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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 **EXCEPTIONS**
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	

Applicant, Utility Source, L.L.C hereby files its Exceptions to the Administrative Law Judge's Recommended Opinion and Order as issued on December 17, 2004. The Company will not comment on all aspects on the Recommended Opinion and Order with which it does not agree, but its major exceptions are as follows:

1. Generally, the Company believes the tone of the Recommended Opinion and Order is overly punitive. The Company certainly acknowledges that it a got off to a bad start in the administrative process with the Commission Staff, and we will comment on that below. However, we also believe that the Company has made extraordinary efforts to rectify any perceived wrongdoing and quickly and completely comply with all requirements of the Commission and the other regulatory agencies with which it and the development company have been involved. We believe that much of the

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discussion and resultant recommendations in the Opinion and Order are unduly harsh on the Company and provide no offsetting benefits to the customers or the public.

2. Denial of the Order Preliminary. One of the most significant, and problematic issues for the Company's owners, the third party developers, and the Company's future and existing customers, is the recommended denial of the Order Preliminary. This again appears to be punitive. The Opinion and Order acknowledges that Orders Preliminary have not been a common procedural vehicle of the Commission in recent years. However, as acknowledged, the Statutes do contemplate this procedure that was used regularly, and we believe almost without exception, from the time of statehood until the mid-1980s when the "Conditional CC&N" procedure was adopted. The Company is certainly cognizant of the Commission's reluctance to issue a CC&N if adequate water is not available. Although the Conditional CC&N could certainly contain conditions such that the public is fully protected, the Order Preliminary procedure is a direct Commission confirmation of those facts prior to the Company offering any service. As the record reflects the Company has expended substantial dollars in drilling additional 2,000 plus feet deep wells to prove the water adequacy. Although at the time of the Hearing in this matter, the Arizona Department of Water Resources has not completed its analysis as to issue the Physical Availability Determination for Phase 2, as it did for Phase 1, most of that data for Phase 2 has been provided and the Company believes the Phase 2 PAD will be issued soon. Although the Arizona Groundwater Code did not exist at the time the Order Preliminary Statute was adopted, it is submitted that this is precisely the type of other, subsequent governmental agency approval that was contemplated in that statute. The burdensome nature of the denial requires the Company to file another CC&N Application and endure the 7 to 10 month process. It is submitted that virtually all information the Commission needs to issue the certificate for that area is known at this time, with the exception of the confirmation of the water availability. Although not recited in the Recommended Order, the Company also has a third deep well that produces 74 gallons

per minute. Additionally, and the Company has already constructed the wastewater treatment plant and water storage facilities that are capable of providing service to all 675 customers at the completion of Phase 2. An Order Preliminary certainly provides the Commission total control over the service to that area without the burden on the Company and the Commission Staff to process yet another application. Obviously, any delay in expanding the service area denies the developers and future lot owners that service. Also, existing customers will be required to support the substantial Rate Base as determined by Staff and they will not enjoy the economies of scale associated with an earlier expansion. As indicated in the Recommended Order, the Staff was supportive of the Order Preliminary procedure in this docket. The Company is of the opinion the Order Preliminary adequately burdens the Company to assure compliance, and also protects the public.

3. The Recommended Penalty. The Company recognizes the desire of this Commission to more aggressively assure that existing and future Public Service Corporations comply with Commission Orders as well as the underlying laws. The Company supports that concept, but believes the substantial penalty recommended in the Opinion and Order is overkill. The record fully explains the history of Mr. McCleve's forming a homeowners association to provide water to a limited size and remote development. This was a companion service to the not-for-profit wastewater service that does not require the Commission's economic regulation. The record also explains that when the development unexpectedly grew beyond the initial small stages, for which it was already providing service through the homeowners association, Mr. McCleve acted as quickly as possible in response to the Staff's correspondence suggesting the filing of either an Application for Adjudication as a Not a Public Service Corporation, or a Certificate of Convenience and Necessity Application. Neither in the Staff Report, nor in its presentation at the hearing on this matter, did the Commission Staff, suggested any type of penalty upon the Company. Nor did the Presiding Judge inquire of any party in that regard. There is no record suggesting any action or inaction by Mr.

McCleve or the Company to avoid Commission regulation or to resist any recommendation, inquiry, or demand made by the Staff or any other agency before or during the processing of this Application. The Company is of the opinion that it has totally cooperated with Staff since the start of its relationship with the Commission and that the penalties are unwarranted and not consistent with establishing the Company as the sound water and wastewater provider. In short, there is no basis in the record for the recommended penalty.

4. The Performance Bond. The Company is aware that in "start-up" companies it is not uncommon for the Commission to require a Performance Bond. This bond is typically an approximation of the first years operating expenses, and generally less than $25,000. Mr. McCleve did operate the water and wastewater systems for the truck stop subsequent to 1995. The Company is not aware of the Commission Staff recommending a performance bond close to the magnitude of that in the Recommended Order. This appears to be punitive in nature as well. The Company can cite at least two recent applications similar to the present application in which those companies operated as non-regulated homeowners associations prior to receiving a Certificate of Convenience and Necessity and in which the Commission authorized Hook-up Fees, required no Performance Bonds, and provide no penalties for prior operations. (See *DS Water Company*, Decision No. 65977, dated June 17, 2003; *White Horse Ranch Owners Association, Inc.*, Decision 67103, dated July 9, 2004) The Company requests that the Commission set the Performance Bond at the more traditional level.

Denial of the Hook-up Fee Tariff. The homeowners association that provides service now, and did before the formation of the Company, established rates for its members that were identical to the City of Flagstaff, including the Hook-Up Fees. Without any actual data, the developers believed that to be a reasonable surrogate for the cost of utility services. The Company's application, although the pro forma plant and expense items suggested higher rates, proposed using those

existing rates. The Commission Staff analyzed the pro forma expenses, and apparently believing them to be reasonable, recommended higher rates to support those numbers. The Company had no basis for objecting to those recommended rates, but did argue that a Hook-Up Fee was appropriate. Not only did the numbers support the Hook-Up Fee, homebuilders and buyers, whether in municipal or private systems, now find Hook-Up Fees to be acceptable. Additionally, the builders who purchased lots from the developers contractually agreed to pay these Hook-Up Fees to the utility provider as part of the lot purchase price to offset the utility's capital cost. Although they are not always recommended by Staff, the Commission has certainly authorized Hook-Up Fees for new companies. It should also be noted that the Recommended Order refers to Rate Base levels at several places and expresses a concern with those plant levels. The proposed Hook-Up Fees, which are treated as Contributions, would certainly lessen than the Rate Base to the benefit of the customers. Although the Recommended Order, at Page 9 Line 6, suggests that the Company intended to borrow $3.2 million that is incorrect. That was always intended to be equity in the Company. The only loan proposed was the $575,000. With the substantial capital investment already made in the Company, as well as the need for expanding those facilities, the Company is of the opinion the Hook-Up Fees are reasonable, and should not be yet another penalty imposed on this Company.

In summary, the Recommended Opinion and Order unreasonably and without substantial support in the record, penalizes the Company. It denies a portion of the certificated area that was requested, it denies the Staff's recommended rate levels, it requires a full-fledged rate case based on Test Year 2005, it denies the Company's proposed short-term financing, it denies the proposed Hook-Up Fees, it imposes a Performance Bond ten times the size of the normal Bond, and it penalizes the Company for its legitimate belief that it could commence operations in the form it did. The Company believes those combined positions are overly harsh.

WHEREFORE, the Company would respectfully urge the Commission to modify the Recommended Opinion and Order to grant the Order Preliminary, eliminate the proposed penalty, reduce the Performance Bond as requested, and approved the proposed Hook-Up Fees.

Respectfully submitted this 20TH day of December, 2004.

SALLQUIST & DRUMMOND, P.C.

By_____

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Original and fifteen copies of the foregoing filed this 20TH day of December, 2004, with:

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