

EXCEPTION



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Arizona Corporation Commission

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2007 DEC 13 P 3: 21
 AZ CORP COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF)	DOCKET NO. WS-04235A-06-0303
UTILITY SOURCE, LLC FOR A)	
DETERMINATION OF THE CURRENT FAIR)	EXCEPTIONS TO
VALUE OF ITS UTILITY PROPERTY AND FOR)	RECOMMENDED OPINION
AN INCREASE IN ITS WATER AND)	AND ORDER
WASTEWATER RATES AND CHARGES FOR)	
UTILITY SERVICE.)	

Utility Source, LLC ("Utility Source" or the "Company"), by and through undersigned counsel, hereby files its Exceptions to the Recommended Opinion and Order issued December 4, 2007.

The critical flaw in the Recommended Opinion and Order ("ROO") is that it adopts entirely the Staff position which recommends rates that produce a negative Operating Margin for the Company. This is obviously an untenable position for a Company that is expected to provide any level of service to its customers.

The Staff, and the Administrative Law Judge as evidenced by the regurgitation set forth in the Background section of the ROO, seem to never want to forget, let alone forgive, the start-up history of this Company. The initial utility service to the area was through the homeowners association ("HOA"). As you know, the Arizona Constitution, at Article 15 Section 2, permits unregulated wastewater service to be provided by non-profit HOA's. At the time of commencing water service, it was not an uncommon practice of homeowners associations to provide water service along with unregulated wastewater service, and it is submitted that there still exist

1 numerous homeowners associations throughout the state providing such services that are not
2 regulated by the Commission. Staff seems to overlook the fact that the HOA's Covenant,
3 Conditions and Restrictions ("CC&R's") clearly state that the surrogate rates initially set for
4 those services were the utility rates of the City of Flagstaff which were to be adjusted annually
5 based upon the actual cost to the HOA of providing those services. Despite that, and the fact that
6 Staff's recommended rates in the initial Certificate of Convenience and Necessity case were
7 nearly as high as those requested by the Company in this proceeding, Staff appears to want to
8 continue to punish the Company for its past sins. The Company believes that is inappropriate,
9 and that that gratuitous discussion should be stricken.

10 As to the substance of the ROO, the record is clear. To provide water service to its
11 customers, the Company has invested literally millions of dollars to develop the 2,500 plus foot
12 deep wells to serve the existing CC&N area. Even then, all the costs of Well #4 are not included
13 in this case. To ameliorate the impact of that investment on current customers and at no small
14 risk to the Company, the Company has proposed "proforming", and the Staff has adopted,
15 inclusion of 350 nonexistent customers into the rate-making process to lessen the impact. This,
16 despite the fact that the record is clear that subsequent zoning changes provide for a maximum of
17 279 additional lots, not 350 lots, and with the present real estate market it is unlikely that many,
18 if any, of those pro forma customers will materialize in the next few years. Using standard
19 ratemaking procedures, the required increase without including the 350 pro forma customers
20 would have been in the neighborhood of 300%.

21 Further the ROO does not provide a reasonable return. The Applicant's Brief filed in this
22 docket discusses this extensively. The ROO blindly adopts the Staff's rate of return
23 recommendations. In addition to being too low, the ROO adopts a different return for the Water

1 and Wastewater Divisions, 6.23% and 8.9% respectively. The record clearly establishes how
2 Staff "backed into" the 6.23% rate of return it is recommending for the Water Division, after it
3 included Well # 4 in the Rate Base to match that plant with the 350 pro formed water customers.
4 This mathematical computation developed the exact revenue level of their previous
5 recommendation that did not include Well #4 in Rate Base. That return level of 6.23% clearly
6 does not recognize the risk associated with including 350 proformed customers. Even the
7 combined return on both Divisions of 7% is below the cost of debt established in this proceeding.
8 Moreover, the ROO adopts a combined rate of return over 200 basis points below returns
9 allowed by the Commission in recent similar cases.

10 All that said, the bottom line is that Staff's recommended rates, and those adopted by the
11 ROO, leave the Company in an Operating Loss position. This is inconsistent with the obligation
12 of the Commission to permit the Company to recovery its legitimate costs, let alone earn a return
13 on its investment.

14 WHEREFORE, Utility Source respectfully requests that the Commission refer this matter
15 back to the Hearing Division with the instruction to modify the ROO to adopt the Company's
16 proposed rates, or at a minimum, provide rates that permit the Company to recovery of the Staff's
17 approved operating costs and provide a reasonable Operating Margin.

18 Respectfully submitted this 13th day of December, 2007.

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

20 By: Richard L. Sallquist

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1 The original and fifteen copies
of the foregoing were filed
2 this 31 day of December, 2007:

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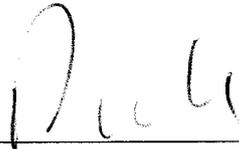
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