



December 20, 2012

Mr. Tom Buschatzke
Director of the Water Management Division
Arizona Department of Water Resources
3550 N. Central Avenue
Second Floor
Phoenix, AZ 85012

RE: CAWCD Responses to Comments Regarding CAWCD's Proposed Pricing Methodology for the Reallocation of CAP Non-Indian Agricultural Priority Water

Dear Mr. Buschatzke:

CAWCD staff has reviewed all of the comments submitted to ADWR, and forwarded to CAWCD, regarding the proposed reallocation of CAP Non-Indian Agricultural Priority Water. Seventeen entities commented on CAWCD's proposed pricing methodology, which was outlined in CAWCD's October 2, 2012, white paper titled, "Non-Indian Ag Reallocation, CAP Acquisition Pricing Methodology". CAWCD staff has collapsed the comments from these seventeen entities and has identified eight discrete questions/comments related to CAWCD's proposed pricing methodology. Each of the comments is summarized below, with CAWCD staff's response to the comments.

Comment 1: Pricing seems aimed at keeping smaller users out of the market.

Response: CAWCD's proposed pricing methodology for the acquisition of CAP Non-Indian Agricultural Priority Water ("NIA Priority Water") is not intended to keep any users out of the market. The components of the pricing methodology are either cost based (e.g., the 9(d) Debt component, the Back Capital Charges component and the Supply Availability Charge) or based on a statutory formula (the Back Property Tax Equivalency component). As outlined in CAWCD's October 2, 2012 white paper titled, "Non-Indian Ag Reallocation, CAP Acquisition Pricing Methodology", the acquisition cost for NIA Priority Water is comprised of four elements: (1) the 9(d) Debt component; (2) the Back Capital Charges component; (3) the Back Property Tax Equivalency component (applicable only to allocations made to users outside of the CAP three-county service area); and (4) the Supply Availability Charge.

The 9(d) Debt component is set at an amount sufficient to cover the portion of the discharged 9(d) debt of the CAP Non-Indian Agricultural subcontractors who relinquished their entitlements to CAP water. A portion of that debt was assumed by CAWCD pursuant to the Arizona Water Settlement Agreement. CAWCD will deposit the proceeds of the 9(d) Debt component collected from those entities receiving an allocation of NIA Priority Water into a "sinking fund", which will, in combination with interest earned on such deposits, provide the necessary funds to meet CAWCD's 9(d) debt obligation. The intent of the sinking fund is to maintain a neutral net cost impact to CAWCD between 9(d) Debt component payments received by CAWCD (including interest earned by CAWCD on such payments) and 9(d) debt payments made by CAWCD to the United States.

The Back Capital Charges component, like the 9(d) Debt component, is also cost based. The quantity of CAP Non-Indian Agricultural Priority Water reallocated by the Secretary to ADWR for future reallocation to non-Indian M&I water users pursuant to the Arizona Water Settlement Agreement and the Arizona Water Settlements Act of 2004 ("AWSA"), is included in the CAP repayment model as interest-bearing and subject to the CAP M&I Capital Charge. Simply put, despite its title and priority, the NIA Priority Water is treated as M&I water for purposes of CAP repayment – it bears the CAP M&I Capital Charge. As such, the NIA Priority Water carries with it a charge of the accumulated assessed M&I Capital Charges since repayment began in 1993, plus interest, which is represented by the Back Capital Charges component.

The Back Property Tax Equivalency component is required by A.R.S. § 48-3715.B, and is based on the formula set forth in that statute.

Finally, with respect to the last cost component, the Supply Availability Charge, it appears that there is no support for CAWCD to assess this charge at this time. Therefore, CAWCD staff intends to recommend to the CAWCD Board of Directors that they not include such a charge in the acquisition price for NIA Priority Water.

Comment 2: CAWCD's existing financing statutes should be reviewed to determine whether they should be revised.

Response: CAWCD continuously reviews and updates its enabling legislation relating to its financing authority and other matters. There have been numerous updates and amendments to CAWCD's statutes since 1983. CAWCD staff believes the current CAWCD statutes are adequate and don't need to be changed.

Comment 3: CAWCD should include a third payment option to allow the transfer of long-term storage credits as full or partial payment for NIA Priority Water.

Response: CAWCD staff considered this comment and concluded that accepting long-term storage credits as full or partial payment for reallocated NIA Priority Water is unworkable for the following reasons. CAWCD does not need any long-term storage credits

at this time. Accordingly, the proposal would require the involvement of a third party, or the CAGR, to act as an intermediary to exchange the credits for cash. Doing so would lead to the undesirable result of introducing an extraneous market into the allocation process. However, CAWCD notes that individuals and entities are free to market their long-term storage credits and use the proceeds to pay for NIA Priority Water.

Comment 4: Contractors who do not use or benefit from the CAP system (i.e., contractors located outside the CAP three-county service area) should not be charged the Back Capital Charges cost component.

Response: Actual use of the CAP infrastructure is not the determining factor as to "who pays". CAP M&I Capital Charges ("Capital Charges") are paid by long-term subcontractors independent of their water deliveries, including periods of time when no deliveries have occurred. Receipt of a CAP allocation and payment for the CAP system are inextricably linked. As explained in Response to Comment 1 above, the cost of the CAP system is apportioned across the water supply for the system. The NIA Priority Water to be reallocated by ADWR for non-Indian M&I users is treated like CAP M&I water for purposes of repayment; it carries Back Capital Charges, as well as ongoing Capital Charges. There are practical, legal and contractual precedents that require every CAP subcontractor to pay a proportional share of the Capital Charges, based on its CAP entitlement. If any CAP subcontractor, regardless of whether it utilizes the CAP system a little, a lot, or not at all, does not pay its proportional share of costs, these costs must be borne by other CAP subcontractors. CAP allocations to entities outside the CAP three-county service area should not increase costs to CAP subcontractors located inside the service area. The CAP capital model and the CAP repayment contract have assumed equal cost shares for each acre-foot of CAP water for over two decades and it is not practical or equitable at this point to modify the model to cover costs on some other basis, particularly where some recipients pay nothing towards the cost of the CAP system and others pay more than a 100% share.

Comment 5: In the CAWCD proposal, the starting date for the Back Capital Charges component is 1993. Since the irrigation districts relinquished their allocations in 2004, if they paid capital charges up to that point, the beginning date for Back Capital charges should be 2004, not 1993.

Response: To the extent that irrigation districts (CAP Non-Indian agricultural subcontractors) paid any capital charges, the annual capital charge was only \$2.00 per acre-foot as specified in the CAP Non-Indian agricultural subcontract ("Ag subcontract"). In fact, most irrigation districts paid little, if any capital charges.

As outlined in CAWCD's pricing methodology white paper, the CAP Repayment model (upon which the CAP Repayment settlement is based) divides the CAP water supply into three classifications, each with a different payment obligation. The three categories of water are: (1) "Federal water" – this category of water represents water allocated for Indian uses, it has no CAWCD repayment obligation; (2) "Irrigation water" – this category

of water represents the CAP water set aside for the Ag settlement pool, it has an interest-free repayment obligation component; and (3) "M&I water" – this category of water represents all other non-Federal, non-Irrigation water, and specifically includes the NIA Priority Water to be reallocated to non-Indian M&I users in Arizona. This water has an interest-bearing repayment obligation component and is subject to the M&I Capital Charges set by the CAWCD Board. All of the water in the M&I category is assumed to pay the M&I Capital Charges from the beginning of the repayment period (October 1, 1993).

The amount of Ag capital charges actually paid by the irrigation districts under their Ag subcontracts is far less than the cost allocated to the Ag settlement pool, so there is no overlap and no double billing. There is nothing to deduct from the Back Capital Charges for reallocated NIA Priority Water.

Comment 6: Some of the NIA Priority Water being reallocated was sold as Excess CAP Water with a capital charge as one of the rate components. The Back Capital Charges should be reduced by the amount of the capital charges previously collected for Excess CAP water.

Response: CAWCD staff has considered this comment and is willing to make an adjustment to its proposal as follows. Currently, CAWCD's Policy Regarding the Relinquishment and Transfer of CAP M&I Subcontract Allocations, dated November 7, 2002, ("CAP Transfer Policy") allows a reduction in the amount of Back Capital Charges due from the entity receiving a transferred CAP entitlement equal to the amount that the receiving entity has paid as a "facility use fee" rate component (which is a capital charge equivalency component) for Excess Water it used after the transfer was requested but before it was completed. The Transfer Policy states,

"If the entity receiving the subcontract allocation purchased excess CAP water at the full-cost M&I rate after requesting the subcontract transfer but before the transfer was completed, then the payment due CAWCD from the receiving entity shall be reduced by any "prepaid charges," plus interest from the date of payment. "Prepaid charges" shall be computed by multiplying (i) the amount of full-cost excess water purchased each year (up to the amount of the subcontract allocation(s) being transferred) after the transfer was requested, by (ii) the M&I capital charge that was in effect at the time the excess water was purchased."

CAWCD staff proposes the adoption of a similar policy with respect to NIA Priority Water. Specifically, to the extent a recipient of NIA Priority Water can demonstrate (1) it purchased CAP Excess Water after receiving a recommended allocation of NIA Priority Water and before a CAP subcontract for NIA Priority Water has been fully executed; and (2) paid a "facility use fee" or capital charge equivalent rate component as a portion of the cost of such CAP Excess Water, then the Back Capital Charges component associated with the recipient's NIA Priority Water will be reduced by the actual amount of facility use fee paid by the recipient on a per-acre-foot basis for each year between the recommended

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reallocation and execution of the final subcontract, up to the amount of NIA Priority water received by the recipient.

Comment 7: Contractors who do not use or benefit from the CAP system (i.e., contractors located outside the CAP three-county service area) should not be charged the Back Property Tax Equivalency component.

Response: State law requires CAWCD to charge and collect a fee in lieu of property taxes from non-Indian CAP water users located outside of the CAP three-county service area in accordance with the formula set forth in A.R.S. § 48-3715.B. Charging a Back Property Tax Equivalency component is a statutory requirement that CAWCD must comply with. Some have suggested an alternate interpretation of A.R.S. § 48-3715.B, however, the clear language of the statute does not support the alternate interpretation.

Comment 8: The CAP Supply Availability Charge is not justified. The explanation of the use of the funds collected from this charge is not clear, or how any benefit from the overall improvement of the availability of CAP water will accrue to the NIA Priority Water being reallocated and not to other contractors who are not contributing.

Response: It appears that there is no support for CAWCD to assess a Supply Availability Charge at this time. Therefore, CAWCD staff intends to recommend to the CAWCD Board of Directors that they not include such a charge in the acquisition price for NIA Priority Water. Two points of clarification – First, the Supply Availability Charge was not intended to remedy interruptions to the CAP NIA supply during Colorado River shortages. Rather, it was intended to address the situation where on-river use grows to an extent that the NIA Priority Water is simply not available to CAP in normal supply years. Second, failure to collect such a charge at this juncture could be viewed as a missed opportunity and means that others will have to address and fund a solution to this problem in the future.

Sincerely,



Thomas W. McCann
Assistant General Manager
Operations, Planning and Engineering

cc: Randy Chandler, USBR
Sandy Fabritz-Whitney, ADWR