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December 21, 2005

HAND DELIVERED

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Re: Forest Highlands Water Company Rate Application;
Compliance Item; Docket No. W-02493A-04-0701

Dear Sir/Madam:

In accordance with the ordering paragraph on page 13 of Decision No. 67983, Forest Highlands Water Company files the attached Water Use Agreement between The Forest Highlands Association d/b/a Forest Highlands Golf Club and Forest Highlands Water Company.

Very truly yours,

GALLAGHER & KENNEDY, P.A.

By:

Todd C. Wiley

TCW/plp
11134-4/1320919
Attachment

Original and 13 copies filed with Docket
Control this 21st day of December, 2005.

cc (w/attachment): Chris Kempley, Chief Counsel, Legal Division
David Ronald, Legal Division
Ernest Johnson, Utilities Division
Brian Bozzo, Compliance Section, Utilities Division

WATER USE AGREEMENT

This Water Use Agreement ("Agreement") is entered this 19th day of December 2005, by and between The Forest Highlands Association, a nonprofit homeowners association doing business as Forest Highlands Golf Club ("Association") and Forest Highlands Water Company, Inc., an Arizona corporation ("FHWC"). In consideration of the mutual terms and conditions contained herein, the Parties hereby agree as follows:

ARTICLE I USE OF WATER AND WELLS

1.1 Forest Highlands Water Company is an Arizona public service corporation engaged in providing public water utility service to approximately 663 commercial and residential customers in the Forest Highlands Development in Coconino County, Arizona. FHWC provides such water utility service under a Certificate of Convenience and Necessity (CC&N) issued by the Arizona Corporation Commission ("Commission" or "ACC") in Decision No. 55903 dated March 9, 1988. FHWC is owned by The Forest Highlands Association.

1.2 In providing public water service to its customers, FHWC operates a water system that consists of seven (7) wells (1, 2, 2b, 3, 4, 5b and 8) and one storage tank. The wells used by FHWC in providing water utility service are owned as follows:

WELL NAME	ADWR ID NO.	OWNER
Well 1	55-514733	Forest Highlands Water Co.
Well 2	55-588892	Forest Highlands Association
Well 2b	55-202755	Forest Highlands Association
Well 3	55-515547	Forest Highlands Water Co.
Well 4	55-5517583	Forest Highlands Water Co.
Well 5b	55-588893	Forest Highlands Water Co.
Well 8	55-562728	Forest Highlands Association

1.3 On September 27, 2004, FHWC filed a rate application with the Commission under Docket No. W-02493A-04-01701. On July 22, 2005, the Commission issued Decision No. 67983 and approved FHWC's rate application. In Decision No. 67983, the Commission ordered that FHWC "shall file in this docket as a compliance item, by December 31, 2005, a long term water use agreement with its parent Forest Highlands Association that demonstrates that the Company will have available for its use an adequate supply of water to meet its long term customer needs from the wells owned by Forest Highlands Association." FHWC and the Association hereby enter this Agreement in compliance with that Decision and ordering paragraph.

1.4 The Association is the owner of Wells 2, 2b and 8. By this Agreement, the Association hereby leases and conveys to FHWC the rights to use Well 2, Well 2b and Well 8 in providing public water service in accordance with the terms and conditions set forth below. Under this Agreement, Well 2, Well 2b and Well 8 shall be used by FHWC for a well site and withdrawal of water for any lawful purpose, including providing public utility water service.

ARTICLE 2 TERM

2.1 Term. This Agreement shall be for a term of twenty-five (25) years commencing on the day first written above and terminating on the 25th anniversary thereof.

2.2 Extension of Term. FHWC shall have the option to extend the term of this Agreement for a period not to exceed an additional twenty-five (25) years provided FHWC is not in material default of this Agreement at the time this option to extend is exercised by FHWC. To exercise the option to extend, FHWC shall give the Association notice of exercise within twelve (12) months prior to the end of the initial term of this Agreement. If the option is exercised by FHWC, this Agreement shall continue on the same terms and conditions and for the same amount of rent as set forth in this Agreement with respect to the initial term. Notwithstanding the foregoing provisions of this section, if FHWC remains in possession of Well 2, Well 2b and Well 8 following the initial term of this Agreement, FHWC shall be deemed to have exercised its option to extend for an additional twenty-five (25) years.

2.3 Early Termination. FHWC shall have the right to terminate this Agreement at any time during the initial term or extended term by giving the Association thirty (30) days prior written notice of termination. Subject to earlier termination as provided in this paragraph, the term of this Agreement shall commence on the effective date and continue indefinitely during the Association's ownership of the property.

2.4 Continuation. In the event that the Association conveys its ownership interest in Well 2, Well 2b and/or Well 8 to a subsequent party, this Agreement shall continue indefinitely until such time as FHWC exercises its right to terminate as provided herein. Under this Agreement, the Association hereby agrees to obtain such subsequent party's written consent and approval of this Agreement.

ARTICLE 3 PAYMENT

3.1 Annual Payment. FHWC agrees to pay the Association as rent for use of Well 2, Well 2b and Well 8 one dollar (\$1.00) per year. FHWC may make one payment of twenty-five dollars (\$25.00) for the rent due for the entire term of the Agreement.

ARTICLE 4 USE OF WELLS

4.1 Use. Well 2, Well 2b and Well 8 shall be used by FHWC for a well site and withdrawal of water for any lawful purpose, including providing public utility water service. FHWC shall, at its expense, keep and maintain Well 2, Well 2b and Well 8 in good order and

condition. FHWC shall report to the Association and appropriate law enforcement authorities any known or suspected trespass or waste committed on such wells as necessary.

4.2 No Water Rights Conferred. This Agreement does not confer upon FHWC any express or implied use of any water rights owned by the Association. Any withdrawal or use of water from Well 2, Well 2b and Well 8 by FHWC shall be pursuant to other water rights owned by FHWC. FHWC shall file all appropriate reports with the Arizona Department of Water Resources with respect to such wells and shall be solely responsible for all water withdrawal fees and other fees or costs associated with such filings.

4.3 Quiet Enjoyment. The Association covenants that FHWC shall peaceably and quietly enjoy the use of Well 2, Well 2b and Well 8 during the term of this Agreement so long as FHWC is in compliance with all material provisions of this Agreement.

4.4 Inspection. The Association, and its duly authorized agents, employees and representatives, shall have the right to enter upon and inspect Well 2, Well 2b and Well 8 and all improvements thereon at any reasonable time. Except in an emergency, the Association shall give FHWC reasonable advance notice of any such inspection. No inspection shall interfere with FHWC's use of the wells.

4.5 Surrender. FHWC shall surrender peaceably the possession of the property upon expiration of this Agreement.

ARTICLE 5 WELL REPAIR, REPLACEMENT AND ABANDONMENT

5.1 Repairs to Well. FHWC shall have the right to make such repairs and improvements to Well 2, Well 2b and Well 8 as FHWC may desire, at the Association's sole expense unless otherwise agreed by the Parties. FHWC shall make ordinary repairs necessary to keep the well in reasonably good operating condition, normal wear and tear excepted.

5.2 Replacement of Well. Upon written request by FHWC, the Association shall allow FHWC to replace the wells if reasonably necessary for the continued use of the property as a well site. The replacement well shall be installed, operated and maintained by FHWC at the Association's sole expense unless otherwise agreed. FHWC shall be responsible for obtaining all permits or licenses required by law for drilling and insulation of the replacement well. All well casings installed by FHWC as part of the replacement wells shall be the property of the Association unless otherwise agreed by the Parties. All pumps, motors and other removable equipment installed by FHWC as part of the replacement well shall remain the property of the Association and may be removed from the property by the Association.

5.3 Abandonment of Well. If either Well 2, Well 2b or Well 8 at any time must be abandoned and closed pursuant to Arizona Department of Water Resources requirements, the Association shall abandon and close the well at its sole expense.

ARTICLE 6
LIENS

6.1 Payment. FHWC shall keep the Wells free and clear from all mechanic's liens and other liens and encumbrances resulting from work done for FHWC or persons claiming under it; provided, however, that FHWC may in good faith, and with reasonable diligence, contest or dispute any such lien claims in an appropriate forum so long as the Wells are not actually in danger of levy or sale.

6.2 Notice. Should any such claim of lien or other encumbrances be filed against the property or any action affecting the title to the property be commenced, the party receiving notice of such lien or action shall immediately give the other party written notice thereof.

ARTICLE 7
DEFAULT AND REMEDIES

7.1 Breach. In the event that either party shall be in material default of its obligations under this Agreement, the other party shall be entitled to such rights and remedies as it may have under applicable law, and shall be entitled to seek specific performance of the defaulting party's obligations hereunder. Before either party may claim a material default, such party shall give the other party reasonable notice of the default and a reasonable time to cure the default.

7.2 No Waiver. No waiver of breach of any provisions of this Agreement shall be construed as a waiver of any succeeding breach of the same or other provision.

ARTICLE 8
MISCELLANEOUS

8.1 Binding Effect. Each provision of this Agreement shall be binding on and inure to the benefit of the parties hereto and their respective successors and assigns. This Agreement shall be binding upon all subsequent owners and/or purchasers of the Wells during the term of this Agreement.

8.2 Construction. This Agreement shall be construed according to Arizona law.

8.3 Notice. Notices shall be in writing and shall be given by certified mail or hand delivery or by facsimile if a copy is also given by one of the other methods of notice authorized in this section. Notices shall be delivered or addressed to FHWC and the Association at the addresses set forth below or at such other address as a party may designate in writing. The date notice is deemed to have been given, received or become effective shall be the day on which the notice is delivered, if notice is given by hand delivery or certified mail.

The Association:
The Forest Highlands Association d/b/a
Forest Highlands Golf Club
657 Forest Highlands,
Flagstaff, AZ 86001

FHWC:
William Strauss, Manager
Forest Highlands Water Company
657 Forest Highlands
Flagstaff, AZ 86001

8.4 Consent. Wherever in this Agreement or any other reports, permits or filings as may be required to carry out the intent of this Agreement the consent or approval of either party is required, such consent or approval shall not be unreasonably withheld.

8.5 Partial Invalidity. In the event any provision of this Agreement is declared unenforceable by a court of competent jurisdiction, such provision shall be deemed to be severed from this Agreement, but the remainder of the Agreement shall continue in full force and effect.

8.6 Amendment. This Agreement may be amended only in writing executed by both parties.

**THE FOREST HIGHLANDS ASSOCIATION,
d/b/a Forest Highlands Golf Club**

By: 

Its: PRESIDENT

Date December 19, 2005

**FOREST HIGHLANDS WATER
COMPANY**

By: 

Its: PRESIDENT

Date 19 DEC 2005