds v. Rio Rancho Estates, Inc.*, 95 N.M. 560, 624 P.2d 502 (N.M., 1981.) ("When determining the extent of a municipal water right, it is appropriate for the court to look to a city's planned future use of water from the well caused by an increasing population. *State v. Crider*, 78 N.M. 312, 431 P.2d 45 (1967). Thus, the amount of water a city is presently using from a well may not be the limit of its water right."); *State ex rel. Martinez v. City of Las Vegas*, 135 N.M. 375, 387, 89 P.3d 47, 59 (N.M.,2004) ("We have applied this principle to municipalities in order to allow for "normal increase in population within a reasonable period of time.") *Crider*, 431 P.2d at 49. In addition, a municipality may be given a more substantial "reasonable time" for its population growth than a typical water user would have to complete an appropriation. Compare NMSA 1978, § 72-1-9 (2003) (providing, based on public welfare and the conservation of water, that municipalities have forty years "to plan for the reasonable development and use of water resources" and that municipal water rights can be based on "reasonably projected additional needs within forty years"), with NMSA 1978, § 72-5-28(A) (2002) (providing for forfeiture of water rights one year after notice of four years of nonuse).")

Some neighboring states to Montana have codified these municipal use principles. In 2003, Washington State passed its Municipal Water Supply—Efficiency Requirements Act

("MWL"). The Washington legislature passed MWL in order to clarify where municipal utilities can use existing water rights, define which suppliers are municipal utilities exempt from Washington's relinquishment statute, establish new conservation measures, and establish criteria for changing and transferring municipal water rights, among other things. (Washington already had a 1967 law – RCW 90.14.140(d) – that exempted municipal water rights from statutory relinquishment through nonuse.) The MWL developed, in part, out of some cases in Washington that raised the issue of whether non-use by a municipality would result in forfeiture.

The leading case on the issue is *State Dept. of Ecology v. Theodoratus*, 135 Wash. 2d 582 (Wash.,1998). Theodoratus was a developer who had received some water rights that originally had been issued based on the "pumps and pipes" theory, that is, on the amount of water that the system would convey to the development once all of the homes had been built. The development was delayed repeatedly for a variety of reasons, and Theodoratus kept requesting extensions on his rights to develop the water. Finally, the Washington Department of Ecology conditioned his receipt of a final vested water right not on his system capacity but on the actual amount of water used. He appealed, and the lower courts went back and forth until the Supreme Court finally held that his right had to be determined by actual use and not on the pipes and pump method. However, the Court specifically carved out a possible exception for municipalities, stating:

> We are also not persuaded by Appellant's claim that a distinction is warranted because his is a public water supply system. Initially, we note that Appellant is a private developer and his development is finite. Appellant is not a municipality, and we decline to address issues concerning municipal water suppliers in the context of this case. We do note that the statutory scheme allows for differences between municipal and other water use. E.g., RCW 90.03.260; 90.14.140(2)(d). We also note that 1997 legislation which would have allowed for a system capacity measure of a water right "[f]or those public water supplies that fulfill municipal water supply purposes," was vetoed by the Governor on the ground that the provision, along with another vetoed section, would have provided an unfair advantage to public water systems by creating great uncertainty in determining water availability for other water rights and new applicants, as well as uncertainty in the protection of instream resources, and would have increased the difficulty of managing the state's waters. In determining legislative intent of a statute, the reviewing court considers the intent of the Governor when he

> vetoes a section. Plainly, the Governor's veto message is strong evidence of intent that system capacity is not the measure of a water right under current statutes.

The dissent in *Theodoratus* explains the progressive and growing communities doctrines and advocates a municipal use water policy that acknowledges the special needs of cities planning for their expansion. The theory of the dissent eventually carried the day, as the vetoed legislation mentioned in *Theodoratus* is a predecessor to the legislation that was eventually passed as the MWL, the legislature thereby reaffirming a distinction between beneficial use as it is understood for the run-if-the-mill water right versus a municipal water right, and allowing for the capacity.

California and Idaho have both specifically protected municipal water rights from forfeiture for lack of beneficial use when they are held in anticipation of future needs. Idaho's Municipal Water Rights Act codifies the common law growing communities doctrine at Idaho Code 42-222 and 223. See also California Water Code 106.5. "It is hereby declared to be the established policy of this State that the right of a municipality to acquire and hold rights to the use of water should be protected to the fullest extent necessary for existing and future uses, but that no municipality shall acquire or hold any right to waste water, or to use water for other than municipal purposes, or to prevent the appropriation and application of water in excess of its reasonable and existing needs to useful purposes by others subject to the rights of the municipality to apply such water to municipal uses as and when necessity therefor exists."

Unlike other prior appropriation states, Montana has not been explicit in its case law in adopting the growing communities doctrine, likely because the issue never has been directly presented to the Supreme Court. Nonetheless, evidence of the doctrine can be found in various cases and statutes. Montana has previously acknowledged the progressive growth doctrine, which is the foundation of the growing communities doctrine, in *St. Onge v. Blakely* (1926), 76 Mont. 1, 245 P. 532. In *St. Onge*, the Montana Supreme Court stated that

> It is not requisite that the use of water appropriated be made immediately to the full extent of the needs of the appropriator. It may be prospective and contemplated, provided there is a present ownership or possessory right to the lands upon which it is to be applied, coupled with a bona fide intention to use the water, and provided that the appropriator proceeds with due diligence to apply the water to his needs....The evidence sufficiently shows the bona fide intention of this appropriator to use the water, and

> there is nothing to show lack of due diligence in applying the full amount of her water to a beneficial use.

St. Onge, 245 P. at 539. This principle is also reflected in Montana Code Annotated § 85-2-312 (recognizing that permits may be issued for "gradually increased use of water").

Montana's statutes also acknowledge the special status of municipal water rights in Montana Code Annotated 85-2-227, which includes "criteria for presumption of municipal nonabandonment." This section states:

> (4) In a determination of abandonment made under subsection (3), the legislature finds that a water right that is claimed for municipal use by a city, town, or other public or private entity that operates a public water supply system, as defined in 75-6-102, is presumed to not be abandoned if the city, town, or other private or public entity has used any part of the water right or municipal water supply and there is admissible evidence that the city, town, or other public or private entity also has: . . . .
>
> (b) acquired, constructed, or regularly maintained diversion or conveyance structures for the future municipal use of the water right;
>
> (c) conducted a formal study, prepared by a registered professional engineer or qualified consulting firm, that includes a specific assessment that using the water right for municipal supply is feasible and that the amount of the water right is reasonable for foreseeable future needs; or
>
> (d) maintained facilities connected to the municipal water supply system to apply the water right to:
>
> (i) an emergency municipal water supply;
>
> (ii) a supplemental municipal water supply; or
>
> (iii) any other use approved by the department under Title 85, chapter 2, part 4.

The principles set forth in this legislation specifically recognize that the growing communities doctrine is recognized in Montana. Given the link between historical use and abandonment, the factors recognized by the legislature also should extend to the demonstration of historical use required for a change permit. The statute embodies the doctrine that municipalities may possess water rights that are needed for future but not current use. Based on this we believe Mountain Water may present a viable change

application to the Department even if the application is not based purely on actual historical use.

CONCLUSION

Based upon these authorities, we believe that MWC's municipal water rights implicitly include the ability to expand use over time. In a community like Missoula where the population is growing and is projected to keep growing, it is critical to MWC that it maintain sufficient water rights to adequately serve such growth. There is ample support for including the growing communities doctrine in MWC's existing water rights. There also is nothing in the law to suggest that a change application would cause this protection to be lost. Accordingly, we respectfully request that you concur that MWC may submit a viable application to change its existing rights without the risk that rights will be lost as part of the change process.

Very truly yours,

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