

March 9th, 2011

Central Arizona Project
P.O. Box 43020
Phoenix, AZ 85080-3020
Board of Directors

Dear Mr. Modeer,

Recently, CAP staff presented stakeholders of the Arizona Municipal Water Users Association (AMWUA) with a proposed shortage and recovery policy, including the document entitled "Recovery of Stored CAP Water for M&I Subcontractors Guiding Principles" dated November 19, 2010. While the presentation was clearly articulated and produced meaningful dialogues, a number of the issues raised need additional discussion and clarification. However, the City of Mesa is very receptive to shortage and recovery planning and thought this was a very proactive gesture as shortages seem to be looming for CAP subcontractors.

Historically, it was this type of intelligent proactive planning that resulted in the creation of the Arizona Water Banking Authority (AWBA), which has been storing excess CAP water brought into this state through the Central Arizona Project to protect Arizona municipal and industrial (M & I) users against future water shortages (ARS§ 45-2401(H)(2) et seq). The legislature provided the AWBA with the mission, power and duty to "distribute long-term storage credits (Credits) earned by the authority to make water available to M & I users of Colorado river water in this state that are inside or outside the CAWCD service area" (ARS§ 45-2423(B)(7)(e)). Mesa recognizes the importance of this mission in light of Arizona's priority to Colorado water under *Arizona v. California*. At the same time, it is also important to recognize the parameters under which the AWBA must operate. Significantly, credits accrued through property taxes (property tax credits) *must* be distributed to CAWCD to the extent necessary to fulfill demands of M & I subcontractors during shortage disruptions. ARS § 45-2457(B)(7). Conversely, Credits accrued without use of property taxes may be distributed at the discretion of the AWBA. ARS § 45-2457(D)

At the meeting, CAWCD staff highlighted certain proposed points regarding shortage sharing and recovery planning:

- 1) The CAWCD staff suggested that "*Shortage sharing may not be handled equally across the entire CAP service area on a "pro-rata" sharing basis*". The City respectfully submits that this could occur only under voluntary arrangements. The City has always relied upon the provisions in section 4.7 of our Subcontract that require a pro-rata shortage sharing model. We presume that CAWCD staff is contemplating voluntary sales, exchanges, or other arrangements that can take place after the pro-rata distribution has been determined, and do not believe that the CAWCD has the ability to force any alternative result.
- 2) The CAWCD staff suggested that "*The CAP would determine (quantify) the sub-contractor's shortage and recovery needs based on "demands"*". The City presumes that the CAWCD recognizes that its contractual obligation is to maintain equity across the M & I pool in fulfillment of its Subcontract orders during shortage conditions, and therefore has no role in determining the

relative value of use by subcontractors for Project Water during a shortage. Therefore, we are confused about this statement and would appreciate clarification of CAWCD's intent.

In addition, Mesa offers the following comments regarding the "Guiding Principles" draft document:

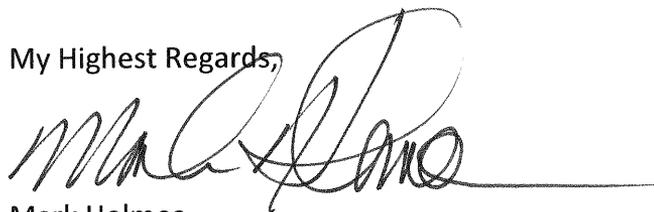
- Page 2-11 "Development of Facilities for Direct Recovery" states that the CAWCD will develop recovery facilities, and page 2-12 states that "CAWCD will include the costs of recovered CAP water into the regular CAP water rates." Mesa respectfully submits that recovered AWBA credits are not within the definition of Project Water as set forth in the Master Repayment Contract and the Revised Stipulation. Therefore, the CAWCD has no basis for charging subcontractors for recovered AWBA credits through the Subcontracts. The only mechanism for such charges would be through a new, voluntary arrangement or contract. Similarly any arrangements to move non-Project water through the canal during a shortage must also be voluntary, and the costs of such activities, including pumping costs, should not be subsidized by other subcontractors, tri-County taxpayers, or the federal government, who have all contributed to the costs of the physical infrastructure of the canal for the purpose of delivering Project Water. In other words, those who receive the benefit of wheeling non-Project water should pay equitably for that benefit. Such payments should be used to offset Fixed OM&R charges, which would otherwise be higher during shortage situations since fixed costs will be distributed over smaller quantities of Project Water.
- Page 2-8 "Goals for Recovery" states that "CAWCD will be responsible for the recovery of the water stored by AWBA." State statute is clear that the AWBA has the authority and responsibility to distribute credits in fulfillment of its purposes. However, again, recovered AWBA water is not Project Water and the CAWCD has no contractual basis for charging subcontractors for recovered AWBA credits through the Subcontracts. A.R.S. 45-2457 states that "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 the operation of the central Arizona project". Thus it is certainly reasonable and the statute clearly contemplates that, rather than recovering this water, the CAWCD would distribute the credits to M&I subcontractors who can then recover the water themselves more efficiently and inexpensively. Moreover, A.R.S. 45-2457 also states that "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," which clearly indicates that the AWBA may distribute credits to an entity other than the CAWCD, or alternatively, extinguish credits rather than distribute them at all. Extinguishment would occur, for example, in a case where an M&I Subcontractor pumps additional groundwater and a like amount of AWBA credits are extinguished.
- Page 2-10 "Indirect Recovery with Willing Partners Only" states that the CAWCD may pay for operating costs of third parties to recover AWBA credits. We agree this is contractually possible, but the costs of such arrangements cannot be included in fixed OM&R charges for Project Water as again, it is not Project Water this is being recovered. Rather, the charges must be assigned to those who, through a voluntary contract with the CAWCD, wish to receive deliveries of recovered AWBA credits through the CAP canal. Presumably a wheeling contract with the Bureau will be necessary to accomplish this.

The City would also like to better understand what method the AWBA will use to determine the distribution or extinguishment of AWBA credits. While the City believes the standalone authority of the AWBA is clear in statute, we believe additional procedures regarding the distribution or extinguishment of credits are needed which may necessitate the use of the State's rule making process.

While it may make economic sense for multiple entities, including the CAWCD, to invest in new well fields and to wheel non-Project recovered water through the canal, such arrangements can only be voluntary. The simple distribution of credits may make significantly more sense economically and from a resource perspective for those cities that have adequate well capacity. If the CAWCD is interested in examining whether recovery for multiple entities can be more efficiently (and less expensively) achieved through economies of scale and movement of recovered AWBA water through the canal through voluntary arrangements, Mesa is happy to consider participation in such proposals. However, this arrangement cannot be assumed.

The City of Mesa respectfully requests a structured stakeholder process whereby the provisions of the various statutes and Subcontracts can be properly outlined and incorporated into a well defined policy. Thank you again for taking proactive steps to address shortage issues. We look forward to working with you on these important issues.

My Highest Regards,



Mark Holmes
Water Resources Advisor

cc: Arizona Water Banking Authority
Arizona Department of Water Resources
Arizona Municipal Water Users Association
U.S. Bureau of Reclamation
City of Mesa, City Manager