

**April 12, 2018**

**Written Testimony of Central Arizona Water Conservation District on the House Natural Resource Committee's Subcommittee on Energy and Mineral Resource Subcommittee hearing on "The Benefits of the Navajo Generating Station to Local Economies."**

Chairman Gosar, Ranking Member Lowenthal, and Subcommittee Members, thank you for the opportunity to submit testimony on behalf of the Central Arizona Water Conservation District (CAWCD) for the record. We appreciate the Subcommittee's interest in supporting the people of Arizona and providing a forum for discussion on this important topic.

CAWCD manages and operates the Central Arizona Project (CAP). The CAP is the crucial water infrastructure that transports water from the Colorado River through a 336-mile water delivery system to communities that depend on water for municipal, industrial, and agricultural uses. Water from CAP is the lifeblood of the Central Arizona economy. CAWCD, an Arizona municipal corporation governed by a 15-member volunteer board elected by voters in its three-county service area, is the largest single source of renewable water supplies in Arizona.

What is the relationship between CAP and the Navajo Generating Station (NGS), the facility that is the focus of today's hearing? Historically, NGS provided much of the energy needed to pump CAP water from the Colorado River into central Arizona. At one time, CAP received more than 90% of its energy from NGS, although in recent years CAP has relied more on other sources of energy. Currently, NGS supplies about 70-75% of CAP's energy needs.

CAP does not have an ownership stake in NGS. However, the United States is a partial owner, holding 24.3% of NGS—547 megawatts of capacity—for the benefit of CAP. The original plan to power the CAP called for construction of two dams on the Colorado River, at Bridge Canyon and Marble Canyon. But when that plan proved infeasible, the United States elected to partner with five southwest utilities to construct NGS. The US entitlement at NGS was intentionally sized about one-third larger than needed for CAP pumping to allow for the sale of surplus energy to help pay for CAP construction.

CAP benefitted from its partnership with NGS for many years, and as is explained in detail below, we would welcome a continuation of this partnership if this can be accomplished consistent with CAP's obligation to our water ratepayers. CAP has a responsibility to its water users and taxpayers to operate the project in a reliable manner and at the lowest reasonable cost.

**Higher Energy Costs mean Higher Water Rates for CAP Customers**

The cost of energy is a key component of the water rates paid by the Indian tribes, municipal communities and agricultural interests that rely on CAP water. Lower CAP energy costs translate to more affordable rates for the millions of people who rely on CAP water supplies.

For much of the plant's life, NGS provided energy at very competitive rates. But in recent years NGS energy has become more expensive than other options available to CAP. That change is

due, in large part, to a fundamental shift in the energy market driven by cheap and plentiful natural gas and the rapid growth in renewable generation.

In 2016, the last year NGS was operated under a normal maintenance regime, the budgeted cost of NGS energy to plant owners was \$37.20/megawatt-hour, of which \$22.40 was the cost of fuel. By comparison, the average price actually paid by CAP for energy purchased on the market in 2016 was \$17.21/megawatt-hour—less than half of the cost of NGS energy and most significantly, \$5/megawatt-hour less than the cost of fuel for NGS. The average price CAP paid for energy purchased on the market in 2017 was \$19.68/megawatt-hour, and 2018 is looking similar. These are real numbers, not projections. CAP cannot ignore that reality.

### **CAP's Role in Providing Water to Tribes**

There are 22 federally recognized tribes in the state of Arizona. Many tribes receive a significant portion of their water through the CAP pursuant to Indian water rights settlements. Tribes with CAP water contracts include the Ak-Chin Indian Community, Gila River Indian Community, Fort McDowell Indian Community, Salt River Pima-Maricopa Indian Community, Tohono O'odham Nation, Camp Verde (Yavapai-Apache) Tribe, San Carlos Apache Tribe, White Mountain Apache Tribe (pending effective date of settlement), Pasqua Yaqui Tribe and Tonto-Apache Tribe. The 2004 Arizona Water Settlements Act set aside an additional 67,300 acre-feet of CAP water for future Indian water rights settlements in Arizona. In total, 650,724 acre-feet, 46% of the CAP water supply, is reserved for use by Arizona Indian tribes. While under federal law Tribes are not required to repay the costs of CAP construction, they do pay the energy costs associated with CAP water deliveries. Higher CAP energy costs place a significant burden on central Arizona tribes.

### **The Relationship between NGS Closure and CAP's Repayment Obligation**

As noted above, sales of surplus NGS energy were expected to contribute to CAP repayment, and they have. To date, NGS surplus revenues have repaid more than \$600 million of CAWCD's \$1.65 billion repayment obligation, returning nearly double the \$350 million that the United States spent to construct NGS and install SO<sub>2</sub> scrubbers.

But NGS was never expected to cover the entire CAP repayment obligation. That is why the United States insisted that Arizona create a single entity with ad valorem taxing authority to contract for CAP repayment—the Central Arizona Water Conservation District. The United States spent more than \$4 billion to build the CAP, of which \$350 million was spent on NGS. CAWCD is obligated to repay approximately \$1.65 billion. After making the payment due in January 2018, the remaining principal amount owed on the federal debt is a little less than \$1.1 billion. NGS has more than paid for itself. The outstanding portion of the CAP debt is related to other facilities.

Even with the closure of NGS, there will continue to be other revenues to the Lower Colorado River Basin Development Fund that will assist in CAP repayment—e.g., surcharges on Arizona sales of energy from the Hoover and Parker-Davis projects, which contribute nearly \$6 million per year on average. CAWCD also collects tax revenues from its three-county service area that

it can use to meet its annual repayment obligation, and capital charges from CAP's city and business water purchasers. By contract, capital charges are to be used to repay CAP construction costs related to the delivery of water to cities, towns and private water companies, which is effectively the outstanding balance of the CAP repayment obligation.<sup>1</sup>

In short, closure of NGS will not impact CAWCD's ability to meet its annual repayment obligation.

Some argue that CAP should support continued operation of NGS even if it is a more expensive energy solution because NGS surplus sales could provide repayment assistance. But that argument ignores the fact that CAP Indian tribes, who would be harmed by higher CAP energy prices, are not responsible for CAP repayment. The CAP Tribes should not be required to pay more for their water deliveries to reduce the capital charges paid by non-Indian water users. Moreover, the energy savings that CAP expects to realize after closure of NGS could equal or even exceed any increase in capital charges for municipal water users.

### **CAP's Need to Plan for its Future Energy Needs, which could include NGS**

CAP must take appropriate action to ensure that it has the energy it needs to deliver water in the event that NGS closes. The current NGS owners have stated publicly that they are not going to operate the plant beyond 2019. Despite ongoing efforts by those who favor the plant staying open, there is no new ownership group in place to operate the plant or contract for power delivery after 2019. To ensure that we are able to continue to deliver water at the best possible rates, the CAWCD Board must work to replace the energy from NGS at costs that reflect what is available in the energy market.

In November 2017, CAP issued a Request for Proposals (RFP) for energy to be delivered beginning January 1, 2020. CAP received numerous responses to its RFP and discussed the responses at Board meetings in March and April. As a show of good faith to proponents of NGS, the CAP Board has agreed to delay its decision on the RFP until May 3, 2018. However, further delay is inconsistent with our responsibility to ratepayers. CAP plans to execute contracts for replacement power this summer.

Even after CAP executes contracts based on its RFP, there will be room in the CAP portfolio for both short- and longer-term opportunities for potential new owners of NGS. While CAP is not obligated to purchase any power from NGS after the current contracts expire in 2019, CAP has repeatedly stated that it would welcome the opportunity to contract for competitively priced post-2019 power, including from NGS in the event that a new ownership group emerges. But the CAP Board has determined that, after the current NGS contracts end, CAP should assemble a diverse energy portfolio, with no single generation source supplying more than 15-20% of CAP's

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<sup>1</sup> More information related to the relationship between NGS and the Repayment Obligation is available at <http://www.cap-az.com/documents/departments/finance/Repayment-Obligation-102017.pdf> . For further information on sources of revenue for CAP repayment, see: [http://www.cap-az.com/documents/meetings/2017-09-26/1661-9b.%20Workshop%20Presentation\\_Repayment%20and%20Capital%20Charges-0917.pdf](http://www.cap-az.com/documents/meetings/2017-09-26/1661-9b.%20Workshop%20Presentation_Repayment%20and%20Capital%20Charges-0917.pdf)

energy needs. That means that CAP does not intend to contract for more than 75 megawatts from any individual source, including a post-2019 NGS.

CAP is a public entity and has a responsibility to our rate payers to deliver a reliable water supply at the lowest reasonable cost. Lower energy costs benefit CAP water users. CAP has significantly reduced its pumping energy costs in recent years by curtailing generation at NGS and buying more energy from the market. That has resulted in substantial savings to CAP water users. The CAP pumping energy rate, which was \$77 per acre-foot (AF) in 2017, was reduced to \$65/AF in 2018. Just last week CAP published its proposed rates for 2019-2024, which show a provisional pumping energy rate for 2020, the first year without NGS, of only \$54/AF. That represents a 30% decrease compared to 2017, which means a savings of \$23/AF to all CAP customers, including Indian tribes, agricultural and municipal and industrial water users.

### **Conclusion**

In closing, we appreciate the Subcommittee's concern about these important matters. CAP has an obligation to its customers to obtain a reliable source of power at competitive rates. NGS can play a role in this: the question is one of cost. If NGS remains open under new ownership, there is room in the CAP portfolio, including both short-term and longer-term opportunities, for CAP to purchase NGS power. We appreciate and share the Subcommittee's concern about the impacts that closure of NGS will have on the Hopi and Navajo tribes. Thank you for considering our views and for working with us for the good of Arizona communities.