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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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ORIGINAL

IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY – TOWN DIVISION
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

Docket No. W-01212A-12-0309

IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – PALO VERDE UTILITIES
COMPANY FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. SW-20445A-12-0310

IN THE MATTER OF THE APPLICATION OF WATER
UTILITY OF NORTHERN SCOTTSDALE, INC. FOR A
RATE INCREASE

Docket Nos. W-03720A-12-0311

IN THE MATTER OF THE APPLICATION OF
WATER UTILITY OF GREATER TONOPAH FOR
THE ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-02450A-12-0312

IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY – GREATER
BUCKEYE DIVISION FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND CHARGES FOR
UTILITY SERVICE DESIGNED TO REALIZE A
REASONABLE RATE OF RETURN ON THE FAIR
VALUE OF ITS PROPERTY THROUGHOUT THE
STATE OF ARIZONA

DOCKET NO. W-02451A-12-0313

GLOBAL'S REPLY BRIEF

Arizona Corporation Commission

DOCKETED

OCT 31 2013

DOCKETED BY

1 IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – SANTA CRUZ WATER COMPANY
2 FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
3 SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
4 PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-20446A-12-0314

5 IN THE MATTER OF THE APPLICATION OF
WILLOW VALLEY WATER COMPANY FOR THE
6 ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
7 DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
8 THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-01732A-12-0315

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11 **GLOBAL'S REPLY BRIEF**

12 **October 31, 2013**
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1 **I. Introduction.**

2 **A. The settlement agreement is fair, widely-supported and should be approved.**

3 The settlement agreement provides a fair outcome that is supported by a remarkably large and
4 diverse group of parties. It provides many benefits that could not be obtained through litigation.
5 Global's¹ witness, Mr. Walker, gave this impassioned explanation of why the settlement agreement is
6 reasonable and in the public interest:

7 ... We reached a very fair resolution between Staff, RUCO, the City, the HOAs and
8 Global that... allows us to restore our balance sheet. And we found a way to do that and
9 to put back used and useful rate base into rates without anything like rate shock.... We
10 are phasing in test year expenses over three years. We are phasing in rate recovery over
11 eight years. We have got 13 of 14 HOAs in agreement, state senators, county
12 supervisors, mayors, a unanimous city council, Staff and RUCO all of whom looked at
13 this issue for years saying that this a fair compromise between honestly held differences
14 of opinion.... This settlement is, I think, as good as it could possibly be. It protects the
15 ratepayers, the HOAs, the cities. It protects the developers, whether they agree or not.²

16 Global implores the Commission not to reject a settlement supported by so many different
17 parties, that provides numerous benefits that cannot be achieved through litigation and that resolves
18 one of the most complex and controversial issues before the Commission, because of the objections by
19 two disgruntled developers. The objecting developers—SNR and NWP—represent two out of 172
20 ICFAs. They are highly sophisticated real estate developers, who knew exactly what was in the ICFAs
21 when they negotiated and signed them in 2006. Years later, after reaping considerable benefits from
22 their ICFAs, they now ask the Commission to cast aside this remarkable settlement and to rewrite their
23 ICFA contracts. The Commission should reject their self-serving pleas.

24 **B. The SIB Mechanism will protect customers from rate shock and promote critical
25 investment in infrastructure.**

26 Also at issue in this case, and unresolved in the settlement, is the issue of the SIB mechanism
27 for Global's Willow Valley system. The urgent need for infrastructure replacement in this system is

¹ All defined terms in this reply brief have the meanings set forth in the "Table of Defined Terms" in
Global's Post-Hearing Brief dated October 18, 2013.

² Tr. at 671.

1 explained at length in Global's and Staff's closing briefs. RUCO opposes the SIB mechanism, making
2 the same arguments it always makes. RUCO says that the SIB mechanism will violate the fair value
3 requirement in Arizona's Constitution, but in reality each SIB filing will include fair value
4 information, and each SIB order will include a fair value finding. Fundamentally, RUCO thinks
5 customers are better off with larger rate increases in infrequent rate cases, rather than gradual rate
6 adjustments each year. Countless customers disagree.

7 **II. Reply to Staff, RUCO, the City and the Maricopa HOAs regarding the settlement**
8 **agreement.**

9 In their Closing Briefs, Staff, RUCO, the City and the Maricopa HOAs each strongly urge the
10 Commission to approve the settlement agreement. Each brings a unique perspective, and each has
11 their own reasons for supporting the settlement. But some points are made in nearly every brief filed
12 by the settling parties. They explain the fair and open settlement process and the hard fought
13 negotiations. They explain the many issues that are resolved, and the benefits to residential customers,
14 the City, and the HOAs. Many of them note that some of these benefits could not be obtained in
15 litigation. The settling parties also note the importance of resolving the ICFA issues, and how
16 complex and difficult the ICFA issues have been. The settling parties have dealt with ICFAs for many
17 years; their combined experience and effort on this issue are enormous. Yet they all came together to
18 support the settlement. Lastly, while having their own spin and perspective, the settling parties each
19 note their support for the rates established by the settlement, and especially the three year phase-in of
20 expenses and the eight-year phase-in of the CIAC de-imputation. The Commission should heed the
21 views of these diverse parties.

22 **III. Reply to SNR and NWP.**

23 **A. The Commission should not rewrite contracts to suit NWP and SNR.**

24 At the heart of SNR's and NWP's briefs is a request that the Commission re-write their
25 contracts with Global Parent. It is undisputed that SNR and NWP are highly sophisticated parties.
26 They signed their contracts with Global after lengthy negotiations and while represented by able and
27

1 experienced counsel.³ They signed because they believed the ICFAs were the best option for them.
2 The ICFAs certainly solved many problems for them. The ICFAs enabled SNR and NWP to escape
3 from the inept and ramshackle West Maricopa Combine utilities, to avoid being subject to a sewer
4 company controlled by a rival developer (Balterra),⁴ and most importantly, to obtain crucial approvals
5 from Maricopa County. Indeed, as the arbitration panel found, Global Parent's performance of the
6 ICFA "greatly benefited SNR and NWP and increased the value of their land holdings."⁵

7 For Global Parent, the cost of performing its obligations under the SNR and NWP ICFAs has
8 been steep. Global Parent had to spend \$54.3 million to buy WMC, and a further \$1.3 million to buy
9 Balterra Sewer Corp.⁶ Global Parent spent over \$17 million to date repairing the dilapidated WMC
10 systems,⁷ with numerous expensive projects still required.⁸ Global Parent also obtained the required
11 Section 208 and CC&N permits, after lengthy and expensive proceedings.⁹

12 Now, after seven years and tens of millions of dollars of performance by Global Parent, SNR
13 and NWP want to change their contracts. The Commission should reject SNR's and NWP's attempt to
14 dishonor their contracts, just as the arbitration panel rejected SNR's and NWP's attempts to rescind
15 their ICFAs.¹⁰ The enforceability of contracts lies at the core of the American legal and economic
16 systems. Re-writing contracts would be a truly extraordinary undertaking for the Commission.

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18

³ See generally the discussion in Global's Brief at 19, and citations therein.

19 ⁴ See Ex. A-20 (Fleming Rebuttal) at Attachments B, C, D, and E and Tr. at 295-297 (Jellies) for a
20 description of SNR's and NWP's opposition to Balterra Sewer Corp. See also Ex. A-37 (Judgment
21 against SNR) at Exhibit A (Arbitration Award), page 6, line 14 to page 7, line 4 (discussing joint
Global, SNR and NWP opposition to Balterra).

22 ⁵ Ex. A-37 (Judgment against SNR) at Exhibit A (Arbitration Award), page 9, lines 12-13.

23 ⁶ Ex. A-25 (Acquisition Summary). There is no dispute that the ICFAs required Global Parent to
24 purchase WMC. Global purchased Balterra Sewer Corp. in order to comply with its obligation to
acquire the 208 permit to serve SNR and NWP. See Ex. A-37 (Judgment against SNR) at Exhibit A
(Arbitration Award), page 6, lines 22 to 26.

25 ⁷ Ex. A-10 (Fleming Direct) at 6:4.

26 ⁸ Ex. A-10 (Fleming Direct) at Attachment 2 (listing 53 issues requiring correction at time of
purchase).

27 ⁹ See e.g. the relevant CC&N dockets, Docket Nos. W-02450A-06-0626 and SW-20422A-06-0566.

¹⁰ See Ex. A-37 (Judgment against SNR) at Exhibit A (arbitration award), pages 7 to 8.

1 Moreover, as Staff points out, there is strong legal precedent that the Commission “cannot
2 change or modify a contract that was voluntarily entered into between two private parties.”¹¹ Cases
3 like *General Cable* and *Trico* clearly state that contracts are the domain of the courts, not the
4 Commission.¹² For this same reason, a recent Commission Procedural Order vacated a hearing, noting
5 that “the construction and interpretation to be given to legal rights under a contract reside solely with
6 the courts and not with the Corporation Commission.... It would not further the interests of
7 administrative efficiency if the Commission were to continue to expend its resources, or require the
8 parties to incur additional costs litigating this matter at the Commission, when the Court of Appeals
9 has clearly indicated that the dispute is squarely within the jurisdiction of the courts.”¹³ Here, the
10 Commission should stay out of the contractual squabble raised by SNR and NWP, especially when
11 SNR and NWP have already fought—and lost—numerous contractual issues before the arbitration
12 panel.

13 Ironically, while attacking the ICFA's here at the Commission, SNR continues to sing their
14 praises elsewhere. For example, in asking for its “Development Master Plan” to be renewed, SNR
15 recently told Maricopa County that the funds SNR paid under the ICFA, and its support of the WMC
16 purchase, shows SNR’s “dedication” to the development.¹⁴ Likewise, less than three months ago,
17 SNR told the Bankruptcy Court that SNR needs to “assume” the ICFA (keep it in effect), because in
18 SNR’s “sound business judgment,” the ICFA is “in the best interest of the Debtor [SNR], its estate,
19 and its creditors” and will “benefit” SNR.¹⁵

20 Re-writing these contracts is likely beyond the Commission’s jurisdiction, as explained by
21 Staff. But even if the Commission had jurisdiction, such an extraordinary remedy is unwarranted here,

22
23 ¹¹ Staff’s Brief at 26:7-8.

24 ¹² *General Cable Corp. v. Citizens Utilities Co.*, 27 Ariz. App. 381, 555 P.2d 350 (1976); *Application*
25 *of Trico Elec. Co-op.*, 92 Ariz. 373, 377 P.2d 309 (1962).

26 ¹³ Procedural Order dated October 23, 2013 in Docket No. G-01551A-12-0379 (quotation marks and
27 citation omitted).

¹⁴ Ex. A-26 (DMP Renewal Applications) at (hand numbered) page 8.

¹⁵ Ex. A-20 (Fleming Rebuttal) at Exhibit A (“Motion to Assume Infrastructure Agreement”), page 4,
lines 19 to 22 and page 5, line 19 to 20.

1 given the lengthy and expensive performance by Global Parent, the great benefits reaped by SNR and
2 NWP from that performance, and SNR's recent re-affirmance of the ICFA.

3 **B. The CPI clause in the ICFAs is reasonable and non-discriminatory.**

4 SNR and NWP rail against the alleged injustice of the CPI clause. They both claim that the
5 CPI clause somehow puts them at a competitive disadvantage. SNR asks the Commission to eliminate
6 the CPI clause altogether,¹⁶ while NWP asks that the clause be limited to only part of its ICFA
7 payments.¹⁷ These requests must be rejected.

8 First, these sophisticated parties were well aware of the CPI clause before they signed their
9 agreements. The CPI clause was very important to Global Parent, and Global Parent would almost
10 certainly have not signed the ICFA without a CPI clause.¹⁸

11 Moreover, to address competitive issues, SNR and NWP insisted on a "most favored nations"
12 or "MFN" clause to protect them. Again, these contract issues are beyond the Commission's
13 jurisdiction. Moreover, the MFN clause, as negotiated by the parties, applies to ICFAs or similar
14 agreements in a specific area, not hook-up fees set by the Commission.¹⁹ Further, CPI clauses are
15 standard,²⁰ and SNR and NWP have failed to identify any ICFA without one. Lacking any support in
16 the actual words of the MFN clause, SNR and NWP are reduced to invoking the "spirit" of the
17 clause.²¹ The arbitration panel has already rejected SNR's and NWP's attempt to re-write the MFN
18 clause to reflect some vague spirit of the clause; instead the panel relied on what the clause actually
19 says.²² So should this Commission.

20 Further, the CPI clause serves a critical purpose. The SNR and NWP ICFAs cover thousands
21 of acres and contemplate thousands of homes. Development of these properties could take decades,

22 _____
¹⁶ SNR Brief at 17.

23 ¹⁷ NWP Brief at 12.

24 ¹⁸ Ex. A-20 (Fleming Rebuttal) at 4:14-17.

25 ¹⁹ The MFN clause is Section 15 of each ICFA. The SNR ICFA is attached Ex. SNR-1 (O'Reilly
Direct), and the NWP ICFA is attached to Ex. NWP-3 (Jellies Direct).

26 ²⁰ See Ex. A-20 (Fleming Rebuttal) at 4:19 (CPI clause is standard).

27 ²¹ SNR Brief at 17:14, NWP Brief at 12:18.

²² Ex. A-37 (Judgment against SNR) at Exhibit A (arbitration award), page 4, lines 1-8.

1 perhaps many decades. It makes no sense to price services in 2006 dollars, when the final costs may
2 not be incurred until 2036 or 2066. That's why the CPI clause is in the ICFA. As Mr. Fleming
3 explained, "Even a low rate of inflation adds up over the years, and there is always the risk that
4 inflation will not be low. The CPI provision is directly tied to the most widely used measure of
5 inflation and protects Global Parent from this risk."²³ And as Mr. Walker elaborates, the CPI clause
6 "was an essential element of those contracts to protect our side from the term risk which we don't
7 control. We don't control when the developers are actually going to move forward under these
8 contracts."²⁴

9 In contrast to ICFAs, hook-up fees are not set in stone for unknown decades to come. They are
10 re-evaluated in each rate case. Mr. Walker candidly testified that he "completely" expects Staff and
11 RUCO to seek an increase in the hook-up fee in the very next rate case.²⁵ In each future rate case, the
12 Commission will reset the hook-up fee to a proper level considering then-current costs and other
13 factors. In contrast, the ICFA will not, and cannot, be reset in each future rate case. Indeed,
14 eliminating the CPI clause could cause another problem, because in the future the hook-up fee could
15 be set at a value that exceeds the ICFA fee set in 2006. This would be contrary to the intent of the
16 settlement, which is to have the hook-up fees paid out of the ICFA fees. As Mr. Olea testified, under
17 the settlement agreement, "[a]s developers pay their obligation per the ICFAs, a portion of those
18 payments will go to the Global individual utilities as HUFs."²⁶

19 Moreover, eliminating the CPI clause would leave the Commission entangled in ICFA issues
20 for years to come. This would thwart one of the main benefits of the settlement: putting an end to the
21 Commission having to deal with ICFA disputes.²⁷

22
23 ²³ Ex. A-20 (Fleming Rebuttal) at 4:24-26.

24 ²⁴ Tr. at 669:20-24.

25 ²⁵ Tr. 646-647, as quoted in NWP Brief at page 9, lines 1-5.

26 ²⁶ Ex. S-5 (Olea Testimony) at 11:10-12.

27 ²⁷ Tr. at 191:11-15 (Quinn)("main primary benefit" is resolution of ICFAs including that they are
"gone"); Ex. S-5 (Olea Testimony) at 13:25 (listing "resolution of ICFA issues" as a "significant
customer benefit").

1 SNR and NWP both point to the part of the CPI clause that states “The Parties, however,
2 further agree to renegotiate this CPI Factor in good faith in the event that it results in a Landowner
3 Payment in excess of related financing requirements.”²⁸ This renegotiation clause is of no help to
4 them. The remedy provided by the renegotiation clause is negotiation, not re-writing by the
5 Commission. And like any contractual provision, this clause is for the courts, not the Commission, to
6 enforce. Further, even if it was enforceable before the Commission, there is no evidence in the record
7 as to what the “related financing requirements” might be, so SNR and NWP cannot even establish that
8 the clause applies.

9 SNR places great emphasis on certain quotes from the hearing testimony of Global’s witness,
10 Paul Walker, responding to questions from Judge Nodes.²⁹ Unfortunately, SNR omits many of the key
11 points made by Mr. Walker. Global agrees that this exchange is important testimony, and Global
12 encourages the ALJ and the Commissioners to review this testimony in full, on pages 640 to 650 of the
13 transcript. For convenience, these pages are attached as Appendix 1 to this brief. Some of the
14 important points made by Mr. Walker include:

- 15 ● Hook-up fees will be reset in future rate cases.³⁰
- 16 ● Hook-up fees are paid by developers who are about to develop, and are based on
17 current development prices. In contrast, no one knows when ICFA lands will develop
18 and when the ICFA fees will be paid.³¹
- 19 ● “It’s not just about SNR and NWP.” Global has 170 other ICFAs that would be
20 affected.³²

23 ²⁸ SNR Brief at 16:21-24; NWP Brief at 11:23-25. The renegotiation clause is in Section 4 of the
24 ICFA. The SNR ICFA is attached Ex. SNR-1 (O’Reilly Direct), and the NWP ICFA is attached to
25 Ex. NWP-3 (Jellies Direct).

25 ²⁹ SNR Brief at 14-16.

26 ³⁰ Tr. at 640:20 to 641:4.

26 ³¹ Tr. at 645:18 to 646:12.

27 ³² Tr. at 649-650.

- 1 • The developers with ICFAs in this area have already “locked up” all the available
2 groundwater in this area; any new developer would have to bring in outside water at
3 great cost. This gives ICFA holders, like SNR and NWP, a “very, very significant
4 competitive advantage.”³³
- 5 • The water industry would “love to have” hook-up fees indexed to CPI, but Staff and
6 RUCO likely “wouldn’t be thrilled by that.”³⁴
- 7 • The parties negotiated “down to the last dollar on the table”; Mr. Olea and Mr. Quinn
8 understood that the CPI clause would not be modified.³⁵

9 And because the parties negotiated down to the last dollar, Mr. Walker testified that
10 eliminating the CPI clause from 172 ICFAs would definitely be a material alteration of the settlement
11 agreement in Global’s view.

12 SNR and NWP also try to make something out of their claim that they were not offered a main
13 extension agreement by Global as an alternative to an ICFA.³⁶ SNR goes so far as to argue that
14 Global Parent “acted at all times as the regulated utility with the monopoly by demanding payments
15 under the ICFAs....”³⁷ These remarks do not accord with reality. At the time the SNR and NWP
16 ICFAs were signed, Global did not own WMC, which owned the water utility in the area. How could
17 Global hold a “monopoly” over an area actually served by another company? How could a main
18 extension agreement (with a utility) provide for the purchase of that utility, especially when the
19 Commission’s rules³⁸ limit main extension to the extension of infrastructure to un-served areas? SNR
20 and NWP have no answers to these questions.

21
22 _____
23 ³³ Tr. at 641-643.

24 ³⁴ Tr. at 644:8-24.

25 ³⁵ Tr. at 648:17-18 and 649:17-25.

26 ³⁶ SNR Brief at 4; NWP Brief at 11.

27 ³⁷ SNR Brief at 10.

³⁸ Arizona Administrative Code (AAC) R14-2-401(14)(defining “main extension”); R14-2-406(B)(MXA funds are refundable advance); R14-2-406(B)(4)(requiring refund if amount paid is less than cost of construction; R14-2-606(similar).

1 **C. The settlement agreement includes appropriate safeguards regarding ICFA funds.**

2 The settlement includes extensive safeguards on ICFA funds—safeguards intended to protect
3 developers. Most importantly, the settlement agreement establishes significant hook-up fees, and
4 provides that the ICFA payments will be applied to the hook-up fees. Hook-up fees are paid to the
5 regulated utility, and they are subject to stringent requirements, including separate, restricted bank
6 accounts and detailed reporting. The portion of ICFA payments (approximately 70% in most cases)
7 used to cover the hook-up fee will have all of these protections. Moreover, the use of the hook-up
8 fees, and Global’s overall compliance with the settlement agreement, will be subject to the scrutiny by
9 Staff and RUCO. These are substantial additional safeguards that go beyond what developers
10 negotiated in their ICFAs.

11 SNR and NWP ask the Commission to go even further. They want to specify how the
12 remaining funds payable to Global Parent are used. The Commission should not entangle itself in
13 trying to color code and specify the use of such parent level funds. SNR and NWP are already getting
14 far more protections than exist in the ICFAs they negotiated and signed. Moreover, the basic premise
15 of SNR’s and NWP’s request is mistaken. Their premise is that ICFA funds are intended to pay
16 directly for infrastructure. This premise is directly contrary to the express terms of the ICFAs. SNR’s
17 and NWP’s ICFAs clearly lay out what the ICFA fees are intended to cover: the carrying costs of
18 regional infrastructure, and acquisition the of WMC.³⁹ Actually paying for the direct cost of the
19 physical infrastructure is an additional cost over and above the ICFA fees; under the ICFAs Global is
20 obligated to pay for this infrastructure. Thus, directing a large part of the ICFA fees to the hook-up fee
21 to directly pay for infrastructure is actually directly contrary to the expressed intent of the ICFAs.
22 Regardless, Global has consented to the hook-up fee provisions. Again, this is far beyond what SNR
23 and NWP are entitled to under their ICFAs, and they have no grounds to ask for more.

24
25 _____
26 ³⁹ For carrying cost, see Recital “H” of the SNR and NWP ICFAs. For the WMC acquisition, see
27 Recital J and Tr. at 249:4-8 (O’Reilly). The SNR ICFA is attached Ex. SNR-1 (O’Reilly Direct), and
the NWP ICFA is attached to Ex. NWP-3 (Jellies Direct).

1 **D. The settlement agreement sets appropriate rates for Water Utility of Greater**
2 **Tonopah.**

3 NWP also objects to the rates established for Water Utility of Greater Tonopah. But the rate
4 increase is far less than would otherwise be the case. As Mr. Rowell explains, if Tonopah’s rate were
5 based on the fair value of its assets in rate base, the rate increase would be \$560,000, but because
6 Global consents to using an operating margin, the rate increase is only \$199,983.⁴⁰ Moreover, that
7 reduced rate increase is then phased-in over three years, with no increase at all in the first year.

8 As Mr. Rowell explained, before the settlement agreement, NWP’s own rate expert, Mr. Igwe,
9 recommended that Tonopah’s rate increase be limited to recovery of expenses and a reasonable profit,
10 but not a return on rate base related to reversing the CIAC imputation in the last rate case.⁴¹ As Mr.
11 Rowell demonstrates, this is exactly what the settlement does.⁴² Perhaps that is why NWP never
12 offered Mr. Igwe’s testimony into evidence.

13 NWP’s complaint now is that the higher rates may reduce the price it can get for its land. As
14 Mr. Rowell explains, NWP is asking the Commission to set rates below the cost of service, contrary to
15 “any accepted ratemaking practice.”⁴³ Pumping up NWP’s home prices through artificially low rates
16 is “problematic” at best and is “inconsistent with any accepted ratemaking standards.”⁴⁴

17 **E. The settlement appropriately addresses inter-affiliate issues.**

18 SNR and NWP argue that the Global Utilities’ affiliates, including Global Parent, require
19 greater regulation, and the put forward several poorly defined proposals to that end. These proposals
20 should be rejected. Global Parent and the other affiliates are already subject to the Commission’s
21 affiliated interest rules—the same rules that SNR’s witness had not reviewed and was not familiar
22 with,⁴⁵ despite his demand for unspecified greater regulation of these same affiliates. SNR and NWP
23 fail to note that Global’s corporate structure was reviewed in the prior rate case, and that it is the result

24 _____
⁴⁰ Ex. A-27 (Rowell Rebuttal) at 2.

25 ⁴¹ *Id.* at 3:6-13.

26 ⁴² *Id.* at 3:15-16.

27 ⁴³ *Id.* at 3:21 to 4:13.

⁴⁴ *Id.* at 4:11-13.

⁴⁵ Tr. at 252:20 to 253:5.

1 of several corporate reorganizations approved by the Commission over the years.⁴⁶ Moreover, the
2 affiliate issues will be further addressed in the Code of Conduct required by the settlement agreement.
3 The settlement agreement specifically requires the Code to address affiliate issues, and requires that it
4 include at a minimum certain recommendations of Staff's Chief Accountant, Mr. Armstrong.⁴⁷ The
5 existing Global affiliated interest orders and the proposed Code of Conduct will strongly regulate
6 Global's affiliate issues. SNR's and NWP's vague proposals add nothing and are unnecessary.

7 **IV. Reply to RUCO regarding SIB mechanism.**

8 Staff's brief provides a full review of Global's investment to-date in the Willow Valley
9 system,⁴⁸ as well as a detailed description of the current problems in the SIB project area that must be
10 addressed, including: (1) aged, fragile and corroded pipes; (2) absence of looping; (3) pipes located in
11 customer backyards, impeding access and raising public health concerns due to nearby septic systems;
12 (4) inoperable valves; (5) inadequate fire hydrants; (6) high level of line breaks; and (7) high level of
13 water loss.⁴⁹

14 In contrast, RUCO's brief avoids any discussion of the condition of this specific system.
15 RUCO's objections to the SIB are entirely generic. As RUCO states "the reasons that RUCO opposes
16 the SIB in this case are for the most part the same as in other cases."⁵⁰ RUCO has already lost on
17 these same issues in the Arizona Water Company (AWC) Eastern Group Case, and the AWC Northern
18 Group Case.⁵¹ As the Commission explained last month in the Northern Group case, "RUCO has not

19 _____
20 ⁴⁶ See e.g. Decision No. 71878 (September 15, 2010) at 4-5 (discussing Global's corporate structure).
21 For orders approving various corporate restructurings of Global, see e.g. Decision No. 69920 (Sept.
22 27, 2007)(transferring Palo Verde's and Santa Cruz's CC&Ns from LLCs to corporations); Decision
23 No. 70183 (February 27, 2008)(transferring CC&N of Water Utility of Greater Buckeye to Valencia
24 Water Company and creating two divisions of Valencia); Decision No. 70310 (April 24,
25 2008)(approving acquisition of Balterra Sewer Corp.); Decision No. 70980 (May 5, 2009)(approving
26 initial public offering and corporate restructuring with conditions); Decision No. 72730 (January 6,
27 12012)(approving further issuance of equity and corporate restructuring with modified conditions).

⁴⁷ Settlement Agreement, Section 8.7.

⁴⁸ Staff Brief at 27 to 28.

⁴⁹ Staff Brief at 28 to 30.

⁵⁰ RUCO Brief at 2:24.

⁵¹ Decision No. 74081 (September 23, 2013) at 34-36, 39-43, 45-49, and 58-62.

1 brought forth any new information or put forth any new arguments in this case to cause the
2 Commission to reverse its decision on the SIB mechanism. The Commission has determined that the
3 SIB Agreement and the SIB mechanism created thereby, as modified with the additional protections
4 adopted in Decision No. 73938, are consistent with the Commission's legal authority and will result in
5 rates and charges that are just and reasonable."⁵² This case is the same. RUCO has raised no new
6 arguments, and RUCO's old arguments should be rejected for the same reasons the Commission
7 rejected them in the AWC Eastern Group and Northern Group cases.

8 RUCO strongly objects to the fact that the SIB Mechanism adjusts rates based on additions to
9 plant outside of a rate case. RUCO tries to paint the SIB Mechanism as some sort of unprecedented
10 and dramatic break with past Commission practice. In reality, the Commission has approved many
11 adjustor mechanisms based on plant costs. As the Commission explained in the Eastern Group case,
12 "From a practical perspective, the SIB would operate very similarly to the existing ACRM, with which
13 the Commission now has extensive experience, and which the Commission has determined to be
14 lawful."⁵³ As long ago as 1979, the Arizona Supreme Court recognized that step increases based on
15 post-test year construction work in progress would be lawful.⁵⁴ In addition to many ACRM orders, the
16 Commission has approved plant-based adjustor mechanisms in Arizona Public Service Company's
17 renewable energy⁵⁵, energy efficiency/demand side management⁵⁶, and environmental improvement
18 surcharge⁵⁷ adjustors.

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20
21 ⁵² Decision No. 74081 (September 23, 2013) at 59:27 to 60:5.

22 ⁵³ Decision No. 73938 (June 27, 2013) at 50:20-22.

23 ⁵⁴ *Arizona Community Action Assoc. v. Arizona Public Service Co.*, 123 Ariz. 228, 231, 599 P.2d 184
24 (1979) (noting "The adjustments ordered by the Commission in adding the CWIP to that determination
25 of fair value were adequate to maintain a reasonable compliance with the constitutional requirements
26 if used only for a limited period of time."). See also Decision No. 73938 (June 27, 2013) at 42 to 43)
(discussing *Arizona Community Action* in the context of a SIB).

27 ⁵⁵ Decision No. 73183 (May 24, 2012) at Exhibit A, Page 9 of 22, Section 8.2; see also Decision No.
71448 (December 30, 2009) (approving an earlier version of renewable energy adjustor).

⁵⁶ Decision No. 71448 (December 30, 2009).

⁵⁷ Decision No. 73183 (May 24, 2012) at Exhibit A, Page 16 of 22, Section 11.2.

1 RUCO hangs its hat on a single phrase in *Scates* that refers to “narrowly defined, operating
2 expenses.”⁵⁸ *Scates* did not involve a plant-based adjustor mechanism, and therefore this stray remark
3 is *dicta* not controlling precedent. In *Scates*, the Court of Appeals found the Commission acted
4 unlawfully when it changed rates “without any examination of the costs of the utility apart from the
5 affected services, without any determination of the utility's investment, and without any inquiry into
6 the effect of this substantial increase upon [the utility's]...rate of return on that investment.”⁵⁹ The
7 court's *holding* was that the Commission “is required by our Constitution to ascertain the value of a
8 utility's property within the State in setting just and reasonable rates.”⁶⁰ Indeed, the Court expressly
9 left open the issue of raising rates based on “summary” filings, cautioning, “We do not decide in this
10 case, for example, whether the Commission could have referred to previous submissions with some
11 updating or whether it could have accepted summary financial information.”⁶¹

12 Here, the Commission will have all the information that was missing in *Scates*. Each SIB
13 filing must include “an analysis of the impact of the SIB Plant on the fair value rate base, revenue, and
14 the fair value rate of return...”⁶² Moreover, each SIB filing must include the following data⁶³:

- 15 (1) the most current balance sheet at the time of the filing;
- 16 (2) the most current income statement;
- 17 (3) an earnings test schedule;
- 18 (4) a rate review schedule (including the incremental and pro forma effects of the proposed
increase);
- 19 (5) a revenue-requirement calculation;
- 20 (6) a surcharge calculation;
- 21 (7) an adjusted rate base schedule;

23 ⁵⁸ RUCO Brief at 6, citing *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 535, 578 P.2d 612, 616
24 (Ct. App. 1978).

25 ⁵⁹ *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 533, 578 P.2d 612, 614 (Ct. App. 1978)

26 ⁶⁰ *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (Ct. App. 1978).

27 ⁶¹ *Id.*

⁶² Decision No. 73938 (June 27, 2013) at 50:15-17 (citation and quotation marks omitted).

⁶³ Decision No. 73938 (June 27, 2013) at 50-51.

- 1 (8) a CWIP ledger (for each project showing accumulation of charges by month and paid
vendor invoices);
2 (9) calculation of the three factor formula (as requested by Staff); and
3 (10) a typical bill analysis under present and proposed rates.

4 This extensive information includes all of the information that *Scates* criticized the
5 Commission for not considering. Thus, even if the SIB is not an “adjustor mechanism”, it certainly
6 complies with Arizona’s constitutional fair value requirement. To hold otherwise would be to read
7 into the Arizona Constitution the Commission’s detailed rate case filing rules, which did not exist at
8 the time the Arizona Constitution was adopted.

9 Moreover, the Court of Appeals decision in *Scates* (1978) must be read in light of the Arizona
10 Supreme Court’s subsequent decision in *Arizona Community Action* (1979) which, as discussed above,
11 contemplated that plant-based adjustments are allowable. Further, as the Court of Appeals noted in
12 *Phelps Dodge*, the Commission has “discretion to adopt various approaches to fulfill its functions, as
13 long as the method complies with the constitutional mandate and is not arbitrary and unreasonable.”⁶⁴
14 Under the Arizona Constitution, the Commission is required to “use fair value to aid it in discharging
15 its duties, including setting rates, and... the Commission cannot ignore fair value in setting rates.”⁶⁵
16 The SIB mechanism fully complies with this requirement by requiring a fair value finding and
17 additional, extensive financial information.

18 The SIB is therefore legal, as the Commission found in the Northern Group and Eastern Group
19 cases. And if the SIB is legal, it is more than appropriate for Willow Valley, which faces extensive
20 infrastructure needs, as shown at length in Staff’s and Global’s Closing Briefs. The SIB will protect
21 customers by replacing sudden, large rate increases with gradual rate changes.

22 Lastly, RUCO claims that the mechanics of the SIB, “based on the evidence in this case... is a
23 mystery.”⁶⁶ RUCO’s claim must be rejected. The mechanics of the SIB are set forth in great detail in

24 ⁶⁴ *Phelps Dodge Corp. v. Arizona Elec. Power Co-op., Inc.*, 207 Ariz. 95, 109, 83 P.3d 573, 587 (Ct.
25 App. 2004)(citation and quotation marks omitted.)

26 ⁶⁵ *Phelps Dodge Corp. v. Arizona Elec. Power Co-op., Inc.*, 207 Ariz. 95, 105, 83 P.3d 573, 583 (Ct.
App. 2004).

27 ⁶⁶ RUCO Brief at 10:4.

1 the SIB Settlement Agreement approved in the Eastern Group case, which was entered into evidence
2 as Exhibit A-45. Staff's Brief outlines these requirements at length with full record citations for each
3 item.⁶⁷ There is no lack of evidence as to how the SIB will work.
4

5 RESPECTFULLY SUBMITTED this 31st day of October, 2013.

6 ROSHKA DEWULF & PATTEN, PLC

7
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25 _____
26 ⁶⁷ Staff Brief at 31-33. However, on page 36, Staff states that the 5% revenue cap is based on the
27 revenue requirement in the Eastern Group case. That should read the revenue requirement established
for Willow Valley in this case.

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By Rebbie Maud

Appendix

"1"

1 if the settlement agreement is adopted as proposed, a
2 developer that is not part of an ICFA could come in,
3 simply pay the HUFs and get service and thereby
4 presumably sell homes at a lesser price than they can
5 being subject to the ICFAs, including the provision with
6 the CPI adjuster, which then makes it just even more,
7 you know, uncompetitive, from their perspective, at
8 least compared to a developer that's not under an ICFA
9 and wants to sell homes.

10 Can you -- there has been some discussion
11 already, but would you agree that they, whether or not
12 they knew what they were doing, being, you know,
13 professionals and seasoned investors and developers, can
14 you see or can you explain why that is not a valid
15 argument from their point of view?

16 A. Sure, Your Honor. And I will skip all the
17 caveats about, you know, they entered into the contract.
18 But let's, if I can, let's, can we divide it a bit?

19 Q. Sure.

20 A. The CPI is one piece. And in regards to that
21 element, the hookup fees, I testified to this in either
22 my direct or rebuttal on the settlement, the hookup fees
23 are not like static. Hookup fees get adjusted by the
24 Commission in rate cases. And so my expectation is that
25 Staff and RUCO will, in future rate cases, look at what

1 the hookup fee is and they will look at what the market
2 conditions are and what has happened with plant
3 expenses, inflation. And they will make a determination
4 on what that amount should be.

5 So if we say we should eliminate all of the CPIs
6 and these ICFAs, we will fix then, in 2013 dollars, the
7 value of the ICFA fees. And then going forward five,
8 ten or 15 years from now, the amount of money that is
9 sort of on the table for Staff to look at putting into a
10 hookup fee is capped in 2013 dollars.

11 And you heard Mr. Jellies testified, and I think
12 it has been clarified, he had a 15, 1-5, year horizon.
13 There are a lot of ICFAs covering a lot of territory
14 that, in my opinion, we will be lucky to see a 15-year
15 horizon. That's a long way out. And so if we fix that
16 CPI today, what will happen is we are effectively
17 capping what the hookup fee could be 15 or 20 years from
18 now. And I don't think that makes sense. If I was in
19 Staff's position I don't think I would want to do that.

20 Regarding the competitive disadvantage,
21 Mr. Fleming has testified to this, and I spoke about it
22 in the context of paper versus wet water. The area out
23 there, DWR has been very clear, they, they had serious
24 concerns that paper water claims were about three times
25 higher than what the sub basin could do. So they have

1 stopped approving those, the paper water claims. They
2 brought in -- you know, we worked with DWR and the
3 developers. We came into it. And what we have done is
4 we have overlaid the area with ICFAs and we have got a
5 pending dozen applications for designations of assured
6 water supply. That accounts for all of the wet water
7 that DWR says is there. So if someone else wants to
8 come into that area and develop, they are going to have
9 to bring water in. And, you know, there is, there are
10 two ways I know to do that.

11 One, they are going to have to try and get CAP
12 water and a contract and then build some sort of
13 facility to treat that CAP water. That's very
14 nontrivial considering what the Colorado River flows
15 look like they are and what the allocations look like
16 they are.

17 There is another opportunity. And that is
18 W Holdings Vanderbilt Farms. Mr. Conley Wolfswinkel's
19 group have acquired very significant groundwater
20 resources out in the Harquahala, H-A-R-Q-U-A-H-A-L-A,
21 Valley region. So that would be another way. They
22 could contract and then put in a pipeline to bring that
23 water from that basin over. The 1980 Groundwater
24 Management Act provides a specific exemption for that
25 basin to do what is otherwise prohibited by the act,

1 which is transmit water from that basin to another
2 basin.

3 So, you know, we have thought about this a
4 little bit and worked on these issues a bit. I
5 participated in CAGRD, Central Arizona Groundwater
6 Replenishment District, in their conversations about how
7 to go forward. And just the reality is there is just
8 not that much water that's going to be available in that
9 area. And to get water out there, it looks like it is
10 going to be very, very expensive. So to the extent that
11 someone else is going to come in and compete with them,
12 I think my view is the ICFA holders who are in that DAWS
13 application have a very, very significant competitive
14 advantage over someone who wants to enter that sub
15 basin.

16 Q. Okay. Well, putting aside the cost of water
17 acquisition, that will be what it is in some future
18 time, and putting aside, you know, your opinion that the
19 Commission can't in any way alter the contract because
20 it is through an unregulated affiliate or parent, why
21 shouldn't there be some tie between the HUF that is
22 proposed in the settlement and what is the obligation
23 under the ICFAs and also tying perhaps the future
24 increases in HUFs to the CPI adjuster? Do you
25 understand the gist of what I am saying, so that

1 effectively all developers would be on an equal footing,
2 again, putting aside the acquisition of water issue?

3 A. I think I understand Your Honor's question. And
4 so, again, I think that there is no question in our
5 minds but that Staff and RUCO will continue to look at
6 what the ICFA fees available are and what the hookup fee
7 is at a given point in time.

8 The Commission, I would think, could put a CPI
9 adjuster on a hookup fee. I would argue, having done a
10 lot of work with water companies and with a trade group
11 that represents water companies, you would see a wave of
12 applications at the Commission wherein water and
13 wastewater companies would say I want a hookup fee and I
14 want to be able to adjust it every year for CPI and I
15 will see you in the next rate case. My guess is that
16 Staff and RUCO wouldn't be thrilled about that.

17 And --

18 Q. But that --

19 A. -- you put me in a difficult question because,
20 you know, is that a good thing. And so, you know, if I
21 put on my responsible water hat, which is the trade
22 group, you know, maybe so. Maybe we would love to have
23 a flurry of hookup fees that all let us change the
24 hookup fee every year outside of a rate case based on
25 our calculations. But in the context of this

1 settlement, I don't think that's what we bargained for
2 and I don't think that you should give us that.

3 Q. Right. And I understand, you know, your
4 position and why you are advocating for your position.
5 I am just trying to explore.

6 And doesn't the fact that you believe Staff and
7 RUCO and probably the Commission would not be
8 particularly amenable to putting CPI adjusters on hookup
9 fees, doesn't that kind of support the argument of the
10 developers in this case, that why should they have to
11 have a CPI adjuster on the funds that they are paying
12 towards getting utility service, when other similarly
13 situated developers will not in the future have to pay
14 similar escalators on their hookup fees?

15 A. I completely agree with, you know, the logic
16 behind I think what your question is. It is an
17 interesting point to explore.

18 The hookup fee, though, is paid by developers
19 who are about to develop. And so when the Commission,
20 through Commission Staff and RUCO's analysis and input,
21 sets a hookup fee, they are looking at current market
22 conditions, current capital costs. And they are setting
23 it to accurately reflect it.

24 The ICFA fees, though, we are not in that
25 horizon. No one knows when these ICFA fees are going to

1 get paid. It is completely outside of Global's control.
2 And it may well be outside of many of the developers'
3 control. The market just is what it is, and if they
4 have a 10-year or 15-year or 20-year horizon, then we
5 are at the point of trying to figure out, well, how do
6 we accurately reflect what the costs of providing these
7 ICFA services are to the developer. And that's where
8 the local CPI entered into the ICFA, because Global has
9 no control on when this is going to actually occur but
10 is undertaking obligations that, as I said before, I
11 think have really significant costs. So it was put into
12 there to protect Global from that term risk.

13 Q. Right. And I understand. And it makes perfect
14 sense from, you know, if you are negotiating a contract
15 you want to be protected from the effects of inflation.

16 I guess the question is why, if you have now
17 agreed to a particular level of HUF fees and you don't
18 know when those are ever going to be collected either, I
19 mean it might be 20 years before you have somebody, and
20 maybe that's an exaggeration, but some number of years,
21 but why shouldn't that be the baseline for everyone that
22 then, if, you know, in a subsequent case that HUF is
23 increased, why should the CPI not be somehow tied to
24 whatever level of increase there is in a HUF from this
25 point in time to effectively replace or mimic the CPI

1 adjuster so that developers are left basically on an
2 equal footing?

3 A. I think I understand exactly your point. And I
4 completely expect that in the next rate case Staff and
5 RUCO are going to want to do exactly that to our hookup
6 fee.

7 Q. Exactly what? To increase it?

8 A. Adjust, increase it. And I think, if I was
9 Staff or RUCO, the first thing I would do is say what
10 has the CPI been. So I don't want to get into
11 litigating the next case.

12 Q. Right.

13 A. I don't think, you know, Mr. Olea or Mr. Quinn
14 do. I think what we are trying to do is just wrap up
15 seven years of fighting and get to a baseline. But I
16 think you are asking exactly the questions that are
17 going to be in the next rate case.

18 Q. Okay.

19 A. And I don't mean to --

20 Q. No.

21 A. I could discuss this all day long with you, Your
22 Honor, but I think you are maybe a step ahead of where
23 we are in this case. But you are exactly, I think,
24 right in terms of what we are going to talk about in the
25 next rate case. And I would imagine some point after

1 2017 you and I will probably be sitting here reflecting
2 on this conversation and I will be having some position
3 on whether I think the CPI should have been applied.

4 Q. Yeah. Well, so, you know, and I don't know what
5 anybody is going to recommend in the future in a future
6 case, you know, at all, but would Global be amenable to
7 some sort of tying of the CPI adjuster to any subsequent
8 increase in the HUF rate that is maybe increased down
9 the road, I mean such as using a baseline now and, if
10 the HUF is increased by \$300 in some future rate case,
11 then there would be some equivalent adjustment for the
12 CPI? Or you would simply, the holder or the developers
13 would essentially just have to pay whatever that
14 increase is in the HUF as opposed to having a CPI
15 adjuster imposed?

16 A. I understand, Your Honor. So what I think is
17 reflected in the settlement is that we argued down to
18 the last dollar on the table. And, you know, I don't
19 know that we really have more dollars on the table. I
20 mean there is a lot of dollars on the table.

21 We are at a three-year phase-in of expense
22 recovery. We are at an eight-year phase-in of used and
23 useful rate base recovery. So, again, Your Honor, I
24 mean I appreciate where you are going, but I think
25 that's, that's the pound of flesh that will be there in

1 next round when we get there.

2 Q. No, and I understand and appreciate, you know,
3 all the elements of the settlement agreement. I
4 understand the appeal.

5 I guess I am just looking at it, you know, you
6 have two developers that obviously are not signed onto
7 the settlement agreement. And I guess I am -- and you
8 are not going to be collecting any cash under those,
9 under the CPI adjuster until some point in the future
10 when they are ready to move forward anyway. So I guess,
11 you know, I am just wondering why there shouldn't be
12 somehow a relationship between subsequent HUF increases
13 and the CPI adjuster if, in effect, you know, those two
14 things are related to the same purpose, which is to
15 recognize the effects of inflation on future
16 construction costs.

17 A. And I appreciate it, sir. I understand we have
18 two developers, you know, unhappy. But we also have 172
19 of these agreements at various stages in development.
20 And, you know, honestly, that CPI right now provides us
21 with a little bit of upside until the next rate case.

22 And I think, I think Mr. Olea and Mr. Quinn
23 appreciated that. And without getting into
24 conversations that I had, I think, just say I think they
25 understood what the dollars were on the table and how

1 many of those they could get to their side of the table
2 without making it not work for us.

3 Q. Right, right.

4 A. So, again, I think the hookup fees is going to
5 be something we debate at great length in future rate
6 cases. But it is not, it is not just about SNR and NWP.
7 There is a lot of other ICFAs and there is a lot of
8 other developments that probably will move forward.

9 ACALJ NODES: Right. Okay. Well, those are all
10 the questions I have at the moment. So we are going
11 to --

12 How much, Mr. Sabo, how much redirect do you
13 believe you will have?

14 MR. SABO: Your Honor, I would say between ten
15 and 15 minutes.

16 ACALJ NODES: Okay. Well, let's go ahead and
17 get started with that. And are you ready now or would
18 you rather --

19 MR. SABO: Sure.

20 ACALJ NODES: -- take a break and come back?

21 MS. WOOD: Can we take a small break now?

22 ACALJ NODES: Sure. Why don't we take lunch
23 right now. And that way, Mr. Sabo, you can develop your
24 redirect. So we will take a lunch break until 1:00.

25 (A recess ensued from 11:56 a.m. to 1:03 p.m.)