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7 **BEFORE THE ARIZONA CORPORATION COMMISSION**

9 **COMMISSIONERS**

10 GARY PIERCE, CHAIRMAN
11 PAUL NEWMAN
12 SANDRA D. KENNEDY
13 BOB STUMP
14 BRENDA BURNS

Arizona Corporation Commission
DOCKETED

SEP 05 2012

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15 **IN THE MATTER OF THE**
16 **APPLICATION OF CLEAR SPRINGS**
17 **UTILITY CO., INC., FOR AN**
18 **INCREASE IN RATES**

Docket Nos. W-01689A-11-0401
W-01689A-11-0402
WS

**CLEAR SPRING'S RESPONSE TO
STAFF'S CLOSING BRIEF**

19 **and**

20 **IN THE MATTER OF THE**
21 **APPLICATION OF CLEAR SPRINGS**
22 **UTILITY CO., INC., FOR AUTHORITY**
23 **TO INCUR LONG-TERM DEBT**

24
25 Clear Springs Utility Co., Inc. ("Company"), hereby files its response to Staff's
26 Closing Brief, addressing the accounting treatment of the income gained to pay the Debt
27 Service Reserve Fund ("DSRF") required under the proposed Water Infrastructure
28 Finance Authority ("WIFA") loan.

1 **I. DSRF BENEFITS WIFA, NOT THE COMPANY OWNER.**

2 WIFA's standard loan agreement requires companies to assign to WIFA all of
3 their interests in the DSRF. Cash Collateral Agreement, ¶ 3 (*see* Attachment 1).¹ "The
4 Debt Service Reserve Fund and all amounts deposited therein shall be held in the sole
5 dominion and control of [WIFA] and shall be administered by [WIFA] as a collateral
6 account for the benefit of [WIFA], and [company] shall have no rights or powers with
7 respect to, or control over, the Debt Service Reserve Fund or any part thereof." Cash
8 Collateral Agreement 4(a) (emphasis added). Once the DSRF is equal to the amount the
9 company owes, WIFA "shall: Apply the Debt Service Reserve Fund to pay in full all
10 amounts payable by Borrower under this Agreement." Loan Agreement Ex. D, § 1 (e)(i)
11 (emphasis added) (*see* Attachment 2).²

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15 Accordingly, for the first five years of a loan, in addition to the principal and
16 interest, WIFA requires borrowers to pay the DSRF. The DSRF amounts to 20% of the
17 annual principal and interest. If the annual principal and interest payment were totaled
18 \$100,000, then the required DSRF payment would be \$20,000 and the borrower would
19 have to pay WIFA \$120,000 for the first five years of the loan. By the end of the fifth
20 year, the DSRF would total \$100,000, which is equal to one year's principal and interest
21 payment. In approximately 19 years, the DSRF should be equal the amount remaining on
22 the WIFA loan, and WIFA would apply the DSRF to the loan balance. In other words,
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28 ¹ The Company moves the Court to admit this document as a late-filed exhibit.

² The Company moves the Court to admit this document as a late-filed exhibit.

1 WIFA holds the DSRF for 19 years and then uses those funds to pay the last year of the
2 loan.

3
4 In spite of these express terms in the WIFA loan documents, Staff argues “the
5 DSRF is essentially a savings account that accumulates to the direct benefit of the utility
6 owners.” Staff’s Closing Brief at p. 2, lines 3-4. Staff’s assertion that the DSRF is
7 analogous to a company owner’s savings account is simply wrong. In contrast to a
8 savings account, the company owner has no control over the DSRF and should never
9 receive money from it (except the small amount of money “left over” after WIFA used
10 the DSRF to pay the loan balance). As the Cash Collateral Agreement expressly states,
11 the DSRF is an account that “shall be administered” by WIFA “for the benefit of” WIFA,
12 not the company’s owner. Further, as the loan term ends, WIFA keeps the money and
13 pays itself the balance of the loan; it does not give the money to the company. If there is
14 a bank that manages savings accounts this way, rest assured the Company will not be
15 banking there.

16 **II DISCLAIMED ARGUMENT HAS NO MERIT**

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21 A.R.C.P. Rule 11(a) requires that every pleading be warranted by existing law or
22 offer a good faith argument to change or extend the law. Arguments asserted without
23 legal authority should not be considered. *In re \$26,980.00 U.S. Currency*, 199 Ariz. 291,
24 ¶ 28, 18 P.3d 85, 93 (App.2000).

25
26 Here, Staff’s Closing Brief does not present any authority in support of its
27 argument. In fact, Staff disclaims the argument. Staff expressly states, “[t]he foregoing
28 analysis is for informational purposes only and should in no way or manner be construed

1 as legal advice.” See Staff’s Closing Brief at p. 2, n. 1. So on one hand, Staff is telling
2 this Court that it should require the Company as a matter of law to collect income and
3 treat it as a regulatory debt. On the other hand, Staff is telling this Court that its entire
4 argument is for informational purposes only and disclaims that its argument may or may
5 not be correct.
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8 Nowhere in the Closing Brief is there a citation to legal authority or evidence that
9 supports its position. In fact, besides the attorney’s argument, the only other citation is to
10 late-filed Exhibit S-8, which includes an “Illustrative Journal Entries as T-Accounts” and
11 “Illustrative Journal Entries – Year 1”. Clearly, presented with nothing more than
12 unsupported legal argument and illustrations, the argument should not be adopted. More
13 importantly, the fact that Staff’s attorneys felt it was necessary to disclaim the argument
14 makes it abundantly clear that this Court should not require the Company to follow this
15 recommendation.
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18 **III. COMPANY WOULD INCUR SUBSTANTIAL ACCOUNTING COSTS**

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20 Finally, Staff’s recommendation would require the Company to spend thousands
21 of dollars on both a regulatory accountant and a tax accountant to try and stay compliant
22 with this recommendation while not committing tax evasion. This small water company
23 is not staffed with accountants, so it will have to pay two specialized accountants to
24 review the records annually to try and abide by this proposed rule and the federal and
25 state tax codes. The high cost of these professionals will necessarily be included in rates
26 as soon as practical at a much higher cost than whatever small savings Staff believes will
27 flow to the customers in 20 years.
28

1 **IV. CONCLUSION**

2 Therefore, the Company moves this Court to not adopt Staff's recommendation
3 that the income collected to pay the DSRF be treated as an expense.
4

5 Dated this 5th day of September, 2012.

6 **MOYES SELLERS & HENDRICKS LTD.**

7
8 
9 _____
10 Steve Wene

11 Original and 13 copies of the foregoing
12 filed this 5th day of September, 2012 with:

13 Docket Control
14 Arizona Corporation Commission
15 1200 West Washington
16 Phoenix, Arizona 85007

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ATTACHMENT 1

CASH COLLATERAL AGREEMENT

This Cash Collateral Agreement is made as of TBD 2012 between [REDACTED] Water Company ("Pledgor"), and Water Infrastructure Finance Authority of Arizona ("Lender").

RECITALS:

A. Pledgor and Lender have entered into that certain Loan Agreement of even date herewith (the "Loan Agreement"), pursuant to which Lender has made available to Pledgor a loan of up to thirty thousand dollars (\$30,000) (the "Loan").

B. Pursuant to the Loan Agreement, certain funds are required to be deposited from time to time by Pledgor in a Debt Service Reserve Fund administered by the Lender and in a Replacement Reserve Fund administered by the Borrower, both of which are pledged to Lender to secure repayment with interest of the Loan. Amounts deposited with the Lender in the Debt Service Reserve Fund and in the Replacement Reserve Fund are referred to herein as the "Pledged Funds".

C. Pledgor and Lender desire to enter into this Cash Collateral Agreement to provide for the deposit and holding of the Pledged Funds.

D. The Loan Agreement, this Cash Collateral Agreement and all other documents securing or otherwise relating to the Loan shall be referred to collectively in this Cash Collateral Agreement as the "Loan Documents". All capitalized terms used in this Cash Collateral Agreement and not otherwise defined shall have the meanings given to such terms in the Loan Agreement.

E. It is a condition to the making of the Loan that Pledgor and Lender enter into this Cash Collateral Agreement.

NOW, THEREFORE, in order to induce Lender to make the Loan and in consideration thereof, Pledgor and Lender agree as follows:

1. Definitions. The following terms shall have the following meanings:

"Cash Collateral Agreement" means this Cash Collateral Agreement, as the same may be amended, supplemented or otherwise modified from time to time.

"Debt Service Reserve Fund" shall have the meaning ascribed thereto in Section 2 hereof.

"Obligations" shall mean all the obligations of Pledgor to Lender under the Loan Agreement and the Note and all other obligations and liabilities of Pledgor to Lender, whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter incurred, arising under, out of, or in connection with, the Loan Agreement, this Cash Collateral Agreement or any of the Loan Documents.

"Pledged Funds" shall mean as defined in the Recitals to this Agreement.

"Replacement Reserve Fund" shall have the meaning ascribed thereto in Section 2 hereof.

2. Establishment of Debt Service Reserve Fund and Replacement Reserve Fund. Pledgor and Lender agree that concurrently with the execution and delivery of this Cash Collateral Agreement there is established and shall be maintained a Debt Service Reserve Fund pursuant to the Loan Agreement. At such time as is required pursuant to the Loan Agreement Borrower shall establish a Replacement Reserve Fund in the name of Borrower in which there shall be deposited by Pledgor all Pledged Funds as required by the provisions of the Loan Agreement.

3. Grant of Security Interest. As collateral security for the prompt and complete payment when due of all the Obligations, Pledgor has granted, bargained, sold, assigned, pledged, and set over and by these presents does hereby grant, bargain, sell, assign, pledge, transfer and set over unto the Lender, and its successors and assigns, all of Pledgor's right, title and interest in and to any Pledged Funds now or hereafter held or deposited in the Debt Service Reserve Fund and the Replacement Reserve Fund.

4. Terms and Conditions.

(a) The Debt Service Reserve Fund and all amounts deposited therein shall be held in the sole dominion and control of Lender and shall be administered by the Lender as a collateral account for the benefit of Lender, and Pledgor shall have no rights or powers with respect to, or control over, the Debt Service Reserve Fund or any part thereof. Pledgor's sole right with respect to the Pledged Funds in the Debt Service Reserve Fund shall be as provided herein and in the Loan Agreement.

(b) If no Event of Default, and no event which with the giving of notice or the passage of time or both could become an Event of Default, has occurred and is continuing, Pledgor from time to time may withdraw moneys from the Replacement Reserve Fund and apply the moneys withdrawn for one or more of the following purposes: (i) for the acquisition of new, or the replacement of obsolete or worn out, machinery, equipment, furniture, fixtures or other personal property for the Facility provided that the property is depreciable; (ii) for the performance of repairs with respect to the Facility which are of an extraordinary and non-recurring nature provided that the property is depreciable; (iii) for the acquisition or construction of additions to or improvements, extensions or enlargements to, or remodeling of, the Facility provided that the property is depreciable; and/or (iv) to make payments to Lender on the Loan.

(c) From and after the occurrence and during the continuation of an Event of Default, Lender may, in the sole and absolute discretion of Lender, apply the Pledged Funds in the Debt Service Reserve Fund, and, if there are insufficient Pledged Funds in the Debt Service Reserve Fund, in the Replacement Reserve Fund, to the Obligations in the following order: (i) all outstanding costs, expenses, fees and late charges due to Lender, (ii) interest at the rate or rates specified in the Loan Documents and (iii) the principal amount of the Obligations. All interest and other investment earnings amounts from time to time accrued and paid on the Pledged Funds in the Debt Service Reserve Fund and the Replacement Reserve Fund shall be retained in the Debt Service Reserve Fund

and the Replacement Reserve Fund and shall be applied in accordance with the Loan Agreement and this Cash Collateral Agreement.

(d) Lender shall have, with respect to the Pledged Funds, all rights and remedies of a secured party under Article 9 of the Arizona Uniform Commercial Code and other applicable laws.

5. Further Assurances. Pledgor will, at any time and from time to time, execute and deliver such further documents and do such further acts as shall be required by law or be reasonably requested by Lender to confirm or further assure the interest of Lender hereunder.

6. No Liability for Lawful Actions. Neither Lender nor any of its officers, directors, employees, agents, attorneys-in-fact or affiliates shall be liable for any action lawfully taken or omitted to be taken by any of them under or in connection with this Cash Collateral Agreement (except for gross negligence or willful misconduct).

7. Notices. All notices, requests, demands or other communications to or upon the parties hereto shall be deemed to have been given or made when mailed, delivered or transmitted in accordance with the requirements of the Loan Documents.

8. No Failure, etc. No failure to exercise and no delay in exercising on the part of Lender of any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or privilege preclude any other or further exercise thereof, or the exercise of any other power or right. The rights and remedies herein provided are cumulative and not exclusive of any rights or remedies provided by law.

9. Waiver; Amendments. None of the terms and provisions of this Cash Collateral Agreement may be waived, altered, modified or amended except by an instrument in writing executed by the parties hereto.

10. Representations and Warranties; Covenants.

(a) Pledgor hereby represents and warrants to Lender, effective upon the date hereof and each deposit of Pledged Funds to the Debt Service Reserve Fund and the Replacement Reserve Fund, that:

(i) No filing, recordation, registration or declaration with or notice to any person or entity is required in connection with the execution, delivery and performance of this Cash Collateral Agreement by Pledgor or in order to preserve or perfect the first priority lien and charge intended to be created hereunder in the Pledged Funds.

(ii) Except for the security interest granted to Lender pursuant to this Cash Collateral Agreement, Pledgor is the sole owner of the Pledged Funds, having good and marketable title thereto, free and clear of any and all mortgages, liens, security interests, encumbrances, claims or rights of others.

(iii) No security agreement, financing statement, equivalent security or lien instrument or continuation statement covering all or any part of the Pledged Funds is on file or of record in any public office, except such as may have been filed by Pledgor in favor of Lender.

(iv) This Cash Collateral Agreement constitutes a valid and continuing first lien on and first security interest in the Pledged Funds in favor of Lender, prior to all other liens, encumbrances, security interests and rights of others, and is enforceable as such as against creditors of and purchasers from Pledgor.

(b) Without the prior written consent of Lender, Pledgor hereby covenants and agrees that it will not sell, assign, transfer, exchange or otherwise dispose of, or grant any option with respect to, the Pledged Funds, nor will it create, incur or permit to exist any pledge, lien, mortgage, hypothecation, security interest, charge, option or any other encumbrance with respect to any of the Pledged Funds, or any interest therein, except for the security interest provided for by this Cash Collateral Agreement.

(c) Pledgor hereby covenants and agrees that it will defend Lender's right, title and security interest in and to the Pledged Funds against the claims and demands of all persons whomsoever except to the extent which arise out of the willful misconduct or gross negligence of Lender.

11. Lender's Expenses and Liabilities. Pledgor shall pay all costs and out-of-pocket reasonable expenses of Lender in connection with the maintenance and operation of this Cash Collateral Agreement made in accordance with the terms hereof. Pledgor also agrees to pay all costs of Lender, including reasonable attorneys' fees, incurred with respect to the enforcement of Lender's rights hereunder.

12. Governing Law. This Cash Collateral Agreement shall be deemed to be a contract under, and for all purposes shall be governed by, and construed and interpreted in accordance with, the law of the State of Arizona.

13. Severability. Any provision of this Cash Collateral Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

14. Successors and Assigns. This Cash Collateral Agreement and all obligations of Pledgor hereunder shall be binding upon the successors or assigns of Pledgor, and shall, together with the rights and remedies of Lender hereunder, inure to the benefit of Lender and its successors and assigns.

15. Termination. This Agreement shall terminate and, upon request of Pledgor, all monies (if any) remaining in the Debt Service Reserve Fund and the Replacement Reserve Fund shall be returned to Pledgor at such time as all of the following have occurred: (i) all amounts payable to Lender under the Loan Documents have been paid in full and all other obligations of Pledgor to Lender pursuant to

the Loan Agreement have been performed in full, and (ii) Lender has no further obligation to make any loans or advances to Pledgor pursuant to the Loan Agreement or any of the other Loan Documents.

16. Counterparts. This Agreement may be executed in counterparts, all of which executed counterparts shall together constitute a single document. Signature pages may be detached from the counterparts and attached to a single copy of this Agreement to form physically one document.

IN WITNESS WHEREOF, the parties hereto have executed or caused this instrument to be duly executed and delivered as of the date first above written.

Pledgor:  Water Company

By: _____
Name: 
Title: Owner

Lender: Water Infrastructure Finance Authority of Arizona

By: _____
Executive Director

ATTACHMENT 2

[REDACTED] Water Company and
Water Infrastructure Finance Authority of Arizona

Loan Agreement

Borrower's Copy – Table of Contents

<u>Document</u>	<u>Tab</u>
[REDACTED] Water Company's Borrowing Resolution	1.
WIFA Board Resolution	2.
Loan Agreement.....	3.
Loan Agreement Addendum-Wage Rate Requirements for Compliance with P.L. 111-88	4.
Exhibit A: Financial Assistance Terms and Conditions	5.
Exhibit B: Technical Terms and Conditions.....	6.
Exhibit C: Reporting Requirements.....	7.
Exhibit D: Debt Service Reserve and Replacement Reserve Provisions.....	8.
Exhibit E: Limits on Additional Indebtedness without Lender Consent	9.
Exhibit F: Form of Promissory Note	10.
Exhibit G: Form of Opinion of Counsel to Borrower.....	11.
Exhibit H: Borrower Disclosure	12.
Loan Agreement Standard Terms and Conditions.....	13.
Subordination Agreement	14.
Cash Collateral Agreement.....	15.
UCC Financing Statement	16.
Continuing Security Agreement	17.
WIFA Disbursement Requisition Procedures and Payment Requisitions (on CD)	

Exhibit D

Debt Service Reserve And Replacement Reserve Requirements

Section 1. Debt Service Reserve Fund.

(a) There is established and maintained a Debt Service Reserve Fund held by the Lender. The deposits required pursuant to this Exhibit shall be automatically debited from the Borrower Deposit Account along with Borrower's regularly scheduled payments of principal and interest. The amount allocated to the Debt Service Reserve Fund shall be administered and invested by the Lender and allocated to the Borrower (the "Debt Service Reserve Fund"). Amounts therein shall secure payment to Lender of Loan repayments payable under the Loan Documents. The regularly scheduled deposits into the Debt Service Reserve Fund shall be in an amount, as determined by Lender, so as to accumulate over five (5) years an amount equal to the highest amount of Loan repayments by Borrower in any fiscal year as shown in the Loan repayment schedule, which Borrower and Lender agree is the initial amount of the debt service reserve requirement (the "Debt Service Reserve Requirement") for the Loan. Initially, the amount of the Debt Service Reserve Requirement and the amount of the required periodic build up are set forth in Exhibit A. The amount of the Debt Service Reserve Requirement and the amount of the required periodic build up will be adjusted to reflect any adjustment of the Loan repayment schedule.

(b) For so long as the Loan is outstanding, if on any Interest Payment Date or Principal Repayment Date Borrower has not paid to Lender an amount equal to the amount of principal and interest due on the Loan pursuant to this Agreement, Borrower hereby consents and directs the Lender to transfer, the amount of the deficiency from the Debt Service Reserve Fund to the payment of any amounts due. Borrower shall then cause to be delivered to Lender for deposit to the Debt Service Reserve Fund after provision is made for payment of amounts which have become due under this Agreement an amount sufficient to cause the amount credited to the Debt Service Reserve Fund to be at least equal to the amount then required to be on deposit therein.

(c) The Lender may commingle funds of Borrower with other funds but shall keep adequate and accurate records of moneys and investment earnings on amounts credited to the Debt Service Reserve Fund. Borrower shall pay the reasonable fees and charges of the Lender for administering the Debt Service Reserve Fund from investment earnings on amounts credited to the Debt Service Reserve Fund in an amount not to exceed 10% of investment earnings.

(d) Not less than annually, Lender shall deliver to Borrower an accounting of the Debt Service Reserve Fund, indicating the principal amount therein, and net annual investment earnings (investment earnings less administrative costs and fees pursuant to Clause (c) of this Section) (the "Net Earnings"). Net Earnings shall be applied not less than annually as a prepayment of principal.

(e) Subject to subsections (a), (b), (c), and (d) of this Section, when the Debt Service Reserve Fund is equal to or greater than the amounts due from the Borrower, the Lender shall:

- (i) Apply the Debt Service Reserve Fund to pay in full all amounts payable by Borrower under this Agreement.
- (ii) Transfer to Borrower all monies remaining in the Debt Service Reserve Fund after payment in full of all amounts payable by Borrower.

Section 2. Replacement Reserve Fund.

(a) Borrower shall establish a separate account to secure payment to Lender of Loan repayments payable under the Loan Documents (the "Replacement Reserve Fund"). The Replacement Reserve Fund shall be held and administered by the Borrower in an account which is acceptable to Lender pursuant to the provisions of the Agreement. Borrower shall cause to be deposited on or before the first business day of each month commencing with the sixty-first (61st) month following the month in which the first Advance occurs amounts at least equal to one-twelfth (1/12th) of twenty percent (20%) of the highest amount of Loan repayments by Borrower in any fiscal year as shown in the Loan repayment schedule. Initially, the amount of the required monthly deposit and the aggregate annual deposits are set forth in Exhibit A. The amount of the required monthly deposit will be adjusted to reflect any adjustment of the Loan repayment schedule.

(b) For so long as the Loan is outstanding, if no Event of Default, and no event or occurrence which, with the giving of notice or the passage of time or both, would become an Event of Default (an "Unmatured Event of Default"), has occurred and is continuing, Borrower from time to time may withdraw moneys from the Replacement Reserve Fund and apply the moneys withdrawn for one or more of the following purposes: (i) for the acquisition of new, or the replacement of obsolete or worn out, machinery, equipment, furniture, fixtures or other personal property for the drinking water system provided that the property is depreciable; (ii) for the performance of repairs with respect to the drinking water system which are of an extraordinary and non-recurring nature provided that the property is depreciable; (iii) for the acquisition or construction of additions to or improvements, extensions or enlargements to, or remodeling of, the drinking water system provided that the property is depreciable; and/or (iv) to make payments to Lender on the Loan.

(c) For so long as the Loan is outstanding, if on any Interest Payment Date or Principal Repayment Date Borrower has not paid to Lender an amount equal to the amount of principal and interest due on the Loan pursuant to this Agreement, and the Debt Service Reserve Fund does not hold sufficient moneys to cover the deficiency, Lender will direct the Borrower to transfer, and Borrower hereby consents to transfer, the amount of the deficiency from the Replacement Reserve Fund to Lender.

(d) The Lender shall require that the Borrower shall keep adequate and accurate records of moneys, investments and investment earnings on amounts credited to the Replacement Reserve Fund. Lender shall have the right to audit the records of the Borrower insofar as they pertain to the Replacement Reserve Fund.

Section 3. Debt Service Reserve Fund and Replacement Reserve Fund as Collateral.

(a) Grant of Security Interest. As collateral security for the prompt and complete payment when due of all obligations of the Borrower to the Lender under the Agreement and the Note and all other obligations and liabilities of the Borrower to the Lender, whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter incurred, arising under, out of, or in connection with, the Agreement or any of the Loan Documents (the "Obligations"), Borrower has granted, bargained, sold, assigned, pledged, and set over and by these presents does hereby grant, bargain, sell, assign, pledge, transfer and set over unto the Lender, and its successors and assigns, all of the Borrower's right, title and interest in and to any amounts held or deposited in the Debt Service Reserve Fund and in the Replacement Reserve Fund (the "Pledged Funds").

(b) Terms and Conditions.

(i) The Debt Service Reserve Fund and all amounts deposited therein shall be held in the sole dominion and control of the Lender and shall be administered by the Lender as a collateral account for the benefit of the Lender, and Borrower shall have no rights or powers with respect to, or control over, the Debt Service Reserve Fund or any part thereof. Borrower's sole right with respect to the Pledged Funds in the Debt Service Reserve Fund shall be as provided in the Agreement.

(ii) From and after the occurrence and during the continuation of an Event of Default, Lender may, in the sole and absolute discretion of the Lender, apply the Pledged Funds in the Debt Service Reserve Fund, and, if there are insufficient Pledged Funds in the Debt Service Reserve Fund, in the Replacement Reserve Fund, to the Obligations in the following order: (i) all outstanding costs, expenses, fees and late charges due the Lender, (ii) interest at the rate or rates specified in the Loan Documents and (iii) the principal amount of the Obligations. All interest and other investment earnings amounts from time to time accrued and paid on the Pledged Funds in the Debt Service Reserve Fund and the Replacement Reserve Fund shall be retained in the Debt Service Reserve Fund and the Replacement Reserve Fund and shall be applied in accordance with the Agreement.

(iii) Lender shall have, with respect to the Pledged Funds, all rights and remedies of a secured party under Article 9 of the Arizona Uniform Commercial Code and other applicable laws.

Section 4. Representations, Warranties and Covenants.

(a) Borrower agrees to establish upon closing and maintain the Debt Service Reserve Fund and the Replacement Reserve Fund in accordance with the provisions of the Agreement.

(b) The Borrower covenants that it will not apply, or permit the application of, amounts on deposit in, or required by the provisions of this Agreement to be on deposit in, the Debt Service Reserve Fund and/or the Replacement Reserve Fund except in accordance with the provisions of this Agreement.

(c) Borrower hereby represents and warrants to Lender, effect on the date of the Agreement and on the date of each deposit of Pledged Funds to the Debt Service Reserve Fund and the Replacement Reserve Fund, that:

(i) No filing, recording, registration or declaration with or notice to any person or entity is required in order to preserve or perfect the first priority lien and charge intended to be created hereunder in the Pledged Funds.

(ii) Except for the security interest granted to the Lender pursuant to this Agreement, Borrower is the sole owner of the Pledged Funds, having good and marketable title thereto, free and clear of any and all mortgages, liens, security interests, encumbrances, claims or rights of others.

(iii) No security agreement, financing statement, equivalent security or lien instrument or continuation statement covering all or part of the Pledged Funds is on file or of record in any public office except such as may have been filed by the Borrower in favor of the Lender.

(iv) This Agreement constitutes a valid and continuing first lien on and first security interest in the Pledged Funds in favor of the Lender, prior to all other liens, encumbrances, security interests and rights of others, and is enforceable as such as against creditors of and purchasers from the Borrower.

(d) Without the prior written consent of the Lender, the Borrower hereby covenants and agrees that it will not sell, assign, transfer, exchange or otherwise dispose of, or grant any option with respect to, the Pledged Funds, nor will it create, incur or permit to exist any pledge, lien, mortgage, hypothecation, security interest, charge, option or any other encumbrance with respect to any of the Pledged Funds, or any interest therein, except for the security interest provided for by the Agreement.

(e) Borrower hereby covenants and agrees that it will defend Lender's right, title and security interest in and to the Pledged Funds against the claims and demands of all persons whomsoever except to the extent, which arise out of the willful misconduct or gross negligence of the Lender.