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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF NORTHERN SUNRISE WATER COMPANY FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WATER UTILITY SERVICE IN COCHISE COUNTY, ARIZONA.	DOCKET NO. W-20453A-06-0247
IN THE MATTER OF THE APPLICATION OF SOUTHERN SUNRISE WATER COMPANY FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WATER UTILITY SERVICE IN COCHISE COUNTY, ARIZONA.	DOCKET NO. W-20454A-06-0248
IN THE MATTER OF THE JOINT APPLICATION OF NORTHERN SUNRISE WATER COMPANY AND SOUTHERN SUNRISE WATER COMPANY FOR THE APPROVAL OF SALE AND TRANSFER OF WATER UTILITY ASSETS, AND CANCELLATION OF CERTIFICATES OF CONVENIENCE AND NECESSITY, FOR MIRACLE VALLEY WATER COMPANY, COCHISE WATER COMPANY, HORSESHOE RANCH WATER COMPANY, CRYSTAL WATER COMPANY, MUSTANG WATER COMPANY, CORONADO ESTATES WATER COMPANY, AND SIERRA SUNSET WATER COMPANY, LOCATED IN COCHISE COUNTY, ARIZONA.	DOCKET NOS. W-20453A-06-0251 W-20454A-06-0251 W-01646A-06-0251 W-01868A-06-0251 W-02235A-06-0251 W-02316A-06-0251 W-02230A-06-0251 W-01629A-06-0251 W-02240A-06-0251

EXCEPTIONS TO RECOMMENDED OPINION AND ORDER

Pursuant to A.A.C. R14-3-110(B), Northern Sunrise Water Company ("Northern") and Southern Sunrise Water Company ("Southern") (collectively herein, "Applicants"),

submit these Exceptions to the Recommended Opinion and Order ("ROO") dated June 21, 2006.

I. OVERVIEW AND SUMMARY OF APPLICANTS' EXCEPTIONS.

Applicants have submitted three applications related to their proposed acquisition of the seven water utility systems known as the McLain Systems. The Arizona Corporation Commission ("Commission") is well aware of the troubled history of these water systems and has repeatedly expressed its desire to have a qualified water utility provider take over service to the beleaguered McLain ratepayers. Given the shortness of time available to Applicants and the Commission, a reiteration herein of the background, procedural history and critical facts underlying the three applications (as well as these Exceptions) is not possible. For now, it will have to suffice to remind this Commission that, despite the Herculean efforts of the Utilities Division Staff ("Staff") and Administrative Law Judge ("ALJ") Rodda, acquisition of the McLain Systems continues to pose substantial risk to the Applicants. The modifications to the ROO requested in these Exceptions are intended to reduce that risk to a level acceptable to Applicants. For the convenience of the Commission, Applicants' Exceptions are briefly summarized immediately below, and then discussed in greater detail in the remainder of this filing.

A. Babocomari Conditions.

> The ROO's requirement that inclusion of the Babocomari Development in the Northern Certificate of Convenience and Necessity ("Certificate of Convenience and Necessity") be conditioned on the filing of a Letter of Water Adequacy is contrary to the public interest as presented in the unique circumstances presently before the Commission. The record reflects that there is adequate water available for Northern to serve this new development area. The imposition of additional requirements that would not otherwise exist, but for the Commission's order, is not only unfair to the property owners and Applicants, but would place in jeopardy the landowners' gift of an ideal site for construction of storage and booster facilities needed to bring the McLain Systems into compliance. Additionally, the requirement places the potential growth in the systems at

risk, a potential that is the primary incentive for Applicants' willingness to take over the McLain Systems. Those risks outweigh any stated interest in a formalized finding of water adequacy where one is not otherwise required.

B. Lifting of Existing Moratoria.

Applicants understand the need for the Commission to continue the moratoria on new connections currently in effect for the McLain Systems until such time as necessary system improvements are completed. At that time, however, Applicants continue to advocate for a process that is timely. The ROO's allowance of more time for Staff to respond to notification that improvements are complete is objectionable.

C. Recovery of Transaction Costs.

Applicants have and will continue to incur significant costs associated with the acquisition of the McLain Systems. Applicants require a clear and unambiguous finding by this Commission in these dockets that up to $300,000 of such expenses are reasonable and prudent and recoverable from ratepayers, subject only to verification in future proceedings of actual cost being incurred in connection with the transaction. In addition, Applicants require Commission assurance that the additional costs associated with compliance with the Decision in these dockets will be recoverable through rates.

D. Timing of Tariff Filings.

The ROO's requirement that Applicants file a Backflow Prevention Tariff and Curtailment Plan within 45 days of the Decision should be modified to require such filings within 45 days of the close of the sale transaction to avoid Applicants having to make such filings before they actually acquire the assets of the McLain Systems.

E. ASUA Transition.

The ROO should be modified to make it absolutely clear that Applicants bear no responsibility for transitioning the Commission's Interim Operator, ASUA, out of its role.

II. APPLICANTS' EXCEPTIONS TO THE RECOMMENDED OPINION AND ORDER DATED JUNE 21, 2006 AND REQUESTS FOR CLARIFICATION.

A. Conditioning Inclusion Of The Babocomari Development On A Letter Of Water Adequacy Is Unfair To Property Owners And Would Frustrate The Public Interest As Well As Applicants' Incentive For Taking Over The McLain Systems.

In its Application, Northern sought to include an area known as the Babocomari Development, a currently undeveloped area not included in any of the McLain Systems' CC&Ns. Northern's request was based on a request for service from the landowners and on the willingness of those landowners to contribute a parcel of land upon which storage tanks and booster facilities necessary to improve the McLain Systems can be sited. ROO at 6. Northern's request was also consistent with its primary motivation for agreeing to acquire the McLain Systems—that being the potential for growth in these systems as represented primarily by the Babocomari Development.

Regarding inclusion of the Babocomari Development in Northern's CC&N, the ROO concludes that "it is not in the public interest nor good policy to grant a CC&N where there is no demonstration of adequate water supply." ROO at 8. While the Applicants generally agree with such an assertion, the circumstances presented in these dockets are unique and require extraordinary relief. The Applicants have already demonstrated that there is an adequate water supply to serve the development. The developers of the Babocomari area have commissioned a hydrology study for the project by Errol L. Montgomery & Associates. ROO at 6. That report, which appears to have been ignored by Staff, concluded that there was adequate water available to meet the needs of the development.[1] The requirement for any greater showing is unnecessary and impractical.

[1] During the hearing, Staff's witness testified that he had not reviewed and was unaware of the hydrology report for the Babocomari Development included in Northern's CC&N application. Hearing Transcript ("TR") at 255.

The owners of the Babocomari Development are not legally obligated to obtain the Letter of Water Adequacy the ROO would require. TR at 258. Accordingly, the Commission would be imposing water adequacy and land-use planning requirements on landowners that may be in excess of those required by the Arizona Department of Water Resources, the agency charged with the duty to regulate use of the State's water resources, and Cochise County, the local land-use planning agency. Applicants respectfully suggest that the Commission should avoid such excessive regulation, especially in this case.

As an element of providing service to the Babocomari development, the landowners have agreed to provide Applicants with a well situated property for the placement of storage and booster facilities that will substantially improve the adequacy and reliability of water service to existing customers of the McLain Systems. TR at 48-51. This land-gift would save Applicants the time and cost to purchase or condemn that site, or an inferior alternative site. Any additional costs necessitated by such acquisition will ultimately burden the ratepayers, who are already shouldering the cost of the previous owners' acts and omissions. *Id.* *See also* ROO at 7.

If the ROO's condition of a Letter of Water Adequacy is adopted by the Commission (which condition is beyond the requirements to which the Babocomari Development is otherwise subject), it is reasonable to expect that the landowners will seek water service in some other manner and not provide Applicants with the land parcel for placement of critical utility improvements. TR at 51. *Id.* In that event, not only will Applicants lose the site for locating facilities, but they will be deprived of one of the primary reasons they are willing to take over the McLain Systems—the potential for future growth in the region. Accordingly, conditioning the inclusion of the Babocomari Development in the Northern CC&N on a Letter of Water Adequacy as proposed would clearly frustrate the public interest.

B. The ROO's Recommended Procedures For Lifting Existing Moratoria On New Connections Are Unnecessarily Burdensome.

Given the dreadful condition of the McLain Systems, Applicants have never objected to continuation of the Commission-imposed moratoria on new connections following acquisition. However, Applicants do object to the ROO's proposed process for the lifting of individual moratorium because such process would allow Staff to delay the lifting of the moratorium by seeking an extension of the time for responding to Applicants' notice beyond the allotted 20 days. ROO at 26.

ADEQ is the appropriate entity to assist Applicants in making the technical determinations necessary to improve the McLain Systems and ADEQ will be responsible for issuing the requisite approvals for new construction. If all matters necessary to bring the systems into compliance are not completed to ADEQ's satisfaction, including well capacity, pumping capacity, storage capacity, pipe pressure, then the systems will not be in compliance and Applicants will be subject to violations and enforcement actions by ADEQ. Accordingly, Staff can and should rely on ADEQ's jurisdiction in this area and will be able to promptly confirm that the notice supports lifting of the moratorium without the need for extensions of time that prejudice Applicants.

C. The Commission Should Make It Clear That Applicants' Transaction Costs Will Not Be Subject To A Prudency-Type Review In Future Rate Cases.

Applicants were also "puzzled" by Staff's recommendations concerning recovery of transaction costs and, at one time, shared the ROO's conclusion that the dispute between them and Staff over future review of transaction costs might simply "be an issue of semantics." ROO at 12. This was the case until Staff's witness testified that Staff's recommendation actually was to "defer a prudency analysis of the transaction costs for the future rate case." TR at 273.

To make the Applicants' position regarding recovery of all transaction costs clear:

1. Applicants require the Commission's unambiguous declaration that the transaction costs actually being incurred by Applicants are appropriate to further the public interest and are reasonable and prudent, to a maximum amount of $300,000, and that recovery of such costs is subject only to a future verification of the actual amount spent or incurred to further the transaction.

2. All reasonable costs incurred in compliance with the Decision in this docket, including, without limitation, the costs of filing future applications to extend the respective CC&Ns for Northern and Southern, proceedings related to lifting of the moratoria and other compliance filings. As reflected herein, and in the ROO, Applicants have objected to the use of continuing Commission proceedings to further effectuate the transfer of operations to Applicants. If the Commission nevertheless elects to impose numerous future compliance requirements on Applicants, it must also ensure that the reasonable costs of such compliance are fully recoverable through rates charged to Applicants' future customers. Furthermore, it should be clear that such assurance of recovery is separate and apart from the $300,000 cap on transaction costs Applicants have agreed to accept.

D. The Deadline For The Filing Of Backflow And Curtailment Tariffs Should Be Triggered By The Close Of The Sale Transaction.

Applicants do not object to being required to file a Backflow Prevention Tariff or Curtailment Plan in the forms found on the Commission's website. ROO at 21, 34. However, the requirement that these filings be made within 45 days of the Decision places the Applicants in the possible position of having to file the tariff and plan *before* they actually own the assets. The date of the closing of the actual acquisition is, to a great extent, outside Applicants' control. Accordingly, the ROO should be modified to require the filing of a Backflow Prevention Tariff and Curtailment Plan within 45 days of the closing of the sale transaction.

E. <u>The ROO Should Be Clarified To Provide Applicants Unambiguous Assurance That Removal Of ASUA As Interim Operator And All Related Matters Are The Responsibility Of The Commission And Its Staff.</u>

Applicants request confirmation that none of the matters addressed in the ROO respecting ASUA, including elimination of the SIS recently approved in Decision No. 68667, will be their responsibility. ROO at 21-23.

III. CONCLUSION.

The Commission, its Staff and the Hearing Division, along with the Applicants and other interested stakeholders, have worked very hard to reach the point of bringing an order before the Commission that will further the public interest by providing the authority necessary before Applicants can take over service to customers of the McLain Systems. The ROO brings the interested stakeholders much closer to achieving that goal. However, the modifications to the ROO outlined by Applicants in these exceptions are necessary if the goal of Applicants acquiring the McLain Systems and taking over service to those customers is to be accomplished. Accordingly, Applicants respectfully request that the Commission consider these Exceptions and make the necessary modifications to the ROO in its final order in these consolidated dockets.

DATED this 26th day of June, 2006.

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