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AZ CORP COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF UTILITY SOURCE, L.L.C. FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WATER AND WASTEWATER SERVICE IN COCONINO COUNTY, ARIZONA.	DOCKET NOS. WS-04235A-04-0073 WS-04235A-04-0074 **RESPONSE TO STAFF REPORT**
IN THE MATTER OF THE APPLICATION OF UTILITY SOURCE, L.L.C. FOR AUTHORITY TO ISSUE PROMISSORY NOTE(S) AND OTHER EVIDENCE OF INDEBTEDNESS PAYABLE AT PERIODS MORE THAN TWELVE MONTHS AFTER ISSUANCE	

Arizona Corporation Commission
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Applicant, Utility Source, L.L.C., pursuant to the Procedural Order dated August 23, 2004 and in response to the Staff Report dated September 22, 2004 hereby files this Response. The Company does not attempt to rebutt each and every number and statement with which it does not agree in the Staff Report. Company witnesses may address certain additional items during the course of this proceeding, but its major objections are as follows:

1. The Company objects to Staff's recommendation to deny the Water Certificate of Convenience and Necessity ("CC&N") Application, while at the same time the Staff recommends numerous Commission requirements consistent with the issuance of a Water CC&N, and recommends approval of the Wastewater CC&N. The Company submits that it is either a Public Service Corporation, or it is not. If the Application is denied, that is equivalent to an Adjudication that it is not a Public Service Corporation, and the other requirements recommended by the Staff

should not apply. If the Company is a Public Service Corporation and the recommended conditions apply, then a CC&N should be issued.

2. The apparent basis for the recommended denial of the Water CC&N is the lack of an Arizona Department of Water Resources Letter of Adequacy. The Company has explained to the Staff on numerous occasions why that Letter has not been issued as of this date, and has updated the Staff on the progress in obtaining the Letter of Adequate Water Supply. The Company is hopeful of receiving that Letter before, or shortly after, the hearing in this matter. The Company believes it is appropriate that the CC&N be issued as is typical with CC&N applications with the requirement that the Company file the ADWR Letter within 365 days of the Decision.

3. The Staff Report states at Page 1 that the proposed Certificated area will include a golf course. It will not. There has never been a golf course in the Master Plan for this area.

4. At Page 3 of the Staff Report it recites certain capacity levels for the Company's wells. Those levels are either incorrect or out dated. The Company will present the Company's hydrologist as a witness at the hearing with the full capacity availability for all Company wells.

5. The Staff is recommending that the Hook-Up Fee Tariff ("HUF") of $1,000 for water service and $1,800 for wastewater service be denied because Staff believes it to be "inappropriate". The Company understands that while that may be reasonable in typical new CC&N applications, it is not in the instant case. In most start-up utility companies there is a relatively small equity investment. In this Application the Company's owners have invested approximately $3.8 million that is already in the ground and has been confirmed by the Staff Report. Normally, collection of a HUF could reduce a company's Rate Base so that the company has no equity investment by the owners. However, in this instance, and even assuming all 626 lots proposed in the development pay their respective HUF's of $1,000 and $1,800, that would reduce the Rate Base with a Contribution of $1,752,800. That still leaves approximately $2.0 million in net investment during Year One, which

grows to approximately $4.0 million by Year Five. The proposed plant additions in Year Two and Year Five are proposed to be funded by the HUF's. The proposed HUF's and the proposed levels are reasonable. With a total first year investment in backbone plant of approximately $3.8 million serving the ultimate 626 customers, that average cost is $6,075 per unit. With a combined HUF of $2,800, the recovery is only 45% of the capital investment.

6. Staff recommends that the Company file the Arizona Department of Environmental Quality Approvals to Construct for the subject facilities. ATC's for the entire project, except Flagstaff Meadows Unit 3, were filed with the original Application as Tab 7. Approvals of Construction for many of the construction segments have been received and all will be filed within 365 days of the Decision.

7. Staff recommends that the Company file a Curtailment Tariff and a Backflow Prevention Tariff. The Company filed what it believed to be the then-current versions of both of those Tariffs at Tab 5 to the Application as Sheet Nos. 14 through 22. The Company will file the updated versions of those Tariffs at the conclusion of this proceeding when filing the Tariff for approval containing the Commission's determined rates and charges.

8. Staff recommends that the Company file the Rate Application using the Test Year 2005. The Company objects as that filing requirement is too soon. The Company will then have only one year experience operating as a regulated company. With only the start-up customer levels, relatively high plant investment and uncertain first-year operating expenses, Test Year 2005 will not be an appropriate period to determine the ongoing revenues, expenses or investment in the Company. The Commission should require the more typical follow-up filings, either a 2005 Short Form Rate Review filing, or a full Rate Case Application based upon the Company's fifth year of operation.

9. The Staff recommends denial of the entire Financing Application. First, the Company did not request any equity approval as the Company is a limited liability company and will not issue any

capital stock that encumbers assets of the Company. Approval of the requested $575,000 Short-Term Revolving Line of Credit is needed to meet the operating and construction needs of the Company during the start-up phase. It is submitted that this Revolving Line is not permanent capital and that it need not match any particular asset. The pro forma Cash Flow filed with this Application indicates that the repayment on the Revolving Line would start in Year Three. At the Staff's recommended rate levels that repayment will obviously be accelerated substantially.

The Company will present testimony and exhibits at the hearing in this proceeding supporting both Applications and in opposition to the above Staff recommendations.

Respectfully submitted this 6TH day of October, 2004.

SALLQUIST & DRUMMOND, P.C.

By _____

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Original and fifteen copies of the foregoing filed this 6TH day of October, 2004, with:

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