ARIZONA WATER COMPANY

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April 18, 2023

Arizona Water Banking Authority
Attn. Ms. Rebecca Bernat
1110 W Washington Street, Ste. 310
Phoenix, AZ 85007

Re: Distribution of AWBA Long-Term Storage Credits (LTSC) for Firming Central Arizona Project (CAP) Municipal & Industrial (M&I) Priority Subcontract Supplies

Dear Ms. Bernat:

Thank you for the opportunity to offer our comments and suggestions to the AWBA's request to reconsider the 2019 policy to meet all reductions to scheduled CAP M&I Priority Water due to a Shortage Condition or required Drought Contingency Plan (DCP) contributions ("Firming Policy"). If reconsidered, the AWBA also asked for feedback about two alternative firming methods that would extend the availability of the 3.22 million acre-feet (MAF) of long-term storage credits ("firming credits") accrued through 2022 for the purpose of offsetting Colorado River shortage reductions to CAP M&I Priority Water.

To the first question, Arizona Water Company (AWC) believes the Firming Policy should not only be revisited, but rescinded entirely. The data provided by AWBA staff at the April 11, 2023 meeting shows the damage the Firiming Policy could cause by exhausting the entire 3.22 MAF of firming credits in just two to five years, instead of the decades anticipated. The AWBA has been developing firming credits since 1997 to monetize what essentially amounts to an insurance policy against Colorado River shortages at a cost of over $225 million dollars. The Firming Policy, if implemented, would essentially plunder one of Arizona's strongest water management strategies. It has taken the AWBA over 25 years to develop these LTSCs. To replace them today, on the open market, would cost over **$1.6 billion dollars**.

It's very important to remember the context behind the AWBA and its purpose. The idea was conceived in the early 1990s with the intention of storing every drop of unused CAP water as a hedge against future Colorado River shortages. By doing this, the AWBA hoped to enhance the water security for M&I Priority, Tribal Water and on-River Water users. While the AWBA conducted modeling at the time and reguarly since, the "storage goals" set for the AWBA are just goals. The storage goals were established for operational and planning purposes, so the AWBA could conduct its business in a responsible manner. The storage goals are just a 100-year modeling projection of how many firming credits might be needed to firm portions of M&I Priority and on-River Water uses and ultimately to firm all Tribal Settlement obligations.

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Specific to M&I Priority Water, since inception, and as part of the modeling assumptions, the AWBA planned to offset up to a 20% reduction to M&I Priority water caused by Colorado River shortages. Consquently, the firming credits were never intended to be the only strategy to offset shortages. Using firming credits is one of many strategies to offset shortage volumes.

Other strategies include:

- more aggressive conservation measures by water providers,
- shifting reliance to other available water supplies including LTSCs, extinguishment credits and groundwater,
- the use of the Assured Water Supply rule exemptions and, of course,
- applying the existing in-state priority systems established for use of CAP water.

It is also important to remember, the benefit provided by the AWBA to M&I Priority Water users is making actual CAP water available during shortage to, for example, protect direct use of CAP water being treated at water treatment plants. The benefit is not and has never been the actual firming credits. The firming credits are the vehicle the AWBA uses to make actual CAP water available by entering into agreements with recovery partners that can absorb the shortage by pumping firming credits. In other words, the firming credits are a liability not a benefit. When the firming credits are viewed as the benefit, then people start to see the firming credits as a water supply. Based on its history and the nature of its task and resources, the water stored by the AWBA was never intended to be a water supply.

The purpose of the Firming Policy is very narrow. It is to provide certainty about the distribution of AWBA credits to meet demands of M&I CAP subcontracts **under the terms** of the Lower Basin Drought Contingency Plan (LBDCP) during the interim period. The policy also provides a period of time for the AWBA to learn how to operate under shortage conditions in order to make better decisions about how to offset shortages after the interim period. Under the LBDCP, there is no mitigation for either Tier 3 reductions or reductions of any Tier after the interim period. As can be seen from the AWBA's analysis, an unintended consequence of the Firming Policy would essentially convert the firming credits to a mere 32,200 AF assured water supply, the vast majority of which would be distributed, **for free,** to the largest water providers in the CAP service area. This would be a poor outcome to one of the most successul water policies implemented in the State of Arizona over the last 25 years. This should be unacceptable to the AWBA Commission.

Assuming the AWBA rejects the idea of distributing all of the AWBA credits in the next 3 to 5 years, of the alternatives and scenarios provided, AWC prefers Alternative Method 1, Scenario 1A. But there are certain aspects of this Alternative and Scenario that could be improved upon. The analysis conducted by staff assumes firming credits will be made available through 2123. The original intention was to provide firming for 100 years starting from when the AWBA began storing water in 1997. As such, the analysis should be limited to the period between 2023 and 2097. Furthermore, when the AWBA's authorities were expanded to include Tribal Water firming, the AWBA's obligation ends in 2108. Staff's analysis assumes firming well beyond this period. The matter of extending the services of the AWBA beyond the intended time frame is an important policy question. But this policy question should be answered separate from the question of how to distribute firming credits today. At any rate, the analysis should be updated to reflect the time period assumed for providing firming services consistent with all previous analyses and the original intentions. This is particularly relevent when considering the issue of using withdrawal fees for Tribal Water firming instead of for M&I firming, as Tribal Water firming is an obligation.

Both methods and all of the scenarios assume the AWBA will no longer develop firming credits. While this may one day be proven true, it is premature to assume no future firming credits will be developed. The AWBA should not develop policies that would interfere with the AWBA's role of developing firming credits in the future. The Colorado River will ultimately stablize and the shortfall will likely be back-filled wth another water supply. Moreover, the Colorado River could also one day be in surplus conditions. Under such conditions, unused water could become available for AWBA purposes. Above all else, the AWBA needs flexibility. There will be a time when the AWBA will return to its role of storing water and not distributing firming credits. Any policy should take this into account.

One of the AWBA's basic responsibilities is to use its discretion to make decisions regarding the distribution of firming credits. Specific to M&I Water firming, the AWBA "may distribute or extinguish these long-term storage credits to the extent necessary to meet the demands of CAWCD's municipal and industrial subcontractors during times in which CAWCD's diversions from the Colorado river have been or will be disrupted by shortages on the Colorado river or by disruptions in operation of the central Arizona project". It is not an obligation like the AWBA has with Tribal Water firming. The AWBA should protect and take its responsibility to use its discretion seriously. The AWBA should carry out its responsibilities through the AWBA's existing Annual Operating Plan process which provides ample opportunity for feedback from M&I Subcontractors. Both Alternative Methods and all of the Scenarios undermine the AWBA's existing authority and does not allow for changes on the Colorado River system. In the end, removing the AWBA's discretion stymies the ability of the AWBA to fulfill its mission.

Additional Suggestions & Considerations:

Alternative Method 2 puts the AWBA in the position of enforcing management plan requirements even more aggressively than would be done by the Arizona Department of Water Resources. Such a role is not appropriate for the AWBA and would not even be desirable. This is not to say that more aggressive conservation measures should not be considered and enforced during shortages. In fact, AWC would argue that such measures should be taken, but this should be directly managed through ADWR and not indirectly "encouraged" by withholding AWBA credits. This indirect approach would be like your insurance company saying they will only pay for damages to your car if you agree to drive your car less. Again, AWBA credits were intended to enhance water security by mitigating reductions of up to a 20% in the M&I Priority Pool. The credits are not an assured water supply and they are not a management plan enforcement tool.

AWC suggests the AWBA start viewing its firming credits more like an insurance company would view its assets relative to paying its claims. Instead of money, the asset is water, so there are different considerations. One consideration might be employing different credit distribution strategies by AMA. Another consideration might be providing incentives to water providers like making more AWBA credits available if the water provider agrees to match AWBA firming credits with the use of its own LTSCs. This would be a more appropriate way to incentivize water providers and would not burden the AWBA with enforcement functions. Another consideration might be to disallow the distribution of firming credits to a water provider that develops or purchases LTSCs while benefiting from AWBA credits. Alternatively, the AWBA could limit the volume of firming credits distributed to specific CAP subcontractors based on the accrual of LTSCs by that subcontractor during the same year.

The AWBA should consider relying on the use of Shortage Reparation credits, to the extent they are not required for meeting on-River firming contractual requirements, before relying on water storage tax credits. There are nearly 110,000 AF of Shortage Reparation credits that were intended for use during the interim period. These credits should be used for that purpose whether to meet on-River or M&I firming. The AWBA may need to consider different strategies for the use of those credits based on the AMA where they are stored.

The AWBA should also rely on withdrawal fee credits as part of the assets available to the AWBA for M&I firming. These credits are substantial particularly in the Pinal AMA. Some withdrawal fee credits could be used to fully meet up to 20% reductions in the Pinal AMA for 100 years. Also, while clearly withdrawal fee firming credits will be required to meet the AWBA's Tribal Firming obligations, Phoenix AMA withdrawal fee firming credits should be exhausted first before using Pinal AMA withdrawal fee credits since water users in the Pinal AMA do not directly benefit from the Settlement.

Again, AWC appreciates the opportunity to provide comments and suggestions to the AWBA. The AWBA has an important role in providing additional water security in Arizona, and AWC respects that role. Please feel free to reach out to continue the conversation regarding our suggestions. AWC will be sending a separate letter outlining the number of credits that our organization would like the AWBA to distribute to us in 2024.

Very truly yours,

for TSR

Terri Sue Rossi
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