

**PINE CREEK CANYON  
DOMESTIC WATER IMPROVEMENT DISTRICT  
PCCDWID**

Post Office Box 945 Pine, Arizona 85544

Memorandum

January 22, 2008

To: All PCCDWID Customers

From: PCCDWID Chairman, Brian Reinke

**RE: Lawsuit Filed Against the Pine Creek Canyon Domestic Water Improvement District and Resulting Financial Needs of the District to Defend Itself**

Dear Water and Wastewater Service Customer,

Please find attached a memorandum from Mr. Michael Kafka of Ryley Carlock & Applewhite, the District's legal counsel, concerning the status of legal actions recently taken by DNW Holdings / Portal IV LLC (aka the "Anasazi Hills" Developer) against the Pine Creek Canyon Domestic Water Improvement District. The District requested the preparation of the document such that each of you would understand the circumstances facing your water/wastewater service provider. **Please review this important memorandum as the District must consider how to both ensure the continued operation of the water and wastewater facilities, while at the same time, attempt to defend itself, all in the best interest of you, our customer.**

The costs of defending the District against the legal claims filed by DNW Holdings / Portal IV LLC are expected to be substantial. Therefore, the PCCDWID is considering a special assessment of \$1,500 per lot based on the authority granted the District pursuant to A.R.S. § 48-952.7. The Board does not wish to place a burden on its members, but if the District is to defend itself from the claims of DNW / Portal IV LLC, such an assessment will be required. Failure to make the assessment may force the District into a position that is adverse to your and the District's interests.

The Board of Directors of the District intends to hold a special meeting on February 10th, 2007 for purposes of considering this assessment along with your input.

Thank you for your time and understanding.

928.476.2260 E-mail: pccdwid@qwest.net

---

**Memorandum**

ATTORNEYS  
**Ryley Carlock & Applewhite**  
A PROFESSIONAL ASSOCIATION

Date: January 20, 2007

To: Members of Pine Creek Canyon Domestic Water Improvement District

From: Michael T. Kafica

Subject: Notice Regarding Litigation between Pine Creek Canyon Domestic Water Improvement District and DNW Holdings, LLC

The Board of Directors (the "Board") of Pine Creek Canyon Domestic Water Improvement District (the "District") has determined that it would be in the best interest of all District members (the "Members") to provide notice of the pending litigation between the District and DNW Holdings, LLC ("DNW"). Accordingly, this memorandum provides a brief summary of events leading up to the litigation and how the District plans to proceed.

DNW is the successor-in-interest to Portal IV, LLC ("Portal IV") and the developer of Anasazi Hills. DNW has stated that it intends to develop ten residential lots located within Tract "D" of the District. On February 20, 1996, Portal IV petitioned the Gila County Board of Supervisors to establish the District. As part of that formation, Portal IV entered into two Grant Agreements with the District, the first dated March 1, 1998, and the second dated October 1, 1999. Through the Grant Agreements Portal IV agreed to convey certain real and personal property to the District in exchange for a commitment to provide water and wastewater service to all the Members.

In April 2006, DNW filed with the District an application for interconnection, which included certain deficiencies of which DNW was informed. As part of the District's Interconnection Process, DNW was required to submit funds to the District in payment of an interconnection study necessary to determine the impact of DNW's interconnection on the District in terms of technical expansion requirements, costs associated with the expansion, changes to operating and maintenance requirements, and associated impact on the District's rate structure. As of the date of this memorandum, DNW has refused to pay the costs of this hydrologic study, which is essential prior to the District's commitment to interconnect Anasazi Hills with the District's water and wastewater systems.

On August 23, 2006, DNW's counsel sent the District a letter again requesting the District's commitment to serve Anasazi Hills. In that letter, DNW's counsel stated that "[t]he District must serve this subdivision with any and all water pumped from any and all wells owned by the District as well as to [sic] keep any existing or planned water storage units full and to serve the actual water use demands of the property owners of Portal IV." It is DNW's position that, through the Grant Agreements, DNW somehow holds a "special position" in relation to other Members and, therefore, the District is obligated to provide service to DNW on a priority basis and outside the District's Interconnection Process. The District disagrees.

742160.2

1/20/2007

---

The purpose of the District's interconnection study is to determine how the current system will be impacted by the additional hookups requested by DNW. Until such time that the District is adequately certain of its current water supply situation, it cannot commit to the interconnection requested by DNW. It is the Board's position that the District has an obligation to serve, which is shared equally among all members. As stated in the amended Portal Pine Creek Canyon, Unit IV, Public Report: The District shall "have responsibility for the operation of the existing water improvements in a manner necessary to preserve the integrity of the existing wells and concurrently serve the lot owners." By requiring interconnection applicants to follow the Interconnection Process, the District is ensuring the continued

operation of its existing facilities and the integrity thereof, as well as fulfilling its obligation to provide quality service to its customers, current and new alike.

On October 16, 2006, DNW and Portal IV filed two lawsuits against the District. As concerning the District, the first lawsuit asks the court to order the District to transfer interest in certain property within the District that Portal IV had previously conveyed to the District. It also alleges that the District breached a contractual duty to Portal IV by "refusing to deliver water and waste water services to [Portal IV] and its member, DNW." The second lawsuit is a Petition for Special Action requesting that the court order the District to furnish DNW with water and wastewater service. The District strenuously disagrees with the allegations contained in these lawsuits. On December 14, 2006 we filed the District's Answer in the second lawsuit.

Prior to filing its Answers, on December 5, the District's Chairman, Brian Reinke, its Manager, Michael Ploughe, and its attorneys met in good faith with members of DNW and its legal counsel to negotiate a global settlement of both lawsuits. However, the District was unable to resolve either lawsuit. Subsequent good faith efforts by the District to resolve the litigation have been soundly rejected by DNW.

Fortunately, the District's insurance carrier has agreed to defend the District with respect to the first lawsuit and has filed an Answer on behalf of the District. However, no coverage is available for the Petition for Special Action (the second lawsuit) because no monetary damages are being requested by DNW. The District intends to continue to defend itself in both lawsuits.