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CORPORATION AGENDA ITEM

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AZ CORP COMMISSION  
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

6 IN THE MATTER OF THE APPLICATION OF ) DOCKET NOS. WS-04235A-04-0073  
7 UTILITY SOURCE, L.L.C. FOR A ) WS-04235A-04-0074  
8 CERTIFICATE OF CONVENIENCE AND )  
9 NECESSITY TO PROVIDE WATER AND )  
WASTEWATER SERVICE IN COCONINO )  
COUNTY, ARIZONA. )

**EXCEPTIONS**

10 IN THE MATTER OF THE APPLICATION OF )  
11 UTILITY SOURCE, L.L.C. FOR AUTHORITY )  
12 TO ISSUE PROMISSORY NOTE(S) AND )  
OTHER EVIDENCE OF INDEBTEDNESS )  
13 PAYABLE AT PERIODS MORE THAN )  
TWELVE MONTHS AFTER ISSUANCE )

Arizona Corporation Commission

**DOCKETED**

DEC 20 2004

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

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

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

3 2. Denial of the Order Preliminary. One of the most significant, and problematic issues for the  
4 Company's owners, the third party developers, and the Company's future and existing customers, is  
5 the recommended denial of the Order Preliminary. This again appears to be punitive. The Opinion  
6 and Order acknowledges that Orders Preliminary have not been a common procedural vehicle of the  
7 Commission in recent years. However, as acknowledged, the Statutes do contemplate this procedure  
8 that was used regularly, and we believe almost without exception, from the time of statehood until  
9 the mid-1980s when the "Conditional CC&N" procedure was adopted. The Company is certainly  
10 cognizant of the Commission's reluctance to issue a CC&N if adequate water is not available.  
11 Although the Conditional CC&N could certainly contain conditions such that the public is fully  
12 protected, the Order Preliminary procedure is a direct Commission confirmation of those facts prior  
13 to the Company offering any service. As the record reflects the Company has expended substantial  
14 dollars in drilling additional 2,000 plus feet deep wells to prove the water adequacy. Although at the  
15 time of the Hearing in this matter, the Arizona Department of Water Resources has not completed its  
16 analysis as to issue the Physical Availability Determination for Phase 2, as it did for Phase 1, most of  
17 that data for Phase 2 has been provided and the Company believes the Phase 2 PAD will be issued  
18 soon. Although the Arizona Groundwater Code did not exist at the time the Order Preliminary  
19 Statute was adopted, it is submitted that this is precisely the type of other, subsequent governmental  
20 agency approval that was contemplated in that statute. The burdensome nature of the denial requires  
21 the Company to file another CC&N Application and endure the 7 to 10 month process. It is  
22 submitted that virtually all information the Commission needs to issue the certificate for that area is  
23 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

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

11 3. The Recommended Penalty. The Company recognizes the desire of this Commission to  
12 more aggressively assure that existing and future Public Service Corporations comply with  
13 Commission Orders as well as the underlying laws. The Company supports that concept, but  
14 believes the substantial penalty recommended in the Opinion and Order is overkill. The record fully  
15 explains the history of Mr. McCleve's forming a homeowners association to provide water to a  
16 limited size and remote development. This was a companion service to the not-for-profit wastewater  
17 service that does not require the Commission's economic regulation. The record also explains that  
18 when the development unexpectedly grew beyond the initial small stages, for which it was already  
19 providing service through the homeowners association, Mr. McCleve acted as quickly as possible in  
20 response to the Staff's correspondence suggesting the filing of either an Application for  
21 Adjudication as a Not a Public Service Corporation, or a Certificate of Convenience and Necessity  
22 Application. Neither in the Staff Report, nor in its presentation at the hearing on this matter, did the  
23 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.

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

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

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

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

18 In summary, the Recommended Opinion and Order unreasonably and without substantial  
19 support in the record, penalizes the Company. It denies a portion of the certificated area that was  
20 requested, it denies the Staff's recommended rate levels, it requires a full-fledged rate case based on  
21 Test Year 2005, it denies the Company's proposed short-term financing, it denies the proposed  
22 Hook-Up Fees, it imposes a Performance Bond ten times the size of the normal Bond, and it  
23 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.

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4 Judge Dwight Nodes  
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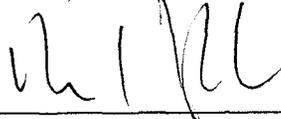
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