

NOTICE OF FINAL RULEMAKING

TITLE 12. NATURAL RESOURCES

CHAPTER 15. DEPARTMENT OF WATER RESOURCES

PREAMBLE

1. Article, Part, or Section Affected (as applicable) Rulemaking Action

<u>Sections Affected</u>	<u>Rulemaking Action</u>
R12-15-725.01	Amend
R12-15-725.02	Repeal

2. Citations to the agency's statutory rulemaking authority to include the authorizing statute (general) and the implementing statute (specific):

Authorizing statute: A.R.S. §§ 45-105(B)(1) and 45-576(H)

Implementing statutes: A.R.S. § 45-576

3. The effective date of the rule:

- a. **If the agency selected a date earlier than the 60 day effective date as specified in A.R.S. § 41-1032(A), include the earlier date and state the reason or reasons the agency selected the earlier effective date as provided in A.R.S. § 41-1032(A)(1) through (5):**

Pursuant to A.R.S. § 41-1032(A)(4), the rule amendment and repeal become effective on September 9, 2014. A.R.S. § 41-1032(A)(4) provides that a rule may be effective immediately if the rule provides a benefit to the public and a penalty is not associated with a violation of the rule. The amended rule and rule repeal provide a benefit to the

public by allowing irrigation grandfathered right (IGRF) holders a delay in the reduction of the allocation factor used to calculate extinguishment credits in the Pinal Active Management Area (AMA) until January 1, 2019. This delay is designed to allow IGFR holders in the Pinal AMA time to explore alternatives for meeting the Pinal AMA's management goal and make recommendations to the Arizona Department of Water Resources (Department). Additionally, no penalty is associated with a violation of the rule.

4. Citations to all related notices published in the Register as specified in R1-1-409(A) that pertain to the record of the final rulemaking package:

Notice of Rulemaking Docket Opening: 20 A.A.R. 1274, June 6, 2014.

Notice of Proposed Rulemaking: 20 A.A.R. 1257, June 6, 2014.

5. Agency contacts who can answer questions about the rulemaking:

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6. An agency's justification and reason why a rule should be made, amended, repealed or renumbered, to include an explanation about the rulemaking:

Reasons for Initiating the Rulemaking

Developers of new subdivisions within an Active Management Area (“AMA”) must either obtain a certificate of assured water supply (“AWS”) from the Arizona Department of Water Resources (“Department”) or obtain a commitment of water service from a municipal water provider designated by the Department as having an AWS prior to the sale of any lots. A.R.S. § 45-576(A). One of several requirements to obtain a certificate or designation of AWS is to demonstrate that any groundwater use is consistent with the management goal of the AMA. The management goal of the Pinal AMA, where a predominately agricultural economy exists, is to allow development of non-irrigation uses and to preserve existing agricultural economies for as long as feasible, consistent with the necessity to preserve future water supplies for non-irrigation uses. A.R.S. § 45-562(B).

One method of demonstrating that groundwater use is consistent with the management goal of the AMA is through a mechanism for the extinguishment of grandfathered groundwater rights in the AMA. Under the Department's AWS Rules, when a grandfathered groundwater right is extinguished, the Department issues credits that can be used by a developer or municipal water provider to demonstrate that a specified volume of groundwater use by the development or water provider will be consistent with the management goal of the AMA.

Prior to 2007, the amount of credits issued for the extinguishment of a grandfathered groundwater right in the Pinal AMA was an annual volume that remained the same each year, regardless of when the right was extinguished. In 2007, the Department amended the rule governing the calculation of extinguishment credits in the Pinal AMA, R12-15-725, to provide for a gradual reduction in the amount of credits given for the extinguishment of grandfathered groundwater rights, depending on when the extinguishment occurs. Under the rule as amended, the first reduction in the allocation factor for calculating extinguishment credits was to take effect on January 1, 2010, with additional reductions each year thereafter until 2054, when no credits would be given for the extinguishment of a grandfathered right.

One of the major reasons for the 2007 amendment was that residential development in the Pinal AMA was increasing rapidly, and the rate of development was projected to continue for the foreseeable future. Some of this development was anticipated to result in

the extinguishment of Irrigation Grandfathered Rights (“IGFRs”) for extinguishment credits. Extinguishment of IGFRs under the extinguishment credit rule in effect at that time, combined with rapid development, would lead to over-allocation of unreplenished groundwater supplies. The 2007 amendment was designed to preserve sufficient groundwater supplies to meet the demands of agricultural irrigation, existing assured water supply determinations and possible future assured water supply determinations, consistent with the Pinal AMA’s management goal.

Shortly after the 2007 rule amendment, the Arizona real estate market began experiencing a significant downturn, and residential development in the Pinal AMA slowed dramatically. In 2009, landowners and irrigation districts in the Pinal AMA expressed concerns to the Department that implementation of the reduction in extinguishment credits as scheduled could result in owners of farm land in the AMA prematurely extinguishing their irrigation grandfathered rights before the first reduction in credits was to take effect on January 1, 2010. It was feared that this would exacerbate the effects of the economic recession in the area by prematurely taking more lands out of agricultural production and increasing the water and power costs for those lands that continued to be farmed.

Consistent with the Pinal AMA management goal of preserving the agricultural economy for as long as feasible while ensuring water supply availability for future municipal and industrial water uses, the Department amended rule R12-15-725 in 2009 to delay the effective date of the first reduction of the allocation factor for calculating extinguishment

credits in the Pinal AMA until January 1, 2014. It was felt that by 2014, economic conditions in the AMA would improve sufficiently so that implementation of the reduction in extinguishment credits at that time would not have a significant negative impact on the local economy. Through the 2009 amendment, the allocation factors for calendar years 2010 through 2013 were increased to 100, and the allocation factors for calendar years 2014 through 2016 were increased to 94, 88 and 82, respectively. No changes were made to the allocation factors for calendar years 2017 and thereafter.

In 2013, a number of landowners in the Pinal AMA requested that the Department again delay the reduction in the allocation factor used to calculate extinguishment credits in the Pinal AMA because economic conditions in the area had not improved as much as expected when rule R12-15-725 was amended in 2009. In response to this request, the Department again amended the AWS rules to temporarily delay the first reduction in the allocation factor until September 15, 2014. This was accomplished through the adoption of two new rules, R12-15-725.01 and R12-15-725.02.

R12-15-725.01 contains a table with the allocation factor for each year beginning with calendar year 2010. Under that table, the first reduction in the allocation factor occurs in calendar year 2019, with an additional reduction each year thereafter until the allocation factor becomes zero in 2060. R12-15-725.01 contained an “automatic repeal” provision stating that the section repealed automatically effective September 15, 2014.

R12-15-725.02 contained a table of allocation factors that became effective on September 15, 2014. Under that table, the first reduction in the allocation factor occurred on September 15, 2014, with additional reductions occurring each year thereafter until the allocation factor became zero in 2055.

The combined effect of the adoption of R12-15-725.01 and R12-15-725.02 was that the first reduction in the allocation factor was delayed until September 15, 2014, when the reduction schedule adopted in 2009 was to become effective again. The temporary delay in the reduction schedule was designed to allow water users and other interested parties in the Pinal AMA to work together to examine conditions within the AMA and offer alternatives for meeting the Pinal AMA's management goal.

In late 2013 the Pinal Local Water Group (Water Group) was formed by Arizona State Representatives T.J. Shope and Frank Pratt to examine the AWS extinguishment credit rules in the Pinal AMA, explore alternatives to the existing rules, and make recommendations to the Department. The group is comprised of AMA water users including farmers, local elected officials, municipalities, developers, and real estate investors. On March 12, 2014, the Water Group requested that the Department delay, for a third time, implementation of the allocation factor reductions in the Pinal AMA to allow the Water Group additional time to explore alternative solutions to extinguishment credit reductions in the AMA and make recommendations before the first extinguishment credit reduction becomes effective. The Water Group explained that more time is needed

to fully explore alternatives to the allocation factor reductions and make informed recommendations to the Department.

Specifically, the Water Group asked the Department to make the allocation factor reduction table contained in R12-15-725.01 permanent. After considering this request, the Department agrees that the reduction schedule in R12-15-725.01 should be made permanent. This means that the first allocation factor reduction will be delayed until January 1, 2019. The delay will allow the Water Group and any other interested water users in the AMA ample time to fully explore alternative long-term solutions and make suggestions to the Department.

Explanation of the Rules

Rule R12-15-725.01 is amended by deleting subsection (B), which states “[t]his section shall repeal automatically effective September 15, 2014.” Rule R12-15-725.02, the rule containing the allocation factor reduction table scheduled to become effective on September 15, 2014 is repealed. Therefore, the allocation factor reduction table in R12-15-725.01 becomes permanent, thereby delaying the first reduction in the allocation factor used to calculate extinguishment credits in the Pinal AMA until January 1, 2019.

- 7. A reference to any study relevant to the rule that the agency reviewed and either relied on or did not rely on in its evaluation of or justification for the rule, where the public may obtain or review each study, all data underlying each study, and any**

analysis of each study and other supporting material:

None.

8. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

Not applicable.

9. A summary of the economic, small business, and consumer impact:

The rule amendment will have potential positive economic impacts on IGFR holders who would have prematurely extinguished their IGFRs under the existing rule, but will retain their IGFRs and continue farming under the rule amendment. These IGFR holders may benefit in the following ways: 1) by continuing farming operations so that they can receive an income from the land, 2) by maintaining the lower tax rates applicable to agricultural land uses, and 3) from an increased volume of extinguishment credits if they decide to extinguish their IGFRs between September 15, 2014 and December 31, 2059.

The rule amendment will likely have positive economic impacts on businesses within the Pinal AMA that sell farming materials, such as seed and equipment.

Lastly, the rule changes may have a positive economic impact on land developers and new homeowners within the Pinal AMA who develop or purchase homes in subdivisions with AWS determinations based wholly or in in part on extinguishment credits created between September 15, 2014 and December 31, 2059. Because this rulemaking delays

the first extinguishment credit allocation factor reduction from September 15, 2014 to January 1, 2019 and also extends the period in which extinguishment credits can be issued from December 31, 2053 to December 31, 2059, the rulemaking may increase the total number of extinguishment credits that will be created. This will potentially reduce some of the costs associated with Central Arizona Groundwater Replenishment District membership for developers and new homeowners because it will likely allow more groundwater to be used without a replenishment obligation.

The rule amendment may have a negative short-term economic impact on governmental entities that receive tax revenues from the real estate taxes assessed on lands within the Pinal AMA, such as Pinal County and Maricopa County. Some lands within the AMA that otherwise would have been taken out of agricultural production may remain in agricultural production during the September 15, 2014 to January 1, 2019 delay period. These lands would retain their lower agricultural tax status during that period. However, the loss in real estate tax revenue may be offset by more revenues from other taxes paid by the persons farming the lands, such as income taxes and sales taxes.

The rule amendment will likely result in more unreplenished groundwater withdrawals within the Pinal AMA, as some IGFR holders will likely continue irrigating their lands with groundwater during the period from September 15, 2014 to January 1, 2019.

Additionally, those IGFR holders who extinguish their rights between September 15, 2014 and December 31, 2059 will receive more extinguishment credits than they would receive without the rule amendment. These additional unreplenished groundwater

withdrawals could have a slight negative economic impact on groundwater users and landowners within the general areas of the withdrawals by reducing the physical availability of groundwater supplies in those areas. The economic impact is not possible to quantify because it depends on factors such as the current groundwater levels and rates of urbanization in the areas of the withdrawals. However, the Department believes there will be no significant negative economic impact.

10. A description of any changes between the proposed rulemaking, to include supplemental notices, and the final rulemaking:

There are no changes between the proposed rules and the final rules.

11. A summary of the public or stakeholder comments made about the rulemaking and the agency response to the comments:

Comment from the Pinal Partnership: The Pinal Partnership supports the proposed rulemaking and urges its expedient enactment.

Response: The Department appreciates the support and is requesting an immediate effective date for the rule amendment and repeal pursuant to A.R.S. § 45-1032(A)(4).

Comment from the Pinal Partnership: The Pinal Partnership acknowledges the need to continue to address the impacts of this rule and work toward evaluating reasonable approaches consistent with the Pinal AMA management goal. The Pinal Partnership urges ADWR to follow the enactment of this rule change with the institution of a process

that engages appropriate stakeholders on a mission to evaluate the effects of the rule and develop acceptable alternatives well in advance of the rule's future effective date.

Response: The Department is making the rule change in order to provide ample time for interested persons to meet and suggest alternative solutions to the Pinal AMA extinguishment credit allocation factor reductions. The Department urges interested persons to attend the Water Group meetings. Information regarding the Water Group, including notices of its meetings, is posted on the Department's website – www.azwater.gov. The Department will continue to participate in and meet with the Pinal Local Water Group after the current rulemaking. The Department notes that the Pinal Partnership is a separate organization from the Pinal Local Water Group. Information regarding the Pinal Partnership can be found on its website <http://pinalpartnership.com>.

12. Any other matters prescribed by statute applicable to the specific agency or to any specific rule or class of rules.

a. Whether the rule requires a permit, whether a general permit is used and if not, the reasons why a general permit is not used:

The rules do not require a permit.

b. Whether a federal law is applicable to the subject of the rule, whether the rule is more stringent than federal law and if so, citation to the statutory authority to exceed the requirements of federal law:

Federal law is not applicable to the subject of the rules because the rules are based on state law.

c. Whether a person submitted an analysis to the agency that compares the rule's impact of the competitiveness of business in this state to the impact on business in another state:

No analysis was submitted.

13. A list of any incorporated by reference material as specified in A.R.S. § 41-1028 and its location in the rule:

None.

14. Was this rule previously made, amended, or repealed as an emergency rule?

No.

15. The full text of the rules follows:

TITLE 12. NATURAL RESOURCES

CHAPTER 15. DEPARTMENT OF WATER RESOURCES

ARTICLE 7. ASSURED AND ADEQUATE WATER SUPPLY

Section

R12-15-725.01. Pinal AMA – Extinguishment Credits Calculation; ~~Automatic Repeal~~

R12-15-725.02. ~~Pinal AMA – Extinguishment Credits Calculation Effective September 15,~~
~~2014~~ Repealed

ARTICLE 7. ASSURED AND ADEQUATE WATER SUPPLY

R12-15-725.01. Pinal AMA – Extinguishment Credits Calculation; Automatic Repeal

A. The Director shall calculate the extinguishment credits for the extinguishment of a grandfathered right in the Pinal AMA as follows:

1. No Change
2. No Change
 - a. No Change
 - b. No Change
3. No Change
4. No Change
 - a. No Change
 - b. No Change
 - i. No Change
 - ii. No Change

~~**B.** This section shall repeal automatically effective September 15, 2014.~~

R12-15-725.02. Pinal AMA – Extinguishment Credits Calculation Effective September 15, 2014 Repealed

~~Beginning September 15, 2014, the Director shall calculate the extinguishment credits for the extinguishment of a grandfathered right in the Pinal AMA as follows:~~

- ~~1.—For the extinguishment of a type 2 non-irrigation grandfathered right, multiply the number of acre-feet indicated on the certificate by the applicable allocation factor as determined under subsection (3) or (4) of this Section.~~
- ~~2.—For the extinguishment of all or part of an irrigation grandfathered right, or all or part of a type 1 non-irrigation grandfathered right, an amount calculated by multiplying 1.5 acre-feet by the number of irrigation acres associated with the extinguished irrigation grandfathered right or the number of acres to which the extinguished type 1 non-irrigation grandfathered right is appurtenant, and then multiply that product by the applicable allocation factor as determined under subsection (3) or (4) of this Section, except that:
 - ~~a.—If only a portion of an irrigation grandfathered right or a type 1 non-irrigation grandfathered right is extinguished, the Director shall include in the calculation only those acres associated with the portion of the right that is extinguished; and~~
 - ~~b.—If an extinguished irrigation grandfathered right has a debit balance in the corresponding flexibility account established under A.R.S. § 45-467, the Director shall subtract the amount of the debit from the amount of the extinguishment credits.~~~~
- ~~3.—Except as provided in subsection (4) of this Section, in calculating the extinguishment credits for the extinguishment of a grandfathered right under subsection (1) or (2) of this Section, the Director shall use the allocation factor associated with the year or portion of a year in which the grandfathered right is extinguished, as shown in the table below.~~

Year	Allocation Factor
2010	100
2011	100
2012	100
2013	100
January 1, 2014 through September 14, 2014	100
September 15, 2014 through December 31, 2014	94
2015	88
2016	82
2017	76
2018	74
2019	72
2020	70
2021	68
2022	66
2023	64
2024	62
2025	60
2026	58
2027	56
2028	54
2029	52
2030	50
2031	48
2032	46
2033	44
2034	42
2035	40
2036	38

2037	36
2038	34
2039	32
2040	30
2041	28
2042	26
2043	24
2044	22
2045	20
2046	18
2047	16
2048	14
2049	12
2050	10
2051	8
2052	6
2053	4
2054	2
After 2054	0

4. ~~If, before January 1, 2055, there is a moratorium on adding new member lands and member service areas in the Pinal AMA pursuant to A.R.S. § 45-576.06(A), in calculating the extinguishment credits for the extinguishment of a grandfathered right under subsection (1) or (2) of this Section, the Director shall use an allocation factor determined as follows:~~

a. ~~If the grandfathered right is extinguished while the moratorium is in effect, the Director shall use the allocation factor associated with the year in which the moratorium first became effective, as shown in the table in subsection (3) of this Section.~~

- ~~b. If the grandfathered right is extinguished when the moratorium is no longer in effect, the Director shall use the allocation factor associated with the year determined pursuant to this subsection, as shown in the table in subsection (3) of this Section. The Director shall determine the year as follows:~~
- ~~i. Subtract the year in which the moratorium first became effective from the year in which the moratorium ended.~~
 - ii. Subtract the difference in subsection (4)(b)(i) of this Section from the year in which the grandfathered right was extinguished.