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Dear Tom and Terri Sue,

Thank you for meeting with me and Patricia McCraw on December 1, 2010 to explain the CAP Staff ADD Water Program Proposal ("Staff Proposal"). After reviewing the Staff Proposal and other materials that more fully describe both the framework and implementation of the ADD Water Program, we have identified a number of policy and legal issues that require further consideration. My staff and I are available to work with you to hopefully resolve these issues.

Under the Staff Proposal, the Central Arizona Water Conservation District ("CAWCD") would obtain water from various sources, including (1) Colorado River water through a Section 5 contract with the U.S. Bureau of Reclamation, (2) groundwater imported from outside of an Active Management Area ("AMA"), or (3) brackish groundwater from within an AMA. CAWCD would then allocate the water to municipal, industrial, agricultural or Indian water users within CAWCD's three-county service area by entering into contracts with the highest bidders. Subsequently, the ADD water contract entitlement could be permanently assigned or temporarily leased to a third party, subject only to limited CAWCD review. This allocation process does not require that the water be used to meet current needs, and does not consider the type of any subsequent uses of the water. This proposed allocation method raises several concerns.

The cornerstone of the Staff Proposal is an auction process in which CAWCD would allocate the state's water supply based solely upon one criterion, highest bid. The stated goal of this allocation method is to bring demand in line with the water supply that will be made available at each offering, with any profit over and above the actual water acquisition cost being used to reduce the "floor-price" for the next phase of allocation. This allocation method puts highest bid ahead of other considerations, the most important of which is distribution of the State's water supplies in a manner that supports the future welfare and economy of the State. The Department does not believe that the described auction process adequately addresses this important consideration.

In addition, the Staff Proposal would allocate water for any legal use within CAWCD's service area, regardless of current and projected municipal and industrial water demand in the state. This could result in allocation of the state's limited water supply for future needs while current demand goes unmet; or for low priority, temporary or intermittent water demands, while critical water needs associated with a growing population go unmet. This is of particular concern regarding requirements for post-ADD Water enrollment in the Central Arizona Groundwater Replenishment District (CAGR). The Department believes that requiring post-ADD Water enrollees in the CAGR to be responsible for acquiring water supplies to meet post-ADD water obligations will result in increasing competition among new development interests to "lock-up" water supplies as they become available for potential, future development, to the detriment of less affluent communities with near-term water needs.


The Staff Proposal also creates a framework in which the ADD Water contractor would be able to assign or lease the acquired water supply with no oversight of the financial terms involved. This suggests that the assignment and leasing of ADD Water contracts could generate a profit, in spite of language in the proposal indicating that remarketers would be excluded from the ADD Water allocation process. The ADD Water contractors would control the subsequent allocation of these water supplies, as long as CAWCD determines that there are no adverse third-party delivery impacts to other subcontractors. This concept deserves much broader discussion and consideration than it can receive within the ADD Water planning process.

Further discussion is needed regarding the proposed qualification of the ADD Water portfolio for Assured Water Supply purposes. The proposal notes that ADD Water is intended to qualify under current rules, but the source of supply and reliability described in the Staff Proposal do not always support that determination.

Although the Staff Proposal describes a creative approach to bring demand in-line with supply, the Department cannot support an allocation process that is based solely on highest-bid or that does not take into consideration actual need for the water supply. Reasonable access to water for the state's growing

population is a requirement for prudent economic development, and should be the basis for any reallocation of the state's limited water resources. Allocation of the state's water supplies must protect the welfare of Arizona citizens, whether or not those citizens are ADD Water participants. We recognize the importance of the ADD Water Program and are committed to working with CAP to develop alternatives that address the important issues described in this letter. Please feel free to contact me if you have any questions; I can be reached at 602-771-8408.

Sincerely,



Perri Benemelis, Manager
Colorado River Section

C: Herb Guenther