

**JOINT STAKEHOLDER COMMENTS ON CAP WHEELING PROPOSAL**  
**July 30, 2014**

It is increasingly clear that an effective CAP wheeling program will be critical to many aspects of Central Arizona's water future. As recent stakeholder discussions and various water planning studies have indicated, CAP wheeling is necessary to serve expected growth and existing and new industrial needs from Colorado River supplies, imported groundwater, and other sources, provide for expanded firming above and beyond the protections offered by the Arizona Water Bank, provide opportunities to meet existing agricultural needs as agricultural contracts expire, and meet CAGR's current and future obligations (both with regard to existing demands in the current Plan of Operation and new demands associated with future Plan(s) of Operation).

The 3-19-13 CAWCD Staff Proposal for Wheeling Non-Project Water Supplies ("Staff Proposal") and the more recently-revised 6-11-2014 Supplemental Staff Position Statements on Wheeling Non-Project Water ("Supplemental Statements") have provided a good initial foundation for stakeholder discussion and input into the proposed CAP wheeling program. However, coming out of the initial stakeholder meetings on CAP wheeling, a group of stakeholders supportive of wheeling have made an effort to further map out a number of shared concerns related to various elements of the Staff Proposal and Revised Staff Proposal that we believe should be considered as part of the process going forward. This stakeholder group is comprised of representatives from the following entities: Arizona Municipal Water Users Association and its member municipalities, Freeport Minerals Corporation, Greenstone Resource Group, LLC, CV Harquahala, LLC, Resolution Copper Mining, LLC, Salt River Project, and Water Asset Management, LLC.

As detailed further below, these issues revolve around several general categories of concern:

- Ensuring open access to CAP wheeling capacity, based on a clearly defined, transparent process that largely defers to the requirements of existing regulatory programs (*see comments ##1-4*);
- Providing a process by which entities seeking to obtain and wheel new supplies can obtain assurances with regard to access to wheeling capacity in advance of significant investments and efforts to obtain necessary transfer approvals (*see comment #5*);
- Ensuring that wheeling can be made available on a flexible basis to support a diversity of potential supply types, individuals or groups of users, and end uses, including short-term supplies and use for recharge (*see comments ##6-9*);
- Ensuring that requirements related to transfers of water supplies, replacement of supplies and/or extension of existing wheeling contracts, system loss changes, provision of power, and requirements related to water quality are sufficiently flexible and are tied back to management of system impacts (*see comments ##10-14*);
- Ensuring transparency in rates, construction timelines, and capital costs associated with capacity expansion (*see comments ##15-16*).

Each of these issues is discussed in greater detail in the sections that follow.

**1. Access to CAP wheeling capacity needs to be open to all users and based on clear, non-discretionary criteria.**

The Staff Proposal states that “all water users, including Tribes, will be eligible to obtain a wheeling agreement.” However, in stakeholder meetings, CAWCD staff has also indicated from time to time that CAWCD may also seek to reserve the right to reject a wheeling application based upon discretionary criteria, e.g. a demonstration by the proposed wheeling party of sufficient “need” for access to a wheeled supply. In keeping with the self-determination principles that have generally governed how Arizona communities, agricultural districts, and other water users plan for their future water supply needs, CAWCD should not be engaged in assessing the relative merits of particular wheeling proposals, provided that the party(ies) making the proposal demonstrate the technical, financial, and legal ability to perform their obligations under a wheeling agreement. While specific limitations on access to wheeling may be appropriate to prevent oversubscription and protect the integrity of canal operations, these limitations should be based upon defensible, objective standards that are tied back to those interests.

**2. Approval of wheeling agreements needs to be built around a clearly defined, transparent process.**

The Staff Proposal provides that “each individual wheeling agreement will require approval by the CAWCD Board.” While CAWCD Board involvement in the approval of wheeling agreements is clearly appropriate, it is critical that this approval be undertaken based on technical or other objective criteria established in a clearly defined wheeling policy that identifies both the process and timelines for wheeling approval(s) in order to (a) limit the opportunity for politically-motivated opposition to wheeling approvals, and (b) keep CAWCD clear of third-party legal or political conflicts related to proposed projects. Similarly, if a wheeling contract is denied, good cause should be shown for the denial, and specific items of non-compliance with the wheeling contract should be identified.

To ensure that potential participants in a water supply acquisition project have a clear idea of what items need to be addressed as they are undertaking and negotiating the project, a wheeling policy should incorporate a specific “checklist” of items that must be addressed by the applicant in connection with a final wheeling contract approval. For example:

- Relevant Arizona Department of Water Resources (ADWR) approvals or permits (pursuant to Policy and Procedure for Transferring an Entitlement of Colorado River Water (Colorado River Transfer Policy) or groundwater transportation statutes);
- U.S. Bureau of Reclamation (Reclamation) approval of transfers of Colorado River delivery contracts;
- Relevant National Environmental Policy Act (NEPA) and/or other environmental documentation;
- A financial capability demonstration by the applicant (demonstrating the ability of the applicant to make required payments on its own capacity or through appropriate financial assurance);<sup>1</sup>
- A “system impact” study<sup>2</sup> related to the proposed wheeling, addressing the impact of the proposed wheeling on system capacity and water quality.

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<sup>1</sup> CAWCD should develop criteria for demonstrating financial capability that would be applied uniformly to all applicants.

<sup>2</sup> Similar to the process required for interconnection to transmission projects, a transfer policy could require the applicant (in cooperation with CAP) to study the specific system impact associated with a proposed wheeling approval in terms of timing of system use, available capacity, water quality, and so forth. It may be desirable for CAWCD to conduct the system impact study using a standard set of guidelines that apply to all applications for wheeling.

**3. Aside from consideration of impacts on the CAP system, CAWCD wheeling approvals should defer to existing regulatory requirements.**

Water transfers are likely to be inherently controversial by their nature; however, there are already well-established, existing statutory and regulatory provisions for public input and administrative review through ADWR and Reclamation that should control whether new water supplies – surface water, imported groundwater, or other potential sources – can be legally transported from their points of origin. For example, transfers of Colorado River entitlements will be subject to a variety of existing statutory, regulatory, and policy requirements, including state-level review under ADWR’s Colorado River Transfer Policy, federal review by Reclamation of the transfer of Colorado River delivery contract entitlements, as well as related environmental reviews pursuant to NEPA, among other potential requirements. The Supplemental Statements propose that for Colorado River water, these existing regulatory review processes would serve as the “primary ‘filter’” for determining the suitability of the end use of wheeled water; however, for other supplies, CAWCD would make an independent evaluation of end use suitability “comparable to those that apply to Colorado River supplies.” Existing regulatory review processes for the transfer of Colorado River water should be the only filter for determining the suitability of the end use of wheeled water.

Evaluation of end use suitability for non-Colorado River supplies should also defer to existing regulatory requirements as established by the Arizona legislature, ADWR, and other agencies with primary jurisdiction. For example, transfers of imported groundwater will be subject to existing basin-specific statutory requirements on groundwater transportation established by the Arizona legislature in A.R.S. §45-550 et. seq.; these statutes each impose different basin-specific limitations on both the entities that are qualified to undertake transportation from those basins, the permitted places of end use, as well as (for some basins) the acceptable types of use. Existing statutes also impose payment of statutory transportation fee requirements under A.R.S. 45-556, potential damage claims under A.R.S. 45-545, well spacing requirements under A.R.S. 45-559, Assured Water Supply rules, land management requirements under A.R.S. 45-558, and other regulatory requirements. ADWR has also previously circulated draft rules on groundwater transportation that may govern transportation from some groundwater basins in the future, and the Governor’s Regulatory Review Council has previously required ADWR to adopt a formal transportation rule before authorizing transportation from the Big Chino groundwater basin where the underlying statute was deemed not to be self-executing.<sup>3</sup> Wheeling of non-Colorado River supplies would also presumably be subject to some level of federal environmental review under NEPA.

To the extent that deficiencies may exist in existing requirements for transportation of surface water, groundwater, or other sources, those deficiencies should be addressed by appropriate legislative and/or rulemaking actions by the state or federal agencies having primary jurisdiction and policy responsibility with regard to those sources. Aside from ensuring that supplies can in fact be legally transported, CAWCD should not be inserting new independent requirements into these existing processes. Consistent with CAWCD’s responsibilities, the focus of any additional requirements that may be imposed through a wheeling program should be limited to ensuring that particular supplies can be wheeled without compromising the integrity of the CAP.

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<sup>3</sup> These draft rules did not go through the regulatory process and were not adopted, and the stakeholder group is not commenting on the substance of these rules.

***4. The wheeling program should not prevent users from wheeling supplies for purposes of groundwater recharge and/or indirect delivery.***

Groundwater recharge and indirect delivery approaches are well-established mechanisms for meeting water supply needs in Central Arizona. In keeping with the general policy of deference to existing regulatory requirements recommended in comment #3, and consistent with the self-determination principles noted in comment #1, CAWCD should not use a wheeling policy to prevent the development of new supplies for purposes of recharge and/or indirect delivery. Importantly, wheeling water for recharge is comparable to wheeling water for CAGRDR replenishment. Entities wishing to wheel water for underground storage for later use should not be held to a different standard than CAGRDR.

It is critical that the program allow wheeling for purposes of indirect delivery, including exchanges. Even in the absence of indirect delivery, however, recharge is a well-established means of meeting the requirements of AWS designations and creating water supplies that are useable for purposes of exchange. The ability to use wheeled water for recharge would also significantly enhance the capacity of users to work together to develop wheeled supplies, avoid “gaps” in the utilization of wheeling capacity, and allow for the opportunity for water users to grow into wheeled supplies and store water for their future use. During the stakeholder meetings, the primary reason stated in support of this restriction was to limit opportunities for “speculation.” However, the potential for speculation is already adequately controlled under existing statutes and regulations, which generally require that all water be put to uses that have been deemed to be beneficial as a matter of state policy within a reasonable timeframe.

***5. The proposed “intent to contract” process for pre-approving wheeling contracts needs to provide sufficient certainty to applicants who are making investments in transfer approvals and related environmental clearances.***

Originally, the Staff Proposal provided that “all regulatory approvals related to the transfer of the non-Project water supply, including environmental compliance, must be completed before a wheeling agreement will be offered.” As discussed during the stakeholder process, this would have created a nearly insurmountable barrier for many potential wheeling applicants, as the applicant would have to expend considerable resources (potentially in the tens or hundreds of millions of dollars) to obtain a water supply, seek and obtain all necessary transfer approvals, and develop necessary infrastructure while bearing the risk that wheeling would not be available once this had occurred. Many approvals, including environmental clearances through NEPA, could also likely not be practically pursued in the absence of an existing wheeling agreement specifying the amount, timing, and place of water use.

At a minimum, CAP will need to provide for a party to obtain a relatively firm “option” or similar agreement on wheeling access in advance of acquiring a water supply and seeking transfer approvals. To avoid issues with parties tying up wheeling capacity for protracted periods, such an agreement should specify specific timelines and milestones for completing necessary approvals, and provide for CAWCD cooperation in relevant environmental studies, etc. The Supplemental Statements, which propose the use of defined time- and performance-based benchmarks built around an “intent to contract” agreement, may adequately address these concerns – provided that the “intent to contract” process provides applicants with a high level of certainty that they will have access to wheeling capacity after making investments in new supplies and completing potentially time-consuming and expensive transfer approvals.

**6. The wheeling program must provide a mechanism for the wheeling of short-term water supplies.**

The Staff Proposal indicated a strong bias towards limiting wheeling to “permanent” or “long-term” water supplies that was the subject of extensive discussion during the stakeholder process; the Supplemental Statements and recent staff presentations have proposed that wheeling should in fact be available for shorter-term supplies. The stakeholder group’s own assessment of likely supply sources, particularly potential Colorado River supplies, indicates that many opportunities for the development of new supply are likely to be on a short-term basis, e.g. investments in water conservation or following agreements like that recently undertaken by the CAWCD and Yuma Mesa, development and delivery of ICS credits in Lake Mead, or similar approaches. For a wheeling program to be practical, it thus must provide mechanisms for wheeling of such short-term supplies. As noted in the discussion of financing mechanisms below, most of the potential issues that could be associated with short-term use of wheeling capacity could be addressed by allowing for capital investments made by one user to be repaid by a subsequent user.

**7. The wheeling program should allow users to bundle multiple supplies, replace existing supplies, and renew or extend wheeling contracts.**

The Staff Proposal indicates that “an agreement must be tied to a specific physically and legally available non-Project water supply.” As noted above, many opportunities for new supplies appear likely to be short-term in nature, such that it may be practical to “bundle” together multiple potential supplies, or provide for the ongoing replacement of initially-wheeled supplies under a wheeling contract over time. A requirement to seek a new wheeling contract each time a new short-term supply is available would likely not provide sufficient certainty to a potential wheeling user to undertake the necessary investments to embark on wheeling, and would also limit the opportunity to obtain “programmatic” environmental approvals for wheeling of multiple potential supplies.

Similarly, wheeling contracts should have clearly established provisions and criteria for their renewal or expansion to limit uncertainty. For example, contracts could require that a user declare its intent to continue an expiring contract several years in advance of expiration, commit to the continued payment of costs, and identify the water supply that would be used under a continued contract. Although not presently fleshed out, the Staff Proposal and Supplemental Statements seem to generally support the approaches to supply bundling, replacement, and contract renewal discussed above.

**8. Wheeling contracts need to be readily transferable in connection with the transfer of underlying water supplies.**

As discussed during the stakeholder process, wheeling contracts need to be transferable between parties in connection with the transfer of underlying water supplies, both as a means to facilitate multi-party, cooperative development of wheeled supplies and to encourage users to make efficient decisions about water use by allowing users to shift to other supplies as they become available. Concerns about “profit” from the sale of wheeling contracts can be managed by having clear rules with regard to the repayment of capital costs between parties (see below). Other stated concerns, e.g. changes in capital costs, changes in points of diversion, and so forth could be addressed by requiring the party to a transfer to meet all requirements for a new wheeling agreement in connection with the transfer. The Supplemental Statements appear to adequately address this issue, subject to concerns raised below with regard to repayment.

**9. Wheeling contracts may need to involve multiple users working together as a group.**

Because of the significant investments that will likely be required in order to acquire new water supplies and obtain necessary transfer approvals, applications for wheeling are likely to be undertaken in relatively significant blocks (e.g., costs of NEPA compliance are likely to be similar for a 500 acre-foot supply, 5,000 acre-foot supply, and 25,000 acre-foot supply). To ensure that wheeling is available to smaller users, it is critical to provide for multiple parties to be able to work together to develop and wheel future water supplies. Although not explicitly addressed in the Staff Proposal or Supplemental Statements, our understanding from the stakeholder process discussion is that this approach is acceptable to CAWCD staff.

**10. Calculation of system loss should more closely mirror actual loss.**

The Staff Proposal would apply a uniform system loss (5%) across all wheeled supplies, regardless of point of origin or delivery. While this may benefit ease of administration, system loss assessments should mirror actual losses as closely as possible. A review of the data presented by CAWCD during the stakeholder process suggests that there is significant annual variation in system losses, which are frequently much lower than 5% (closer to 4%); these are presumably also variable depending on the point of origin and the point of delivery. It is unfair to charge an entity wheeling water 50 miles the same losses as someone wheeling the length of the CAP canal.<sup>4</sup> A simple solution would be to create a per mile rate similar to that used by the Salt River Project (SRP) for wheeling non-SRP water in the SRP system.

**11. The proposed wheeling rate structure and capital improvement financing program should create a tighter relationship between proposed “system improvement fees” and planned capital improvements, and provide a transparent process for reimbursement of capital costs when wheeling contracts are transferred.**

In general, the proposed rate structures in the Staff Proposal and Supplemental Statements seem to represent a reasonable approach to ensuring that the costs of a wheeling program are distributed equitably among its participants, and in reasonable proportion to the burdens that would be imposed by a particular project. However, the “system improvement fee” concept that is proposed as the primary means of funding capital improvements to the system appears potentially problematic, as it will not necessarily guarantee that the system improvements for which the fees are being collected can in fact be completed (e.g., if enrollment in wheeling is insufficient to raise funds necessary to complete a particular phase of improvements, if enrollment proceeds too slowly to timely complete improvements, or if costs rise between the time that fees are collected and infrastructure is completed). In this respect, this is not dissimilar to the dilemma that a municipality can face when relying on development fees to fund infrastructure expansion.

To address this issue and to limit the risk that wheeling participants could face rapidly increasing fees (e.g., where fees end up chasing an under-enrolled phase of infrastructure improvements or growing construction costs resulting from substantial delays), the process for funding system improvements should directly tie the costs and funding streams required for improvements needed to provide a particular phase or increment of new capacity to those needed improvements. Consistent with how development fees are presently assessed by municipalities, CAWCD should at a minimum

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<sup>4</sup> Freeport may not necessarily agree with this statement.

provide for both the initial system improvement fee and ongoing capital assessments to be tied back to a “capital improvement plan” that identifies the particular improvements that will be financed by the fee and the schedule upon which these improvements are planned to be completed.

However, since CAWCD will also likely be unable to finance wheeling improvements using other revenues available to the CAP in the event of delays and/or under-enrollment, it may make sense to replace the initial “system improvement fee” with a contractual requirement for wheeling parties to cover a proportionate share of the costs of constructing system improvements identified in the “capital improvement plan” for the relevant phase of additional wheeling capacity. This would mirror an approach that is already widely used to finance municipal improvements incident to development projects, in which a developer can be required to construct or directly fund the construction of specific improvements to public infrastructure. This approach would serve to limit the risk that a wheeling party would make a substantial up-front payment to cover the costs of infrastructure that would end up not being constructed or that would not result in new certified annual delivery capacity. It would also provide an easier vehicle for the use of low-risk, tax-exempt bonding of capital improvement costs by municipalities, since these costs could be built into capital improvement plans and would be linked to the construction of specific improvements on a defined timeframe.

It will be equally important to provide a transparent process and clearly defined criteria for the repayment of capital costs that were paid by an initial user of wheeling capacity by a future user of that capacity (or when underlying supplies are transferred). Although the Supplemental Statements propose that a contractor could be entitled to “partial reimbursement” of System Improvement Charges, the rules for reimbursement will need to be quite clearly defined in order for potential contractors to make an objective assessment of the actual costs and risks of entering into wheeling agreements on the front end (particularly in the case of short-term contracts where capital costs will need to be amortized over shorter periods). In combination with a tight relationship between capital cost charges and the costs of infrastructure for each phase, this would also provide a ready means of addressing two key issues: (1) ensuring that shorter-term wheeling contracts do not later result in stranded capacity, by transferring risk associated with the capital investment in capacity to the short-term user; and (2) ensuring that the construction of system improvements is not unreasonably delayed.

Under the approach suggested here, each user of wheeling capacity would be expected to fund the construction of improvements necessary to result in additional certified delivery capacity, with the understanding that they would receive repayment of those costs from a future user in the event that (a) they were no longer using the wheeling capacity due to the expiration of their contract, or where they transferred the underlying supply; or (b) they had paid for “oversize” capacity that would later be shared with other users. In the case of a short-term wheeling contract, a contractor could fund the permanent improvements needed to allow its wheeling, with an expectation that those capital costs would be refunded later (but the contractor would also bear the risk that a future user does not step in to use the capacity after the short-term contract expired). In the case of a longer-term user, improvements necessary to make a given increment of wheeling capacity available could be completed prior to the time that this capacity was fully enrolled, with the initial users paid back for capital costs incurred by later enrollees.

***12. The wheeling program should allow prospective contractors to “bring their own power.”***

The Staff Proposal is silent on the ability of a wheeling contractor to “bring its own power” in lieu of paying for CAP pumping energy at the market rate. It may be possible for a contractor to access a more economic source of power than may be made available by the CAP, or the contractor may have a commitment to use a non-fossil fueled power source for its energy needs. In either case, it does not appear that there is a valid reason for ruling out the ability of a contractor to arrange for the delivery of power to CAWCD and to thus avoid paying the energy charges associated with the wheeling of its water. To ensure that this is consistent with CAP operations, any proposal where the contractor accepts responsibility for providing an alternative source of pumping energy should be subject to reasonable terms and conditions regarding issues such as timing and scheduling, and the contractor should be responsible for any additional fees that might result.

***13. Certification of delivery capacity should be tied to specific milestones in capital improvement plans.***

To limit uncertainty about when certified delivery capacity will in fact become available, the capital improvement plan for canal capacity expansion should additionally include defined timelines and milestones for the completion of improvements and related capacity certifications.

***14. Water quality restrictions should be tied to evaluation of impacts on downstream users rather than fixed standards.***

During the stakeholder meeting discussions, it was indicated that the Staff Proposal anticipated establishing “canal-side” water quality standards for delivery of water into the CAP canal; the Supplemental Statements have further proposed that federal MCLs serve as the presumptive standard for water introduced into the CAP system. While the introduction of a wheeled supply should not be to the detriment of existing users, the staff approach appears to be insufficiently flexible and would likely make it difficult to wheel supplies other than Colorado River water. To limit the cost and complexity of meeting water quality requirements and the need for additional, potentially unnecessary water treatment or substantial canal-side storage to provide for post-treatment residence time, the wheeling policy should establish an approach to compliance that is focused on prohibiting water quality degradation that would result in negative impacts to downstream users.

***15. A programmatic NEPA study on wheeling impacts should be strongly considered.***

Given the potential complexity of individual environmental reviews, a wheeling policy should allow for a potential “programmatic” NEPA study of the common aspects of CAP wheeling, in order to limit the costs of individual environmental reviews. An equitable funding mechanism should be identified as part of this concept.

***16. Requirements for the wheeling of water to replace existing Project Water supplies should be developed in parallel.***

Replacement of existing Project Water supplies may become a priority in the near future as a result of potential declines in Lake Mead, and investments in system reliability by existing CAP contractors may be a primary vehicle for the development of new water supplies that could be wheeled through the CAP, either in isolation (pursuant to a dry-year option or similar arrangement with an



on-river user) or in cooperation between a current CAP contractor with an interest in securing a supply that could be delivered during shortage years and a user who could wheel that supply for other use during non-shortage years. Some available sources of water, including imported groundwater, are also inherently amenable to projects that would involve a combination of year-round supply and intermittent (i.e. shortage-year) supply. For example, a city may want to develop a new water supply that would be usable for self-firming purposes in cooperation with another user that can utilize an interruptible supply.

CAP indicates that it believes that wheeling of supplies to replace existing Project Water supplies will not require separate authorization under the Master Repayment Contract. Because of the close potential relationship between new wheeled supplies and replacement supplies during shortage conditions, the development of wheeling contracts for purposes of replacing existing supplies should proceed in parallel with the development of wheeling contracts for the use of 8.18 space in the canal.