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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF UTILITY SOURCE, L.L.C. FOR A DETERMINIATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PROPERTY AND FOR AN INCREASE IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICES	**WS-04235A-06-0303** **COMMENTS ON, AND OBJECTIONS TO, LATE FILED ALJ SCENERIO #4**

Utility Source, L.L.C. (the "Company") hereby files its comments and objections to Scenario # 4 filed by Staff at Administrative Law Judges Teena Wolfe's request on June 22, 2007.

At the hearing in the subject docket on June 20, 2007 Administrative Law Judge Teena Wolfe (the "ALJ") requested that the Staff file as a late filed exhibit (hereinafter referred to as Scenario # 4) an exhibit similar to Staff's Exhibit S-2, Schedule JMM-W-1, embodying what the ALJ referred to as Scenario # 4. That Scenario was to utilize the assumptions contained in the Staff's Scenario # 2 for the Company's Water Division as set forth in Staff Exhibit S-2, (Staff's Surrebuttal filing), but incorporating the ALJ's requested revisions. Staff duly docketed Scenario # 4 on June 22, 2007.

All Parties were granted an opportunity to comment on Scenario # 4 by June 29, 2007, and the Company hereby files its comments and objections to that scenario.

Staff's Scenarios # 1 and 2 included the Company's Well Number 4 in Rate Base and the 350 pro-formed customers and related revenues, which resolved that issue between the Staff and

Company (the "Resolution"), although the Parties still had differing opinions as to the Depreciation Expense, Property Taxes and Rate of Return. Scenario # 4 includes the 350 customers, but considers Well Number 4 to be a Contribution in Aid of Construction and thereby excluding the capital cost from Rate Base and excluding Depreciation Expense from the Income Statement.

The Company objects to the ALJ or the Commission considering Scenario # 4 for several reasons:

1. There is No Evidence Supporting Scenario # 4. There is no testimony nor any exhibit in the record of this proceeding supporting the proposition that Well Number 4 was constructed with the proceeds of an Advance In Aide of Construction ("AIAC") or a Contribution In Aide of Construction ("CIAC") made by the Owners of the Company or by any Developer. To the contrary, there was testimony that the Owners of the Company paid for that well. The 350 customers in the Resolution are located in Flagstaff Meadows Unit Three, a development owned by a third-party company, Empire Builders, who are not the owners of the Company. Payment for the improvements by the Owners of the utility company is the definition of equity investment in Rate Base.

2. Scenario # 4 Effectively Confiscates Company Property and the Owners' Equity. This scenario in which Well Number 4 is considered as CIAC, arbitrarily and in direct opposition to the evidence in this case, results in an illegal confiscation of the Owners investment in Well Number 4. There is no legal basis, or even a logical basis, for disallowing this plant in Rate Base or denying a Rate of Return thereon, except the ALJ's desire to reach

a preconceived decision to establish and support the otherwise improperly computed Revenue Requirement proposed by Staff. That is blatantly unconstitutional.

3. Scenario # 4 Totally Disregards the Resolution between the Company and Staff. Although no formal agreement between the Staff and Company was docketed, the record is clear that the bargain was to leave the plant in Rate Base in exchange for including 350 customers and their revenues. This is not a sham resolution to permit only a Rate Base increase, but it genuinely benefited the present and future customers. Staff's Scenario # 3 was the "clean" or traditional Arizona rate-making procedure; Well Number 4 was not considered, nor were the 350 additional customers and Revenues. Both Staff and Company testified that the rate increase in that scenario is in the 300% range. That is precisely why the Company offered, and the Staff accepted, the compromise Resolution. If Well Number 4 is disregarded, the customers must be disregarded, and the present and future customers of the Company will suffer the consequences.

4. Scenario # 4 Misses the Purpose of the Post Test-Year Adjustments. The evidence is clear that the Company included the 350 customers in the water and wastewater application analysis, and the substantial revenues were also included in this proceeding solely in response to the Staff's proposed disallowance of the Well Number 4 capital cost and the exclusion of the operating costs[1] as "post Test-Year" matters. The Company was not, and is not, obligated to voluntarily include those

[1] Note , no Pumping Power Costs or any Repair & Maintenance Costs were included, only Depreciation Expense.

customers and revenues. It did so to "match" the post Test-Year plant which is necessary for obtaining the Arizona Department of Water Resources Adequate Water Supply Letter associated with all customers to be served from Well Number 4. The inclusion of that well makes clear the larger capacity of Well Number 4 will be matched with all the customers it would serve, not just Flagstaff Meadows Unit Three customers. If the 350 customers revenues ($83,560 used by both Staff and the Company) are to be included in any analysis, the well costs (agreed by the Company and Staff to be $736,583) must be included as Rate Base.

5. Scenario # 4's Adoption Would be a Permanent Irreversible Ruling Addressing a Temporary Problem. Although it may meet the ALJ's perception of rational rate-making, this extreme action denies the Company's ability to earn a reasonable return on that plant forever. Disallowing the $736,583 booked during the Test Year, with an additional $300,000 or $400,000 subsequently booked to complete the well, denies any return on or of that owner invested capital in the Revenue Requirement in this or any future rate case. Any aberration in Rate of Return or Operating Margin caused by the Resolution is a phenomenon caused by the timing of the required plant additions. Properly applied, the Resolution circumvents the other untenable proposals under Staff Scenario 3 and ALJ Scenario # 4, while providing the Company with needed revenues. When the Flagstaff Meadows Unit Three customers come on-line, the next rate case will be "normal" with no proformed revenues and the plant serving those customers will properly be in the Rate Base.

6. The Company Cannot Be Forced to Accept Pro Forma Revenues. With all due respect, neither the ALJ nor the Commission can force the Company to include the 350 customers and the associated revenues in this proceeding. The number of customers is not a "known and measurable" post test-year adjustment. The evidence is clear that the additional customer level is more probably maximized at 276 customers. The revenue level for each of those customers is totally assumed. Likewise, the Well Number 4 costs are not known and measurable. The $736,583 is certainly known, but as the testimony indicates that is not the total cost of that well, which will increase by $300,000 or $400,000. Without the Company agreeing to the revenue level for these non-existent customers, and the Staff agreeing to the Rate Base inclusion, (both adopted solely for the stated purpose of ameliorating the otherwise 300% required increase), neither the Rate Base nor the proforma revenue can be included. The Resolution is in everyone's best interest, especially the present and future customers of the Company.

7. Scenario # 4 Does Not Remedy the Flaws of the Staff Position. Although Scenario # 4 addresses one of the flaws in the Staff's position, that is, the unsupportable difference in the recommended Rates of Return between the Water Division and the Wastewater Division, the Scenario is equally flawed by arbitrarily declaring the $736,583 investment by the Company to be CIAC. Although a cosmetic correction of the Rate of Return discrepancy, it merely raises the other flaws cited above. It still does not

address the underlying flaw in the Staff position, that is, the recommended Revenue Requirement.

8. Scenario # 4 Provides Insufficient Operating Margin. As stated, although the treatment of Well Number 4 as CIAC artificially reduces Rate Base so that the Staff's improperly computed recommended Rate of Return coincidentally produces the approximate Staff Revenue Requirement, the resultant Operating Margin and Rate of Return are totally inadequate. Attached are two sheets in the format of Rejoinder Exhibit 1 to Company Exhibit A-5, the Rejoinder Testimony of Thomas Bourassa, showing the resultant returns from Scenario # 4. The Operating Margin, as with the other Staff Revenue Recommendations, provides insufficient Operating Margins and Rate of Return for the Company to continue providing quality service.

In summary, Scenario # 4 should not be considered by the ALJ due to the fact that it would result in improper, illegal and artificially forced computations to meet Staff's Revenue Requirement, which are also unsupported. The Scenario cannot be adopted without the Company's acceptance of the pro forma revenues, which the Company can not agree to accept without the inclusion of Well Number 4 in Rate Base. Further, Scenario # 4 disregards the Resolution between the Company and the Staff which provides a rationale procedure to set just and reasonable rates, and greatly benefits the customers over the only other legal method of setting the Company's Revenue Requirement as set forth in Staff Scenario # 3. Scenario # 4 should be rejected by the ALJ.

The Company vehemently objects to the consideration of Scenario # 4 for the above stated reasons, and in the event any consideration of the matter continues, the Company reserves the right to withdraw the 350 customers and the associated proformed revenues from consideration in this proceeding.

Respectfully submitted this 29th day of June 2007.

SALLQUIST, DRUMMOND & O'CONNOR, P.C.

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Original and ten copies of the foregoing filed this 29 day of June 2007, with:

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Utility Source, L.L.C. - Combined Water and Sewer
Test Year Ended December 31, 2005
Projected Revenues and Expense and Return on Rate Base Using Staff Proposed Rates (8.9% ROR)
Based On ALJ Scenario #4 for Water Division and Staff Proposed Sewer

Line No.		Adjusted Test Year at Present Rates[1]	Adjusted Test Year at Proposed Rates[1]	Projected Year 1	Projected Year 2	Projected Year 3
6	Customer Growth			**50**	**50**	**50**
8	Cummulative Additional Customers			50	100	150
10	Effective Customer Growth 1/2 year			25	75	125
12	Revenues[2]	$ 150,320	$ 305,775	$ 327,881	$ 368,093	$ 408,305
14	Operating Expenses	$ 331,897	$ 305,058	$ 305,058	$ 305,058	$ 305,058
16	Operating Income	$ (181,577)	$ 717	$ 22,823	$ 63,035	$ 103,247
18	Operating Margin	-120.79%	0.23%	6.96%	17.12%	25.29%
20	Rate Base	$ 3,168,479	$ 3,168,479	$ 3,168,479	$ 3,168,479	$ 3,168,479
22	Return on Rate Base	-5.73%	0.02%	0.72%	1.99%	3.26%

[1] Excludes pro-forma revenues from customer growth.
[2] Half-year convention used for projected customer growth and revenues. Based on average bill for 3/4 inch metered customer.

Utility Source, L.L.C. - Combined Water and Sewer
Test Year Ended December 31, 2005
Projected Revenues and Expense and Return on Rate Base Using Staff Proposed Rates (8.9% ROR)
Based On ALJ Scenario #4 for Water Division and Staff Proposed Sewer

Line No.		Adjusted Test Year at Present Rates[1]	Adjusted Test Year at Proposed Rates[1]	Projected Year 1	Projected Year 2	Projected Year 3
6	Customer Growth			**100**	**100**	**100**
8	Cummulative Additional Customers			100	200	300
10	Effective Customer Growth 1/2 year			50	150	250
12	Revenues[2]	$ 150,320	$ 305,775	$ 349,987	$ 430,411	$ 510,835
14	Operating Expenses	$ 331,895	$ 305,056	$ 305,056	$ 305,056	$ 305,056
16	Operating Income	$ (181,575)	$ 719	$ 44,931	$ 125,355	$ 205,779
18	Operating Margin	-120.79%	0.23%	12.84%	29.12%	40.28%
20	Rate Base	$ 3,168,479	$ 3,168,479	$ 3,864,478	$ 3,864,478	$ 3,864,478
22	Return on Rate Base	-5.73%	0.02%	1.16%	3.24%	5.32%

[1] Excludes pro-forma revenues from customer growth.
[2] Half-year convention used for projected customer growth and revenues. Based on average bill for 3/4 inch metered customer.