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COMMISSIONERS

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- GARY PIERCE
- BRENDA BURNS
- BOB BURNS
- SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS EASTERN GROUP AND FOR CERTAIN RELATED APPROVALS.

Docket No. W-01445A-11-0310

NOTICE OF FILING TESTIMONY

Pursuant to the Procedural Order dated March 21, 2013, the Arizona Investment Council submits the testimony of Gary Yaquinto in support of the Settlement Agreement.

RESPECTFULLY SUBMITTED this 2nd day of April, 2013.

Arizona Corporation Commission
DOCKETED

APR 02 2013

DOCKETED BY [Signature]

GALLAGHER & KENNEDY, P.A.

By [Signature]

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BEFORE THE ARIZONA CORPORATION COMMISSION

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BOB STUMP, Chairman
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IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN ARIZONA
CORPORATION, FOR A DETERMINATION OF
THE FAIR VALUE OF ITS UTILITY PLANT AND
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RATES AND CHARGES FOR UTILITY SERVICE
FURNISHED BY ITS EASTERN GROUP AND FOR
CERTAIN RELATED APPROVALS.

Docket No. W-01445A-11-0310

Settlement Agreement Testimony

of Gary Yaquinto

on Behalf of

Arizona Investment Council

April 2, 2013

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I. QUALIFICATIONS

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Q. Please state your name, position and business address.

A. Gary M. Yaquinto. I am President and CEO of the Arizona Investment Council ("AIC").
Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

Q. Please summarize your educational background and professional experience.

A. I earned B.S. and M.S. Degrees in Economics in 1974 from Arizona State University, as well as an MBA from the University of Phoenix in 2005. From 1975 to 1977, I was employed by the State of Wyoming as an economist responsible for evaluating the economic, fiscal and demographic effects of resource development in Wyoming. From 1977 to 1980, I was Chief Research Economist for the Arizona House of Representatives. From 1980 to 1984, I was employed as an economist in the consulting industry. Since 1984, I have worked in various capacities in government and the private sector in the area of utility regulation, including positions with the Utilities Division Staff of the Arizona Corporation Commission, a competitive local exchange telephone carrier and as a consultant. I also served as the Chief Economist at the Arizona Attorney General's Office from 2003-2005 and as the Director of the Governor's Office of Strategic Planning and Budgeting from 2005-2006. I became AIC's President in December of 2006.

1 **II. ARIZONA INVESTMENT COUNCIL (“AIC”)**

2 **Q. What is the Arizona Investment Council and what is its mission?**

3 A. The AIC is a non-profit association organized under Chapter 501(c)(6) of the Internal
4 Revenue Code. AIC’s membership includes approximately 6,000 individuals – many of
5 whom are debt and equity investors in Arizona utility companies and other Arizona
6 businesses.

7
8 AIC’s mission is to advocate on behalf of its members’ interests, primarily before
9 regulatory bodies as well as the Legislature and, specifically, to enlarge and maximize the
10 influence of utility investors on public policies and governmental actions that impact
11 investors and their investments.

12
13 AIC also works with the Commission and policymakers generally to find ways to support
14 investment in Arizona’s essential backbone infrastructure, as well as improvements to, or
15 remediation of, existing facilities. We view this aspect of our mission as complementary
16 to our core advocacy of investor interests.

17
18 AIC also sponsors research into subjects affecting Arizona, its citizens and its utilities. In
19 that regard, and very relevant to the issues in this docket, continuing investment in
20 essential, backbone infrastructure is critical to support a well-functioning and robust
21 economy, as well as the health and welfare of Arizonans. In 2008, AIC published
22 “Infrastructure Needs and Funding Alternatives for Arizona: 2008-2032” – a
23 comprehensive study that took a close look at infrastructure, operations and funding

1 requirements over that 25-year period in four important areas: energy, water,
2 telecommunications and transportation. This report, prepared by economists from
3 Arizona State University, estimated investment requirements of about \$500 billion to
4 meet the State's needs in these four critical areas.

5
6 Specifically in the areas of water and wastewater systems, AIC's 2008 study projected a
7 funding shortfall of some \$30 billion as to what will be needed to support water supply
8 augmentation and water/wastewater infrastructure to meet the State's needs. This
9 includes both municipal, as well as private, water and wastewater operators.

10
11 **Q. Are the study's observations still relevant today and in the context of this Docket**
12 **specifically?**

13 **A.** Yes. Although Arizona's population growth slowed since the study's original publication
14 in 2008, the fact remains that our recovery continues and Arizona is at a serious
15 crossroads in supporting investment in these systems. According to the report: "The
16 infrastructure systems built decades ago are now due for replacement – what the
17 American Water Works calls the 'dawn of the replacement era' is upon Arizona."¹

18
19 In the case of Arizona Water Company's Eastern Group system, the need to replace aging
20 and deteriorating infrastructure was thoroughly documented by the Company in its rate
21 case. That fact was acknowledged by the Commission in its Decision No. 73736 as a

22
23 ¹ *Infrastructure Needs and Funding Alternatives*, L. William Seidman Research Institute, W.P. Carey School of
Business, Arizona State University, prepared for Arizona Investment Council, May 2008, p. 389.

1 reason to consider further a surcharge mechanism to assist in financing system
2 replacements and improvements.²
3

4 **Q. Please summarize AIC's interest in this case**

5 A. AIC's interest in this case is twofold:
6

7 First, AIC believes the System Improvements Benefit ("SIB") rate mechanism described
8 in the Settlement Agreement provides Arizona Water Company an important tool for
9 acquiring the capital needed to finance badly needed repairs to, and replacement of,
10 infrastructure in the Company's Eastern Group systems. The Settlement Agreement
11 provides the criteria under which a narrowly defined SIB charge may be imposed
12 (Section 6.3), as well the infrastructure asset categories eligible for rate treatment under
13 the SIB (Section 6.4). The opportunity timely to recover some of these costs between
14 rate cases afforded through the SIB mechanism reduces the regulatory lag which
15 effectively penalizes investors for supplying the capital needed to ensure safe and
16 adequate service to customers.
17

18 Second, AIC has supported ratemaking mechanisms like the SIB for all water and
19 wastewater companies whose rates are regulated by the ACC for the reasons stated. The
20 SIB authorized in the Settlement Agreement for Arizona Water Company will serve as a
21 template for other companies to seek such a mechanism.
22

23 ² ACC Decision No. 73736, February 20, 2013, p. 104.

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III. AIC SUPPORTS THE PROPOSED SETTLEMENT AGREEMENT

Q. Is AIC a signatory to the Settlement Agreement?

A. Yes.

Q. Why does AIC support the Settlement Agreement?

A. First and foremost, AIC supports the Settlement Agreement, because the SIB mechanism positions Arizona Water Company to compete for capital on better terms and conditions than would otherwise be available to make critical repairs and improvements to its Eastern Group systems. It does so by enabling the more timely recovery of capital costs related to water system repairs and improvements. As stated in Section 2.3 of the Settlement Agreement, “[t]he SIB mechanism is a ratemaking device designed to provide for the timely recovery of the capital costs (depreciation expense and pre-tax return on investment) associated with distribution system improvement projects meeting the requirements . . . and that have been completed and placed in service . . .”

Further, ratemaking mechanisms like the SIB proposed in the Settlement Agreement also signal to investors generally an improved regulatory climate in Arizona. This enhances the overall ability of Arizona’s utilities to compete for scarce capital.

Q. Are there other reasons AIC supports the Settlement Agreement?

A. Yes. Because the investments that qualify for SIB treatment are needed to ensure safe, reliable and adequate water service to customers, they also benefit from the clause.

1 Further, efficiency gains from the investments are passed through to customers through
2 an efficiency credit which is equal to five percent of the SIB revenue.

3
4 By providing more timely recovery of the capital costs associated with system
5 improvement, small rate adjustments are spread more evenly between rate case filings.
6 Without the SIB, these costs accumulate and compound until they can begin to be
7 recovered only after completion of the Company's next rate case. That results in much
8 larger rate increases and rate shock, which is not good for consumers, the Commission,
9 the utility or its investors. Finally, this rate gradualism is further encouraged by the
10 Settlement Agreement, because any SIB surcharge is capped at five percent annually.

11
12 **IV. AIC'S RECOMMENDATION REGARDING THE SETTLEMENT AGREEMENT**

13 **Q. Mr. Yaquinto, what is AIC's recommendation for the Commission in relation to the**
14 **Settlement Agreement?**

15 A. The Settlement Agreement represents an appropriate, productive balance among
16 divergent views of the signatories on a challenging and a very important issue. We
17 recommend the Commission enter its Order approving the Settlement Agreement.

18
19 **Q. Does that conclude your testimony?**

20 A. Yes.

21

22

23