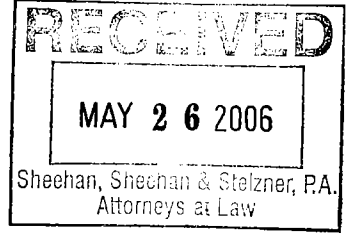


BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION



IN THE MATTER OF THE APPLICATION OF)
INDEPENDENT UTILITY COMPANY FOR APPROVAL)
TO ABANDON ASSETS AND RETAIN CERTAIN)
WATER RIGHTS; THE JOINT APPLICATION OF)
INDEPENDENT UTILITY COMPANY AND NEW MEXICO)
WATER SERVICE COMPANY FOR THE SEVERAL)
APPROVALS AND AUTHORIZATIONS REQUIRED IN)
CONNECTION WITH THE ACQUISITION OF)
INDEPENDENT UTILITY COMPANY'S ASSETS BY)
NEW MEXICO WATER SERVICE COMPANY; AND THE)
APPLICATION BY NEW MEXICO WATER SERVICE)
COMPANY FOR APPROVAL TO OPERATE CERTAIN)
WATER FACILITIES,)

Case No. 05-00208-UT

INDEPENDENT UTILITY COMPANY AND)
NEW MEXICO WATER SERVICE COMPANY,)

Applicants.)

and)

IN THE MATTER OF THE APPLICATION OF)
INDEPENDENT UTILITY COMPANY FOR APPROVAL)
OF WATER RATE INCREASE,)

Case No. 05-00305-UT

INDEPENDENT UTILITY COMPANY,)

Applicant.)

FINAL ORDER

THIS MATTER comes before the New Mexico Public Regulation Commission ("Commission") on the Recommended Decision of the Hearing Examiner issued by Marilyn S. Hebert on April 20, 2006. Having considered the Recommended Decision and the record in this case and being fully apprised in the premises, the Commission issues this Final Order.

STATEMENT ON THE CASE

The Commission adopts the Statement of the Case contained in the Recommended Decision through the April 20, 2006 date of issuance.

On May 3, 2006, New Mexico Water Service Company's ("NMWSC") Exceptions to the Recommended Decision of the Hearing Examiner was filed. On May 4, 2006, Henry Coors ("Coors") filed his Objections to the Recommended Decision of the Hearing Examiner.

On May 9, 2006, the Commission issued its Order Extending Suspension Period thereby extending the suspension period for the rates filed in this case by an additional three months from August 20, 2005 pursuant to the authority granted the Commission by NMSA 1978, Section 62-8-7.C (2003).

On May 12, 2006, Sandia Knolls Neighborhood Association's ("SKNA") Response to New Mexico Water Service Company Exceptions and Coors' Objections to the Recommended Decision of the Hearing Examiner was filed.

DISCUSSION

This consolidated case presents several issues that the Hearing Examiner fully discusses in the Recommended Decision. The Commission adopts the Hearing Examiner's Discussion and expands on that discussion with this Order.

Independent Utility Company ("IUC") provides water service to some 400 customers in Sandia Knolls and Juan Tomas subdivisions in Bernalillo County, New Mexico. IUC has been in bankruptcy since 2002 and has continued to provide service to its customers as a debtor-in-possession. Its system is badly in need of maintenance and repair due to years of neglect.

NMWSC is also a public utility that provides water and wastewater services in the Rio Communities and water services to Meadow Lakes Estates in Valencia County and

Elephant Butte Estates in Sierra County. It is a wholly owned subsidiary of California Water Services Group, Inc. whose business is the ownership of water and wastewater utilities.

On April 22, 2004, the Bankruptcy Court approved the sale of IUC's assets to NMWSC free and clear of liens and encumbrances. Thereafter, IUC and NMWSC filed their application docketed as Case No. 05-00208-UT seeking the Commission's approval for IUC to sell and NMWSC to acquire certain assets of IUC. NMWSC requests Commission approval to own and operate IUC as a public water utility pursuant to NMSA 1978, Sections 62-6-12.A and 62-6-13. IUC seeks to abandon its certificate of public convenience and necessity ("CCN") issued by the Commission pursuant to NMSA 1978, Section 62-9-5 in 1992. IUC seeks to abandon its facilities and retain and hold any water rights determined to be surplus. IUC and NMWSC also ask for a determination of whether IUC has any surplus water rights and a determination of rate base for the purposes of the acquisition. NMWSC seeks the issuance of an amended CCN pursuant to NMSA 1978, Sections 62-9-1 and 62-9-6 to include the ownership and operation of IUC's water facilities including any rate increase approved by the Commission.

IUC's abandonment of its CCN, the sale of the assets to NMWSC and the operation of the water utility by NMWSC were uncontested before the Hearing Examiner. The water system is in a state of disrepair and in need of professional management. NMWSC is part of one of the largest water system operating companies in the country already serving some 5,800 customers in New Mexico. The customers currently served by IUC will not see any interruption in their service due to the sale and abandonment since NMWSC will immediately take control. The only controversies involved in the sale and abandonment were the issues of surplus water rights and loan concerning Capital Concepts.

On July 16, 2005, IUC filed an application for a rate increase together with its advice notice that was docketed as Case No. 05-00305-UT. The Commission subsequently granted the motion of IUC and NMWSC to consolidate Case Nos. 05-00208-UT and 05-00305-UT. IUC requested approval of new rates that would increase Base Period revenues by 46.7% to be collected through monthly system and commodity charges. Because IUC's system is in disrepair and in need of substantial improvements, Staff agreed that a substantial rate increase is necessary. While Staff submitted that a rate increase of some 43.7% would ultimately be justified, they recommend a 33.1% increase now since certain improvements by NMWSC will not be implemented in time for consideration now. Staff recommended a revenue requirement of \$232,210 compared to IUC's proposal of \$255,860.

In its proposed findings of fact and conclusion of law, NMWSC stated that while it believed the rates proposed by IUC were justified, it would not object to Staff's proposal being adopted. The Hearing Examiner recommends adoption of Staff's proposed rate increase and rate design and the Commission accepts that recommendation.

The Exceptions filed by NMWSC pertain only to the issue of water rights. The Objections of Coors relate to water rights and a loan to IUC. The Response filed by SKNA supports the Recommended Decision and addresses water rights matters in the Exceptions of NMWSC and Coors' Objections.

Background-Water Rights

IUC owns 325 ace-feet of water rights in the Sandia Underground Water Basin and 15 acre-feet of water rights in the Estancia Underground Water Basin. The 325 acre-feet are used for Sandia Knolls while the 15 acre-feet are used for the two customers in Juan Tomas. In the Application filed in this matter on May 12, 2005, IUC

and NMWSC request that the Commission determine whether IUC has any surplus water rights. If the Commission determines there are surplus water rights, IUC and NMWSC propose that IUC hold such water rights, maintain such water rights in good standing and not to sell, lease or encumber the water rights determined to be surplus. If the Commission determines that IUC does not have any surplus water rights, all water rights held by IUC are to be included as water rights transferred from IUC to NMWSC under the Purchase Agreement with no additional compensation paid to IUC.

In the event the Commission determines there are surplus water rights, under the terms of the Purchase Agreement, IUC and NMWSC agree to a formula for payment to IUC's shareholders by NMWSC for such water rights. For a period of 10 years following the closing date, NMWSC would not pay an additional amount for surplus water rights put to use within IUC's existing service area, but will pay IUC's existing shareholders for surplus water rights put to use outside the existing service area at the prevailing market value of water rights in the Sandia Underground Water Basin. At the end of 10 years, NMWSC would pay IUC's existing shareholders 60% of the prevailing market rate for their remaining water rights in the Sandia Underground Water Basin.

The Hearing Examiner recommends that the Commission approve the acquisition of IUC's assets by NMWSC, including the entire 340 acre-feet of water rights owned by IUC. Therefore, the Hearing Examiner rejected the assertions by IUC, NMWSC and Coors that substantial portions of the water rights are surplus. As discussed herein, the Commission agrees with the Hearing Examiner's rationale contained in the Recommended Decision.

Exceptions

A wide range of estimates concerning the past, present and future water usage in Sandia Knolls were presented in this case. The parties and Staff did not agree on the acre-foot per year ("AFY") per customer of water rights that are sufficient for Sandia Knolls now or in the future using historic usage data. In fact, they could not even agree on the number of lots within the subdivision for their calculations. NMSWC believes there are a total of 524 lots of which approximately 397 are developed and provided with water service by IUC. Recommended Decision, p. 16. SKNC asserts that there are a total of 564 lots that can potentially need water service. Tr. 2/1/06 at 48.

Relying on historic usage, NMWSC asserts that 0.29 acre-feet per lot should remain with the utility and the remainder declared surplus.¹ Intervenor Entramosa Water and Wastewater Association presented testimony that between 0.24 and 0.32 acre-feet per year is the typical amount of water required per customer in the East Mountain Area. Coors testified that customers in Sandia Knolls use 0.227 acre-feet per year. SKNA presented testimony supporting 0.6 acre-feet per year as the correct amount per customer.² This wide range of opinions on usage demonstrates why the use of historic data is suspect and unreliable even if the parties could agree on the number of potential customers in Sandia Knolls.

Adding to the unreliable nature of historic usage patterns is IUC's history and status. IUC's record keeping, and therefore the data, is poor and suspect. Tr. 2/1/06 at 32-34. NMWSC witnesses testified that there had been no investigation into IUC's meter records or the procedures used by IUC to test meters, if any. Tr. 2/1/06 at 66-69.

¹ As noted on page 54 of the Recommended Decision, NMWSC originally present testimony supporting 0.25 AFY per customer plus a reserve factor of 15%.

² SKNA's evidence was based on water use calculations supported by guidance offered by the Bernalillo County Code and by the New Mexico Office of the State Engineer rather than historic data from IUC. Recommended Decision, pp. 33-34.

Further, the fiscal and financial condition of IUC, which filed for bankruptcy relief in 2002 and has been a debtor-in-possession since that time, is admittedly poor and the facilities inadequate and badly in need of repair. Tr. 2/1/06 at 32-34.

The Hearing Examiner further rejected the use of historic usage data because it does not take into account reasonable future factors that could increase water usage. Changes in circumstance such as the increased use of evaporative cooling, vacation homes becoming full-time residences, increased size of households and increased irrigation are cited by the Hearing Examiner to cast further doubt on the reliability of historic usage data.

The evidence presented by SKNA in this case gives further support for the rejection of historic data. SKNA's witness, a hydrologist and water-planning manager, used the New Mexico Office of the State Engineer's ("OSE") recommended methodology for estimating water use. The OSE methodology takes into account household use, outdoor use, fire protection and system losses. Recommended Decision, pp. 33-34. SKNA's witness concluded that using the OSE methodology, a water use calculation of 0.6 acre-feet per lot was needed to provide an adequate water supply for Sandia Knolls. SKNA also cited to the Bernalillo County Code as support of its position that 0.6 acre-feet per lot is the amount needed for an adequate supply.³

In its exceptions, NMWSC asserts that the Commission must use historical data because "the substantial weight of evidence, and indeed the only reliable evidence regarding the amount of water rights needed within the Sandia Knolls System, was 165 acre-feet, leaving 160 acre-feet of water rights surplus..." NMWSC's Exceptions also states that the "Recommended Decision ignores the weight of the evidence, relying

³ Bernalillo County Code Section 74-92 provides that the total annual water requirement for a subdivision in acre-feet is computed by multiplying the number of parcels by 0.6. Since Sandia Knolls was in existence when this Code provision was enacted, it does not apply to that subdivision.

instead on speculative proposals by one intervenor (SKNA) regarding vague and unsupported future needs.” However, it is historic data based on speculation, conjecture and suspect information that has been shown to be unreliable. While the Hearing Examiner certainly considered SKNA’s evidence, her recommendation does not rely solely on that evidence as NMWSC contends. Instead, the recommendation is sound and supported by substantial evidence.

NMWSC is correct that the Commission’s policy is that the public utility should own the water rights required to serve the utility’s customers base and that the public interest demands a safe, reliable and adequate supply of water when a utility is “changing hands.” NMWSC Exceptions, p.8. Substantial and reliable evidence was presented in this case supporting the Hearing Examiner’s recommendation that all water rights should be transferred from IUC to NMSWC to ensure a safe, reliable and adequate water supply.

In its Exceptions, NMWSC takes a “not to worry” approach to surplus water rights that remain with IUC. NMWSC notes that the Purchase Agreement provides that such water rights would be available for use in Sandia Knolls. NMWSC further states that surplus water rights would not be subject to any encumbrance and that IUC cannot take any action to diminish such rights without the consent of NMWSC. However, any water rights found to be “surplus” under the Purchase Agreement would remain with IUC which is still in bankruptcy. As the Hearing Examiner found, the parties were not sure what the effect of the bankruptcy proceeding could ultimately have on IUC’s ownership of water rights it retains. Creditors could attempt to have the water rights sold and attack the Purchase Agreement as an attempt to prevent liquidation of assets in derogation of creditor’s rights. Recommended Decision, p. 56.

The "Objections" filed by Coors are confusing and contain contradictions. Coors states that he does not take issue with the fact that all 325 acre-feet of water rights associated with Sandia Knolls should be owned by the operating utility. That is exactly what the Hearing Examiner found: all 325 acre-feet of water rights should be retained by the utility and no water rights are surplus. However, Coors then states that he takes issue with the Hearing Examiner's "failure to recognize that there are excess water rights." Coors' Objections, p.2. If water rights were found to be surplus, under the Purchase Agreement they would remain with IUC rather than under the ownership of the operating utility, NMWSC.

Coors also argues that if all 325 acre-feet of water rights stay with the operating utility (NMSWC), the water rights that are not actually being used could be declared abandoned by the State Engineer. Coors' Objections, pp. 2-3. However, the Hearing Examiner found that water rights could be deemed abandoned during a proceeding before the State Engineer requesting a change of place of production or use as opposed to maintaining the water rights with the utility. Recommended Decision, p.57. The water rights in question have not been found to be surplus and thus unused. Also, the water rights involved in this case are permitted rights recognized by the State Engineer as recently as 1998. Recommended Decision, pp.56-57. Further, if there is a question of nonuse of the water rights, NMSA 1978, Section 72-12-8(B) provides for an application process to extensions of time to put water rights to beneficial use.

Coors also objects to the "refusal" of the Hearing Examiner to address the extent of the lien of Capital Concepts on the assets of IUC. Coors' Objections, p.3. Coors states that this issue must be addressed because the nature and effect of a lien on a utility asset affects the utility. However, the Hearing Examiner spelled out how the Bankruptcy Court had declared the lien of Capital Concepts to be void as to the utility

assets being sold. Recommended Decision, p.58. The Hearing Examiner concluded as follows: "Neither the existence or amount of the Capital Concepts loan is relevant to the utility, as the loan no longer burdens or affects the utility or its ratepayers."

The Commission concludes that NMWSC's Exception and Coors' Objections are not well taken and are rejected. The Recommended Decision of the Hearing Examiner concerning the matters contained in said Exceptions and Objections is well taken and will be adopted by the Commission. The Commission finds that all water rights became dedicated to public service at the time the State Engineer declared them for the use of the water utility and they shall remain with the utility.

THE COMMISSION FINDS AND CONCLUDES:

1. The Commission has jurisdiction over the parties and the subject matter of this case.
2. The Recommended Decision of the Hearing Examiner is well taken and should be adopted.
3. The Statement of the Case, Discussion, and all findings and conclusions contained in the Recommended Decision are incorporated by reference as if set forth herein, and are adopted, approved and accepted as Findings and Conclusions of the Commission.
4. NMWSC's Exceptions and Coors' Objections are not well taken and are rejected.

IT IS THEREFORE ORDERED:

- A. The Orders or Decretal Paragraphs contained in the Recommended Decision are incorporated by reference as if set forth herein, and are ADOPTED, APPROVED and ACCEPTED as Orders of the Commission.

B. The Recommended Decision is ADOPTED, APPROVED and ACCEPTED in its entirety.

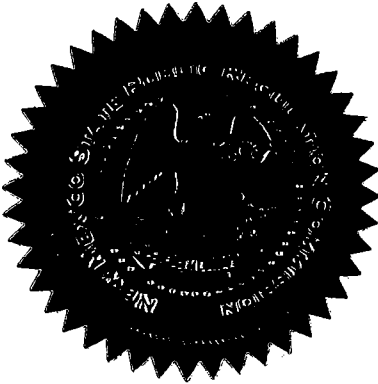
C. This Order is effective immediately.


D. Copies of this Order shall be mailed to all persons listed on the attached Certificate of Service.

E. This docket is closed.

ISSUED at Santa Fe, New Mexico this 23rd day of May, 2006

NEW MEXICO PUBLIC REGULATION COMMISSION





BEN R. LUJAN, CHAIRMAN

TELEPHONICALLY APPROVED

JASON MARKS, VICE CHAIRMAN



DAVID W. KING, COMMISSIONER

TELEPHONICALLY APPROVED

LYNDA M. LOVEJOY, COMMISSIONER



E. SHIRLEY BACA, COMMISSIONER

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF)
INDEPENDENT UTILITY COMPANY FOR APPROVAL)
TO ABANDON ASSETS AND RETAIN CERTAIN)
WATER RIGHTS; THE JOINT APPLICATION OF)
INDEPENDENT UTILITY COMPANY AND NEW MEXICO)
WATER SERVICE COMPANY FOR THE SEVERAL)
APPROVALS AND AUTHORIZATIONS REQUIRED IN)
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NEW MEXICO WATER SERVICE COMPANY; AND THE)
APPLICATION BY NEW MEXICO WATER SERVICE)
COMPANY FOR APPROVAL TO OPERATE CERTAIN)
WATER FACILITIES,)

INDEPENDENT UTILITY COMPANY AND)
NEW MEXICO WATER SERVICE COMPANY,)

Applicants.)

and)

IN THE MATTER OF THE APPLICATION OF INDEPENDENT)
UTILITY COMPANY FOR APPROVAL OF WATER RATE) Case No. 05-00305-UT
INCREASE,)

INDEPENDENT UTILITY COMPANY,)

Applicant.)

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing **Final Order**,
issued May 23, 2006, was mailed first-class, postage pre-paid, to each of the following:

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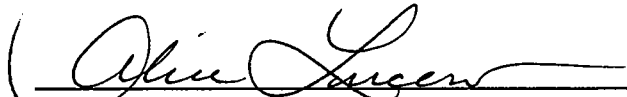
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DATED this 23rd day of May, 2006.

NEW MEXICO PUBLIC REGULATION COMMISSION



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