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BEFORE THE ARIZONA CORPORATION COMMISSION  
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AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION OF LIBERTY UTILITIES (LITCHFIELD PARK WATER AND SEWER) CORP. FOR APPROVAL OF AN EXTENSION OF THEIR CERTIFICATE OF CONVENIENCE AND NECESSITY FOR WATER UTILITY SERVICE IN MARICOPA COUNTY, ARIZONA.

DOCKET NO. W-01427A-14-0134

**ORIGINAL**

IN THE MATTER OF THE APPLICATION OF LIBERTY UTILITIES (LITCHFIELD PARK WATER AND SEWER) CORP. FOR APPROVAL OF AN EXTENSION OF THEIR CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WASTEWATER UTILITY SERVICE IN MARICOPA COUNTY, ARIZONA.

DOCKET NO. SW-01428A-14-0180

IN THE MATTER OF THE APPLICATION OF VALLEY UTILITIES WATER COMPANY, INC. FOR AN EXTENSION OF ITS CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WATER UTILITY SERVICE IN MARICOPA COUNTY, ARIZONA.

DOCKET NO. W-01412A-14-0262

**STAFF'S CLOSING BRIEF**

**I. BACKGROUND.**

On April 17, 2014, and June 5, 2014, Liberty Utilities (Litchfield Park Water and Sewer), Corp. ("Liberty") filed Applications for extensions of its Certificates of Convenience and Necessity ("CC&N") to provide water and wastewater services, respectively, to a portion of Maricopa County. On June 13, 2014, Liberty's water and wastewater CC&N extension applications were consolidated. On July 3, 2014, The Utilities Division Staff ("Staff") the Arizona Corporation Commission ("ACC" or "Commission") informed Liberty the applications were sufficient for administrative purposes. A hearing was set for September 3, 2014.<sup>1</sup>

<sup>1</sup> Ex. S-1, Staff Report.

1 On July 15, 2014, Valley Utilities Water Company, Inc., (“Valley”) filed an application to  
2 extend its CC&N for water service to include the area sought by Liberty. On July 31, 2014, Staff  
3 informed Valley that its application was sufficient for administrative purposes. The Valley and  
4 Liberty applications were consolidated on August 7, 2014.<sup>2</sup>

5 The requested area is a 365 acre property (approximately 248 acres of Marbella Ranch  
6 Subdivision land and approximately 117 acres of restricted use land), located on El Mirage Road  
7 alignment between Glendale Avenue and Northern Avenue, in Section 2 of Township 2 North, Range  
8 1 West. The requested area is in the unincorporated area of Maricopa County but within the City of  
9 Glendale’s strip annex and planning area, and it is west of Luke Air Force Base (“Luke”) Air  
10 Installation Compatible Use Zone (“AICUZ”).<sup>3</sup>

11 The requested area will be developed in phases. Phase I is planned for 600 single family  
12 homes and is located in the southern portion of the requested area. Phase II is located in the northern  
13 portion of the property and is planned for 660 dwelling units (300 single family and 360 apartment  
14 units) and includes a 50.5 acre industrial parcel. The property is currently owned by El Paso Natural  
15 Gas Company, L.L.C. (“El Paso”). TRS 8, LLC (“TRS 8”) is under contract to purchase the property  
16 from El Paso and expects to close the purchase on September 30, 2014.<sup>4</sup>

17 The requested CC&N extension area is not contiguous to Liberty’s current CC&Ns though  
18 they are within a mile of them. Liberty received a request for service by the developer for the area  
19 for which it has requested an extension. Valley’s water CC&N comes within a mile on the west side  
20 of the proposed planned development and is contiguous on two sides (east and south). Valley does  
21 not provide wastewater service and has requested that Liberty provide wastewater service should  
22 Valley be awarded the CC&N. Valley has not received a request for service.<sup>5</sup>

23 Staff’s Engineering Report<sup>6</sup> describes the two Companies’ current water systems, the  
24 proposed water plan, the projected water construction schedule, and the costs to serve the requested  
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26 <sup>2</sup> *Id.*

27 <sup>3</sup> *Id.* at 1.

28 <sup>4</sup> *Id.* at 2.

<sup>5</sup> *Id.*

<sup>6</sup> Ex. S-1 at Attach. A.

1 area. The report includes the findings that Liberty and Valley are in compliance with Arizona  
2 Department of Water Resources (“ADWR”) and with Maricopa County Environmental Services  
3 Department (“MCESD”). Both companies are currently in compliance with Commission Decisions.<sup>7</sup>

4 The report indicates that Liberty’s water system has adequate production and storage  
5 capacities to support the existing customer base and growth in both Phase I and Phase II of the  
6 requested area. Whereas Valley’s water system has adequate production and storage capacities to  
7 support the existing customer base and growth in Phase I of the requested area, Staff concluded that  
8 an additional water source will be needed to serve Phase II customers. Valley disagrees with this  
9 conclusion and believes that Well No. 1 will be able to provide adequate production to serve Phase II  
10 customers.<sup>8</sup>

11 The Staff Report also indicates that the proposed water plans by Liberty and Valley are  
12 appropriate and the costs are reasonable. No “used and useful” determination of the proposed plant  
13 was made, and no conclusions should be inferred for future rate making or rate base purposes. Staff  
14 would note that the Valley proposal does not include any on-site water plan or associated cost  
15 estimates. Technically, Valley has not provided a complete engineering construction plan. Valley  
16 provided its proposed off-site construction plan and stated that it will adopt Liberty’s proposed on-  
17 site water construction plan.<sup>9</sup>

18 Staff’s financial analysis<sup>10</sup> describes the two Companies’ Capital Structures. Liberty intends  
19 to finance water and wastewater facilities through a combination of contributions, advances in aid of  
20 construction and equity. Valley intends to finance the water facilities entirely with advances in aid of  
21 construction. Staff is concerned about a continuing over-reliance on Advances in Aid of  
22 Construction (“AIAC”) and Contributions in Aid of Construction (“CIAC”). Staff normally  
23 recommends that the combined ratio of AIAC and net CIAC funding ratio not exceed 30 percent of  
24 total capital for private and investor-owned utilities. Currently, both companies’ combined AIAC  
25 and net CIAC funding ratio exceeds 30 percent of total capital. The funding ratio for Valley is 88

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26 <sup>7</sup> *Id.* at 2.

27 <sup>8</sup> *Id.* at 3.

28 <sup>9</sup> *Id.*

<sup>10</sup> *Id.* at Attach. C.

1 percent for water, while Liberty's funding ratio is 43 percent for water and 59 percent for  
2 wastewater.<sup>11</sup>

3 It is Staff's opinion that the efficiencies inherent in a combined water/wastewater company  
4 are greater than those presented by two separate companies providing those services. An example  
5 would be the reduction of duplicated costs and the ability to manage the entire system as opposed to  
6 only a part of the system.

7 Staff believes that Liberty is the best suited utility to receive this CC&N extension. There are  
8 several reasons for this: request for service from the developer; efficiency from the combined  
9 services; access to more capital for funding; a lesser reliance on AIAC and CIAC; and lower rates.

10 However, should the Commission wish to select Valley, that would be a viable alternative.  
11 Valley presents several compelling reasons for its possible selection: proximity of the extension area;  
12 greatly increase the long term viability of the company as it would result in an 87 percent increase in  
13 customer base;<sup>12</sup> and this is the only contiguous area for Valley to expand its service area.

14 **II. STAFF ANALYSIS.**

15 Staff ultimately recommends that the Commission approve Liberty's applications for the  
16 extensions of its CC&Ns to provide water and wastewater service subject to five conditions.<sup>13</sup> In  
17 particular Staff recommends that any approval of the CC&Ns to Liberty be subject to the following  
18 conditions:

- 19 1. To require Liberty to charge its existing rates and charges in the proposed extension area.
- 20 2. To require Liberty to file with Docket Control, a Certificate of Approval to Construct for  
21 Phase I water plan as a compliance item in this docket no later than December 31, 2015.
- 22 3. To require Liberty to file with Docket Control, a copy of a Certificate of Approval to  
23 Construct for Phase I wastewater plan as a compliance item in this docket no later than  
24 December 31, 2015.
- 25 4. To require Liberty to file with Docket Control, a copy of the county franchise agreement  
26 for the extension area as a compliance item in this docket no later than December 31,  
27 2015.

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27 <sup>11</sup> Ex. S-1 at 3.

28 <sup>12</sup> Ex. V-3 at 4.

<sup>13</sup> Ex. S-1 at 6.

1 5. To require Liberty to fund its future infrastructure needs with 70 percent equity and no  
2 more than 30 percent AIAC and CIAC combined.<sup>14</sup>

3 Finally, Staff recommends that, if the Commission grants the CC&N extension to Liberty, the  
4 extension be considered null and void, after due process, should Liberty fail to meet Conditions 2, 3,  
5 and 4 within the time specified.<sup>15</sup>

6 Liberty, both in its response to the Staff Report,<sup>16</sup> and at the hearing, only takes exception  
7 with recommendation number five. First, Liberty asserts that that recommendation conflicts with the  
8 Company's existing service tariffs. Second, Liberty argues that the issues concerning financing and  
9 investment in utility infrastructure are more appropriately addressed in rate case proceedings.<sup>17</sup>

10 **A. Staff's Modified Recommendation Number Five Does Not Conflict with Liberty's**  
11 **Tariffs.**

12 Liberty asserts generally that Staff's recommendation number five conflicts with its existing  
13 water and wastewater hookup fee tariffs and at least currently conflicts with its general wastewater  
14 service tariff approved by the Commission in Decision No. 74437, which Liberty asserts requires all  
15 main extensions to be completed at cost and to be treated as CIAC.<sup>18</sup> However, both Staff and  
16 Liberty agree that the requirement that "all main extensions shall be completed at cost and shall be  
17 treated as non-refundable contributions in aid of construction" is an error in the tariff.<sup>19</sup> Further,  
18 Liberty has acknowledged that it is in the process of filing a corrected tariff for review by Staff.<sup>20</sup> It  
19 is conceivable that this process will be complete prior to the Commission's issuance of a decision in  
20 this matter. In which case, this conflict would be resolved prior to a decision in this matter. At a  
21 minimum, Liberty suggests that recommendation number five should be modified to state: "To  
22 require Liberty to fund its future infrastructure needs with 70 percent equity and no more than 30  
23 percent AIAC and CIAC combined, subject to Liberty's applicable water and wastewater tariffs."<sup>21</sup>

24 <sup>14</sup> Ex. L-7 at 5.

25 <sup>15</sup> *Id.*

26 <sup>16</sup> Ex. L-7 at 2.

27 <sup>17</sup> Ex. L-7 at 2.

28 <sup>18</sup> *Id.*

<sup>19</sup> Ex. L-7 at 2, Tr. at 157.

<sup>20</sup> Ex. L-7 at 2.

<sup>21</sup> Ex. L-7 at 4.

1 Staff agrees with Liberty, in part, that its original version of recommendation number five  
2 may conflict with Liberty's existing hook-up fee tariffs in certain circumstances where Liberty would  
3 be required to charge more than 30 percent of the costs of a particular project because of the amount  
4 of its hook-up fees. However, beyond the main extension language addressed above, which will  
5 likely be resolved in the near future, Liberty has not identified any other tariffs that would conflict  
6 with this recommendation. In order to address Liberty's concern in part, Staff modified  
7 recommendation number five to read: To require Liberty to fund its "future infrastructure needs with  
8 70 percent equity and no more than 30 percent AIAC and CIAC combined," subject to Liberty's  
9 applicable water and wastewater hook-up fee tariffs.<sup>22</sup>

10 Liberty also makes several arguments regarding management interference and prudence.  
11 Additionally, Liberty believes that issues regarding plant financing should be dealt with in a rate case.  
12 Liberty asserts that it is up to Liberty to determine how to finance plant, consistent with law and  
13 regulation.<sup>23</sup> Liberty further argues that, if the Commission ultimately requires it to fund plant for  
14 new development with equity, then this invades the management function of Liberty.<sup>24</sup> Liberty also  
15 argues that under this scenario it would be entitled to a return on and of its investment even if the  
16 development does not build out as planned and even if the plant is not yet used and useful, because  
17 the Commission obligated the Company to fund the plant for new growth.<sup>25</sup> This is incorrect. While  
18 Staff's recommendation specifies the amount of any investment that must be equity and the  
19 maximum amount of AIAC and CIAC Liberty can use, it is ultimately Liberty that decided to pursue  
20 a CC&N extension.

21 Liberty intends to finance water and wastewater facilities through a combination of  
22 contributions, advances, and equity.<sup>26</sup> Staff normally recommends that the combined AIAC and  
23 CIAC funding ratio not exceed 30 percent of total capital for private and investor-owned utilities.<sup>27</sup>  
24 As of December 31, 2013, for the Liberty Utilities water system pro-forma (including the proposed

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25 <sup>22</sup> Tr. at 53:15-19.

26 <sup>23</sup> Ex. L-7 at 3.

27 <sup>24</sup> *Id.*

27 <sup>25</sup> Ex. L-7 at 3.

28 <sup>26</sup> Ex. S-1 at 3.

28 <sup>27</sup> *Id.*

1 CC&N extension) the combined AIAC (\$30,894,797) and net CIAC (\$5,918,237) is \$36,813,034 or  
2 43 percent of the total capital.<sup>28</sup> For Liberty Utilities wastewater system pro-forma at December 31,  
3 2013 (including the proposed CC&N extension) the combined AIAC (\$12,757,449) and net CIAC  
4 (\$29,767,064) is \$42,524,513 or 59 percent of the total capital.<sup>29</sup> Staff's concern regarding Liberty's  
5 continuing overreliance on AIAC and CIAC prompted the recommendation that the Company fund  
6 its infrastructure needs with 70 percent equity and no more than 30 percent AIAC and CIAC  
7 combined, in order to provide a better balance of financial risk for the Company and its ratepayers.<sup>30</sup>

8 If a company over-relies on AIAC and CIAC, it may not have rate base sufficient enough to  
9 earn a reasonable rate of return.<sup>31</sup> While Staff acknowledges that Liberty is probably not at risk for  
10 rate base erosion due to over-reliance on AIAC and CIAC, such over-reliance -- even by a well-  
11 funded utility such as Liberty -- can ultimately have a detrimental effect on its earnings and the rates  
12 ultimately authorized by the Commission.<sup>32</sup> It is because of this clear connection to rates and  
13 ratemaking that Staff is making this recommendation and the purpose of Staff's recommendation is to  
14 prevent this from occurring at the outset. Ultimately, it should not be forgotten that the Commission,  
15 in the exercise of its regulatory power, "may interfere with the management of public utilities  
16 whenever the public interest demands."<sup>33</sup>

17  
18 **B. Staff's Recommendation Number Three Is Necessary If the Commission Grants  
the CC&N Extension to Valley.**

19 Staff recommends that the Commission grant Liberty the requested water and wastewater  
20 CC&N extensions. However, if the Commission, in its discretion, decides to grant Valley's  
21 application for extension of its CC&N to provide water service, then Staff recommends the following  
22 conditions:

- 23 1. To require Valley to charge its existing rates and charges in the proposed extension  
24 area.

25 \_\_\_\_\_  
26 <sup>28</sup> Ex. S-1, Attach. C at 2.

27 <sup>29</sup> *Id.*

28 <sup>30</sup> Ex. S-1 at 4.

<sup>31</sup> *Id.*

<sup>32</sup> Tr. at 151:24-153:9.

<sup>33</sup> *Southern Pac. Co. v. Arizona Corp. Comm'n*, 98 Ariz. 339, 343, 404 P.2d 692, 695 (1965).

- 1           2. To require Valley to file with Docket Control, a Certificate of Approval to  
2           Construct for Phase I water plan as a compliance item in this docket no later than  
3           December 31, 2015.
- 3           3. To require Valley to fund the entire construction costs with equity.<sup>34</sup>

4           Staff further recommends that, if the Commission should decide to grant this extension of the  
5 water CC&N to Valley, it be considered null and void, after due process, should Valley fail to meet  
6 Condition number 2 within the time specified.<sup>35</sup>

7           Although Staff is recommending that the Commission grant the CC&N extension for water  
8 service to Liberty, as discussed more fully above, Valley has provided a number of reasons why  
9 granting it the CC&N is appropriate. For example, Valley's current CC&N surrounds the extension  
10 area on three sides. With the addition of Marbella Ranch customers, economies of scale for Valley's  
11 current and future customers would benefit from the extension.<sup>36</sup>

12           While Valley does take issue with Staff's overall recommendation that the water CC&N  
13 extension should be granted to Liberty, Valley only seems to take issue with Staff's recommendation  
14 number three in the event that the Commission grants the CC&N extension for water service to  
15 Valley. Valley indicated in its application that the project would be funded entirely using AIAC.<sup>37</sup>  
16 As with Liberty, Valley's combined AIAC and net CIAC funding ratio already exceeds 30 percent of  
17 total capital as of December 31, 2013. In particular Valley's funding ratio is currently 76 percent.<sup>38</sup>  
18 If one includes the proposed extension area, Valley's combined AIAC and net CIAC funding ratio  
19 jumps to 88 percent of total capital. It is because of this extreme over-reliance on contribution and  
20 advances that Staff recommends that 100 percent of the new plant be funded through the use of  
21 equity.

22           In its response to the Staff Report, Valley also noted that in Decision No. 68309 it was  
23 ordered by the Commission to produce a positive equity position.<sup>39</sup> Specifically, that decision  
24 ordered Valley to develop and institute a plan to produce a positive equity position by December 31,

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25 <sup>34</sup> Ex. S-1 at 7.

26 <sup>35</sup> *Id.*

27 <sup>36</sup> Ex. L-7 at 3.

27 <sup>37</sup> Ex. S-1 at 5.

28 <sup>38</sup> *Id.* at 4.

28 <sup>39</sup> Ex. L-7 at 2.

1 2010, and required Valley to file a copy of the plan as a compliance item.<sup>40</sup> According to  
2 Valley, it has improved its equity position from a negative (\$413,442) for the test year ended  
3 December 31, 2003 to a positive \$313,720 as of December 31, 2013.<sup>41</sup> Further, Valley increased its  
4 rate base from a negative (\$169,027) as of the test year ended June 30, 2008 to a positive \$1,769,212  
5 as of December 31, 2013.<sup>42</sup> Valley indicated that it accomplished this improvement through the sale  
6 of stock and assets.<sup>43</sup>

7 Valley has clearly made significant improvements, which would be significantly impacted if  
8 it were to fund the entire project through advances. It is important to note that, if the Commission  
9 grants the CC&N extension to Valley, the additional service territory would increase its customer  
10 base by 87 percent.<sup>44</sup> If Valley were to fund the project using only AIAC, it would not be entitled to  
11 earn a return on that plant, the amount of AIAC would offset any related additions to rate base,  
12 Valley would have refund obligations to the developer, and any amounts not refunded in the required  
13 time frame would convert to CIAC.<sup>45</sup> All of this could have the effect of reducing or eliminating the  
14 significant gains that Valley has accomplished, and could make it more challenging for the  
15 Commission to set rates in a subsequent rate case.

16  
17 **C. Staff Offered an Alternative Recommendation to Address Some of the  
Companies' Concerns.**

18 Valley and Liberty both take issue with the funding restrictions that Staff is recommending.  
19 In order to address their concerns in part and to give the Commission an alternative recommendation  
20 to consider, Staff proposed an alternative. Although Staff continues to recommend the funding  
21 restrictions discussed above for Liberty and Valley, as an alternative, Staff has the following  
22 recommendation:

23 The Company can choose how to finance the plant but it cannot worsen  
24 the current percentage of combined AIAC and CIAC and the Company

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<sup>40</sup> Dec. No. 68309 at 27.

26 <sup>41</sup> Ex. L-7 at 2.

27 <sup>42</sup> *Id.*

28 <sup>43</sup> Tr. at 102:14-24.

<sup>44</sup> Ex. V-3 at 4.

<sup>45</sup> Tr. at 152:25-153:4, 157:5-13.

1 shall docket a plan by July 31, 2015 of how it will meet and maintain a  
2 70 percent equity to 30 percent AIAC/CIAC ratio.<sup>46</sup>

3 Although this is not Staff's primary recommendation, it does address some of the concerns  
4 raised by Liberty and Valley regarding the funding sources for the project. It also gives the  
5 Commission an alternative to consider.<sup>47</sup>

6 **D. Used and Useful Plant.**

7 Liberty at hearing suggested that Staff's recommendation that the project be funded in a  
8 particular way should also have come with a "used and useful" assessment.<sup>48</sup> Staff does not make a  
9 "used and useful" determination in CC&N cases because there is no plant currently constructed and  
10 no customers currently being served. The prudence and used and usefulness of plant are determined  
11 in the context of a rate case. At some point in the future, if Valley and/or Liberty were granted the  
12 CC&N extension in this case, and if the project were constructed in whole or in part, the CC&N  
13 holder would have the ability to file a rate case application. At that time, Staff would analyze and  
14 determine whether the plant was used and useful and prudently constructed, and would make  
15 recommendations to the Commission in that regard.

16 Funding restrictions in the CC&N extension area are irrelevant to the used and useful and  
17 prudence determinations that the Commission will make in a rate case. In other words, the mere fact  
18 that the Commission may require Liberty and/or Valley to fund the plant in a certain way does not, as  
19 they suggest, mean that the Commission has already predetermined the used and usefulness and  
20 prudence of the plant. The Commission's ratemaking authority is an exclusive grant of power,<sup>49</sup> and  
21 this exclusive jurisdiction is not limited to setting actual rates but extends to matters determined by  
22 the Commission as necessary to the ratemaking process.<sup>50</sup> In this case Staff's recommendations, if  
23 adopted, simply help to ensure that ratepayers' interests are considered and protected. As the Arizona  
24 Supreme Court has stated, the Commission has the "power to lock the barn door before the horse  
25 escapes."<sup>51</sup>

26 <sup>46</sup> Tr. at 145.

27 <sup>47</sup> Tr. at 145.

28 <sup>48</sup> Tr. at 48-49.

<sup>49</sup> See *State v. Tucson Gas, Electric Light and Power Co.* 15 Ariz. 294, 300, 138 P.781, 783 (1914).

<sup>50</sup> *Arizona Corp. Comm'n v. State ex. Rel. Woods*, 171 Ariz. 286, 294, 803 P.2d 807, 815 (1992)

<sup>51</sup> *Id.* at 818, 903 P.2d at 297.

1 **III. CONCLUSION.**

2 This is one of the first cases using the new rules for CC&N applications. The new rules went  
3 into effect in January 2010. These revised rules require that applicants provide documentation  
4 establishing the applicant's financial condition.<sup>52</sup> The purpose of this requirement is to allow Staff to  
5 recommend appropriate restrictions to ensure that the granting of the CC&N will not detrimentally  
6 affect the ability of the public service corporation to provide adequate service and will not impede the  
7 ability of the Commission to ultimately authorize just and reasonable rates. That is the purpose of  
8 Staff's recommendations in this case.

9 RESPECTFULLY SUBMITTED this 17<sup>th</sup> day of October 2014.

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12 \_\_\_\_\_  
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<sup>52</sup> A.A.C. R14-2-402(B)(5)(p) and R14-2-602(B)(5)(q).

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