

## DISCUSSION PAPER

### WATER PRICING FOR AWBA AND OTHER INCENTIVE RECHARGE WATER

This Discussion Paper continues from previous discussion during the AWBA Pricing Committee meetings and other discussion papers. The primary issue is: Should rates for the lowest priority excess water used for underground storage be established to collect a full proportional share of all fixed OM&R costs, pumping energy costs, and capital costs, or to collect only identifiable incremental costs, primarily pumping energy? If all incremental costs are collected, is there any subsidy by other rate payers or taxpayers? If there is any subsidy, should the water pricing to the AWBA be any different considering the source of funds to purchase the water, i.e., property tax from CAP service area or general fund appropriations used for cities outside the service area or groundwater withdrawal fees from CAP area AMAs. Some of the water stored by the AWBA will be returned to CAP in the form of storage credits during times of shortage. Will extra expense be incurred to recover the water for use by CAP customers? If so, should a recovery cost component be included in the AWBA price for that portion of the water to be recovered by CAP.

The AWBA can only take water that is excess after all other orders have been met. The primary purpose of the AWBA is to protect the water supply of CAP users by storing water to offset future shortages and to fully utilize the CAP Colorado River allocation to prevent its development and future use by other states. The consensus of the Committee is that if all incremental costs are collected, if there is no increase in costs or rates to other customers, and if there is no further contribution from reserves, then there is no subsidy. With that consideration, there is no compelling reason to price water differently with regard to different funding sources available to the AWBA from Arizona sources. Pricing for interstate use or for new purposes that may be added to the AWBA will be determined when those specific situations are encountered.

While the main emphasis has been directed towards AWBA pricing, the CAWCD has offered the same incentive price to M&I subcontractors who purchase water for long-term underground storage to supplement their own water supply. When recovered in the future, this water will not be CAP "project water" available for delivery by CAWCD. Other M&I excess water contractors have asked to receive the incentive rate for water to be stored underground but, to date, have been charged the full excess M&I rate. If all incremental costs are recovered through the incentive rate and no subsidy is provided by today's rate payers, it would seem reasonable to offer the incentive rate to all interested parties within Arizona. This would be consistent with a decision not to differentiate among AWBA funding sources. The beneficiaries of the future water supply provided by the AWBA are taxpayers within the CAP service area or other Arizona Colorado River communities. The funds to purchase water are provided by CAP service area taxpayers and groundwater users or general fund appropriations. If there is any implied subsidy or benefit for other incentive recharge customers other than the AWBA, it would generally be for users within the CAP service area who are also CAP taxpayers.

The major concern in developing a price that recovers incremental costs is to identify all incremental costs of delivering this excess water. The Committee looked at several areas of identifiable and

potential incremental costs. An incremental cost to capital repayment may occur if this additional M&I water would increase the proportion of the interest bearing repayment obligation. The increase is difficult to compute and the issue may well be moot if a repayment settlement is reached. The incremental increase to fixed OM&R, if any, is difficult to identify but may be apparent with a good cost of service study which is scheduled for the near future. The loss of revenue from U.S. (Indian) water sales resulting from lower fixed OM&R rates due to greater water deliveries, is identifiable but may also be moot if repayment settlement waives fixed OM&R for Indian deliveries. This same lower rate and loss of revenues applies to subcontractors and excess water contractors who pay the full cost recovery rate for M&I water. However, the cash flow from this loss of revenue can be made up from our ad valorem taxes. These M&I water users contribute to these taxes while the Indian users do not.

The incremental cost of pumping energy is significant and identifiable. Calculation of the cost is, to some degree, complicated by point of delivery vs. postage stamp rates policy issues. Delivery of each additional acre-foot requires a definite additional amount of energy that can be measured. The total amount of energy for each acre foot varies depending on point of delivery. A further issue exists as a result of our power sales contracts. A certain amount of power, a threshold amount, is reserved for CAP pumping at a reasonably low rate. Pumping power above that threshold, surcharge power, is available at a rate that may be 30% to 50% higher in cost per kWh. The threshold power is sufficient to pump about the amount of water used by cities and Indians and the Ag pool water. Water for the AWBA and incentive recharge by other entities must be pumped mostly with the higher cost surcharge power. Current Board policy provides for the establishment of a “postage stamp” rate for pumping energy and for fixed OM&R for subcontract and Indian deliveries. The Board has, for other public policy reasons, decided to subsidize the rates for Ag pool excess water and, in earlier times, the M&I rates. There is no requirement for postage stamp rates for excess water.

A primary purpose of the AWBA is to store water to be made available to CAWCD when there is a shortage of Colorado River water. CAWCD will have to recover or arrange for recovery of the water stored underground and ensure that the recovered water is returned to the CAP system for delivery or delivered directly to a CAP customer. There will be non-traditional CAP O&M expenses required to accomplish this recovery and delivery. At this time it is not clear if pumping energy savings will offset increased O&M expenses. The AWBA, working with CAWCD, will develop recovery plans and projected recovery costs. If it can be determined that a net increase in O&M costs will occur at the time of recovery, that component could be collected in today’s revenues and set aside to offset the future expenses.

The alternative consideration is to collect only incremental delivery costs today so that the cost burden for future water supplies is not placed today’s water users. Any increased cost for use of that future water supply could be collected from the user at that time. Without the storage by the AWBA today, the future user would not have the supplemental supply available at any cost. As provided by current law, today’s taxpayers already pay the cost of purchasing and storing the future water supply. It does not seem reasonable to require them to also pay the future recovery cost.

The Committee consensus is that AWBA and incentive recharge should collect all incremental pumping costs including the higher cost per kWh for surcharge energy. The Committee discussed the difference in cost to point of delivery with full recognition of the much higher cost for the

AWBA to recharge in Pima County if a point of service rate was set. The AWBA authorization constrains money to be spent only to benefit the area where that money was collected. With a “point of delivery” rate some areas would get much less water and less shortage protection. As long as all incremental pumping costs are collected by the AWBA rate, CAP has no reason to differentiate in rates charged to AWBA due to delivery location or source of funds. It is simpler for CAP to set a second postage stamp rate for AWBA and incentive recharge by others that will be higher than the basic postage stamp energy rate for subcontract, Indian, and Ag pool rates.

Regarding fixed OM&R, the Committee believes that any identifiable incremental cost should be collected through a rate component. Even if there are no subsidies, it could be possible to collect some contribution to fixed O&M. The historic pumping energy plus \$5 was originally intended to collect lost revenues from lower Indian rates but does, in fact, make up those losses plus a \$3/AF OM&R contribution. However, it is difficult to identify incremental increases to OM&R costs at this relatively early stage in the expected life cycle of Project facilities. A reasonable alternative would be to collect an OM&R fee equivalent to 10% of the fixed OM&R component established for the water year. If further evaluation allows us to identify incremental costs that exceed this 10% fee, we could establish a fee to collect actual incremental costs.

The process established by the recently adopted Water Pricing Policy will consider cost of service, rate components and rate establishment for future certainty. Many of the issues raised in this Committee may also be raised in that process. The Committee believes that the Board should establish policy guidance for the annual process regarding setting rates for AWBA and incentive pricing. The ongoing process has recommended a continuation of the postage stamp energy rate plus \$5 for 1999. The Committee recommendations for ensuing years are stated below.

#### SUMMARY RECOMMENDATIONS

- I. The rates established for all excess CAP water sold for incentive recharge to the AWBA or other Arizona entities should recover all incremental costs of delivery and any other cost increases to CAP water users. The rate per acre-foot shall be the same to all purchasers of this class of water.
  - A. Staff should determine a pumping energy postage stamp rate for an operating plan without AWBA and incentive recharge and calculate a separate postage stamp rate for the additional pumping required to make deliveries for the AWBA and incentive recharge taking into consideration the cost of any additional surcharge power.
  - B. An additional rate component should be added to include: 1) any identifiable loss of revenues from Indian water sales; and 2) any identifiable appropriate loss of revenues from other water sales.
  - C. Identifiable incremental increases in fixed OM&R but no less than 10% of the fixed OM&R rate component established for the normal M&I delivery rate.
  - D. The consideration of any rate component for capital cost increases resulting from a higher proportion of interest bearing repayment obligation should be held in abeyance until a final repayment relationship is determined either through negotiation or litigation.

O:\board manual\awba incentive recharge water pricing  
January 13, 1999