Arizona Water Banking Authority

Discussion Paper for Distributing Long-term Storage Credits for CAP M&I Firming

<u>Background</u>

The Intergovernmental Agreement (IGA) among ADWR, AWBA, and CAWCD identifies certain cooperative activities and joint planning processes that the parties must participate in periodically. These activities include developing a coordinated and cooperative planning process that addresses issues such as: 1) the future distribution and use of water stored by the AWBA, and 2) the recovery of water stored by the AWBA and CAWCD for water management objectives set forth in Title 45, Chapter 2, Arizona Revised Statutes.

CAWCD has a good understanding of the physical aspects of recovering credits and delivering water during shortages. However, during its recovery planning process, which has focused more on the location, timing, and purpose of recovering credits, several process and policy questions have been raised. AWBA staff identified these questions in a preliminary draft on *Potential Policies Regarding Distribution of Long-Term Storage Credits for M&I Firming,* which was provided at the AWBA Commission meeting on March 30, 2011. AWBA, CAWCD, and ADWR staff have since had initial discussions on these questions, which differ with regard to the source of funding the AWBA used to accrue the credits.

Some of these questions concern the "use" of AWBA credits. Pursuant to A.R.S. § 45-2457(D), except for the distribution of four-cent tax credits for M&I firming and agreements entered into by the Authority, the decision to distribute or extinguish AWBA credits is at the complete discretion of the Authority. Some of these questions will need to be answered, if the Authority is to develop guidelines on the distribution of its credits.

<u>Four- Cent Tax Credits</u>

The AWBA's role is fairly specific concerning the distribution of credits accrued with the four-cent tax. However, additional discussion is needed regarding the appropriate use of these credits during Colorado River shortage operations.

> …shall distribute long-term storage credits accrued with monies deposited in the fund in accordance with section 48-3715.03, subsection B only for the benefit of the county in which the monies were collected. The authority shall distribute these long-term storage credits to CAWCD 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.

Based on the plain reading of the statute, several of the questions identified in the preliminary draft paper discussed above can be resolved fairly easily since they are administrative in nature:

When are the credits distributed (assigned) to CAWCD?

CAWCD will have estimates in October of the amount of CAP water that will be available for delivery in the following shortage year and the amount of M&I demand it has for that water. Based on this information, CAWCD can estimate the amount of credits that will need to be recovered in order for CAWCD to meet its CAP M&I subcontract demands during the shortage year. CAWCD could provide these estimates to the AWBA so that they can be included in the AWBA's Annual Plan of Operation as required by statute. After the shortage year end, CAWCD can determine the number of credits necessary to cover the M&I shortage volume that will be reported to ADWR for recovery well permits held by CAWCD, as well as its recovery partners, along with any credits that will be needed for credit exchange. Based on the CAWCD year end report, the AWBA would request that ADWR assign the appropriate credits to CAWCD.

Are credits returned to the AWBA if CAWCD did not actually need them or do they stay with CAWCD until they are needed?

By requesting that ADWR assign credits at the end of the calendar year based on actual recovery, there is no need for CAWCD or recovering agents to return credits because only those credits that were used would be assigned. However, a mechanism for credit reconciliation would need to be established to address reporting errors that are not discovered until the following year.

What accounting is required for the AWBA to be sure the credits are used for the benefit of the county where the money is collected?

Likewise, by waiting to assign credits at the end of the calendar year, CAWCD can base its notification on the actual amount of credits recovered and water delivered to its customers. The wells from which those credits were recovered must be reported to ADWR as part of the annual reporting requirements. Furthermore, under current ADWR reporting requirements, the place of use of those credits can be verified if they were recovered by an M&I subcontractor pursuant to an agreement with CAWCD and used within that M&I subcontractor's service area or if that subcontractor delivered the recovered water to another M&I subcontractor.

Does the AWBA retain any control over the credits once distributed to CAWCD?

The AWBA would be assigning credits to CAWCD based on end-of-year reporting. ADWR can verify the recovery of these credits as part of its annual reporting review.

The following questions are related more towards policy and require additional discussion. The AWBA is seeking stakeholder input prior to resolving these questions. There may also be a need for additional AWBA policies before a procedure can be implemented. Points for discussion have been included under each question.

Should credits be distributed for water that is requested for the purpose of accruing long-term storage credits?

- The AWBA is required by statute to distribute four-cent tax credits to CAWCD "to the extent necessary" to meet M&I demand during shortages. Should the accrual of long-term storage (LTS) credits be considered "necessary" during times of shortage?

- Should direct use demand be met first before future water needs are considered? [Annual storage and recovery is considered a direct use]

- A leading rationale for establishing M&I firming goals was to assist in protecting a water provider's Designation of Assured Water Supply during shortages. Pursuant to the AWS rules, when a provider's surface water supply falls below the drought volume (80% of normal), a provider can apply to ADWR to qualify for a drought exemption. If approved, the provider's groundwater use would be considered consistent with the mangement goal of the AMA. Thus the firming goal was estimated to provide a replacement water supply up to 20% of CAP M&I supplies during shortages.

    - If shortages are equal to or greater than 20%, would it be reasonable to distribute credits for long-term storage if groundwater is also being pumped? Would there still be some subcontractors that are storing their subcontract water for LTS credits at this point?

    - There is an additional benefit associated with the distribution of AWBA's credits for accruing LTS credits because they could be sold to other entities. Should the AWBA allow its credits to be used for this purpose?

- If credits are distributed for the purpose of accruing LTS credits, would the AWBA distribute 5% less to account for the cut to the aquifer? Would there be an additional cut to account for losses? If so, how would the losses be calculated?

- Distributing credits for the purpose of accruing LTS credits could increase the pace at which four-cent tax credits are utilized. Does this also create issues concerning the equitable distribution of credits?

Should the AWBA be concerned about an equitable distribution of the credits within the county?

- Some M&I subcontractors may not need the full use of their subcontract at the time a shortage is declared because they either have access to other sources of water, have reduced their demand through drought planning, or do not have the demand to make full use of their subcontract.

    - If credits are distributed on a first come, first served basis, will credits be available to those providers in the future when they do make use of their full subcontract?

    - Likewise, if credits are distributed for the purpose of accruing LTS credits early, will credits be available in the future to meet direct use demands?

- How would the AWBA distribute credits to CAWCD to insure that there is equal/fair access to the credits? Would this reduce CAWCD's flexibility in meeting the demand of its M&I subcontractors?

- Does it matter if credits are distributed equitably as long as demand is being met?

Withdrawal Fee Credits

The Authority's role is not as specific in the distribution of the credits accrued with the withdrawal fees:

> …shall distribute or extinguish long-term storage credits accrued with monies collected in accordance with section 45-611, subsection C, paragraph 3 only for the benefit of the active management area in which the monies were collected. The authority 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, to implement the settlement of water right claims by Indian communities in this state or, on request from the director, to meet the other water management objectives set forth in chapter 2 of this title.

What is clear is that withdrawal fee credits can be used for M&I firming and Indian settlements. The AWBA is currently participating in discussions with CAWCD and ADWR concerning the firming of Indian and CAP M&I Priority water. The following questions pertain to the concepts being discussed as part of this process:

Should the AWBA establish a priority for the use of withdrawal fee credits?

Absent the availability of general appropriation funds for the development of Indian firming credits, withdrawal fee credits remain the AWBA's only alternative for meeting its Indian settlement obligations, including Indian leases that have a CAP NIA Priority water firming requirement.

- If Indian firming is identified as the highest priority for the use of withdrawal fee credits, should there be a specific amount of credits identified before credits can be used for other water management goals?
- Withdrawal fee credits in the Pinal AMA may also be needed to meet a replenishment obligation in the southside protection zones.

Should the AWBA reserve a quantity of withdrawal fee credits that will be available for M&I firming?

- How would the quantity of reserved credits be determined?
- Should credits be reserved to meet other water management goals?
- If credits are reserved for M&I firming or other water management goals there could be a risk that they may be needed to meet the Indian settlement obligations.

Should the AWBA wait until there is an actual demand for the credits before they are dedicated for a specific use?

- Given that withdrawal fees are the only credits available to the AWBA for meeting its Indian firming obligations, is it necessary for the AWBA to formally prioritize the use of these credits?

- Would such prioritization provide comfort (to the legislature, settlement participants and/or CAP subcontractors) that the State can meet (has met) its Indian firming obligations?

Does the AWBA distribute withdrawal fee credits for M&I firming in conjunction with the use of the four-cent tax credits or wait until the four-cent tax credits are fully utilized?

The conditions and restrictions regarding use of four-cent tax credits have been identified in statute. Would it make sense to fully utilize those credits for M&I firming before withdrawal fee credits are used for the same purpose since withdrawal fee credits can be used for other purposes and are the only credits currently available for meeting Indian settlement obligations?

If withdrawal fee credits are dedicated, who does the AWBA distribute those credits to?

This would depend on what the credits are used for:

- There would be no need to distribute credits if they are extinguished to meet certain Indian settlement obligations and/or water management goals.
- Credits recovered for Indian firming purposes could be distributed to an entity (including, but not limited to, CAWCD) that has agreed to recover the credits and deliver the water or is accepting the credits pursuant to an exchange.
- If the credits are dedicated for M&I firming, should they be distributed in the same manner as four-cent tax credits are distributed?

Should the AWBA treat withdrawal fee credits similar to the four-cent tax credits and distribute to CAWCD?

If the credits are being used for M&I firming purposes it might be reasonable to follow the same procedure for distributing four-cent tax credits, which may include the assignment of credits directly to a subcontractor that has entered into an agreement with CAWCD.

The following questions are administrative in nature and can be addressed using procedures similar to those identified under the distribution of four-cent tax credits:

Once distributed for M&I firming, how does the AWBA insure the credits are used for the benefit of the Active Management Area where the fees are collected?

By requesting that ADWR assign AWBA credits at the end of the calendar year, the entity receiving the credits can notify the AWBA of the actual amount of credits recovered and used. The wells from which those credits were recovered must be reported to ADWR as part of the annual reporting requirements. Under current ADWR reporting requirements, the place of use of those credits can be verified if they were recovered by an M&I provider and used within that provider's service area.

How are credits returned to the AWBA if they are not fully utilized by the entity that received the credits?

By requesting that ADWR assign credits at the end of the calendar year based on actual recovery, there would be no need to return credits.