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Arizona Corporation Commission

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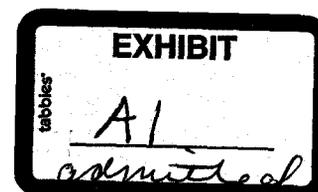
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8 **BEFORE THE ARIZONA CORPORATION COMMISSION**

9 IN THE MATTER OF THE APPLICATION
10 OF PINE WATER COMPANY FOR
11 APPROVAL TO (1) ENCUMBER A PART
12 OF ITS PLANT AND SYSTEM PURSUANT
13 TO A.R.S. § 40-285(A); AND (2) ISSUE
14 EVIDENCE OF INDEBTEDNESS
15 PURSUANT TO A.R.S. § 40-302(A).

DOCKET NO: W-03512A-07-0362

16 **DIRECT TESTIMONY**
17 **OF**
18 **ROBERT T. HARDCASTLE**



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1 **I. INTRODUCTION AND QUALIFICATIONS.**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TELEPHONE**
3 **NUMBER.**

4 A. Robert T. Hardcastle, 3101 State Rd., Bakersfield, California 93308. My telephone
5 number is (661) 633-7526.

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am the President of Brooke Utilities, Inc. ("BUI"). BUI is the sole shareholder of
8 the Applicant, Pine Water Company, Inc. ("PWCo" or the "Company"). I am also
9 the Company's President.

10 **Q. PLEASE BRIEFLY OUTLINE YOUR RESPONSIBILITIES AS THEY**
11 **RELATE TO THE COMPANY.**

12 A. As the Executive Officer, I am generally responsible for managing all operational,
13 administrative, financial, and regulatory matters of BUI and its subsidiaries,
14 PWCo, Strawberry Water Co., Inc. ("SWCo"), Payson Water Co., Inc., Tonto
15 Basin Water Co., Inc., Navajo Water Co., Inc., Brooke Water, L.L.C., and Circle
16 City Water Co., L.L.C. Each of these subsidiaries is a public service corporation
17 providing water utility service under regulation by the Arizona Corporation
18 Commission ("Commission").

19 **Q. HOW LONG HAVE YOU BEEN INVOLVED WITH BUI AND ITS**
20 **SUBSIDIARIES?**

21 A. I have overseen BUI's interests in Arizona since 1995, including our operations in
22 Pine and Strawberry, Arizona since the mid-1990s.

23 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE ARIZONA**
24 **CORPORATION COMMISSION?**

25 A. Yes, on several prior occasions.
26

1 **II. TESTIMONY IN SUPPORT OF APPLICATION.**

2 **A. Background on K2 Agreement.**

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
4 **PROCEEDING?**

5 A. To support the Company's application for two approvals related to the K2
6 Agreement.

7 **Q. WHAT IS THE K2 AGREEMENT?**

8 A. The Joint Well Development Agreement ("K2 Agreement") between PWCo and
9 the Pine-Strawberry Water Improvement District ("PSWID"), dated May 1, 2007.
10 A copy of the K2 Agreement is attached to the Company's Application as
11 **Exhibit 1.** Under the K2 Agreement, PSWID and PWCo have agreed to jointly
12 invest in a deep well project.

13 **Q. WHAT DO YOU MEAN JOINTLY INVEST?**

14 A. PSWID has agreed to fund the first \$300,000 of the K2 Project, which amount is
15 the estimated cost of drilling of a test well at the K2 well site in Strawberry,
16 Arizona.

17 **Q. WHAT HAPPENS AFTER THE TEST WELL IS DRILLED?**

18 A. After the test well is completed and all of the necessary well tests have been
19 conducted, the Project Hydrologist will review the data and a determination will be
20 made of the estimated sustainable yield that may be obtained from a production
21 well to be drilled at the K2 site. If the estimated sustainable yield is at least 150
22 gpm, then a production well will be drilled at the K2 site.

23 **Q. WHO WILL PAY FOR THE PRODUCTION WELL TO BE DRILLED?**

24 A. The Company. If the test well results in an estimated sustainable yield of at least
25 150 gpm, PWCo is committed under the K2 Agreement to spend up to \$1 million
26

1 to drill, equip and interconnect a production well and up to 300,000 gallons of new
2 storage to the PWCo system.

3 **Q. HOW WILL THE INTERCONNECTION OCCUR?**

4 A. The well will be interconnected to both the PWCo and SWCo water systems by
5 direct connection to Project Magnolia, which pipeline is located adjacent to the K2
6 site.

7 **Q. WILL WATER FROM THE WELL BE DELIVERED TO CUSTOMERS OF
8 BOTH COMPANIES?**

9 A. We hope so. Under the agreement, excess water is to be provided by PWCo to
10 SWCo.

11 **B. Requested Commission Approvals.**

12 **Q. IS THE COMPANY SEEKING COMMISSION APPROVAL OF THE K2
13 AGREEMENT?**

14 A. No. As Staff recognized early in the history of this case, the Commission's role is
15 limited to the two specific approvals sought by PWCo.

16 **Q. WHAT ARE THESE TWO APPROVALS?**

17 A. The first is approval to encumber the K2 well site and well property. The second
18 involves approval for the Company to agree to return PSWID's investment in the
19 K2 Project if certain conditions are met. The approvals are being sought under
20 ARS § 40-285(A) and ARS § 40-302(A), respectively.

21 **Q. WHY WILL A LIEN BE ISSUED?**

22 A. The lien in favor of the PSWID secures PWCo's obligations under the K2
23 Agreement, including the obligation to convey the K2 well and well site to PSWID
24 in the event that the test well is unsuccessful and PWCo elects not to move forward
25 with the production well.

26

1 **Q. IS THE K2 WELL USED AND NECESSARY FOR PWCO TO SERVE ITS**
2 **CUSTOMERS?**

3 A. Not at this time, however, in the event that the test well is successful, the
4 production well and all related appurtenances are anticipated to be used and
5 necessary. So, in an abundance of caution, we sought approval to encumber utility
6 property that might become used and necessary in the future.

7 **Q. WHAT ABOUT THE SECOND APPROVAL?**

8 A. A.R.S. § 40-302(A) requires a public service corporation to first secure from the
9 Commission an order authorizing the issuance of stocks and stock certificates,
10 bonds, notes and other evidence of indebtedness. Under the K2 Agreement, the
11 Company has conditionally agreed to return PSWID's investment, along with a 6%
12 return on that investment, if a production well is developed on the site, the
13 production well is placed in service and the costs of the K2 well project are
14 included in rate base. Clearly the K2 Agreement does not require PWCo to issue
15 stocks, stock certificates, bonds or notes. However, again in an abundance of
16 caution, and because of the severity of the consequences specified in A.R.S. § 40-
17 303 if Commission approval were required but not obtained, PWCo is seeking
18 approval at this time in case the Commission concludes the K2 Agreement is an
19 "other evidence of indebtedness."

20 **Q. IS PWCO SEEKING APPROVAL IN THIS DOCKET TO INCLUDE THE**
21 **COSTS OF THE K2 WELL PROJECT IN RATE BASE?**

22 A. No, we are only seeking approval to evidence the Company's obligation to return
23 PSWID's investment in the event the conditions are satisfied.

24 **Q. WILL THE APPROVALS IMPAIR THE COMPANY'S FINANCIAL**
25 **CONDITION OR NEGATIVELY IMPACT THE COMPANY'S ABILITY**
26 **TO SERVE ITS CUSTOMERS?**

1 A. No, actually we hope that the approvals will enhance our ability to serve by
2 allowing the Company to pursue development of a deep well that is anticipated to
3 add a substantial amount of water to the Company's system. Given the history of
4 water supply shortages in the Company's CC&N, finding additional water supplies
5 certainly appears to me to be in the public interest.

6 **Q. HASN'T THE COMMISSION BEEN PUSHING THE COMPANY TO FIND**
7 **LONG-TERM WATER SUPPLY SOLUTIONS?**

8 A. Yes, in several decisions the Commission has directed the Company to take steps
9 to explore and develop long-term water supplies that can be used to serve
10 customers. *See, e.g.,* Decision No. 67166 (August 10, 2004); Decision No. 67823
11 (May 5, 2005). PSWID and PWCo have been working for several years, separately
12 and more recently together, to locate additional water supplies for the region. The
13 K2 Agreement is the latest step. It is also, in our view, the very type of effort the
14 Commission directed the Company to undertake when it ordered PWCo to work
15 with local stakeholders, including PSWID, to develop long-term solutions to the
16 region's chronic water supply shortages. *See* Decision No. 67823 at 13.

17 **Q. DO YOU HAVE ANYTHING ELSE TO ADD TO YOUR TESTIMONY AT**
18 **THIS TIME, MR. HARDCASTLE?**

19 A. Just that we urge the Commission to issue the requested approvals as soon as
20 possible. This past summer saw some of the lowest water levels in our experience
21 and if we are to have any hope of bringing this new water supply online before next
22 summer, we need to get drilling. Right now, we are waiting on the Commission.

23 **Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

24 A. Yes.

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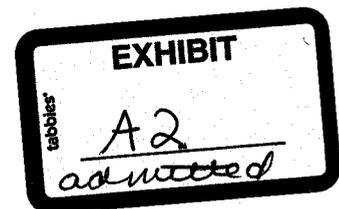
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DOCKET NO. W-03512A-07-0362

16 **REBUTTAL TESTIMONY**
17 **OF**
18 **ROBERT T. HARDCASTLE**



1 **I. INTRODUCTION AND QUALIFICATIONS.**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TELEPHONE**
3 **NUMBER.**

4 A. Robert T. Hardcastle, 3101 State Rd., Bakersfield, California 93308. My telephone
5 number is (661) 633-7526.

6 **Q. ARE YOU THE SAME ROBERT HARDCASTLE THAT FILED DIRECT**
7 **TESTIMONY IN THIS MATTER?**

8 A. Yes, my direct testimony was filed on November 7, 2007 in support of Pine Water
9 Company's ("PWCo" or the "Company") application in this docket.

10 **Q. HAVE YOU REVIEWED MR. CHAVES' AND MR. SCOTT'S**
11 **RESPONSIVE TESTIMONIES ON BEHALF OF STAFF?**

12 A. Yes.

13 **Q. HAVE YOU REVIEWED THE INTERVENERS', MR. GREER'S AND**
14 **MR. KRAFCZYK'S, DIRECT TESTIMONIES?**

15 A. Yes.

16 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

17 A. Generally, to respond to the testimonies by Staff and the two interveners.

18 **Q. PLEASE SUMMARIZE THE COMPANY'S REBUTTAL TO THE**
19 **TESTIMONIES FILED BY STAFF AND THE INTERVENERS.**

20 A. Regarding Staff's testimony, it must be emphasized that Staff continues to
21 recommend approval of the Application and agrees that having its
22 recommendations track the statutory language is appropriate. We do find Staff's
23 advance prudence requirements unusual in this docket but, after consultation with
24 Staff, understand where they are coming from and will work with them towards the
25 common goal of finding long-term, continuous water supplies for our customers.
26 We also completely disagree with Staff that the K2 Agreement is a loan

1 transaction. We are in full agreement with Staff that the Commission need not and
2 should not attempt to characterize the transaction as anything other than "evidence
3 of indebtedness."

4 Regarding the testimony of the Interveners, we are disappointed that they
5 have chosen to ignore the clear cautions by the Judge and at least two
6 Commissioners regarding the Commission's authority and the scope of this
7 proceeding. We are not here to determine whether PSWID should or should not
8 have entered into the K2 Agreement with PWCo, and if so, on what terms. Nor are
9 we here so the Commission can make the Company's operational decisions based
10 on objections by customers who seem to think they know better than we do how to
11 operate this water company. We are simply here, in an abundance of caution as a
12 regulated water provider, to obtain two narrow approvals related to our decision to
13 pursue the K2 well project. With respect to those approvals, the Interveners have
14 presented no credible evidence to support their opposition to our efforts to bring
15 more water to our customers.

16 **II. REBUTTAL TO STAFF TESTIMONIES.**

17 **A. Testimony by Staff Engineer.**

18 **Q. DO YOU HAVE ANY REBUTTAL TO THE TESTIMONY BY THE STAFF
19 ENGINEER, MARLIN SCOTT, JR.?**

20 **A.** I find it somewhat unusual that Mr. Scott is testifying now in this docket to
21 information Staff wants to see if the K2 well project is later sought for inclusion in
22 rate base. *See Scott Responsive Testimony at 3.*

23 **Q. WHY DO YOU FIND THIS TO BE UNUSUAL?**

24 **A.** Because the prudence of the K2 well project is not at issue in this proceeding. The
25 well does not even exist yet. In addition, Staff does not appear to be seeking any
26 affirmative relief in this docket with respect to this issue. The testimony seems to

1 be merely "advisory" in nature. *Id.*

2 **Q. HAS THE COMPANY DISCUSSED THIS MATTER WITH STAFF?**

3 A. Yes, and those discussions confirmed my understanding that Staff is trying to help
4 the Company by identifying the information it would like to see to evaluate the
5 prudence of the K2 well project in a future rate case. Further, Staff has informed
6 us that they have discussed the opinion letter with ADWR, and that ADWR is
7 willing to review test well data and render an opinion regarding the likely "long-
8 term continuous capacity" of the K2 well.

9 **Q. DOES THIS MEAN YOU HAVE TO COMPLETE THE WELL PROJECT**
10 **BEFORE YOU CAN OBTAIN THIS LETTER FROM ADWR?**

11 A. Not to my understanding, and obviously we are not going to invest a million
12 dollars or more in a well project only to have ADWR determine with hindsight that
13 it does not meet Staff's "long-term continuous capacity" requirement.

14 **Q. THEN HOW WILL THIS REQUIREMENT OF STAFF'S BE FULFILLED?**

15 A. Based on my discussions with Staff, I understand Staff would simply like PWCo to
16 supply the information from the test well to ADWR. ADWR will then evaluate
17 that information and provide the Company its opinion whether a production well at
18 the K2 site is likely to provide a "long-term continuous" supply.

19 **Q. DOES THE COMPANY HAVE ANY PROBLEM WITH THIS PROCESS?**

20 A. Not really. Even though there is no clear requirement that the Company take this
21 step, since the Company and PSWID will be evaluating the test well data to
22 determine whether a production well at the K2 site will result in an estimated
23 sustainable yield of 150 gpm, I do not believe Staff's desire for an ADWR opinion
24 letter is overly burdensome.

25

26

1 **B. Testimony by Staff's Public Utility Analyst.**

2 **Q. DO YOU HAVE ANY CONCERNS OVER THE TESTIMONY BY**
3 **MR. CHAVES?**

4 A. This testimony also results in a somewhat unusual situation. Staff and the
5 Company appear to have differing points of view concerning the nature of the
6 transaction contemplated in the K2 Agreement. Nevertheless, both parties agree
7 that the issue is not germane to the relief sought by PWCo in this docket. *See*
8 Chaves Responsive Testimony at 3-4 (adopting PWCo's revised Staff
9 recommended conditions for approval).

10 **Q. HOW DOES THE COMPANY AND STAFF DIFFER OVER THE NATURE**
11 **OF THE TRANSACTION?**

12 A. In PWCo's September 26, 2007 Response to Staff Report, the Company expressed
13 disagreement that, under the K2 Agreement, PSWID is lending and PWCo is
14 borrowing money.

15 **Q. HOW DO YOU CHARACTERIZE THE TRANSACTION BETWEEN THE**
16 **COMPANY AND THE PSWID UNDER THE K2 AGREEMENT?**

17 A. PSWID has agreed to make an investment to further its efforts to find long-term
18 water supplies in the Pine-Strawberry area by drilling a test well at the K2 site.
19 The funds provided by PSWID will be paid directly to the well drillers out of an
20 escrow fund, and if the test well does not lead to a production well being drilled on
21 the site, the test well will be in the sole possession of the PSWID. If the test well is
22 successful, i.e., results in an estimated sustainable yield of 150 gpm, PWCo will
23 invest up to an additional \$1 million to drill and interconnect a production well and
24 additional storage to the PWCo system. Thereafter, if the Commission allows the
25 Company a return on and of the costs of the K2 well project through rate base
26 treatment, PWCo will return PSWID's investment along with a return on that

1 investment.

2 **Q. TO YOUR KNOWLEDGE, DOES PSWID SHARE THIS VIEW OF THE K2**
3 **TRANSACTION?**

4 A. Yes, definitely, as reflected in the *JOINT WELL DEVELOPMENT AGREEMENT:*
5 *The District's Investment to Locate a New Dependable Water Source*, a document
6 prepared by the PSWID at our request. A copy of this document is attached to my
7 rebuttal testimony as **Harcastle Rebuttal Exhibit 1**.

8 **Q. DOES THE COMMISSION NEED TO RESOLVE THE ISSUE OF HOW**
9 **THE K2 TRANSACTION IS CHARACTERIZED IN THIS DOCKET?**

10 A. Not in our view. As discussed in my direct testimony (at page 4), we have sought
11 Commission approval of our contingent obligation to return PSWID's investment if
12 certain conditions come to fruition in the future. It is more than sufficient for the
13 Commission to issue approval of an "other evidence of indebtedness." Again,
14 despite our differing views, Staff and the Company are in agreement on this point.
15 *See Chaves Responsive Testimony at 3-4 (adopting PWCo's revised Staff*
16 *recommended conditions for approval).*

17 **Q. DOES THE COMPANY ACCEPT STAFF'S RECOMMENDATIONS IN**
18 **THIS DOCKET?**

19 A. Yes, as revised in PWCo's Response to Staff Report and accepted by Staff, and
20 subject to the differing points of view discussed in this rebuttal testimony.

21 **III. REBUTTAL TO INTERVENERS' TESTIMONIES.**

22 **Q. DOES THE COMPANY HAVE CONCERNS WITH RESPECT TO THE**
23 **DIRECT TESTIMONY FILED BY MR. GREER AND MR. KRAFCZYK?**

24 A. Yes. The testimonies filed by these interveners suffer from two fundamental flaws.
25 First, Mr. Krafczyk and Mr. Greer have each filed testimony that goes beyond the
26

1 scope of this proceeding. Second, their testimonies make sweeping allegations
2 concerning matters over which the interveners lack personal knowledge.¹

3 **Q. WHY DO YOU BELIEVE THAT THEIR TESTIMONIES GO BEYOND**
4 **THE SCOPE OF THESE PROCEEDINGS?**

5 A. For example, Mr. Greer wants the Commission to address whether conflicts of
6 interest existed before as well as during and after the K2 Agreement was
7 negotiated. Mr. Krafczyk wants the Commission to address PSWID's legal
8 authority to enter into the K2 Agreement, whether the PSWID Board can bind
9 future boards, whether it can put funds in escrow, whether it had sufficient
10 information and whether it has assumed too much risk. Setting aside that these
11 appear to me to be largely legal issues, these matters have nothing to do with
12 whether or not the Commission should approve the requested encumbrance and
13 evidence of indebtedness.

14 Apparently Mr. Krafczyk and Mr. Greer feel it is okay to ignore Judge
15 Nodes who indicated that the PSWID is "an individual government entity that has
16 been formed and the Commission does not have the authority to tell that entity
17 what to do." Transcript, October 26, 2007, at 33-34. *See also* Transcript at 43.
18 Judge Nodes went even further, in responding to Mrs. Krafczyk during public
19 comment, and explained in explicit terms that "frustrations" with the PSWID are
20 "outside the scope of this case and even the Commission's authority to act on what
21 that entity's actions are." *Id.* Chairman Gleason and Commission Mundell echoed
22 Judge Nodes' view that the proceeding does not involve telling PSWID how and
23 where to spend its money or what else it should do. *Id.* at 44-45, 59.

24
25 ¹ PWCo has submitted data requests to the Interveners seeking to discover whether they actually have personal
26 knowledge to support their testimony. However, given the short interlude between the filing of the Interveners'
testimonies and the Company's rebuttal, responses have not yet been received. PWCo will supplement and/or amend
this testimony if necessary after receipt and review of the discovery responses.

1 Q. DO YOU HAVE AN OPINION AS TO WHY THE INTERVENERS ARE
2 RAISING THESE ISSUES DESPITE THE CAUTIONARY COMMENTS BY
3 THE PRESIDING JUDGE?

4 A. I do. The interveners are opposed to the K2 well project, and are looking to
5 leverage every possible opportunity to paint BUI and myself as evil-doers. In
6 effect, these opposition parties not only oppose BUI, but regulation by the
7 Commission in general. Mr. Krafczyk, Mr. Greer and others have a right to their
8 opinion and to pursue their positions in the proper forums. But in this case, while it
9 is unfortunate that Mr. Greer and Mr. Krafczyk have intervened in an effort to
10 expand the issues before the Commission, that effort should fail.

11 Q. WHAT ABOUT YOUR CONCERN THAT THE INTERVENERS ARE
12 TESTIFYING TO MATTERS OVER WHICH THEY DO NOT HAVE
13 PERSONAL KNOWLEDGE?

14 A. Mr. Greer testifies that the K2 site is insufficient and that we do not have adequate
15 access. Mr. Greer has never requested permission to be on the site and he has
16 never consulted with PWCo or its representatives regarding our plans for the K2
17 well project. I do not see how he can offer such testimony.

18 Q. ARE THESE ISSUES EVEN RELEVANT TO THESE PROCEEDINGS?

19 A. I am not a lawyer, but not in my view. As I explained in my prior testimony, in an
20 abundance of caution we have sought two narrow approvals from the Commission
21 related to the K2 Agreement. While we understand the Commission's desire that
22 PWCo locate additional water supplies, we simply do not believe it is the role of
23 the Commission to preempt the operational decisions being made by PWCo in its
24 efforts to locate long-term solutions to the region's chronic water supply problems.
25
26

1 Q. DOES MR. KRAFCZYK OFFER TESTIMONY THAT IS SIMILARLY
2 PROBLEMATIC?

3 A. In my view, yes. Mr. Krafczyk asks the Commission to evaluate whether the
4 property subject to the requested encumbrance is of sufficient value, and like
5 Mr. Greer, he attempts to offer testimony regarding the adequacy of the site and
6 our rights of access. First, as I explained in my direct testimony, the utility
7 property to which the lien will attach does not even exist yet, and I am not aware of
8 any appraisal of the K2 site to support Mr. Krafczyk's testimony. On what basis
9 then is Mr. Krafczyk offering this testimony? The answer appears to be—none
10 whatsoever.

11 Second, as with Mr. Greer, I do not see how Mr. Krafczyk can possibly have
12 personal knowledge concerning the K2 site and our efforts to develop it as a well
13 site. Third, as I testified to earlier, these matters appear to the Company to be
14 outside the scope of this proceeding to approve an encumbrance and evidence of
15 indebtedness.

16 Q. ARE THERE ANY ASPECTS OF THE INTERVENERS' TESTIMONIES
17 THAT YOU BELIEVE ARE GERMANE TO THIS PROCEEDING?

18 A. Mr. Krafczyk testifies that it is "clear" that PWCo does not have the credit
19 worthiness or financial capacity to return PSWID's investment in the K2 well
20 project. I agree that this is something the Commission needs to consider in
21 connection with the approval of an evidence of indebtedness.

22 Q. IS MR. KRAFCZYK CORRECT?

23 A. No, again, it appears that Mr. Krafczyk is testifying to matters outside his personal
24 knowledge. For one thing, Mr. Krafczyk claims to base his testimony on his
25 review of "publicly available records" but he fails to identify those records or the
26 information he has relied upon. He is also wrong. The Company's shareholder,

1 BUI, and the shareholder's shareholder and affiliates are well capitalized. I am
2 absolutely confident that we could return PSWID's investment through an infusion
3 of paid-in-capital and/or debt.

4 **Q. IS MR. KRAFCZYK RIGHT THAT PWCO WILL NEED A**
5 **"SUBSTANTIAL RATE INCREASE"?**

6 A. Not to return PSWID's investment. According to Staff's TIER and DSC
7 calculations, the Company will actually be able to meet all of its obligations from
8 existing revenues. Staff Report at 3. However, if PWCo invests capital in the K2
9 well project and that project is determined to be used and useful, we expect that
10 rates will have to be increased. This should be obvious. If we are going to invest
11 in finding additional water supplies, our ratepayers are going to have to pay for a
12 recovery on and of that investment through rates. That is how regulation works.

13 **Q. DO YOU HAVE ANY OTHER RESPONSE TO THE INTERVENERS'**
14 **TESTIMONY?**

15 A. There are two other issues I would like to address—the location of the K2 well in
16 Strawberry versus Pine and the alleged impact of the K2 well on Fossil Creek and
17 Fossil Springs.

18 **Q. EXCUSE ME, MR. HARDCASTLE, BUT AREN'T THESE OPERATIONAL**
19 **ISSUES OUTSIDE THE SCOPE OF THESE PROCEEDINGS?**

20 A. Yes, as I testified earlier, we do not believe it is the Commission's role or right to
21 direct where the Company locates a deep well. Nevertheless, there has been so
22 much misinformation on these two issues that I would like to respond.

23 **Q. OKAY, PLEASE RESPOND.**

24 A. First, PWCo does not own a satisfactory well site in Pine and despite his claim that
25 we should drill there, Mr. Greer does not offer any evidence to support his
26 allegations regarding our choice of a well site. In contrast, PSWID and the

1 Company have been studying the matter for several years. Based on the
2 information that has been gathered, and after consideration of a number of factors,
3 we have exercised our individual discretions and concluded that the K2 site is the
4 place where we want to continue our collective efforts to find more water. Mr.
5 Greer is free to disagree, but his disagreement does not provide any basis for the
6 Commission to deny the requested approvals in this docket.

7 Second, Mr. Greer offers nothing more than his bare allegation and appears
8 to be speculating. In our view as a water provider in the area for more than a
9 decade now, and based on the volume of water that would come from a successful
10 deep well on the K2 site, we believe the impact on Fossil Creek or Fossil Springs
11 would be not only negligible, but essentially immeasurable.

12 **Q. DO YOU HAVE ANYTHING ELSE TO ADD TO YOUR REBUTTAL**
13 **TESTIMONY, MR. HARDCASTLE?**

14 **A.** Just that we again urge the Commission to move quickly and grant the requested
15 approvals. For years we have been told by just about everyone interested that it is
16 our responsibility to make the decisions to try to bring more water to the
17 communities we serve. Okay, we accept that responsibility, and while we can
18 agree to disagree about the past, no one can legitimately dispute that we are now
19 trying to find more water. At present, while we would like to already be out
20 drilling the K2 test well, individuals like the Interveners are attempting to hijack
21 the regulatory process to further their opposition to BUI, the current PSWID Board
22 and/or regulation in general.

23 In the end, we are doing exactly what this Commission ordered us to do in
24 Decision No. 67823--which is to work with local entities like PSWID to find more
25 water. The success or failure of that effort falls on us and, while I understand that
26 the Commission must consider the concerns of the citizens they represent, there

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comes a time when politics has to stand aside. I respectfully suggest that time is now.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

2005726.1/75206.015

Docket No: W-03512A-07-0362

Hardcastle Rebuttal Exhibit 1

THE JOINT WELL DEVELOPMENT AGREEMENT
The District's Investment to Locate a
New Dependable Water Source

1. The Pine/Strawberry Water Improvement District's (PSWID) entered into the Joint Well Development Agreement in furtherance of its stated mission:

[T]o represent the interests of the communities [of Pine and Strawberry] and to secure long term and reliable sources of water for the communities. To accomplish this we are to: 1) Investigate current and potential sources of water as well as the costs associated with maintaining or expanding present and potential sources. 2) Formulate a plan or plans for improving present water sources of the communities. 3) Formulate a plan or plans for funding such improvements. 4) Implement and formulate plans as necessary to provide long-term available water to communities. PSWID's Mission Statement

2. Since PSWID's formation, PSWID Boards have regularly authorized expenditures on investigations and studies to enhance the potential for improving and supplementing present water sources available to the Pine and Strawberry communities, including investing capital in the joint development and monitoring of the Strawberry Borehole.

3. The Joint Well Development Agreement represents another cooperative effort by PSWID to determine where a new dependable water source can be developed. Under the Agreement:

- a. PSWID is pursuing its mission of enhancing the potential for improving and supplementing water sources available to the Pine and Strawberry communities by investing \$300,000 to fund drilling a deep test well into the R aquifer and conducting pump tests and other evaluations of the test well.
- b. PWCo is committing to either a) convey the project to PSWID, including the well site, or b) if the test well demonstrates there is a likelihood that 150 gpm or more of sustainable yield can be produced at the site, to develop and place in service a production well at the site (something PSWID lacks funding to accomplish independently).

4. The Joint Well Development Agreement does not involve a "loan" to PWCo.
 - a. No money is transferred or given to PWCo. Funds are placed into escrow, where PSWID retains control over their expenditure. All funds will be paid to third parties (not PWCo) for work performed in furtherance of the Joint Well Development Agreement.
 - b. PWCo, as well as all other members of the public, will have access to the pump test and well driller data developed from PSWID's investment. From that data, PSWID and PWCo will determine whether there is a likelihood that a sustainable yield of 150 gpm or more form the K2 site.
 - c. If the work halts at any time before a production well is placed in service, PSWID will receive the improved K2 site at no further cost to PSWID.¹
 - d. However, if the production well is constructed and placed both in service and in PWCo's rate base, then PWCo becomes obligated to return PSWID's capital investment with a reasonable return thereon.
5. Out of an abundance of caution PWCo seeks Commission approval to incur this contingent "indebtedness" pursuant to A.R.S. §40-302(A).
6. PSWID has limited funds and limited funding sources. It does not have sufficient funds to develop a production well on its own.
7. PSWID owns no land upon which it can drill a test well or a production well. If it must pay to acquire a well site or access, the amount available for drilling and testing is reduced.
8. The Joint Well Development Agreement addresses and resolves these limitations by partnering with PWCo on an existing site, with a good hydrologic upside and located in proximity to the existing water distribution system that services both the Pine and Strawberry Communities.

¹ Instead of accepting the Improved wellsite, PSWID, in its sole discretion, may elect to have PWCo abandon the well by encasing and sealing it consistent with ADWR rules

NEW APPLICATION ORIGINAL

RECEIVED

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2 Jay L. Shapiro (No. 014650)
3 Patrick J. Black (No. 017141)
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2007 JUN 11 A 10: 25

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

JUN 11 2007

DOCKETED BY

RD88

BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE APPLICATION
9 OF PINE WATER COMPANY FOR
10 APPROVAL TO (1) ENCUMBER A PART
11 OF ITS PLANT AND SYSTEM
12 PURSUANT TO A.R.S. § 40-285(A); AND
13 (2) ISSUE EVIDENCE OF
14 INDEBTEDNESS PURSUANT TO A.R.S. §
15 40-302(A).

DOCKET NO: W-03512A-07-_____

APPLICATION

W-03512A-07-0362

EXHIBIT
A-3
admitted

14 Pine Water Company ("PWCo") seeks approval to (1) encumber a part of its plant
15 and system pursuant to A.R.S. § 40-285(A); and (2) issue evidence of indebtedness pursuant
16 to A.R.S. § 40-302(A). The request relates to the Joint Well Development Agreement
17 ("Agreement") between PWCo and the Pine-Strawberry Water Improvement District
18 ("PWSID"), dated May 1, 2007. A copy of the Agreement is attached hereto as
19 **Exhibit 1**. PWCO does not seek approval of the Agreement itself. Nor does PWCo seek
20 any ratemaking treatment in this docket.

21 In support of this application, PWCo submits the following:

22 INFORMATION CRITICAL TO APPLICATION

23 1. A.R.S. § 40-285(A) provides in part that "[a] public service corporation shall
24 not . . . encumber the whole or any part of its . . . plant , or system . . . without first having
25 secured from the commission an order authorizing it so to do." An encumbrance made in
26 violation of § 40-285 (A) is void.

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2. Section 4.2.1.5 of the Agreement provides, in part:

Prior to making the first draw, PWCo . . . shall first record, or cause to be recorded with the Gila County Recorder, the form of Notice of Continuing Security Interest and Lien in favor of PSWID attached hereto as **Attachment 5**. As security for the funds and other consideration being provided by PSWID in accordance with this Agreement to secure PWCo's performance under this Agreement, PWCo hereby agrees and grants to PSWID, effective with the first draw from the Escrow, a security interest in the K2 Wellsite and the Project. PWCo agrees that, in addition to the rights provided for herein, PSWID shall have all of the rights and remedies of a secured party under the Arizona Uniform Commercial Code in respect to the K2 Wellsite and the Project if PWCo fails to perform, in whole or in part, its obligations under this Agreement. The parties hereby agree that the Security Interest and Lien granted by PWCo is expressly limited to the K2 Wellsite and the Project and shall not encumber any other asset of PWCo. PSWID may, at its option, file a UCC Form 1 notice of the security interest. (Agreement at 6).

3. The K2 Wellsite is an approximately 30 x 30 well site located in Strawberry, Arizona. The Project includes a well, pumps, water storage facilities, valves, piping, electrical utilities, and other facilities necessary to connect the K2 well to PWCo's water transmission system.

4. A.R.S. § 40-302(A) provides in part that "[b]efore a public service corporation issues . . . other evidences of indebtedness, it shall first secure from the commission an order authorizing such issue" Pursuant to A.R.S. § 40-303(A), failure to obtain the approval required under § 40-302(A) renders the evidence of indebtedness void.

5. Section 4.2.2 of the Agreement provides, in part:

[E]xcept as provided in **Sections 4.2.3 and 4.2.4** below, PWCo shall return the capital provided by PSWID pursuant to this Agreement [\$300,000], together with a return thereon of six percent (6%) per annum from the date the funds are deposited in the Escrow. Payments shall be made by PWCo to PSWID in 36 equal monthly payments with the first payment due the first day of the month immediately following entry of an ACC Decision recognizing the Project as used and useful and included in rate base for rate making purposes. PWCo may prepay PSWID, in whole or in part, at any time without penalty. All payments shall first be applied to accrued interest. (Agreement at 7).

1 **BACKGROUND INFORMATION TO ASSIST THE COMMISSION**

2 1. PWCo is a public service corporation providing water service to
3 approximately 2000 customers in Northern Gila County, Arizona pursuant to a CC&N
4 granted by the Commission in Decision No. 60972 (June 19, 1998). PWCo's current rates
5 and charges were authorized in Decision No. 67166 (August 10, 2004).

6 2. PSWID is a political subdivision of the State of Arizona created by the Gila
7 County Board of Supervisors pursuant to A.R.S. § 48-909(A)(6). The Petition for the
8 Establishment of PSWID and PSWID's Bylaws expressly provide for the expenditure of
9 funds to locate and develop sources of water in quantities sufficient to provide for current
10 needs and the future population growth within PSWID's boundaries, and for the
11 maintenance of a reliable water supply.

12 3. The Pine-Strawberry, Arizona region has long suffered from water supply
13 shortages. Such shortages have led to community-wide concern and to the imposition by
14 the Commission of mandatory curtailment measures and moratoria on new connections
15 and service extensions for PWCo.

16 4. In or around 2005, the PSWID undertook to analyze various supplemental
17 long-term water supply alternatives in either Pine or Strawberry, Arizona. PWCo
18 considered the results of PSWID's analysis, and began discussing with PSWID public-
19 private participation in the further investigation and development of a long-term water
20 source to benefit its customers, PSWID landowners located within PWCo's CC&N, and to
21 a lesser extent, customers of Strawberry Water Company ("SWCo").

22 5. After careful and thorough scientific review of the potential for finding
23 water at a particular site, PWCo and PSWID entered into the Agreement. The Agreement
24 represents a private-public effort to pursue viable options for locating new water supplies
25 in and around the Pine-Strawberry area. By pooling public and private resources to
26 develop new water resources, PWCo submits that it stands a higher likelihood of success

1 at a lower risk to customers. Such conditions are preferable given current drought
2 conditions in Arizona and the history of water supply shortages in and around the Pine-
3 Strawberry region.

4 6. Based on hydrological analyses, the K2 Site is believed to have the potential
5 to provide a sustainable yield of 150 gpm of water. Agreement at Recital E. The goal is
6 to drill and equip a deep well (approximately 1700 feet) on a portion of the K2 Site
7 approximately 30 x 30 feet in size (the "K2 Wellsite"), and to interconnect the well to
8 PWCo's system ("K2 Well Project"). Agreement at Recital F. The proposed well will be
9 significantly deeper than any existing well currently owned by PWCo or, to PWCo's
10 knowledge, any of the privately owned wells in Strawberry, Arizona in the vicinity of the
11 K2 Site.

12 7. The K2 Site is located near the northern terminus of Project Magnolia, a
13 high capacity water supply line owned by PWCo that connects the PWCo and SWCo
14 systems. In the event that the K2 Well Project is successful, its location would allow
15 PWCo to connect the new well to its system with minimal costs. From there, water can be
16 delivered to customers in the PWCo CC&N. Water from the K2 Site could also be
17 delivered to customers in the SWCo CC&N through Project Magnolia.

18 8. The K2 Site is currently owned by SWCo, and already has electric power,
19 some existing water storage and public water utility easements. SWCo has informed the
20 Parties that a portion of the K2 Site approximating 30 x 30 foot (i.e., the K2 Wellsite) is
21 not necessary or useful in the performance of SWCo's duties to the public pursuant to
22 A.R.S. § 40-285(C).¹

23 9. The K2 Well Project is estimated to cost between \$1,000,000 and
24 \$1,300,000. Agreement at Recital G. This estimate is consistent with the estimates

25 _____
26 ¹ Pursuant to the terms of the Agreement, this portion of the K2 Site will be transferred to
PWCo within 60 days of the Commission's approval of the application.

1 PSWID independently secured from a well driller for just drilling and casing the well;
2 however, consistent with its status as a public service corporation, PWCo intends to only
3 spend amounts that are reasonable and prudent.

4 **RELIEF REQUESTED**

5 WHEREFORE, PWCo respectfully requests that the Commission provide the
6 following relief:

- 7 A. Issue an Order authoring PWCo to:
- 8 a. Encumber the K2 Wellsite and K2 Well Project with a lien in favor
 - 9 of the PSWID pursuant to A.R.S. § 40-285 (A); and
 - 10 b. Issue evidence of indebtedness in favor of the PSWID pursuant to
 - 11 A.R.S. § 40-302(A).

12 RESPECTFULLY SUBMITTED this 11th day of June, 2007.

13 FENNEMORE CRAIG, P.C.

14
15 By 
16 Jay L. Shapiro
17 Patrick J. Black
18 3003 North Central Avenue
19 Suite 2600
Phoenix, Arizona 85012
Attorneys for Pine Water Company

20 ORIGINAL and thirteen (13) copies of the
21 foregoing filed this 11th day of June, 2007:

22 Docket Control
23 Arizona Corporation Commission
24 1200 W. Washington St.
Phoenix, AZ 85007

25 By: 

26 1924220.2/75206.015

Exhibit 1

JOINT WELL DEVELOPMENT AGREEMENT

between

PINE WATER COMPANY

and

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT

dated

May 1, 2007

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JOINT WELL DEVELOPMENT AGREEMENT

THIS JOINT WELL DEVELOPMENT AGREEMENT ("Agreement") is made as of the 1st day of May, 2007 by and among Pine Water Company ("PwCo") and the Pine-Strawberry Water Improvement District ("PSWID"). PwCo and PSWID, from time to time, are each sometimes individually referred to herein as a "Party" and collectively as the "Parties".

RECITALS

A. PwCo is a public service corporation as defined in Article 15, Section 2, of the Arizona Constitution and, as such, is regulated by the Arizona Corporation Commission ("ACC"). PwCo has been granted a Certificate of Convenience and Necessity ("CC&N") by the ACC, authorizing PwCo to provide water utility service within its certificated service area in Pine, Arizona.

B. PSWID is a political subdivision of the State of Arizona created pursuant to A.R.S. §48-909A.6. The Petition for the Establishment of PSWID and PSWID's Bylaws expressly provide for expenditure of funds to locate and develop sources of water in quantities sufficient to provide for current needs and for future population growth in PSWID, and for the maintenance of a reliable water supply. PSWID's By-Laws further provide that PSWID's Board, in the exercise of its powers and duties under applicable State Statutes, and in particular A.R.S. §48-1014, shall, as it determines to be appropriate: (a) investigate current and potential sources of water for the Communities as well as the costs associated with maintaining or expanding present and potential sources; (b) formulate a plan or plans for improving present water sources of the Communities (including formulation of a plan or plans for funding such improvements; (c) consult with Federal, State, County and other Local government officials or agencies concerning development of long-term reliable water sources for the Communities; and (d) implement and formulate plans as necessary to provide long-term available water to Communities.

C. The Pine-Strawberry, Arizona region has long suffered from water supply shortages. Such shortages have led to community-wide concern and to the imposition by the ACC of mandatory curtailment measures and moratoria on new connections and service extensions. The ACC has also directed PwCo to continue efforts, including cooperating with other interested stakeholders, to search for long-term permanent solutions to the chronic water supply issues. PSWID and PwCo have worked independently and collectively within the community to promote water conservation and address the water supply shortage. Now, both Parties desire to work cooperatively to develop a new water source to supplement the water supplies currently available in PSWID and PwCo's CC&N. As a certificated water provider in the Pine-Strawberry area, the new water source will be owned and operated by PwCo.

D. In or around 2005, PSWID undertook to analyze various supplemental long-term water supply alternatives in either Pine or Strawberry. PwCo considered the results of PSWID's analysis and proposed a variation of one of the alternatives for PSWID to consider. PSWID agrees with PwCo that the K2 site, defined herein, should be further investigated and developed as a possible source of water for customers of PwCo, and benefiting landowners in PSWID

within the certificated area of PWCo and, to a lesser extent, within the certificated area of Strawberry Water Company ("SWCo").

E. The K2 site is an existing site in eastern Strawberry, Arizona, just south of Strawberry Creek. The legal description for the K2 site is attached hereto as **Attachment 1** (the "K2 site") and the site plan for the K2 site is attached hereto as **Attachment 2**, and both documents are incorporated herein by this reference. The K2 site is currently owned by SWCo, an affiliate of PWCo, and already has electric power, some existing water storage and public water utility easements. The site is also located at the northern terminus of Project Magnolia, a high capacity water supply line owned by PWCo and connecting the communities of Pine and Strawberry, Arizona.

F. The Parties have conducted a careful and thorough scientific peer review of the possibility of finding water at the K2 site. The Parties believe that further development of a portion of this site as a well site would be in the public interest. The Parties' goal is to drill and equip a deep well on a portion of the K2 site approximating 30 foot by 30 foot with a Sustainable Yield of no less than 150 gallons per minute (gpm) and to interconnect the well to PWCo's system ("K2 Well Project" or "Project"). PWCo is informed by SWCo that a portion of the K2 site approximating 30 foot by 30 foot is not necessary or useful in the performance of the SWCo's duties to the public pursuant to A.R.S. §40-285(C).

G. The parties estimate that the Project will cost between one million dollars (\$1,000,000) and one million three hundred thousand dollars (\$1,300,000). PSWID is willing to provide \$300,000 in capital toward the costs of the K2 Well Project in accordance with the terms of this Agreement. PWCo is willing to fund the remaining costs of the Project subject to the terms and conditions set forth herein. PSWID and PWCo acknowledge that despite the hydrologic analyses, the costs, and their best efforts, the Project may not result in a well with a sustainable yield of no less than 150 gpm.

NOW, THEREFORE, in consideration of the mutual conditions and covenants set forth herein, and other good and valuable consideration, the receipt of which is hereby acknowledged, the Parties agree as follows:

AGREEMENT:

1. Incorporation of Recitals. By this reference, the Parties hereby agree to incorporate the recitals above as part of their agreement as if fully set forth herein.

2. The K2 Well Project. The purpose of the K2 Well Project is to drill, equip and interconnect a production well capable of producing a Sustainable Yield of water as defined in **Section 2.2.2**.

2.1 Test Well. PSWID and PWCo agree that the Project shall commence with the drilling of a test well, estimated at 1,700 feet, at the K2 site. The purpose of this test well shall be to determine, to the greatest extent possible, whether a permanent well at the K2 site is capable of producing a Sustainable Yield as defined in **Section 2.2.2**. PSWID and PWCo shall work cooperatively to mutually agree upon a well driller to drill the test well in accordance with **Section 3**.

2.1.1. Commensurate with the drilling of a test well, all necessary and appropriate well testing, as recommended by the hydrologist and mutually agreed to by the Parties, will be conducted for the purposes of determining the Estimated Sustainable Yield as defined in Section 2.2.3.

2.2 Determination of Sustainable Yield.

2.2.1. Hydrologist. Unless otherwise mutually agreed, Steve Noel of Southwest Groundwater Consultants, Inc. shall be hired by PWCo in accordance with Section 3 as the "Hydrologist" for the K2 Project. The role of Hydrologist shall be to (1) make recommendations regarding the test well and regarding testing; (2) review and analyze test data for the purpose of determining the Estimated Sustainable Yield as defined in Section 2.2.3, and (3) review and analyze test data to make a determination of whether a permanent well will result in a Sustainable Yield as defined in Section 2.2.2.

2.2.2. For purposes of this Agreement, "Sustainable Yield" means the determination by the Hydrologist based on pump test of the permanent well and all testing data, including, without limitation, groundwater flux measurements, and other available hydrologic data that a continuous production rate of no less than 150 gpm for twenty-four (24) hours per day, seven (7) days a week, which determination shall, unless otherwise mutually agree otherwise, set forth the major assumptions, limitations and qualifications associated therewith.

2.2.3. For purposes of this Agreement, "Estimated Sustainable Yield" means the determination by the Hydrologist whether the Project has a high probability of resulting in Sustainable Yield. The determination shall be made based on the test well and all testing data, including, without limitation, groundwater flux measurements, and other available hydrologic data, and, unless mutually agreed otherwise, set forth the major assumptions, limitations and qualifications associated therewith.

2.2.3.1. The Estimated Sustainable Yield shall be provided to the Parties for review within 60 days after the test well is drilled. The Parties shall confer and discuss the Estimated Sustainable Yield and whether the Project has a high probability of resulting in the Sustainable Yield. In the event either Party disagrees with or questions the Estimated Sustainable Yield, they may request that a hydrologist, acceptable to the other Party, review the Estimated Sustainable Yield and underlying data and advise whether the Estimated Sustainable Yield constitutes a reasonable estimate of the Project and, if not, the deficiencies with the Estimated Sustainable Yield. Unless otherwise mutually agreed, the Party requesting a second opinion shall pay the cost thereof. No attempt shall be made to direct the outcome of the recommendations of any hydrologist hired pursuant to this Agreement. In the event the two determinations are materially different, the Parties shall determine which determination shall control. In the event the Parties cannot mutually agree, then the lower Estimated Sustainable Yield shall be utilized by the Parties for the purposes of this Agreement.

2.3 Permanent Well/Interconnection. After securing an Estimated Sustainable Yield pursuant to Section 2.2.3, indicating the Project has a high probability of resulting in a Sustainable Yield, confirmed by any second opinion or joint determination that may have been secured pursuant to Section 2.2.3.1, a permanent well shall be drilled, cased and equipped and all

facilities necessary to interconnect such well to the PWCo transmission and delivery system shall be constructed, subject to the terms and conditions herein. Nothing herein, shall prohibit PWCo from proceeding with construction of a permanent well if the Estimated Sustainable Yield is less than 150 gallons per minute if PWCo, in the reasonable exercise of its business judgment, determines such construction is reasonable and prudent.

3. Project Construction.

3.1 Planning, Design, Engineering and Hydrology: Governmental Approvals. PWCo will prepare or have prepared any and all preliminary and final documents, including site plans, engineering drawings and surveys, and hydrologic analyses necessary to construct the Project. PWCo shall also be responsible for obtaining all necessary governmental approvals. PSWID shall have the right to participate in all planning, decisions and proceedings relating to the K2 Well Project and shall be provided copies of planning documents as necessary to participate in a commercially reasonable manner, including, reasonably cooperating in obtaining necessary governmental approvals. The Parties shall cooperate in good faith to resolve differences, but agree and acknowledge that PWCo has the right of final approval of all planning documents related to the construction of the K2 Well Project. PWCo shall use commercially reasonable efforts to procure all necessary licenses, approvals and permits for the construction and operation of the Project (collectively "Approvals"). All such Approvals shall be maintained (including renewal if necessary) until the completion or termination of the Project. Nothing herein shall preclude PWCo, in its discretion, from maintaining the Approvals after the termination of the Project.

3.2 Construction of K2 Well. PWCo agrees, subject to the terms and conditions of this Agreement, to exercise commercially reasonable efforts to retain third parties to undertake design and construction of the Project, such third-parties to include, without limitation, well drillers, hydrologists, engineers, electricians and other contractors as necessary for PWCo to drill, equip and interconnect such wells to the PWCo water distribution system. PWCo shall exercise commercially reasonable efforts to cause the K2 Well Project to be substantially constructed in accordance with the requirements of the plans discussed in Section 3.1 above, and all governmental requirements. PWCo represents and warrants that any contractors hired for the Project will be licensed, when required, and qualified to perform the services contracted for and, as commercially appropriate, will have provided evidence of satisfactory insurance. PWCo shall furnish to PSWID copies of all third-party contracts or any other contracts proposed to be entered into by PWCo for construction of the Project and/or the supplying of materials in connection therewith at least 5 business days before executing them.

3.3 Commencement and Project Timeline. PWCo shall commence construction of the K2 Well Project as soon as logistically possible following receipt of all necessary approvals and obtaining the necessary permits to commence well drilling. A preliminary project timeline for completion of the K2 Well Project is attached to this Agreement as Attachment 3 and incorporated herein by this reference. Subject to Section 3.2, PWCo shall exercise commercially reasonable efforts to construct and complete or cause to be completed, the Project in accordance with the timeline set forth in Attachment 3. The deadlines set forth in Attachment 3 shall be extended for any period of time that progress of design, processing or construction of the Project is reasonably delayed, despite PWCo's reasonable efforts, due to

unexpected delays in scheduling well drilling, unexpected delays in obtaining equipment and supplies necessary for the Project or unnecessary delays caused by material obstacles encountered during the actual drilling of the K2 Well Project. The timeline shall also be extended for any period of time the Project is reasonably delayed due to inclement weather or other natural disaster, unavailability or shortage of labor or materials, national emergency, fire or other casualty, natural disaster, war, unforeseen delays or actions of governmental authorities or utilities, riots, acts of violence, labor strike, injunctions in connection with litigation, or the failure of PSWID to timely pay or deposit any amount required hereunder, or any other matter outside of the reasonable control of PWCo that renders performance within the timeline commercially impracticable.

3.4 Ownership. At all times relevant hereto, the Project, and all facilities and components thereof, however financed, shall be owned by PWCo unless conveyed to PSWID in accordance with Section 6 PWCo's ownership shall be subject to the security interest and liens in favor of PSWID as specified in Section 4.2.1.2 below.

3.5 Liability. The Parties acknowledge and agree that the hydrology of the Pine-Strawberry area makes the likelihood of success or failure of the Project uncertain, and agree that PWCo, as the party responsible under this Agreement for construction of the Project, makes no representation or warranty with respect to the success or failure of the K2 Well Project to result in a Sustainable Yield as defined in Section 2.2.2, and PSWID agrees that PWCo shall have no liability for the failure of the Project to result in a Sustainable Yield other than for the payment of costs as set forth in this Agreement.

4. Project Funding. The Project shall be funded by PWCO and PSWID as follows:

4.1 Budget. PWCo shall prepare a preliminary estimated budget for the total costs of the K2 Well Project within sixty (60) days of the date of this Agreement (the "Budget"). PSWID shall be entitled to approve the Budget, which approval shall not be unreasonably withheld. PWCo shall update and revise the Budget 30 days prior to commencing work on the Project and every ninety (90) days thereafter through completion or termination of the Project and shall deliver a copy of the revised Budget to PSWID.

4.2 Funding of Construction.

4.2.1. PSWID. PSWID shall provide the initial funding for the Project in the amount of \$300,000, which amount shall be used to pay the cost to commence design and construction of the Project, including without limitation, drilling a test well and conducting well tests in accordance with Section 2.1 and, to the extent funds remain therefore, for the construction of the permanent well and interconnection in accordance with Section 2.2. As used herein, the "Cost" of a particular component of the Project shall mean the actual direct cost incurred by PWCo in connection with the construction of the Project, including any costs incurred to obtain the necessary governmental approvals. The funds provided by PSWID shall be paid as follows:

4.2.1.1. Escrow. PSWID shall deposit its \$300,000 funding for the Project in an interest bearing escrow account to be established at First American Title,

Payson, Arizona, or as otherwise mutually agreed (the "Escrow"), provided all the following are satisfied:

a. The ACC has approved this Agreement, upon terms and conditions acceptable to the Parties. The Parties agree to work cooperatively to address terms and conditions deemed unacceptable to them.

b. PWCo notifies PSWID in writing that funding for the Project is available upon terms and conditions acceptable to PWCo within sixty (60) days of receipt of ACC approval of this Agreement;

c. Title to the well site for the Project has been conveyed to PWCo, including easements for ingress, egress, maintenance, repair and replacement (the "K2 Wellsite"), which transfer shall occur within sixty (60) days of receipt of ACC approval of this Agreement; and

d. PWCo provides ten (10) days written notice that it desires the Escrow be funded.

4.2.1.2. Escrow Instructions. The Parties' designated representatives shall mutually agree to the form of the Escrow Instructions prior to opening of the Escrow and such Escrow Instructions shall be attached to this Agreement as Attachment 4, and deemed incorporated herein by this reference.

4.2.1.3. Escrow costs shall be paid out of the Escrow.

4.2.1.4. PWCo may make draws from the Escrow to fund contracts entered into in accordance with this Agreement by presenting a written statement representing and warranting that the amount is due and owing under such contract or contracts, specifying the work covered by the draw and the contract associated therewith. Upon termination of Project or this Agreement for any reason, PWCo shall make no further draws from the Escrow and any funds remaining in the Escrow shall be immediately returned to PSWID.

4.2.1.5. Prior to making the first draw, PWCo shall provide PSWID at least ten days notice and shall first record, or cause to be recorded with the Gila County Recorder, the form of Notice of Continuing Security Interest and Lien in favor of PSWID attached hereto as Attachment 5. As security for the funds and other consideration being provided by PSWID in accordance with this Agreement to secure PWCo's performance under this Agreement, PWCo hereby agrees and grants to PSWID, effective with the first draw from the Escrow, a security interest in the K2 Wellsite and the Project. PWCo agrees that, in addition to the rights provided for herein, PSWID shall have all of the rights and remedies of a secured party under the Arizona Uniform Commercial Code in respect to the K2 Wellsite and the Project if PWCo fails to perform, in whole or in part, its obligations under this Agreement. The parties hereby agree that the Security Interest and Lien granted by PWCo is expressly limited to the K2 Wellsite and the Project and shall not encumber any other asset of PWCo. PSWID may, at its option, file a UCC Form 1 notice of the security interest. PWCo shall cooperate in the perfecting of a security interest and lien as reasonably requested by PSWID. PSWID shall file a release of the Continuing Security Agreement, UCC Form 1 and any other evidence of the

security interest granted by this Section upon repayment of PSWID pursuant to Sections 4.2.2 or 4.2.4 or if there is no repayment obligation in accordance with Section 4.2.3.

4.2.2. Return of PSWID's Capital Investment: PSWID is providing the initial capital for the Project in furtherance of its purpose of investigating current and potential sources of water and implementing plans to provide long-term available water to the Pine and Strawberry communities. However, in the event the Project is successful PSWID will retain no ownership interest in the Project and, therefore, except as provided in Sections 4.2.3 and 4.2.4 below, PWCo shall return the capital provided by PSWID pursuant to this Agreement, together with a return thereon of six percent (6%) per annum from the date the funds are deposited in the Escrow. Payments shall be made by PWCo to PSWID in 36 equal monthly payments with the first payment due the first day of the month immediately following entry of an ACC Decision recognizing the Project as used and useful and included in rate base for rate making purposes. PWCo may prepay PSWID, in whole or in part, at any time without penalty. All payments shall first be applied to accrued interest. PWCo agrees to make application with the ACC to include the Project in rate base no later than June 1, 2008 as required by ACC Decision No. 67166 (August 10, 2004), unless (1) the Project is still underway as of that date but not yet Final in accordance with Section 5.1; (2) the Project is terminated pursuant to Section 5.2 before that date; and/or (3) the ACC has modified the deadline for filing a permanent rate case established in Decision No. 67166.

4.2.3. PWCo shall have no obligation to repay PSWID if any of the following apply:

4.2.3.1. The Project is terminated pursuant to Section 5.2 below.

4.2.3.2. The permanent well is drilled but its water production fails result in a Sustainable Yield as defined in Section 2.2.2 and the well is formally abandoned by PWCo or is transferred to PWSID or PSWID's designee by PWCo.

4.2.4. In the event the permanent well is completed and placed in service by PWCo but its water production is less than the Sustainable Yield, then PWCo's repayment obligation shall be reduced by multiplying the monthly payment obligation set forth in Section 4.2.2 above by the fraction where the numerator is the continuous production rate for twenty-four (24) hours per day, seven (7) days a week expressed as gallons per minute and the denominator is 150 gallons per minute.

4.3 PWCo. All other costs of the Project shall be paid by funds provided by PWCo, including, without limitation, insurance in accordance with Section 4.3.2.

4.3.1. Funding for the Project provided by PWCo shall be financed through equity, debt, and/or advances or contributions in aid of construction as determined by PWCo in its sole and absolute discretion, after consultation with PSWID and subject to its regulation as a public service corporation.

4.3.2. Insurance. PWCo shall procure Insurance, in the name of PWCo, naming PSWID as an additional insured with respect to claims which may arise out of or result from PWCo's acts, operations or negligence or those of its subcontractors, or anyone directly or

indirectly employed by any of them including officers, employees, agents or representatives for matters related to this Agreement. The coverage shall be provided on an "occurrence" basis rather than a "claims made" basis, shall be provided without offset against PSWID's existing insurance and provide for a minimum of thirty (30) days notice to PSWID prior to cancellation, reduction in coverage or other substantial modification. PWCo shall provide a Certificate of Insurance which sets forth the following minimum amounts and types of coverage:

<u>TYPE OF COVERAGE</u>	<u>AMOUNT NO LESS THAN</u>
Workers' Compensation	Statutory
Employers Workers' Compensation Liability	\$100,000 each accident \$100,000 disease each employee \$500,000 disease aggregate
Commercial General Liability (including contractual liability for this Contract; broad form property damage; completed operations; and explosion, collapse and underground coverage)	\$1,000,000 per occurrence \$2,000,000 aggregate combined single limit
Vehicle Liability (including owned, hired and non-owned coverages)	\$1,000,000 combined single limit

4.4 Accounting. PWCo shall keep good and accurate books and records in sufficient detail to allow the Cost of the Project to be calculated, and which evidence that all monies provided under the Financing Agreement are actually used to further the Project. PWCo shall keep separate books and records for the Project, which books and records shall be made available for review (upon prior reasonable notice) by PSWID. Within sixty (60) days after the project is deemed Final or Terminated in accordance with Section 5, PWCo shall deliver to PSWID a reasonably detailed final accounting of the Cost of the Project.

5. Project Completion; Project Termination; use of Water

5.1 Completion of Project. The Project shall be completed and deemed Final when PWCo has completed drilling, construction and interconnection of the permanent well to its system. In the event the permanent well achieves at least a Sustainable Yield, the K2 well will be interconnected to the PWCo system. In the event the permanent well does not achieve at least a Sustainable Yield, PWCo shall meet with PSWID and discuss whether the well should be placed in service, abandoned or transferred to PSWID. In the event PWCo, after consultation with PWSID, in its sole discretion decides not to interconnect the K2 well to the PWCo

distribution system and place it in service, PWCo will offer to convey title to the Project to PSWID or its designated representative at no cost to PSWID or to its designee and will retain the right of first refusal to the purchase of any water produced as a result of the Project at a price to be negotiated consistent with other similar water purchase agreements in the Pine, Arizona region. If PWSID declines to accept the K2 well, then PWCo shall cap and abandon well at its sole cost, unless the Parties agree otherwise.

5.2 Termination of Project.

5.2.1. PSWID may terminate the Project at any time prior to the expenditure of the PSWID funding provided in accordance with Section 4.2.1 if it reasonably determines the time for completion of the Project in accordance with Section 5.1 will exceed two (2) years beyond the execution of this Agreement.

5.2.2. PWCo, in the exercise of its reasonable discretion, after consultation with PSWID, may terminate the Project prior to it being deemed Final in accordance with Section 5.1 if any of the following apply:

5.2.2.1. The ACC fails to approve this Agreement within 180 days after submission for approval or conditions the approval on terms and conditions unacceptable to PWCo.

5.2.2.2. PSWID does not provide funding in accordance with Section 4.2.

5.2.2.3. PWCo, using reasonable discretion of a public service corporation in similar circumstances, determines any of the following apply:

a. PWCo will not be able to secure funds for construction upon reasonable terms and conditions, provided this condition shall no longer be grounds to terminate this Agreement once the Escrow is funded by PSWID in accordance with Section 4.2.1.1.

b. The cost of the Project is not warranted based upon the determination made in accordance with Section 2.2.2 concerning an Estimated Sustainable Yield of less than 150 gpm.

c. The cost of completing the Project has increased to exceed more than one million three hundred thousand dollars (\$1,300,000.00) unless otherwise approved by PWCo.

d. PWCo has a reasonable basis to conclude that the ACC is not likely to include the costs of the Project in PWCo's rate base.

6. Use of Water. PWCo shall not be required to use any water from the K2 Well Project unless (1) the Project has resulted in a Sustainable Yield from the permanent well; and (2) such water can be delivered to PWCo's ratepayers at rates determined by the ACC to be just and reasonable. For purposes of this Agreement, rates are not "just and reasonable" if they do

not include recovery of PWCo's prudently incurred costs of providing water from the K2 Well Project to PWCo's customers and a return on and of PWCo's investment in the Project. In the event PWCo chooses not to use the water developed at the Project, PWCo will offer to convey title to the Project to PSWID or its designee and will retain the right of first refusal to the purchase of any water produced as a result of the Project at a price to be negotiated consistent with other similar water purchase agreements in the Pine, Arizona region.

6.1 Water from the Project in excess of the needs of PWCo will be made available to SWCo. To the extent water is available from the Project in excess of the needs of metered customers of PWCo and SWCo, PWCo shall make water available for fire fighting purposes. All water made available by PWCo for fire fighting purposes shall be metered and subject to law and regulation including all ACC orders, rules, regulations and tariffs. In addition, unless a specific tariff for water provided for fire fighting purposes is approved by the ACC, such water shall be provided by PWCo at cost, which means recovery of associated operating expenses but not operating income as such terms are applicable in ACC ratemaking proceedings.

6.2 PWCo shall, in accordance with its duly approved ACC tariffs, continue to undertake reasonable effort to maximize the quantity of water obtained from its wells, including the Project if it results in a Sustainable Yield as defined in Section 2.2.2 before resorting to hauling water.

7. Authority, Representations and Warranties.

7.1 PSWID represents and warrants that:

7.1.1. PSWID is a political subdivision, duly organized and existing under the laws of the State of Arizona, and has, and as of the date of the Effective Date will have, full legal right, power and authority to: (i) enter into this Agreement; and (ii) carry out and consummate the transactions contemplated by this Agreement.

7.1.2. Any and all hearings, ordinances and approvals prerequisite to the execution and delivery of this Agreement, have been held, enacted or granted and in the processing thereof all notice and hearing requirements under applicable law have been fully complied with, including, but not limited to, open meeting laws of the State of Arizona.

7.1.3. The PSWID Board: (i) has duly authorized and approved the execution and delivery of, and the performance of its obligations under this Agreement; and (ii) have duly authorized and approved the consummation of all other transactions contemplated by this Agreement.

7.1.4. The consummation of the transactions contemplated in this Agreement will not conflict with or constitute a breach of or default under any provision of applicable law or administrative regulation of the State of Arizona or the United States of America or any department, division, agency or instrumentality thereof or any applicable judgment or decree or any loan agreement, bond, note, resolution, ordinance, indenture, agreement or other instrument to which PSWID is a party or may be otherwise subject, to the extent that such conflict, breach or default adversely affects or impacts the terms or performance of this Agreement, the Project or any of the transactions contemplated by this Agreement.

7.1.5. There is no action, suit, proceeding, inquiry or investigation by or before any court, governmental agency, public board or body pending or, to the knowledge of the PSWID, threatened (i) in any way affecting PSWID's powers or the existence of PSWID (ii) in any way contesting or affecting the validity or enforceability of this Agreement or any agreements entered into in connection therewith, or (iii) that may adversely affect PSWID or the Project.

7.2. PWCO represents and warrants that:

7.2.1. PWCo is a public service corporation, duly organized and existing under the laws of the State of Arizona, and has, and as of the date of the Effective Date will have, full legal right, power and authority to: (i) enter into this Agreement; and (ii) carry out and consummate the transactions contemplated by this Agreement.

7.2.2. Any and all approvals prerequisite to the execution and delivery of this Agreement have been obtained.

7.2.3. The consummation of the transactions contemplated in this Agreement will not conflict with or constitute a breach of or default of a contract or any obligation under any provision of applicable law or administrative regulation of the State of Arizona or the United States of America or any department, division, agency or instrumentality thereof or any applicable judgment or decree or any loan agreement, bond, note, resolution, ordinance, indenture, agreement or other instrument to which PSWID is a party or may be otherwise subject, to the extent that such conflict, breach or default adversely affects or impacts the terms or performance of this Agreement, the Project or any of the transactions contemplated by this Agreement.

7.2.4. Construction of the Project will be in accordance with the Plans and the operation of the Project will comply with the Agreement and all applicable laws, zoning ordinances, municipal ordinances, regulations and orders of Federal, State, County, City, local and regulatory authorities of every kind and with all covenants, conditions and restrictions affecting the Project.

7.2.5. All permits, authorizations and approvals required for construction of the Project in accordance with the Plans have been or will be obtained prior to the start of construction.

7.3. Accuracy of Representations and Warranties. The Parties acknowledge that each and every representation, warranty, term and condition in this Agreement shall be true and accurate as of the date of execution of this Agreement, shall constitute a material part of the consideration hereunder, and shall survive the execution of this Agreement.

8. Designated Representative. For purposes of coordination and planning, and to the extent approval from PSWID is required under this Agreement, each Party designates the respective individual named below as its representatives to act on its behalf in all such matters. All inquiries, requests, instructions, authorizations, and other communications with respect to the matters covered by this Agreement shall be made to such representatives. Any Party may, without further or independent inquiry, assume and rely at all times that each representative of

the other Parties (as designated hereunder) has the power and authority to make decisions on behalf of such Parties, to communicate such decisions to the other Parties and to bind such Parties by his or her acts and deeds, unless otherwise notified in writing by the Party designating the representative. Any Party may change its representative under this Agreement at any time by written notice to the other Parties. The initial Designated Representatives of each Party for the purpose of this Section shall be as follows:

PWCo:

Robert T. Hardcastle
President
Brooke Utilities, Inc.
3101 State Road
Bakersfield, CA 93308

PSWID:

1st Designated Representative

James M Richey
4502 Meadow Way
P.O. Box 2379
Pine, Arizona 85544-2379
C- 602-920-7826
jmrpine@msn.com

2nd Designated Representative

Wesley E. Suhr
4119 Whispering Pine Rd
P.O. Box 687
Pine, Arizona 85544-0687
H- 928-476-6418
C- 928-951-3641
wcsuhr@peoplepc.com

The 2nd Designated Representative for PSWID may act when reasonable attempts to reach the 1st Designated Representative have been unsuccessful or when delegated authority to act by the 1st Designated Representative. From and after the Effective Date of this Agreement and until the project is Final, the Designated Representatives of the Parties shall communicate on an as needed basis regarding the status of the Project. PWCo shall be responsible for scheduling the time and manner of such communications and shall give PSWID at least five (5) days' advance notice thereof, unless there is a regularly scheduled location and time, in which event no advance notice is required.

8.1 Authority of Designated Representatives. Each party hereby assents to and confirms that its designated representatives are expressly authorized to:

8.1.1. In accordance with Section 2.1, agree on the well driller, agree on design of the test well and permanent well, agree on hydrologic testing criteria and accept or contest the determination of the Hydrologist of the Estimated Sustainable Yield and the Sustainable Yield as defined in Section 2.2.

8.1.2. In accordance with Section 3, agree to any contract proposed by PWCo.

8.1.3. Agree upon Escrow Instructions in accordance with Section 4.2.1.2.

8.1.4. Extend any time frame set forth in this Agreement.

9. Consent of Parties. Except as otherwise expressly provided herein, wherever in this Agreement PSWID is required to give its consent or approval to any action on the part of PWCo, such consent or approval will not be unreasonably withheld, delayed or conditioned, and will be deemed given if not expressly withheld by written notice given within seven (7) business days following the giving of the notice requesting such consent.

10. Cooperation.

10.1 Need to Cooperate. The Parties acknowledge and agree that the detailed planning, improvement and ultimate success of the K2 Well Project requires a significant commitment of resources on the part of the Parties and that without the Parties good-faith cooperation on all aspects of the Agreement, both express and implied, the Project may not succeed. The Parties agree to cooperate at all times in good faith to achieve their goal of developing a permanent well at the K2 site that has a Sustainable Yield that can be delivered to PWCo's customers at rates that are just and reasonable and include recovery on and of any investment made by PWCo in the Project.

10.2 PSWID Regulatory Participation. PSWID covenants and agrees to support any effort by PWCo to obtain approval of this Agreement by the ACC, which application shall be filed with the ACC within thirty (30) days of the date of this Agreement, as well as in obtaining any State, County or other regulatory approval required for the Project. If the Project is deemed Final in accordance with Section 5.1, PSWID also covenants and agrees to support PWCo's efforts to recover through rates its actual and necessary investment in the Project, including amounts repaid to PSWID by PWCo or its shareholder in accordance with this Agreement. Such support shall, upon reasonable request by PWCo, include PSWID providing public comment supporting this Project and the inclusion of the fair and reasonable cost thereof in rate base in proceedings before the ACC.

10.3 PWCo Participation. PWCo covenants and agrees to support any effort by PSWID to approve this Agreement and shall, upon reasonable request by PSWID, appear before the Board of PSWID and the ACC to provide information regarding the Project.

11. Notices.

11.1 Any notice, approval, consent or other communication required or permitted to be given to a Party must be in writing and delivered in person, or by reputable nationwide overnight courier (e.g., Federal Express), or given by facsimile transmission, or forwarded by certified or registered mail, postage pre-paid, return receipt requested, at the address indicated below, unless the Party giving such notice has been notified, in writing, of a change of address:

PWCo

Brooke Utilities, Inc.
Attention: Robert T. Hardcastle, President
3101 State Road
Bakersfield, CA 93308
Telephone: (661) 633-7526
Facsimile: (800) 748-6981
email: rth@brookeutilities.com

With a copy to:

Jay L. Shapiro
Fennemore Craig, P.C.
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012
Telephone: (602) 916-5366
Facsimile: (602) 916-5566
Email: jshapiro@fclaw.com

PSWID

Pine Strawberry Water Improvement District
Attention: Gary Sherlock, Chairman
P.O. Box 134 Pine, Arizona
H- 928-476-3560
C- 602-989-1942
rgse@earthlink.net

With a copy to:

William P. Sullivan Esq.
Curtis, Goodwin, Sullivan, Udall & Schwab
501 East Thomas Road
Phoenix, AZ 85012-3205
Telephone: (602) 393-1700
Facsimile: (602) 393-1703
Email: wsullivan@cgsuslaw.com

11.2 Notices are effective:

11.2.1. on the earliest of date of delivery (or refusal to accept delivery) if notice is given by personal delivery or facsimile transmission with evidence of error-free transmission prior to 5:00 p.m., Phoenix Time,

11.2.2. on a business day (or the next succeeding business day if given after 5:00 p.m., Phoenix Time or on a Saturday, Sunday or federal or Arizona state holiday),

11.2.3. on the next succeeding business day after deposit with an overnight courier for next day delivery, or

11.2.4. if notice is sent through the United States mail, on the earlier of the date of actual delivery as shown by the addressee's receipt or the expiration of three (3) days following the date of mailing.

12. Indemnification.

12.1 PSWID shall (to the extent permitted by law) indemnify and hold harmless, jointly and severally, PWCo and each director, official, independent contractor or employee thereof (any such person being herein sometimes called an "Indemnified Party"), for, from and against any and all losses, claims, damages or liabilities, joint or several to which any such Indemnified Party may become subject, whether under any statute or regulation at law or in equity or otherwise, whether arising under statute, contract or tort, insofar as and to the extent such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or caused by PSWID having failed to take any and all acts necessary to enter into this Agreement as a political subdivision of the State of Arizona and shall reimburse any legal or other expenses reasonably incurred by any Indemnified Party in connection with investigating or defending any such loss, claim, damage, liability or action, including the fees of expert witnesses.

12.2 PWCo shall (to the extent permitted by law) indemnify and hold harmless, jointly and severally, PSWID and each director, official, independent contractor or employee thereof (any such person being herein sometimes called an "Indemnified Party"), for, from and against any and all losses, claims, damages or liabilities, joint or several to which any such Indemnified Party may become subject, whether under any statute or regulation at law or in equity or otherwise, whether arising under statute, contract or tort, insofar as and to the extent such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or caused by

(a) PWCo having failed to take any and all acts necessary to enter into this Agreement and/or (b) by the active or passive negligence, or the willful action or inaction of Applicant, its officers, directors, employees, agents, servants, contractors or subcontractors in the execution of Applicant's obligations under this Agreement or in connection therewith, including without limitation completing the Project. In case any suit or other proceeding shall be brought on account thereof, Applicant will, if requested by Company, assume the defense at Applicant's own expense and will pay all judgments rendered therein. The provisions of this Paragraph shall survive termination of this Agreement.

12.3 An Indemnified Party shall, promptly after the receipt of written notice of a threat of, or the commencement of, any action against such Indemnified Party in respect of which indemnification may be sought against PSWID or PWCo pursuant to Section 11, notify them in writing of the commencement thereof. The failure of the Indemnified Party to give such notice shall not reduce the liability of PSWID or PWCo unless PSWID or PWCo is actually prejudiced by such failure to receive notice or such failure constitutes a bar pursuant to statute. In case any such action shall be brought against an Indemnified Party and such Indemnified Party shall notify PSWID or PWCo pursuant to this Section, the notified Party shall defend the Indemnified Party therein. The provisions of this Section shall survive the term of the Agreement and any termination hereof

13. Alternative Dispute Resolution. Unless such claim or dispute would fall within the jurisdiction of the ACC, all claims and disputes concerning the Project and this Agreement that may arise between the Parties shall be resolved by Alternative Dispute Resolution as set forth below and in accordance with A.R.S. §12-1501, et seq. Any claim or dispute falling within the jurisdiction of the ACC may be removed to the ACC after then initiation of arbitration and prior to the merits of the matter being heard.

13.1 Any Party by written notice to the other involved Parties within ten (10) business days after a controversy has arisen shall select a person to act as an arbitrator.

13.2 The other involved Party may, by written notice within ten (10) business days after receipt of such written notice by the first Party, appoint a second arbitrator.

13.3 If two arbitrators have been appointed as provided above, they shall agree on a third arbitrator within five (5) business days after their appointment and shall appoint him or her by written notice signed by both of them and a copy mailed to each Party involved. In the event that the Parties fail to appoint a third arbitrator, the Parties authorize the appointment of a third arbitrator by the American Arbitration Association.

13.4 On appointment of three arbitrators (hereinafter, "the Panel") as provided for above, the Panel shall hold a hearing within ten (10) business days after the appointment of the third member of the Panel, or upon the expiration of the time period in Section 13.2 if no other arbitrator is appointed. The hearing shall be held in the City of Phoenix, or at any other place agreed to by the Parties involved. The Parties shall be entitled to reasonable discovery prior to the arbitration.

13.5 At least five (5) business days prior to the hearing, the Parties shall meet, exchange exhibits, stipulate and agree on undisputed facts. No exhibit shall be admitted unless exchanged between the Parties. Prior to or at the hearing, the Parties shall submit memorandums not to exceed five (5) pages outlining the relevant issues for the arbitrators. At the hearing, the laws of evidence of the State of Arizona shall apply, and the arbitrator, or the Panel, as the case may be, shall allow each Party to present that Party's case, evidence and witnesses and render the decision as to the disputed matter. Each Party shall bear their respective expenses of the arbitrators appointed to hear the matter. The prevailing party shall be awarded its reasonable attorneys fees and other reasonable costs incurred.

13.6 The award of the arbitrator or the majority of the Panel shall be final and binding on the Parties to this Agreement.

14. Miscellaneous.

14.1 No Partnership or Joint Venture. Nothing contained in this Agreement is intended to or shall be construed as creating the legal relationship of a partnership or joint venture between the Parties. No Party shall have any liability for the debts or obligations of another Party, either in connection with the construction of the Project or otherwise.

14.2 No Third Party Rights. Nothing in this Agreement shall be construed to permit anyone other than the Parties and their permitted successors and assigns to rely upon the covenants and agreements herein contained or to give any such third Party, including any contractors, subcontractors or suppliers, a cause of action (as a third party beneficiary or otherwise) on account of any nonperformance hereunder.

15. Entire Agreement. This Agreement, together with any exhibits and other matters attached hereto or incorporated herein by reference, constitutes the entire contract between the Parties. All terms, conditions, representations, warranties, understandings, and interpretations contained in any other written or oral communications between the Parties are superseded. In executing this Agreement, the Parties acknowledge that they are relying solely on the matters set forth herein and not on any other inducements, written or oral, by the other Party or any agent, employee or representative thereof.

16. Modification of Agreement. No modification of this Agreement shall be effective unless it is in writing and is signed by both Parties.

17. Waiver. No waiver of any term or condition of this Agreement shall be effective unless it is in writing and is signed by the Party against whom enforcement of the waiver is sought, and then only in the particular circumstances specified. No failure by a Party to exercise any right or privilege provided for herein, or to require timely performance of any obligation herein in strict accordance with the provisions hereof, shall preclude the exercise of such rights or privileges or the enforcement of such obligations in different circumstances or upon the reoccurrence of the same or similar circumstances. Moreover, the exercise of any remedy provided at law, in equity, or herein shall not impliedly preclude the exercise of any other remedy except when, and then only to the extent that, the other remedy is expressly forbidden or limited by the provisions hereof.

18. Severability. The invalidity of any provision of this Agreement shall in no way affect any other provision hereof.

19. Time of the Essence. Time is of the essence of this Agreement and each term hereof.

20. Further Instruments. The Parties further agree to enter into any and all written documents necessary to carry out the terms of this Agreement, including but not limited to construction and utilities easements as same are reasonably needed.

21. Binding Effect; Successors and Assigns. This Agreement shall be binding on each party hereto and shall be binding on their successors and assigns.

22. Bankruptcy. In the event PWCo files bankruptcy before completion or termination of the Project, PWCo agrees that any plan submitted by PWCo in such proceedings shall, to the extent permitted by law, propose conveyance of all assets associated with the Project, including the K2 Wellsite to PSWID at no cost.

23. Time Periods. If the time fixed for performance of any obligation hereunder expires on a Saturday, Sunday or legal holiday, the deadline shall be extended automatically to the next day that is not a Saturday, Sunday or legal holiday. Except as may be otherwise expressly provided herein, the time for performance of any obligation hereunder shall expire at 5:00 p.m. (Phoenix time) on the last day of the period allowed hereunder.

24. Applicable Laws. This Agreement shall be governed by and construed in accordance with the laws of the State of Arizona.

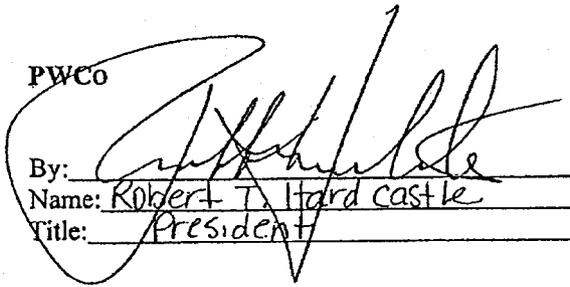
25. Construction. As used in this Agreement, the masculine, feminine and neuter gender and the singular or plural shall each be construed to include the other whenever the context so requires. This Agreement shall be construed as a whole and in accordance with its fair meaning, without regard to any presumption or rule of construction causing this Agreement or any part of it to be construed against the Party causing the Agreement to be written. The Parties acknowledge that each has had a full and fair opportunity to review the Agreement and to have it reviewed by counsel and that no construction against a party due to draftsmanship shall be asserted. If any words or phrases in this Agreement have been stricken, whether or not replaced by other words or phrases, this Agreement shall be construed (if otherwise clear and unambiguous) as if the stricken matter never appeared and no inference shall be drawn from the former presence of the stricken matters in this Agreement or from the fact that such matters were stricken.

26. Descriptive Headings. The descriptive headings of the Sections, Subsections, and other portions of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any provisions herein.

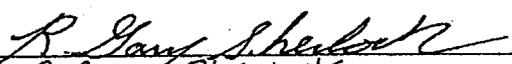
27. Counterparts. This Agreement may be executed in counterparts, each of which may contain fewer than all signatures but all of which, together, shall constitute a single instrument. Facsimile signatures are binding as originals provided, however, upon the full execution hereof, each Party agrees to deliver an original instrument to Escrow Agent.

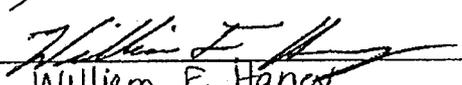
IN WITNESS WHEREOF, this Joint Well Development Agreement has been executed
as of the date first written above.

PWCo

By: 
Name: Robert T. Hardcastle
Title: President

PSWID

By: 
Name: R. Gary Sherlock
Title: Chairman

By: 
Name: William F. Hancy
Title: Secretary

Attachments

1. Legal Description
2. Site Plan
3. Preliminary Project Timeline
4. Escrow Instructions
5. Form of Notice of Continuing Security and Lien

ATTACHMENT 1

LEGAL DESCRIPTION (K2 site)

That portion of the Southeast quarter of the Southwest quarter of Section 22, Township 12 North, Range 5 East of the Gila and Salt River Base and Meridian, Gila County, Arizona, which lies immediately North of and adjacent to the Northerly line of STRAWBERRY KNOLLS UNIT TWO, according to the plat of record in the office of the County Recorder of said county, in-Map File, Map No. 240, described as follows:

COMMENCING at the Northwest corner of Lot 107, STRAWBERRY KNOLLS UNIT TWO; THENCE South 69 degrees 18 minutes 28 seconds East along the Northerly line thereof, a distance of 79.78 feet to an angle point thereon; THENCE South 27 degrees 39 minutes 21 seconds East continuing along said Northerly line of Lot 107, a distance of 69.16 feet to an angle point thereof; THENCE South 48 degrees 27 minutes 40 seconds East continuing along said Northerly line of Lot 107, a distance of 82.94 feet to the Southeast corner of Lot 107, being coincident with a point on the existing Northerly right of way line of Parkinson Drive; THENCE North 68 degrees 56 minutes 15 seconds East along said Northerly right of way line, a distance of 39.81 feet to an angle point thereon; THENCE South 79 degrees 58 minutes 35 seconds East, continuing along said Northerly right of way line, a distance of 85.93 feet to an angle point thereon; THENCE North 81 degrees 27 minute 23 seconds East continuing along said Northerly right of way line, a distance of 56.28 feet to a point; THENCE North 09 degrees 21 minutes 41 seconds East, a distance of 47.43 feet to the TRUE POINT OF BEGINNING; THENCE North 80 degrees 42 minutes 42 seconds East, a distance of 100.61 feet; THENCE North 09 degrees 37 minutes 10 seconds West, a distance of 79.80 feet; THENCE South 79 degrees 22 minutes 32 seconds West, a distance of 100.28 feet; THENCE South 09 degrees 21 minutes 41 seconds East, a distance of 77.46 feet to the TRUE POINT OF BEGINNING.

TOGETHER WITH an easement for ingress and egress over the following described real property:

That portion of the Southeast quarter of the Southwest quarter of Section 22, Township 12 North, Range 8 East of the Gila and Salt River Base and Meridian, Gila County, Arizona, which lies immediately North of and adjacent to the Northerly line of STRAWBERRY KNOLLS UNIT TWO, Gila County Records, Map No. 228, described as follows:

COMMENCING at the Northwest corner of Lot 107, STRAWBERRY KNOLLS UNIT TWO; THENCE South 69 degrees 18 minutes 28 seconds East along the Northerly line thereof, a distance of 79.78 feet to an angle point thereof; THENCE South 27 degrees 39 minutes 21 seconds East continuing along said Northerly line of Lot 107, a distance of 69.16 feet to an angle point thereon; THENCE South 48 degrees 27 minutes 40 seconds East continuing along said Northerly line of Lot 107, a distance of 82.94 feet to the Southeast corner of said Lot 107, being coincident with a point on the existing Northerly right of way line of Parkinson Drive; THENCE North 68 degrees 56 minutes 15 seconds East along said Northerly right of way line, a distance of 34.09 feet to the TRUE POINT OF BEGINNING; THENCE North 10 degrees 37 minutes 01

ATTACHMENT 1 (CONT)

seconds West, a distance of 123.56 feet to a point; THENCE North 79 degrees 22 minutes 32 seconds East, a distance of 275.77 feet to a point; THENCE South 09 degrees 37 minutes 01 seconds East, a distance of 235.10 feet to a point; THENCE North 37 degrees 18 minutes 22 seconds West, a distance of 33.27 feet to a point; THENCE

North 73 degrees 24 minutes 09 seconds West a distance of 16.20 feet to a point; THENCE 09 degrees 37 minutes 01 seconds West, a distance of 167.95 feet to a point; THENCE South 79 degrees 22 minutes 32 seconds West, a distance of 215.25 feet to a point; THENCE South 10 degrees 37 minutes 01 seconds East, a distance of 101.70 feet to a point; THENCE North 79 degrees 58 minutes 35 seconds West, a distance of 27.04 feet to a point; THENCE South 68 degrees 56 minutes 15 seconds West, a distance of 5.72 feet to the TRUE POINT OF BEGINNING.

AND:

That portion of the Southeast Quarter (SW-1/4) of Section 22, Township 12 North, Range 8 East of the Gila and Salt River Base and Meridian, Gila County, Arizona, which lies immediately North of and adjacent to the Northerly line of STRAWBERRY KNOLLS - UNIT TWO, according to the plat of record in the office of the County Recorder of said County, in Map file, Map No. 228, described as follows:

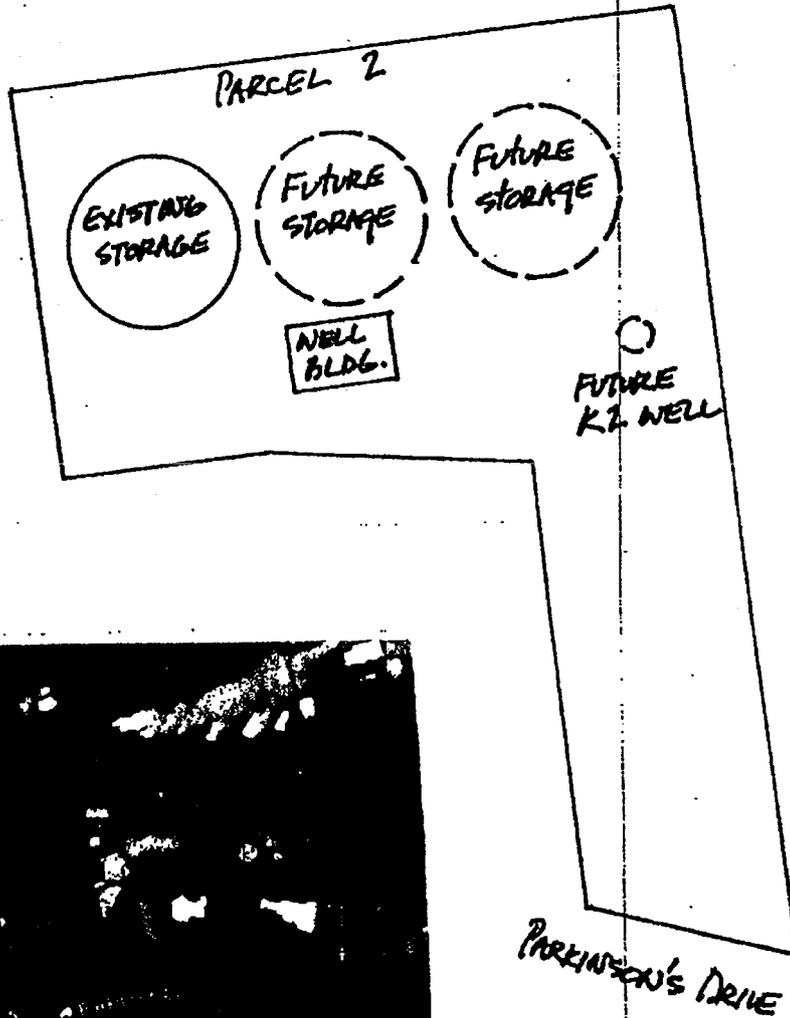
COMMENCING at the Northwest corner of Lot 107, STRAWBERRY KNOLLS-UNIT TWO:
THENCE South 69°18'28" East along the Northerly line thereof a distance of 79.78 feet to an angle point thereon;
THENCE South 27°39'21" East continuing along said Northerly line of Lot 107, a distance of 69.16 feet to an angle point thereon;
THENCE South 48°27'40" East continuing along said Northerly line of Lot 107, a distance of 82.94 feet to the Southeast corner of said Lot 107, being coincident with a point of the existing Northerly right-of-way line of Parkinson Drive;
THENCE North 68°56'15" East along said Northerly right-of-way line, a distance of 34.09 feet to the TRUE POINT OF BEGINNING;
THENCE North 10°37'10" West a distance of 123.56 feet to a point;
THENCE North 79°22'32" East a distance of 245.77 feet to a point;
THENCE South 09°21'41" East a distance of 30.37 feet to a point;
THENCE South 79°22'32" West a distance of 215.35 feet to a point;
THENCE South 10°37'01" East a distance of 101.70 feet to a point;
THENCE North 79°58'35" West a distance of 27.04 feet to a point;
THENCE South 68°56'15" West a distance of 5.72 feet to the TRUE POINT OF BEGINNING.

ATTACHMENT 2

SITE PLAN

ATTACHMENT 2

SITE PLAN



ATTACHMENT 3
PRELIMINARY PROJECT TIMELINE

Total Days from Date of <u>Agreement*</u>	<u>Description</u>
30	File App w/ ACC to approve Agreement (Section 10.2)
60	Budget (preliminary) prepared (Section 4.1)
210	ACC Approval of Agreement (Section 5.2.2.1)
270	Transfer K2 Wellsite and provide Notice to PSWID that funding for Project is available
330	Mobilization and drilling of Test Well (Section 2.1)
390	Hydrologist determination of Estimated Sustainable Yield (Section 2.2.3.1)
510	Mobilization and drilling of Production Well (Section 2.3)
610	Completion of Project
770	Outside Deadline for Project Completion (Section 5.2.1)

*Assumes maximum duration for each step

ATTACHMENT 4

ESCROW INSTRUCTIONS

(To be Mutually Agreed Upon Prior to Opening the Escrow)

ATTACHMENT 5

NOTICE OF CONTINUING SECURITY INTEREST
AND LIEN

When recorded return to:

William A. Sullivan, Esq.
CURTIS, GOODWIN, SULLIVAN,
UDALL & SCHWAB, P.L.C.
501 East Thomas Road
Phoenix, AZ 85012-3502

NOTICE OF CONTINUING SECURITY INTEREST AND LIEN

NOTICE IS HEREBY GIVEN that through that certain Joint Well Development Agreement between Pine Water Company ("PWCo") and Pine-Strawberry Water Improvement District ("PSWID") dated May 1, 2007 (the "Agreement"), that PWCo has provided to PSWID a continuing security interest and lien to secure PWCo's performance of said Agreement. The continuing security interest and lien is expressly limited to the K2 Wellsite described on Attachment 1 hereto and the Project being constructed thereon as more fully described in the Agreement. The continuing interest and lien does not encumber any other asset of PWCO.

IN WITNESS WHEREOF, the parties hereto have executed this Memorandum as of the date first above written.

Pine Water Company

By: _____
Name: Robert T. Hardcastle
Title: President

STATE OF ARIZONA)
) ss.
COUNTY OF Maricopa)

On this ____ day of _____, _____, before me, the undersigned, a Notary Public, personally appeared Robert T. Hardcastle who acknowledged himself to be the President of Pine Water Company, an Arizona public service corporation, and that he as such, being authorized so to do, executed the foregoing instrument for the purposes therein contained.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal.

My Commission Expires:

_____ Notary Public

ORIGINAL

RECEIVED

51

1 FENNEMORE CRAIG, P.C.
2 Jay L. Shapiro (No. 014650)
3 Patrick J. Black (No. 017141)
4 3003 North Central Avenue, Suite 2600
5 Phoenix, Arizona 85012
6 Telephone (602)916-5000
7 Attorneys for Pine Water Company

2007 JUL 26 P 4:41
AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
DOCKETED
JUL 26 2007

DOCKETED BY *JR*

BEFORE THE ARIZONA CORPORATION COMMISSION

7 IN THE MATTER OF THE APPLICATION
8 OF PINE WATER COMPANY FOR
9 APPROVAL TO (1) ENCUMBER A PART
10 OF ITS PLANT AND SYSTEM
11 PURSUANT TO A.R.S. § 40-285(A); AND
12 (2) ISSUE EVIDENCE OF
13 INDEBTEDNESS PURSUANT TO A.R.S.
14 § 40-302(A).

DOCKET NO: W-03512A-07-0362

NOTICE OF FILING

13 Pine Water Company ("PWCo") hereby files this Notice of Filing in the above-
14 captioned matter. Attached hereto as Exhibit A is Amendment No. 1 to the Joint Well
15 Development Agreement ("Agreement") between PWCo and the Pine-Strawberry Water
16 Improvement District, dated July 24, 2007. The amendment was executed by the parties
17 to (a) correct typographical errors in the legal description and construction schedule, (b) amend the
18 legal description to clarify easements, and (c) include reference to A.R.S. § 38-511. The
19 amendment does not materially impact the approval sought from the Commission in this docket.

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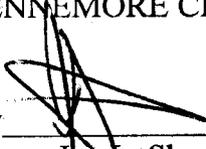
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DATED this 26th day of July, 2007.

FENNEMORE CRAIG, P.C.

By



Jay L. Shapiro
Patrick J. Black
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Pine Water Company

ORIGINAL and thirteen (13) copies of the foregoing filed this 26th day of July, 2007:

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

COPY of the foregoing hand-delivered this 26th day of July, 2007:

Mr. Kevin Torrey, Esq.
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

By: *Maria San Jose*
1940744.1/75206.015

EXHIBIT

A

AMENDMENT NO. 1

to

JOINT WELL DEVELOPMENT AGREEMENT

between

PINE WATER COMPANY

and

PINE-STRAWBERRY WATER IMPROVEMENT DISTRICT

dated

July 24, 2007

AMENDMENT NO. 1 TO
JOINT WELL DEVELOPMENT AGREEMENT

THIS AMENDMENT NO. 1 TO JOINT WELL DEVELOPMENT AGREEMENT ("Amendment No. 1") is made as of the 24 day of July, 2007 by and among **Pine Water Company** ("PWCo") and the **Pine-Strawberry Water Improvement District** ("PSWID"). PWCo and PSWID, from time to time, are each sometimes individually referred to herein as a "Party" and collectively as the "Parties".

RECITALS

A. PWCo and PSWID entered into a Joint Well Development Agreement dated May 1, 2007.

B. PWCo and PSWID enter into this Amendment No. 1 to correct certain technical errors and omissions subsequently discovered to be contained in the Agreement that was executed by the Parties.

NOW, THEREFORE, in consideration of the mutual conditions and covenants set forth in the Agreement and herein, and other good and valuable consideration, the receipt of which is hereby acknowledged, the Parties agree as follows:

AGREEMENT:

1. Incorporation of Recitals. By this reference, the Parties hereby agree to incorporate the recitals above as part of their agreement as if fully set forth herein.

2. New Paragraph 28: Conflict of Interest. PWCo and PSWID hereby add a new Paragraph 28 to the Agreement as follows:

"28. Conflict of Interest. Under Section 38-511, Arizona Revised Statutes, as amended, PSWID may cancel this Agreement within three years after its execution and without penalty or further obligation, if any person significantly involved in initiating, negotiating, securing, drafting or creating this Agreement on behalf of PSWID is, at any time while the Agreement or any extension thereof is in effect, an employee or agent of any other party to this Agreement in any capacity or a consultant to any other party to this Agreement with respect to the subject matter of this Agreement. In addition to the right to cancel this Agreement, PSWID may recoup any fee or commission paid or due to any person significantly involved in initiating, negotiating, securing, drafting or creating this Agreement on behalf of PSWID from any other party to this Agreement arising as the result of this Agreement. In the event PSWID elects to exercise its right under Section 38-511, Arizona Revised Statutes, as amended, PSWID agrees to immediately give written notice thereof to PWCo.

3. Amendments of K2 Site Legal Description. PWCo and PSWID hereby amend the legal description for the K2 site, Attachment 1 to the Agreement, to correct typographical errors and delineate the correct easements for ingress and egress. A corrected Attachment 1 is attached and incorporated herein by this reference.

4. Amendment of Outside Deadline. PWCo and PSWID hereby amend the time frame specified on Attachment 3 as the Outside Deadline for Project Completion to read "730" instead of "770." A corrected Attachment 3 is attached hereto and incorporated herein by this reference.

5. ACC Approval. The references to ACC approval of the Agreement contained in the Agreement (e.g., Paragraphs 4.2.1.1 and 5.2.2.1) is limited to ACC approval of those portions of the Agreement for which approvals may be required by A.R.S. §§ 40-285(A) and 40-302(A).

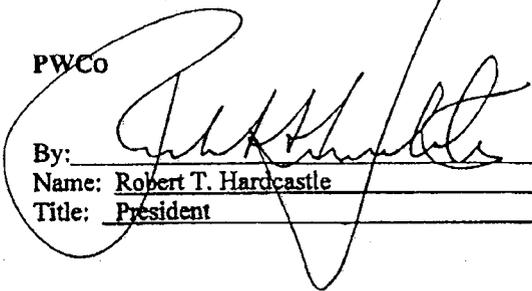
6. Incorporation and Ratification. This Amendment No. 1 shall be attached to and incorporated into the Agreement and the Agreement as amended by this Amendment No. 1 is hereby ratified to be effective May 1, 2007 as if the amendments were in the Agreement *ab initio*.

7. Counterparts. This Amendment No. 1 may be executed in counterparts, each of which may contain fewer than all signatures but all of which, together, shall constitute a single instrument.

THE REMAINDER OF THIS PAGE LEFT INTENTIONALLY BLANK.

IN WITNESS WHEREOF, this Joint Well Development Agreement has been executed as of the date first written above.

PWCo

By: 

Name: Robert T. Hardcastle

Title: President

PSWID

By: _____

Name: R. Gary Sherlock

Title: Chairman

By: _____

Name: William F. Haney

Title: Secretary

IN WITNESS WHEREOF, this Joint Well Development Agreement has been executed
as of the date first written above.

PWCo

By: _____
Name: Robert T. Hardcastle
Title: President

PSWID

By: *R. Gary Sherlock*
Name: R. Gary Sherlock 7/29/07
Title: Chairman

By: *William F. Haney*
Name: William F. Haney
Title: Secretary

Attachments

1. Legal Description (Corrected)
2. NONE
3. Preliminary Project Timeline (Corrected)

CORRECTED ATTACHMENT 1

Composed of:

- 1. Exhibit "A" Legal Description K2 Site (2 pages)**
- 2. Exhibit "B" Depiction of K-2 Wellsite (1 page)**

EXHIBIT "A"
LEGAL DESCRIPTION
K2 SITE

That portion of the Southeast Quarter of the Southwest Quarter of Section 22, Township 12 North, Range 8 East, of the Gila and Salt River Meridian, Gila County, Arizona, which lies immediately north of and adjacent to the northerly line of STRAWBERRY KNOLLS UNIT TWO, according to the plat of record in the office of the Gila County Recorder, Map No. 240, described as follows:

COMMENCING at the northwest corner of Lot 107, STRAWBERRY KNOLLS UNIT TWO;

- Thence: S 69° 18' 28" E, along the northerly line thereof, a distance of 79.78 feet;
- Thence: S 27° 39' 21" E, continuing along said northerly line of Lot 107, a distance of 69.16 feet;
- Thence: S 48° 27' 33" E, continuing along said northerly line of Lot 107, a distance of 82.95 feet to the southeast corner of said Lot 107, being coincident with a point on the existing northerly right-of-way line of Parkinson Drive;
- Thence: N 68° 56' 15" E, along said northerly right-of-way line, a distance of 39.81 feet;
- Thence: S 79° 58' 32" E, continuing along said northerly right-of-way line, a distance of 85.93 feet;
- Thence: N 81° 27' 23" E, continuing along said northerly right-of-way line, a distance of 56.23 feet;
- Thence: N 09° 21' 41" W, a distance of 47.43 feet to the TRUE POINT OF BEGINNING;
- Thence: N 80° 42' 42" E, a distance of 100.61 feet;
- Thence: N 09° 37' 10" W, a distance of 79.80 feet;
- Thence: S 79° 22' 32" W, a distance of 100.28 feet;
- Thence: S 09° 21' 41" E, a distance of 77.46 feet to the TRUE POINT OF BEGINNING.

TOGETHER WITH an easement for ingress and egress and water utilities over the following described real property:

BEGINNING at the southwest corner of Lot 2 of STRAWBERRY KNOLLS UNIT FOUR, AMENDED, as shown on Map 592, Gila County Records;

- Thence: N 09° 37' 01" W, along the west line of said Lot 2, a distance of 109.80 feet;
- Thence: N 79° 22' 32" E, a distance of 30.00 feet;

Thence: S 09°37'01" E, a distance of 235.10 feet to a point on the northerly right-of-way line of Parkinson Drive;

Thence: N 37°18'22" W, along the northerly right-of-way line of Parkinson Drive, a distance of 33.27 feet;

Thence: N 73°24'09" W, continuing along the northerly right-of-way line of Parkinson Drive, a distance of 7.48 feet;

Thence: N 09°37'01" W, a distance of 93.64 feet;

Thence: S 68°58'19" W, a distance of 8.15 feet to the TRUE POINT OF BEGINNING.

Tetra Tech, Inc.
Project No. 1333.0015
July 13, 2007



CORRECTED ATTACHMENT 3
PRELIMINARY PROJECT TIMELINE

Total Days from Date of <u>Agreement*</u>	<u>Description</u>
30	File App w/ ACC to approve Agreement (Section 10.2)
60	Budget (preliminary) prepared (Section 4.1)
210	ACC Approval of Agreement (Section 5.2.2.1)
270	Transfer K2 Wellsite and provide Notice to PSWID that funding for Project is available
330	Mobilization and drilling of Test Well (Section 2.1)
390	Hydrologist determination of Estimated Sustainable Yield (Section 2.2.3.1)
510	Mobilization and drilling of Production Well (Section 2.3)
610	Completion of Project
730	Outside Deadline for Project Completion (Section 5.2.1)

*Assumes maximum duration for each step

RECEIVED

FENNEMORE CRAIG, P.C.
Jay L. Shapiro (No. 014650)
Patrick J. Black (No. 017141)
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012
Telephone (602)916-5000
Attorneys for Pine Water Company

2007 SEP 26 P 4: 36

AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION
OF PINE WATER COMPANY FOR
APPROVAL TO (1) ENCUMBER A PART
OF ITS PLANT AND SYSTEM
PURSUANT TO A.R.S. § 40-285(A); AND
(2) ISSUE EVIDENCE OF
INDEBTEDNESS PURSUANT TO A.R.S.
§ 40-302(A).

DOCKET NO: W-03512A-07-0362

RESPONSE TO STAFF REPORT

In accordance with the Procedural Order dated September 14, 2007, Applicant Pine Water Company ("PWCo") hereby files this Response to the Staff Report dated September 7, 2007. In substance, PWCo and Staff are in agreement that the approvals sought in this docket are in the public interest and should be granted. Therefore, PWCo makes this filing to clarify certain matters in response to the Staff Report. In short, the K2 transaction is not a "loan".

PWCo and the District have entered into a Joint Well Development Agreement "to drill and equip a deep well capable of producing a sustainable yield of no less than 150 gallons per minute ("gpm") on a portion of the K2 site and to interconnect the well to Pine Water's system ("K2 Well Project"). Staff Report at 2. The K2 Well Project is to include a fully equipped and interconnected production well and additional water storage. Staff Report at 4. PWCo has agreed to invest \$1 million in the K2 Well Project. The District has agreed to invest \$300,000 of capital in the K2 Well Project, the estimated cost to drill

EXHIBIT
tabbles
A-5
admitted

1 a test well at the site. Staff Report at 2. *Id.* In the event the K2 Well Project is
2 successful, PWCo has agreed to return the District's capital investment with a 6% return
3 thereon. Staff mischaracterizes this as a "loan." Staff Report at 2, 5.

4 The K2 transaction is not a loan. "The District will provide the \$300,000 as up-
5 front capital to finance the cost of drilling the test well." Staff Report at 2. The District is
6 investing capital to develop a well, including the cost of drilling a test well. If the
7 investment is successful, PWCo will provide the District with a return on and of that
8 investment. The investment will be deemed successful if the K2 well has a sustainable
9 yield of 150 gpm as defined in the Agreement and following entry of an ACC Decision
10 recognizing the Project as used and useful and included in rate base for rate making
11 purposes. If the K2 well is not interconnected to the PWCo water distribution system,
12 PWCo will offer to convey title to the Project to the District at no cost to the District.
13 PWCo respectfully submits that Staff is wrong in characterizing the transaction as a
14 "loan."

15 The error is understandable. In an abundance of caution, PWCo sought
16 Commission approval under ARS § 40-302 which requires approval of "indebtedness."
17 Nevertheless, PWCo's contingent obligation to return the District's investment is not a
18 loan. Nor is the lien, approval of which is also sought in this docket, security for a loan.
19 Rather, the lien secures PWCo's performance according to the terms and conditions of the
20 parties' agreement.

21 Again, Staff and PWCo are in general agreement as to the relief that should be
22 granted in the public interest in this docket. However, in light of the foregoing discussion,
23 PWCo respectfully requests that Staff's first, second and fourth recommendations (Staff
24 Report at 4-5) be amended to more accurately read:

25 "Staff recommends that the Commission authorize PWCo to issue
26 evidence of a contingent indebtedness to the District in the amount of

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\$300,000, together with a 6% per annum return thereon, for the purposes described herein.”

“Staff recommends that the Commission authorize Pine Water’s request to encumber its assets related to the K2 Well Project in an amount not to exceed \$300,000.”

“Staff further recommends that one copy of the executed Joint Well Development Agreement, the Notice of Continuing Security and Lien, and any other document evidencing PWCo’s indebtedness or encumbrance of a part of its plant or system related to the K2 Well Project be filed with Docket Control within 60 days of execution.”

This will help ensure that the terms “loan,” “borrow” and “borrowing” not be utilized by the Commission to characterize the K2 transaction, which is necessary and appropriate because no “loan” or “borrowing” is involved in the K2 is transaction.

DATED this 26th day of September, 2007.

FENNEMORE CRAIG, P.C.

By 
Jay L. Shapiro
Patrick J. Black
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Pine Water Company

ORIGINAL and thirteen (13) copies of the foregoing filed this 26th day of September, 2007:

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

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COPY of the foregoing hand-delivered
this 26th day of September, 2007 to:

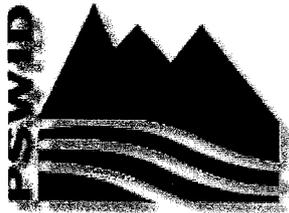
Mr. Dwight D. Nodes
Assistant Chief Administrative Law Judge
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Mr. Kevin Torrey, Esq.
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

COPY of the foregoing mailed
this 26th day of September, 2007 to:

Mr. Michael J. Harper
Rensch Walker & Harper PC
111 W. Cedar Lane, Suite C
Payson, Arizona 85541

By: Maria San Jose
1975886.1/75206.015

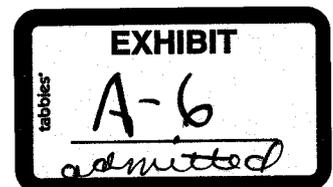


PSWID Pine/Strawberry Water Improvement District

Mission Statement

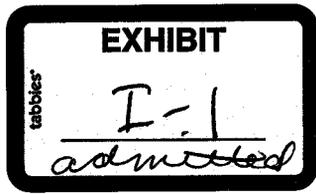
The PSWID Board's mission is to represent the interests of the communities and to secure long term and reliable sources of water for the communities. To accomplish this we are to: 1) Investigate current and potential sources of water as well as the costs associated with maintaining or expanding present and potential sources. 2) Formulate a plan or plans for improving present water sources of the communities. 3) Formulate a plan or plans for funding such improvements. 4) Implement and formulate plans as necessary to provide long-term available water to communities.

- Home
- General Info
- Document Library
- Board Members
- Financial Data
- Conservation Info.
- Borehole Data
- Related Links
- Contact Us



FILE COPY

1 GLIEGE LAW OFFICES, PLLC
2 P.O. Box 1388
3 Flagstaff, AZ 86002-1388
4 (928) 226-8333



5 John G. Gliege (#003644)
6 Stephanie J. Gliege (#022465)
7 Attorney for Fred B. Krafczyk

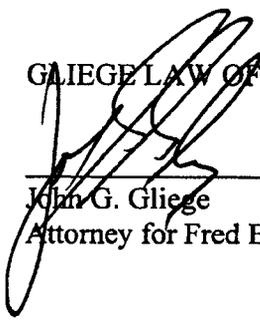
8 **BEFORE THE ARIZONA CORPORATION COMMISSION**

9 **IN THE MATTER OF THE APPLICATION**
10 **OF PINE WATER COMPANY FOR**
11 **APPROVAL TO (1) ENCUMBER A PART**
12 **OF ITS PLANT AND SYSTEM PURSUANT**
13 **TO A.R.S. §40-285(A); AND (2) ISSUE**
14 **EVIDENCE OF INDEBTEDNESS**
15 **PURSUANT TO A.R.S. §40-302(A).**

} **DOCKET NO. W-03512A-07-0362**
} **NOTICE OF FILING**

16
17 FRED B. KRAFCZYK, intervener in the above captioned matter, hereby submits the Notice of
18 Filing in this referenced matter. Attached hereto as Exhibit A is the Direct Testimony of Fred B.
19 Krafczyk.

20 RESPECTFULLY SUBMITTED this 19th day of November, 2007.

21
22 **GLIEGE LAW OFFICES, PLLC**
23 
24 _____
25 John G. Gliege
26 Attorney for Fred B. Krafczyk
27
28
29

1 Original and thirteen copies of the foregoing
Mailed this 19th day of November, 2007 to:

2
3 Docket Control Center
Arizona Corporation Commission
1200 W. Washington Street
4 Phoenix, AZ 85007

5 Copies of the foregoing
6 Mailed this 19th day of November, 2007 to:

7 Fennemore Craig, P.C.
Attn: Mr. Jay L. Shapiro
8 3003 North Central Ave. Ste 2600
Phoenix, AZ 85012-2913
9 Attorneys for Pine Water Company

10 Mr. Dwight D. Nodes
Assistant Chief Administrative Law Judge
11 Arizona Corporation Commission
1200 W. Washington Street
12 Phoenix, AZ 85007

13 Mr. Kevin Torrey, Esq.
Legal Division
14 Arizona Corporation Commission
1200 W. Washington Street
15 Phoenix, AZ 85007

16 RENSCH WALKER & HARPER, PC
Attn: Michael J. Harper
17 111 W. Cedar Lane, Ste C
18 Payson, AZ 85541
928-474-0322
19 Attorneys for Cindy Maack

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EXHIBIT A

Direct Testimony

Of

Fred B. Krafczyk

1 Addressing the first issue, that of the capacity of the District to lend money to Pine Water
2 Company, I hereby incorporate the *Objection to Application to Encumber System and Issue Evidence of*
3 *Indebtedness* filed by Cindy Maack with the Arizona Corporation Commission in the above referenced
4 matter on the 6th day of August, 2007. Clearly this loan of funds to Pine Water Company by Pine-
5 Strawberry Water Improvement District (hereafter "PSWID") constitutes a loan of public funds to a
6 public service corporation in violation of the Arizona State Constitution. My second concern about
7 capacity is whether or not the District can bind future boards of directors to this agreement, because
8 substantial portions of the agreement call for the exercise of discriminatory judgment by Pine Water
9 Company and future boards of PSWID may not be willing to be bound by that judgment. There is a
10 recall election scheduled for March 8, 2008, which will have an impact on the composition of the
11 PSWID Board. My third concern regarding capacity is whether or not the establishment of the escrow
12 account in the K2 Agreement constitutes an unlawful delegation of the power and duties of the Board of
13 Directors of PSWID to some other party.

14 Addressing credit worthiness, I have examined the available financial data on Pine Water
15 Company and cannot in good conscience make a determination that Pine Water Company has the credit
16 worthiness to borrow \$300,000.00 from PSWID.

17 Addressing the concern of collateral, it appears that the parcel of property being offered as
18 collateral is insufficient in value to support a loan in the amount of \$300,000.00. This is because the site
19 has limited legal viable access, its size, and a portion of the property is located in a flood plain.
20 Therefore, the collateral appears to be insufficient.

21 Last, addressing the issue of the capacity of Pine Water Company to repay the debt, absent a
22 substantial rate increase from the Commission to cover the costs of debt repayment, the publicly
23 available records on Pine Water Company make it clear that they do not have the capacity to adequately
24 repay the debt.

25 **Q. 6. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE K2 AGREEMENT?**

26 A.6. Yes, I do have additional concerns regarding the K2 Agreement. It is my understanding that the
27 PSWID acted without complete information concerning the peer reviews of the Hydrological Report of
28 Michael Ploughe.

29

1 Further, the K2 Agreement appears to place all of the risk on PSWID inasmuch as PSWID may
2 advance our taxpayers money and not be repaid under a variety of conditions set forth in the K2
3 Agreement, for example Sections 4.2.3 and 5.2.

4 **Q. 7. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 A. 7. Yes.

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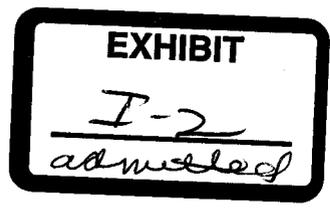
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FILE COPY

1 GLIEGE LAW OFFICES, PLLC
2 P.O. Box 1388
3 Flagstaff, AZ 86002-1388
4 (928) 226-8333



5 John G. Gliege (#003644)
6 Stephanie J. Gliege (#022465)
7 Attorney for Michael Greer

8 **BEFORE THE ARIZONA CORPORATION COMMISSION**

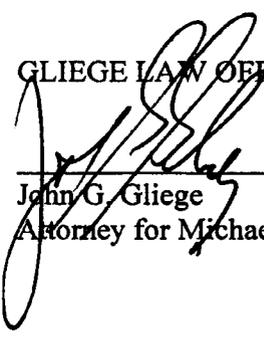
9 **IN THE MATTER OF THE APPLICATION**
10 **OF PINE WATER COMPANY FOR**
11 **APPROVAL TO (1) ENCUMBER A PART**
12 **OF ITS PLANT AND SYSTEM PURSUANT**
13 **TO A.R.S. §40-285(A); AND (2) ISSUE**
14 **EVIDENCE OF INDEBTEDNESS**
15 **PURSUANT TO A.R.S. §40-302(A).**

DOCKET NO. W-03512A-07-0362

NOTICE OF FILING

16
17 MICHAEL GREER, intervener in the above captioned matter, hereby submits the Notice of
18 Filing in this referenced matter. Attached hereto as Exhibit A is the Direct Testimony of Michael Greer.

19
20 RESPECTFULLY SUBMITTED this 19th day of November, 2007.

21
22 GLIEGE LAW OFFICES, PLLC
23
24 
25 John G. Gliege
26 Attorney for Michael Greer
27
28
29

1 Original and thirteen copies of the foregoing
Mailed this 19th day of November 2007 to:

2
3 Docket Control Center
4 Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

5 Copies of the foregoing
6 Mailed this 19th day of November 2007 to:

7 Fennemore Craig, P.C.
8 Attn: Mr. Jay L. Shapiro
3003 North Central Ave. Ste 2600
Phoenix, AZ 85012-2913
9 Attorneys for Pine Water Company

10 Mr. Dwight D. Nodes
Assistant Chief Administrative Law Judge
11 Arizona Corporation Commission
1200 W. Washington Street
12 Phoenix, AZ 85007

13 Mr. Kevin Torrey, Esq.
14 Legal Division
Arizona Corporation Commission
1200 W. Washington Street
15 Phoenix, AZ 85007

16 RENSCH WALKER & HARPER, PC
17 Attn: Michael J. Harper
111 W. Cedar Lane, Ste C
18 Payson, AZ 85541
928-474-0322
19 Attorneys for Cindy Maack

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EXHIBIT A

Direct Testimony

Of

MICHAEL GREER

1
2 **BEFORE THE ARIZONA CORPORATION COMMISSION**

3
4 **IN THE MATTER OF THE APPLICATION**
5 **OF PINE WATER COMPANY FOR**
6 **APPROVAL TO (1) ENCUMBER A PART**
7 **OF ITS PLANT AND SYSTEM PURSUANT**
8 **TO A.R.S. §40-285(A); AND (2) ISSUE**
9 **EVIDENCE OF INDEBTEDNESS**
10 **PURSUANT TO A.R.S. §40-302(A).**
11

} **DOCKET NO. W-03512A-07-0362**

} **DIRECT TESTIMONY OF MICHAEL**
} **GREER**

12 **Q. 1. PLEASE STATE YOUR FULL NAME, ADDRESS AND TELEPHONE NUMBER.**

13 A. 1. Mr. Michael Greer, 3850 Matazal Vista, Pine, AZ 85544. Telephone number is 480-233-1066.

14 **Q. 2. PLEASE STATE YOUR OCCUPATION AND BUSINESS CONTACT INFORMATION**
15 **INCLUDING ADDRESS AND TELEPHONE NUMBER.**

16 A. 2. HAT CREEK Electric Company, Design Build Electircal Services, HC1 Box 1207, Strawberry,
17 AZ 85544. Telephone number is 928-476-4575.

18 **Q. 3. HAVE YOU HAD THE OPPORTUNITY TO REVIEW THE DIRECT TESTIMONY OF**
19 **FRED B. KRAFCZYK?**

20 A. 3. Yes.

21 **Q. 4. DO YOU CONCUR WITH FRED B. KRAFCZYK'S DIRECT TESTIMONY?**

22 A. 4. Yes.

23 **Q. 5. DO YOU HAVE OBJECTIONS OR CONCERNS REGARDING THE JOINT WELL**
24 **DEVELOPMENT AGREEMENT between PINE WATER COMPANY and PINE-**
25 **STRAWBERRY WATER IMPROVEMENT DISTRICT (K2 Agreement)?**

26 A. 5. Yes, I do have concerns regarding the K2 Agreement. In addition to the concerns pointed out by
27 Mr. Krafczyk, which I would like to incorporate herein, I have the following concerns:
28
29

- 1 1. That the usable amount of property at the K2 site is insufficient in size to accommodate the
2 proposed well and storage facilities, because its topography and its location near septic tanks and
3 effluent disposal fields.
- 4 2. As witnessed by last weekends altercations between representatives of Pine Water Company and
5 property owners surrounding the proposed K2 well site which necessitated the calling of the Gila
6 County Sheriff to the site, there are some critical issues concerning Pine Water Companies lawful
7 access to the site and its use of surrounding properties during the course of construction and
8 perhaps future operation.
- 9 3. I am concerned about the location of the proposed K2 well in Strawberry, Arizona for several
10 reasons. If the site is not the most suitable for the well, it is possible that PSWID will be placed
11 in a position of advancing monies which may not be repaid. It would be better to locate a well in
12 Pine, Arizona in the vicinity of other deep wells, which have tapped into the existing known deep
13 aquifer system.
- 14 4. I am concerned about the impact of the well on Fossil Creek and Fossil Springs, both in terms of
15 environmental considerations and on the issue of the K2 well site could impact upon the
16 downstream water rights of other water users in the Verde River Water Shed.
- 17 5. I am concerned that there is an incredible appearance of conflict of interest and other impropriety
18 because of the roles played by both Mr. Richie and Mr. Brenninger. While Mr. Richie was the
19 chief negotiator of PSWID of the K2 Agreement he also purchased a parcel of land from Pine
20 Water Company or its family of organizations. Mr. Brenninger went from being a board member
21 of PSWID who was actively involved in the negotiations of the K2 Agreement to being a hired
22 representative of Pine Water Company or its related family of organizations.
- 23 6. I am concerned that in the event that the cost of the development exceeds the projected 1.3
24 million dollars, that Pine Water Company could abandon the project without repaying PSWID
25 and without further liability to PSWID to complete the work.

26 **Q. 6. DOES THIS CONCLUDE YOUR TESTIMONY?**

27 **A. 6. Yes.**

FILE COPY

RECEIVED

Kevin

SEP 10 2007

MEMORANDUM

LEGAL DIV.
ARIZ. CORPORATION COMMISSION

LEI

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division
DATE: September 7, 2007

EA for EGJ

EXHIBIT
5-1
admitted

RE: STAFF REPORT FOR THE PINE WATER COMPANY, INC. APPLICATION FOR APPROVAL TO ENCUMBER A PART OF PLANT AND SYSTEM PURSUANT TO A.R.S. § 40-285(A); AND ISSUE EVIDENCE OF INDEBTEDNESS PURSUANT TO A.R.S. § 40-302(A) (DOCKET NO. W-03512A-07-0362)

Attached is the Staff Report for the Pine Water Company, Inc. application for approval to encumber a part of plant and system pursuant to A.R.S. § 40-285(A); and issue evidence of indebtedness pursuant to A.R.S. § 40-302(A). Staff recommends approval of the requested financing authorization.

Any party to this procedure who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before September 21, 2007.

EGJ:PMC:red

Originator: Pedro M. Chaves

Attachment: Original and fourteen copies

DOCKET CONTROL
AZ CORP COMMISSION

2007 SEP -7 P 12:46

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Kevin

SEP 10 2007

MEMORANDUM

LEGAL DIV.
ARIZ. CORPORATION COMMISSION

LEI

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division
DATE: September 7, 2007

EA for EGT

RE: STAFF REPORT FOR THE PINE WATER COMPANY, INC. APPLICATION FOR APPROVAL TO ENCUMBER A PART OF PLANT AND SYSTEM PURSUANT TO A.R.S. § 40-285(A); AND ISSUE EVIDENCE OF INDEBTEDNESS PURSUANT TO A.R.S. § 40-302(A) (DOCKET NO. W-03512A-07-0362)

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EGJ:PMC:red

Originator: Pedro M. Chaves

Attachment: Original and fourteen copies

DOCKET CONTROL
AZ CORP COMMISSION

2007 SEP -7 P 12:46

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Service List for: PINE WATER COMPANY, INC.
Docket No. W-03512A-07-0362

Mr. Jay Shapiro
3003 N. Central Avenue, Suite 2600
Phoenix, Arizona 85012

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Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

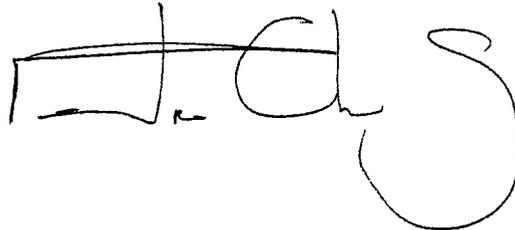
**PINE WATER COMPANY, INC.
DOCKET NO. W-03512A-07-0362**

**APPLICATION FOR APPROVAL TO
ENCUMBER A PART OF PLANT AND SYSTEM
PURSUANT TO A.R.S. § 40-285(A); AND
ISSUE EVIDENCE OF INDEBTEDNESS
PURSUANT TO A.R.S. § 40-302(A)**

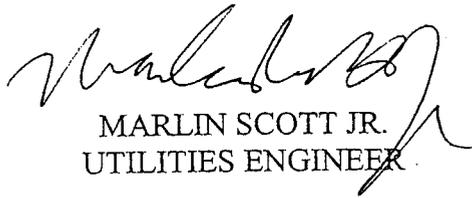
SEPTEMBER 7, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Pine Water Company, Inc. Docket No. W-03512A-07-0362 is the responsibility of the Staff members listed below: Pedro M. Chaves is responsible for the review and financial analysis of the Company's application. Marlin Scott Jr. is responsible for the engineering analysis.

A handwritten signature in black ink, appearing to read 'P. M. Chaves', with a large, stylized flourish at the end.

PEDRO M. CHAVES
PUBLIC UTILITIES ANALYST II

A handwritten signature in black ink, appearing to read 'Marlin Scott Jr.', with a large, stylized flourish at the end.

MARLIN SCOTT JR.
UTILITIES ENGINEER

**EXECUTIVE SUMMARY
PINE WATER COMPANY, INC.
DOCKET NO. W-03512A-07-0362**

Pine Water Company, Inc. ("Pine Water" or "Company"), a Class "C" Arizona public service corporation organized under subchapter "C" of the United States Treasury regulations, entered into a Joint Well Development Agreement ("Agreement") with the Pine-Strawberry Water Improvement District ("PSWID" or "District") on May 1, 2007.

The Agreement attempts to join Pine Water and District resources to address the water supply shortages in the Pine-Strawberry, Arizona region. After extensive research and analysis from the District an existing site in eastern Strawberry, Arizona ("K2 Site") showed to be suitable for further investigation and development as a possible source of water for Pine Water customers and for the benefit of landowners in the District within the certificated area of Pine Water and Strawberry Water Company, Inc.

Pine Water and the District agreed to drill and equip a deep well capable of producing a sustainable yield of no less than 150 gallons per minute ("gpm") on a portion of the K2 site and to interconnect the well to Pine Water's system ("K2 Well Project"). In order to determine whether the K2 Well is capable of producing the minimum sustainable yield, Pine Water and the District will drill a test well at the K2 site.

The estimated cost of drilling the test well is \$300,000. The District will provide the \$300,000 as up-front capital investment. In the event that the test well shows that the K2 Well Project will be able to produce a sustainable yield of 150 gpm, Pine Water has agreed to repay the \$300,000 in 36 equal monthly payments at an interest rate of 6 percent per annum to the District. In addition, Pine Water will finance the remaining costs of the K2 Well Project, estimated at an additional \$981,700. Furthermore, Pine Water will encumber its assets pertaining to the K2 Well Project to the District as collateral for the \$300,000 loan.

On June 11, 2007, the Company filed an application with the Arizona Corporation Commission ("Commission") for approval to encumber a part of plant and system and issue evidence of indebtedness pursuant to the Agreement.

At December 31, 2006, Pine Water's capital structure consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, and 100 percent equity. Staff calculated a pro forma capital structure for the Company composed of 7.1 percent short-term debt, 15.6 percent long-term debt and 77.3 percent equity that reflects a \$300,000 loan and a paid-in-capital investment of \$981,700.

Staff's pro forma TIER and DSC ratios reflecting a three-year \$300,000 loan at 6 percent and a paid-in-capital investment of \$981,700 are 13.79 and 2.41, respectively. The DSC results show that cash flow from operations is sufficient to cover all obligations.

Staff concludes that the benefit of obtaining \$300,000 to drill a test well as a contingent debt obligation exceeds the potential detrimental effect on its capital structure and financial risk.

Staff concludes that issuance of the proposed debt financing for the purposes stated in the application is within Pine Water's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide service.

Staff recommends that the Commission authorize Pine Water's request to borrow an amount not to exceed \$300,000 in new funds from PWSID for the purposes described herein.

Staff recommends that the Commission authorize Pine Water's request to encumber its assets related to the K2 Well Project in an amount not to exceed \$300,000 as collateral for the \$300,000 loan.

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Introduction

On May 1, 2007, Pine Water Company, Inc. ("Pine Water" or "Company") entered into a Joint Well Development Agreement ("Agreement") with the Pine-Strawberry Water Improvement District ("PSWID" or "District")¹.

The Agreement attempts to join Pine Water and District resources to address the water supply shortages in the Pine-Strawberry, Arizona region. After extensive research and analysis from the District an existing site in eastern Strawberry, Arizona ("K2 Site") showed to be suitable for further investigation and development as a possible source of water for Pine Water customers and for the benefit of landowners in the District within the certificated area of Pine Water and Strawberry Water Company, Inc ("Strawberry Water")².

Some portions of the Agreement are limited to Commission approval, pursuant to A.R.S. §§ 40-285(A) and 40-302(A)³.

On June 11, 2007, the Company filed an application with the Arizona Corporation Commission ("Commission") for approval to encumber a part of plant and system and issue evidence of indebtedness, pursuant to the Agreement.

Background

Pine Water is a Class "C" Arizona public service corporation organized under subchapter "C" of the United States Treasury regulations. The Company is primarily engaged in the business of providing water utility service to approximately 2,000 customers in its certificated area in Northern Gila County, Arizona.

The Company is a wholly-owned subsidiary of Brooke Utilities, Inc. ("Brooke Utilities"). Brooke Utilities' principal business office is located at Bakersfield, California.

Public Notice

On August 2, 2007, the Company filed an affidavit of publication verifying public notice of its financing application. Pine Water published notice of its financing application in the *Payson Roundup* on July 17, 2007. The *Payson Roundup* is a newspaper of general circulation in the county of Gila, Arizona. The affidavit of publication is attached along with a copy of the Notice.

¹ PSWID is a political subdivision of the State of Arizona and hence, is not subject to Commission regulation. See further, A.R.S. §40-909(A) (6).

² Strawberry Water is a wholly-owned subsidiary of Brooke Utilities, Inc. and hence, an affiliate of Pine Water.

³ See further, sections 4 and 5 of the Agreement.

Purpose of the Requested Financing

Pine Water and the District agreed to drill and equip a deep well capable of producing a sustainable yield of no less than 150 gallons per minute ("gpm") on a portion of the K2 Site and to interconnect the well to Pine Water's system ("K2 Well Project")⁴. In order to determine whether the K2 Well is capable of producing the minimum sustainable yield, Pine Water and the District will drill a test well at the K2 site. The purpose of the \$300,000 debt financing and related encumbrance of assets is to fund the cost to drill the test well.

Description of the Requested Financing

The District will provide the \$300,000 as up-front capital to finance the cost of drilling the test well. Under the terms of the Agreement, Pine Water is responsible for repayment of the \$300,000 up-front capital in 36 equal monthly payments at an interest rate of 6 percent per annum to the District contingent upon the test well showing that the K2 Well Project will be able to produce a sustainable yield of 150 gpm. In addition, Pine Water will finance the remaining costs of the K2 Well Project, estimated at an additional \$981,700⁵. Furthermore, Pine Water will encumber its assets pertaining to the K2 Well Project to the District as collateral for the \$300,000 loan.

Financial Analysis

Staff's analysis is illustrated on Schedule PMC-1. Column [A] reflects Pine Water's historical financial information for the year ended December 31, 2006. Column [B] presents pro forma financial information that modifies Column [A] to reflect a three-year \$300,000 loan at 6 percent per annum and a paid-in-capital investment of \$981,700.

TIER and DSC

Times interest earned ratio ("TIER") represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long-term but does not mean that debt obligations cannot be met in the short-term.

Debt service coverage ratio ("DSC") represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that cash flow from operations is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

⁴ The K2 Well Project is estimated to cost a total of \$1,281,700 (per the Company's response to Staff's second set of Data Requests), inclusive of \$300,000 related to the test well.

⁵ Pine Water anticipates financing the remaining costs through paid-in-capital.

Schedule PMC-1, Column [A] shows that for the year ended December 31, 2006, Pine Water had no outstanding loans, hence, TIER, and DSC results are not meaningful. The pro forma results reflect a 13.79 TIER and a 2.41 DSC under the scenario described above for Column [B].

As seen in Column [B], Pine Water has satisfactory pro forma TIER and DSC results. The Company's TIER results reflect that operating income would suffice to cover interest expense in the short-term. DSC results indicate that Pine Water will be able to meet all obligations with cash generated from operations.

Capital Structure

At December 31, 2006, Pine Water's capital structure consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, and 100 percent equity (Schedule PMC-1, Column [A], lines 17-25). Inclusion of the requested \$300,000 combined with a paid-in-capital investment of \$981,000 would result in a capital structure composed of 7.1 percent short-term debt, 15.6 percent long-term debt and 77.3 percent equity (Schedule PMC-1, Column [B], lines 17-25).

Capital Structure inclusive of AIAC and CIAC

At December 31, 2006, Pine Water's capital structure, inclusive of Advances In Aid of Construction ("AIAC") and Contributions In Aid of Construction ("CIAC"), consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, 9.9 percent equity, 2.9 percent AIAC and 87.2 percent CIAC (Schedule PMC-1, Column [A], lines 28-40).

Pine Water is currently heavily invested through CIAC. The current balance of equity is \$41,575. In contrast, the current balance of CIAC is \$366,576. In this scenario, AIAC and CIAC funding represents 90.1 percent of total capital, inclusive of AIAC and CIAC. Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC, for private and investor owned utilities. Furthermore, for a utility with access to the capital markets, Staff typically recommends a capital structure with a minimum of 40 percent equity of total capital (short-term debt, long-term debt and common equity) as appropriate to provide a balance of cost and financial risk. Absent access to the capital markets, a privately owned for-profit regulated utility should minimize debt and incur debt primarily as a last resort.

Inclusion of the requested \$300,000 debt combined with a paid-in-capital investment of \$981,000 would result in a capital structure composed of 5.5 percent short-term debt, 12.1 percent long-term debt, 60.1 percent equity, 0.7 percent AIAC and 21.5 percent CIAC (Schedule PMC-1, Column [B], lines 28-40). In this scenario, AIAC and Net CIAC funding represents 22.2 percent of total capital, inclusive of AIAC and Net CIAC, which is below the maximum limit typically recommended by Staff.

Engineering Analysis

According to the Company, the K2 Well Project is estimated to cost between \$1,000,000 and \$1,300,000. Through a data request response by the Company, Staff was provided budgetary estimates with a cost breakdown of this project as follows:

<u>Plant Items</u>	<u>Costs</u>
a. Land, 30 feet by 30 feet	\$ 0
b. Well drilling and casing, 1,700 feet	\$607,000
c. Well pump	\$ 40,000
d. Storage tanks, size and number of tanks	\$200,000
e. Booster system	\$ 0
f. Piping	\$ 18,000
g. Electrical power drop	\$ 16,000
h. Electrical work and controls	\$ 7,700
i. Structures	\$ 55,000
j. Hydrogeological study	\$ 8,000
k. Engineering	\$ 30,000
l. Other - Test Well	\$300,000

Total:	\$1,281,700

Staff has reviewed the K2 Well Project cost and finds the Company's budgetary estimate of \$1,281,700 to be reasonable.

Compliance

There are no compliance issues with Pine Water Company Inc.

Conclusion and Recommendations

Staff concludes that the benefit of obtaining \$300,000 to drill a test well as a contingent debt obligation exceeds the potential detrimental effect on its capital structure and financial risk.

Staff concludes that indebtedness for the amount of \$300,000 is within Pine Water's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends that the Commission authorize Pine Water's request to borrow \$300,000 from the District for the purposes described herein.

Staff recommends that the Commission authorize Pine Water's request to encumber its assets related to the K2 Well Project in an amount not to exceed \$300,000 as collateral for the \$300,000 loan.

Staff recommends authorizing Pine Water to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that one copy of the executed loan documents be filed with Docket Control within 60 days of execution.

FINANCIAL ANALYSIS

Selected Financial Information

		[A] ¹ 12/31/2006		[B] ² Pro Forma	
1	Operating Income	\$	212,853	\$	212,853
2	Depreciation & Amort.		51,571		51,571
3	Income Tax Expense		0		0
4					
5	Interest Expense		0		15,441
6	Repayment of Principal		0		94,078
7					
8					
9	TIER				13.79
10	[1+3] ÷ [5]		N/M ³		
11	DSC				2.41
12	[1+2+3] ÷ [5+6]		N/M		
13					
14					
15					
16					
17	Capital Structure				
18					
19	Short-term Debt		0 0.0%	94,078	7.1% ⁴
20					
21	Long-term Debt		0 0.0%	205,922	15.6%
22					
23	Common Equity		41,575 100.0%	1,023,275	77.3%
24					
25	Total Capital	\$	41,575 100.0%	\$ 1,323,275	100.0%
26					
27					
28	Capital Structure (inclusive of AIAC and Net CIAC)				
29					
30	Short-term Debt		0 0.0%	94,078	5.5%
31					
32	Long-term Debt		0 0.0%	205,922	12.1%
33					
34	Common Equity		41,575 9.9%	1,023,275	60.1%
35					
36	Advances in Aid of Construction ("AIAC")		12,057 2.9%	12,057	0.7%
37					
38	Contributions in Aid of Construction ("CIAC") ⁵		366,576 87.2%	366,576	21.5%
39					
40	Total Capital (Inclusive of AIAC and CIAC)	\$	420,208 100.0%	\$ 1,701,908	100.0%
41					
42					
43	AIAC and CIAC Funding Ratio ⁶		90.1%	22.2%	
44	(36+38)/(40)				
45					
46					

47 ¹ Column [A] is based on 2006 financial information for the year ended December 31, 2006.
48 ² Column [B] is Column [A] modified to reflect a \$300,000 loan, at an interest rate of 6 percent, for 3 years. Column [B] also modifies Column [A] to reflect
49 paid-in-capital investment of \$981,700.
50 ³ Not Meaningful
51 ⁴ Pro Forma Short-term Debt represents the annual principal portion of the proposed loan.
52 ⁵ Net CIAC balance (i.e. less: amortization of contributions).
53 ⁶ Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC,
for private and investor owned utilities.

Chaves

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AZ CORP COMMISSION AUG 03 2007
DOCKET CONTROL

AZ CORP COMM
Director Utilities

1 FENNEMORE CRAIG, P.C.
2 Jay L. Shapiro (No. 014650)
3 Patrick J. Black (No. 017141)
4 3003 North Central Avenue, Suite 2600
5 Phoenix, Arizona 85012
6 Telephone (602)916-5000
7 Attorneys for Pine Water Company

BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE APPLICATION
9 OF PINE WATER COMPANY FOR
10 APPROVAL TO (1) ENCUMBER A PART
11 OF ITS PLANT AND SYSTEM
12 PURSUANT TO A.R.S. § 40-285(A); AND
13 (2) ISSUE EVIDENCE OF
14 INDEBTEDNESS PURSUANT TO A.R.S.
15 § 40-302(A).

DOCKET NO: W-03512A-07-0362

NOTICE OF FILING CERTIFICATION
OF PUBLICATION

16 At Staff's request, Pine Water Company ("PWCo") had published legal public
17 notice regarding PWCo's Application for Approval to (1) Encumber a Part of Its Plant and
18 System Pursuant to A.R.S. §40-285(A); and (2) Issue Evidence of Indebtedness Pursuant
19 to A.R.S. §40-302(A). Accordingly, PWCo hereby submits this Notice of Filing
20 Certification of Publication in the above-captioned matter.

21 On July 17, 2007 legal public notice was published in the *Payson Roundup*. The affidavit
22 of Eve Paludan, Assistant Bookkeeper of the *Payson Roundup*, is attached hereto as Exhibit A.
23
24
25
26

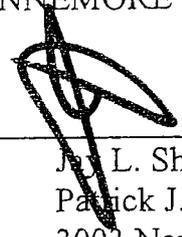
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DATED this 2 day of August, 2007.

FENNEMORE CRAIG, P.C.

By _____



J. L. Shapiro
Patrick J. Black
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Pine Water Company

ORIGINAL and thirteen (13) copies of the foregoing filed this 2 day of August, 2007:

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

COPY of the foregoing hand-delivered this 2 day of August, 2007:

Mr. Kevin Torrey, Esq.
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

By: maria sanjose
1944825.1/75206.015

EXHIBIT

A

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner



IN THE MATTER OF THE APPLICATION OF)
PINE WATER COMPANY FOR APPROVAL TO)
(1) ENCUMBER A PART OF ITS PLANT AND)
SYSTEM PURSUANT TO A.R.S. § 40-285(A);)
AND (2) ISSUE EVIDENCE OF)
INDEBTEDNESS PURSUANT TO A.R.S. §)
40-302(A).)

DOCKET NO. W-03512A-07-0362

RESPONSIVE
TESTIMONY
OF
PEDRO M. CHAVES
PUBLIC UTILITIES ANALYST III
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

NOVEMBER 21, 2007

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STAFF'S RECOMMENDATIONS	4

**EXECUTIVE SUMMARY
PINE WATER COMPANY, INC.
DOCKET NO. W-03512A-07-0362**

On June 11, 2007, the Pine Water Company, Inc. ("Pine Water" or "Company") filed an application with the Commission for approval to encumber a part of its plant and system and issue evidence of indebtedness.

On September 7, 2007, Staff filed a Staff Report recommending approval of the requested financing authorization. On September 26, 2007, Pine Water filed a response to the Staff Report. On November 7, 2007, the Company filed the Direct Testimony of Mr. Robert T. Hardcastle ("Hardcastle Direct").

The purpose of this testimony by Staff witness Pedro M. Chaves is to present Staff's final position which includes consideration of Pine Water's response to the Staff Report and the Hardcastle Direct.

The Staff Report recommended that the Commission authorize Pine Water to: 1) borrow an amount not to exceed \$300,000 in new funds from the Pine-Strawberry Water Improvement District ("PSWID" or "District"); 2) encumber its assets related to the K2 Well Project in an amount not to exceed \$300,000 as collateral for the \$300,000 loan; 3) to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted; and 4) that one copy of the executed loan documents be filed with Docket Control within 60 days of execution.

The Company expressed concern with the language Staff utilized in its recommendations. Specifically, Pine Water asserts that Staff's characterization of the transaction as a "loan" is incorrect and requests that the Commission's decision not refer to the transaction with the terms "loan", "borrow" or "borrowing."

Although in Staff's opinion there is nothing incorrect in the Staff Report, Staff has no objection to the Company's request.

Staff therefore recommends that the Commission authorize Pine Water to: 1) issue evidence of indebtedness to the District in an amount not to exceed \$300,000, at a 6 percent per annum for the purposes described in the Staff Report; 2) encumber its assets related to the K2 Well Project in an amount not to exceed \$300,000; 3) to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted; and 4) that one copy of the executed Joint Well Development Agreement, the Notice of Continuing Security and Lien, and any other pertinent documents evidencing Pine Water's indebtedness or encumbrance of a part of its plant or system related to the K2 Well Project be filed with Docket Control within 60 days of execution.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Pedro M. Chaves. I am a Public Utilities Analyst employed by the Arizona
4 Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business
5 address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst.**

8 A. In my position as a Public Utilities Analyst, I perform studies to estimate the cost of
9 capital component in rate filings used to determine the overall revenue requirement. I also
10 perform analyses regarding requests for financing authorization and other financial
11 regulatory matters.

12
13 **Q. Please describe your educational background and professional experience.**

14 A. I am a graduate of Arizona State University and received a Bachelor of Science degree in
15 Global Business with a specialization in finance. My course of studies included classes in
16 corporate and international finance, investments, accounting, statistics, and economics. I
17 began employment as a Staff Public Utilities Analyst in December 2005.

18
19 **Q. What is the scope of your testimony in this case?**

20 A. On June 11, 2007, Pine Water Company, Inc. ("Pine Water" or "Company") filed an
21 application with the Commission for approval to encumber a part of its plant and system
22 and issue evidence of indebtedness. On September 7, 2007, Staff filed a Staff Report
23 recommending approval of the requested financing authorization. On September 26,
24 2007, Pine Water filed a response to the Staff Report. On November 7, 2007, the
25 Company filed the Direct Testimony of Mr. Robert T. Hardcastle ("Hardcastle Direct").
26 The purpose of this testimony by Staff witness Pedro M. Chaves is to present Staff's final

1 position which includes consideration of Pine Water's response to the Staff Report and the
2 Hardcastle Direct.

3
4 **PINE WATER'S REQUEST**

5 **Q. Please provide a summary of Pine Water's request.**

6 **A.** The Company requests a Commission order authorizing it to:¹

- 7
8 *a. Encumber the K2 Wellsite and K2 Well Project with a lien*
9 *in favor of the District pursuant to A.R.S. § 40-285 (A); and*
10 *b. Issue evidence of indebtedness in favor of the District*
11 *pursuant to A.R.S. § 40-302 (A).*

12
13 **STAFF REPORT RECOMMENDATIONS**

14 **Q. Please summarize the recommendations in the Staff Report.²**

15 **A.** The Staff Report recommended that the Commission authorize Pine Water to:

- 16 1. Borrow an amount not to exceed \$300,000 in new funds from the Pine-Strawberry
17 Water Improvement District ("PSWID" or "District").
18 2. Encumber its assets related to the K2 Well Project in an amount not to exceed
19 \$300,000 as collateral for the \$300,000 loan.
20 3. To engage in any transaction and to execute any documents necessary to effectuate
21 the authorizations granted.
22 4. That one copy of the executed loan documents be filed with Docket Control within
23 60 days of execution.

24
25

¹ Company's Application, page 5.

² Staff Report, pages 4 and 5.

1 **PINE WATER'S CONCERN WITH THE STAFF REPORT**

2 **Q. What is Pine Water's concern with the Staff Report recommendations?**

3 A. The Company asserts that Staff's characterization of the transaction as a "loan" is
4 incorrect and requests that the Commission's decision not refer to the transaction with the
5 terms "loan", "borrow" or "borrowing".
6

7 **Q. Does the Company propose an alternative to the language found in the Staff Report**
8 **recommendations?**

9 A. Yes. Pine Water proposes that Staff's first, second and fourth recommendations be
10 amended to read:³
11

12 *"Staff recommends that the Commission authorize PWCo to*
13 *issue evidence of a contingent indebtedness to the District in*
14 *the amount of \$300,000; together with a 6% per annum*
15 *return thereon, for the purposes described herein."*
16

17 *"Staff recommends that the Commission authorize Pine*
18 *Water's request to encumber its assets related to the K2 Well*
19 *Project in an amount not to exceed \$300,000."*
20

21 *"Staff further recommends that one copy of the executed Joint*
22 *Well Development Agreement, the Notice of Continuing*
23 *Security and Lien, and any other document evidencing*
24 *PWCo's indebtedness or encumbrance of a part of its plant*
25 *or system related to the K2 Well Project be filed with Docket*
26 *Control within 60 days of execution."*
27

³ Pine Water's Response to Staff Report, pages 2 - 3.

1 **Q. Does Staff have any objection to the Company's request to not refer to the**
2 **transaction with the terms "loan, "borrow" or "borrowing"?**

3 A. In Staff's opinion there is nothing incorrect in the Staff Report. However, the Company
4 proposed characterization of this transaction as contained in the above recommendations
5 proposed by the Company is also not incorrect. Therefore, Staff has no objection to the
6 Company's request.

7

8 **STAFF'S RECOMMENDATIONS**

9 **Q. What are Staff's recommendations?**

10 A. Staff recommends that the Commission authorize Pine Water to:

- 11 1. Issue evidence of indebtedness to the District in an amount not to exceed \$300,000
12 at a 6 percent per annum for the purposes described in the Staff Report.
- 13 2. Encumber its assets related to the K2 Well Project in an amount not to exceed
14 \$300,000.
- 15 3. To engage in any transaction and to execute any documents necessary to effectuate
16 the authorizations granted.
- 17 4. That one copy of the executed Joint Well Development Agreement, the Notice of
18 Continuing Security and Lien, and any other pertinent documents evidencing Pine
19 Water's indebtedness or encumbrance of a part of its plant or system related to the
20 K2 Well Project be filed with Docket Control within 60 days of execution.

21

22 **Q. Does this conclude your Direct Testimony?**

23 A. Yes, it does.

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MEMORANDUM

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TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

EG

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OCT 22 2007

2007 OCT 22 P 2:53

AZ CORP COMMISSION
DOCKET CONTROL

DATE: October 22, 2007

LEGAL DIV.
ARIZ. CORPORATION COMMISSION

RE: ADDITION TO STAFF REPORT FOR THE PINE WATER COMPANY, INC. APPLICATION FOR APPROVAL TO ENCUMBER A PART OF PLANT AND SYSTEM PURSUANT TO A.R.S. § 40-285(A); AND ISSUE EVIDENCE OF INDEPTEDNESS PURSUANT TO A.R.S. § 40-302(A) - (DOCKET NO. W-03512A-07-0362)

Pine Water Company, Inc. ("Company") and the Pine-Strawberry Water Improvement District ("District") entered into a Joint Well Development Agreement ("Agreement") on May 1, 2007, to drill and equip a deep well at an estimated cost of approximately \$1.3 million. The construction of this well is known as the K-2 Well Project.

According to the Agreement, sustainable yield means a continuous production rate of no less than 150 gallons per minute ("GPM") for 24 hours per day, seven days a week. In the event the completion of the K2 Well achieves at least a sustainable yield, the K2 Well will be interconnected to the Company's water system.

Staff is filing this addition to its Staff Report in order to inform all parties to this case as to what minimum information Staff will be requesting be supplied by the Company (at some future case when the Company requests that the K2 Well be included in rate base) in order for Staff to make a recommendation to the Commission regarding the question of including the K2 Well Project in rate base. Staff will be:

1. Concerned with when the well tests were performed, i.e., summer or winter.
2. Examining how the tests were performed.
3. Requiring a letter from the Arizona Department of Water Resources ("ADWR") indicating ADWR's opinion as to the long term, continuous capacity (in GPM) of the K2 Well. Therefore, Staff would request that the Company keep ADWR informed and supply ADWR with any information ADWR may require in order for ADWR to supply such a letter to the Commission.

EGJ:MSJ:lh

Originator: Marlin Scott, Jr.

EXHIBIT
S-3
Admitted

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MEMORANDUM

RECEIVED

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

RECEIVED

OCT 22 2007

2007 OCT 22 P 2:53

AZ CORP COMMISSION
DOCKET CONTROL

DATE: October 22, 2007

LEGAL DIV.
ARIZ. CORPORATION COMMISSION

RE: **ADDITION TO STAFF REPORT FOR THE PINE WATER COMPANY, INC. APPLICATION FOR APPROVAL TO ENCUMBER A PART OF PLANT AND SYSTEM PURSUANT TO A.R.S. § 40-285(A); AND ISSUE EVIDENCE OF INDEPTEDNESS PURSUANT TO A.R.S. § 40-302(A) - (DOCKET NO. W-03512A-07-0362)**

Pine Water Company, Inc. ("Company") and the Pine-Strawberry Water Improvement District ("District") entered into a Joint Well Development Agreement ("Agreement") on May 1, 2007, to drill and equip a deep well at an estimated cost of approximately \$1.3 million. The construction of this well is known as the K-2 Well Project.

According to the Agreement, sustainable yield means a continuous production rate of no less than 150 gallons per minute ("GPM") for 24 hours per day, seven days a week. In the event the completion of the K2 Well achieves at least a sustainable yield, the K2 Well will be interconnected to the Company's water system.

Staff is filing this addition to its Staff Report in order to inform all parties to this case as to what minimum information Staff will be requesting be supplied by the Company (at some future case when the Company requests that the K2 Well be included in rate base) in order for Staff to make a recommendation to the Commission regarding the question of including the K2 Well Project in rate base. Staff will be:

1. Concerned with when the well tests were performed, i.e., summer or winter.
2. Examining how the tests were performed.
3. Requiring a letter from the Arizona Department of Water Resources ("ADWR") indicating ADWR's opinion as to the long term, continuous capacity (in GPM) of the K2 Well. Therefore, Staff would request that the Company keep ADWR informed and supply ADWR with any information ADWR may require in order for ADWR to supply such a letter to the Commission.

EGJ:MSJ:lhm

Originator: Marlin Scott, Jr.

FILE COPY

Service List for: Pine Water Company, Inc.
Docket No. W-03512A-07-0362

Mr. Jay Shapiro
FENNEMORE CRAIG
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Phoenix, Arizona 85012
Attorney for Pine Water Company, Inc.

Mr. Robert Hardcastle
Pine Water Company, Inc.
Post Office Box 82218
Bakersfield, California 93380-2218

Mr. Christopher C. Kempsey
Chief, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner



IN THE MATTER OF THE APPLICATION OF)
PINE WATER COMPANY FOR APPROVAL TO)
1) ENCUMBER A PART OF ITS PLANT AND)
SYSTEM PURSUANT TO A.R.S. § 40-285(A);)
AND 2) ISSUE EVIDENCE OF INDEBTEDNESS)
PURSUANT TO A.R.S. § 40-302(A).)
_____)

DOCKET NO. W-03512A-07-0362

RESPONSIVE

TESTIMONY

OF

MARLIN SCOTT, JR.

UTILITIES ENGINEER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

NOVEMBER 21, 2007

**SUMMARY OF TESTIMONY
PINE WATER COMPANY
DOCKET NO. W-03512A-07-0362**

CONCLUSION

Staff has reviewed the K2 Well Project cost and finds the Pine Water Company's ("Company") budgetary estimate of \$1,281,700 to be reasonable.

When the production well is completed and placed into service, Staff recommends that certain additional information be supplied by the Company when the Company requests that the K2 Well be included in rate base. This information is needed for Staff to make a recommendation to the Commission regarding the question of including the K2 Well Project into rate base.

1 **INTRODUCTION**

2 **Q. Please state your name, place of employment and job title.**

3 A. My name is Marlin Scott, Jr. My place of employment is the Arizona Corporation
4 Commission ("Commission"), Utilities Division, 1200 West Washington Street, Phoenix,
5 Arizona 85007. My job title is Utilities Engineer.

6
7 **Q. How long have you been employed by the Commission?**

8 A. I have been employed by the Commission since November 1987.

9
10 **Q. Please list your duties and responsibilities.**

11 A. As a Utilities Engineer, specializing in water and wastewater engineering, my
12 responsibilities include: the inspection, investigation, and evaluation of water and
13 wastewater systems; preparing reconstruction cost new and/or original cost studies, cost of
14 service studies and investigative reports; providing technical recommendations and
15 suggesting corrective action for water and wastewater systems; and providing written and
16 oral testimony on rate applications and other cases before the Commission.

17
18 **Q. Have you previously testified before this Commission?**

19 A. Yes, I have testified in 63 proceedings before this Commission.

20
21 **PURPOSE OF TESTIMONY**

22 **Q. Were you assigned to provide the Utilities Division Staff's ("Staff") engineering**
23 **analysis and recommendation in this proceeding?**

24 A. Yes.

25

1 **Q. What is the purpose of this testimony?**

2 A. To provide Staff's response to Pine Water Company's ("Company") estimated cost of the
3 K2 Well Project.
4

5 **K2 WELL PROJECT**

6 **Q. Have you reviewed the testimony of Robert T. Hardcastle that was filed by the**
7 **Company in this matter?**

8 A. Yes. The Company plans to drill a test well at an estimated cost of \$300,000. If the test
9 well results in an estimated sustainable yield of at least 150 gallons per minute ("GPM"),
10 the Company will drill a production well at an estimated cost of \$1.0 million.
11

12 **Q. Have you reviewed the cost of the well drilling project?**

13 A. Yes. Through a data request response by the Company, Staff was provided budgetary
14 estimates with a cost breakdown for the project as follows:
15

<u>Plant Items</u>	<u>Costs</u>
16 a. Land, 30 feet by 30 feet	\$ 0
17 b. Well drilling and casing, 1,700 feet	\$607,000
18 c. Well pump	\$ 40,000
19 d. Storage tanks, size and number of tanks	\$200,000
20 e. Booster system	\$ 0
21 f. Piping	\$ 18,000
22 g. Electrical power drop	\$ 16,000
23 h. Electrical work and controls	\$ 7,700
24 i. Structures	\$ 55,000
25 j. Hydrogeological study	\$ 8,000
26 k. Engineering	\$ 30,000
27 l. Other - Test Well	\$300,000
28	-----
29	Total: \$1,281,700
30	
31	
32	

1 Staff has reviewed the K2 Well Project cost and finds the Company's budgetary estimate
2 of \$1,281,700 to be reasonable.

3
4 **Q. Did you have any other recommendation?**

5 A. Yes. Staff recommends that the following information be supplied by the Company if and
6 when the Company requests that the K2 Well be included in rate base:

- 7
- 8 1. The time of the year when the well tests were performed, i.e., summer or winter.
 - 9 2. A detailed description examining how the tests were performed.
 - 10 3. A letter from the Arizona Department of Water Resources ("ADWR") indicating
11 ADWR's opinion as to the long term, continuous capacity (in GPM) of the K2
12 Well. Staff requests that the Company keep ADWR informed and supply ADWR
13 with any information ADWR may require in order for ADWR to supply such a
14 letter to the Commission.
- 15

16 **Q. What is the reason for this additional information?**

17 A. Staff is making the request at this time to inform all parties to this case as to what
18 minimum information Staff will be requesting in order for Staff to make a
19 recommendation to the Commission regarding the question of including the K2 Well
20 Project in rate base.

21
22 **Q. Does this conclude your testimony?**

23 A. Yes.