

Information Brief

BOARD OF DIRECTORS



Agenda Number 9.

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MEETING DATE: May 3, 2012

AGENDA ITEM: Report on Wheeling of Non-Project Water Supplies

LINKAGE TO STRATEGIC PLAN, POLICY, STATUTE OR GUIDING PRINCIPLE

- Policy For the Use of Excess Canal Capacity (2006)
- Resolution of the Board of CAWCD Regarding Project ADD Water (2010)
- CAWCD Board of Directors 2010 Strategic Plan
 - Water Supply: New Water Supplies for the CAP Service Area

PREVIOUS BOARD ACTION/ACTIVITY:

April 5, 2012 — Bi-Monthly Report on ADD Water Program Activities

ISSUE SUMMARY/DESCRIPTION:

Wheeling Non-Project Water¹ through the CAP system has been the subject of extensive discussion and Board policy since at least 1983. Most recently, the topic has been integral to concepts proposed in the ADD Water process, and has been raised in the CAGRD "Guiding Principles" discussions. Completing and implementing wheeling agreements is also identified as a priority in the Board's 2010 Strategic Plan.

In the past few months, staff have undertaken a systematic re-examination of previous work on wheeling, and have initiated discussions with Reclamation regarding legal and operational issues. These are the first steps in a process that is anticipated to lead to an

¹ "Project Water" is defined in CAP's Master Repayment Contract and the Repayment Stipulation and includes the Colorado River water available to CAP each year as well as certain Agua Fria River water captured in Lake Pleasant. Project Water is used first to make CAP long-term contract deliveries; any remaining Project Water is sold annually as Excess Water.

"Non-Project Water" is anything other than Project Water. It could be Colorado River water, groundwater or any other water supply.

agreement between CAP and Reclamation on wheeling and the development of a standard form of wheeling agreement, as contemplated in the 1988 Master Repayment Contract.

The standard form wheeling agreement will be a delivery contract between CAP and the wheeling party, subject to Reclamation approval, and tied to a particular water supply. Many of the likely provisions of these contracts—e.g., conditions for delivery, delivery charges, procedure for scheduling—have been explored in the ADD Water process, with general consensus among stakeholders, and will closely resemble current CAP water delivery contracts.

Before the standard wheeling contracts can be implemented, however, there are certain foundational issues that must be resolved between CAP and Reclamation. These issues include: the definition of "availability of project capacity" under section 8.18 of the Master Repayment Contract; federal rights to have water transported under section 8.17 of the Master Repayment Contract; and the identification and quantification of additional capacity associated with system improvements.

Reclamation's Phoenix Area Office does not currently have, but intends to seek, delegated authority to formally negotiate with CAP on wheeling. In the meantime, staff effort is focused on technical issues, including characterization of project capacity that accounts more fully for the variability of the Project Water supply, and an enumeration of the terms and conditions to be included in the standard wheeling contract. Both organizations are committed to an ongoing process that includes stakeholder involvement and are currently working together to schedule an initial public meeting in early June.

SCHEDULED FOR BOARD ACTION:

Staff anticipates a process that will seek Board review of wheeling-related agreements in the fall, with consideration of action by the end of 2012.

Attachment.

1 8.17 Rights Reserved to the United States to Have Water Carried
2 by Project Facilities. As a condition to the construction of project
3 facilities and the delivery of water hereunder, the Contractor agrees that
4 all project facilities will be available for the diversion, transportation,
5 and carriage of water for Indian and non-Indian uses pursuant to
6 arrangements or contracts therefor entered into on their behalf with the
7 Secretary. In the event the responsibility for the OM&R of project
8 facilities is transferred to and assumed by the Operating Agency, such
9 transfer shall be subject to the condition that the Operating Agency shall
10 divert, transport, and carry such water for such uses pursuant to the
11 provisions of the aforesaid arrangements or contracts; Provided, however,
12 That the aforesaid arrangements or contracts will include provisions for the
13 payment of applicable construction costs and OM&R costs in accordance with
14 Articles 9.3 and 9.6 of this contract.

15 8.18 Wheeling Non-Project Water. After taking into
16 consideration the water delivery requirements of contracts for project water
17 service and subject to availability of project capacity, non-project water
18 may be wheeled through project facilities pursuant to wheeling agreements
19 between the Contractor and the entity desiring to use project facilities for
20 wheeling purposes. All such agreements shall be subject to the approval of
21 the Contracting Officer who shall consider, among other things, the impact
22 that the wheeling of such non-project water will have on the quality of
23 project water. The Contractor and the Contracting Officer shall jointly
24 develop a standard form of wheeling agreement including the rate structure
25 for wheeling non-project water. All wheeling charges shall be paid to the
26 Contractor by the entity contracting for the wheeling of non-project water.

1 The Contractor shall be entitled to retain revenues from wheeling charges
2 sufficient to cover all OM&R costs associated with wheeling such non-project
3 water, plus an administrative charge to be jointly determined by the
4 Contractor and the Contracting Officer. All revenues from wheeling charges
5 in excess of the OM&R costs and administrative charges shall be remitted by
6 the Contractor to the Contracting Officer and deposited into the
7 Development Fund.

8 8.19 Use of Project Power to Wheel Non-Project Water. If the
9 energy requirements necessary for the pumping of project water are met and
10 subject to the requirements of the Navajo Power Marketing Plan published in
11 the Federal Register on December 21, 1987, project power may be used to
12 wheel non-project water through project facilities under such conditions of
13 use, including amounts, times of use, losses, costs, and other conditions as
14 are established by the Contractor and approved by the Contracting Officer.

15 9. PAYMENT OF PROJECT COSTS ALLOCATED TO CONTRACTOR

16 9.1 Allocation of Construction Costs.

17 (a) Upon completion of each construction stage, the
18 Contracting Officer will allocate costs to the various project purposes
19 using the separable costs-remaining benefits procedure.

20 (b) For repayment purposes the reimbursable cost allocated
21 to irrigation and M&I water by the separable costs-remaining benefits
22 procedure will be combined and will hereinafter be termed the "water supply
23 allocation." Upon completion of each construction stage, and at the
24 periodic intervals specified in Subarticle 9.3(d), suballocation of the
25 water supply allocation will be made to the irrigation and M&I water
26 functions proportional to the water estimated to be used for each purpose

Report on Wheeling of Non-Project Water Supplies



**May 3, 2012
Thomas W. McCann**

Purpose

- **Desired State:**

CAP is able to offer contracts for the long-term reliable delivery of Non-Project Water without interfering with Project Water deliveries.

- “**Project Water**” – Colorado River water available to CAP, along with certain Agua Fria inflows captured in Lake Pleasant

- “**Non-Project Water**” – Any water other than Project Water, including Colorado River water, imported groundwater or other supplies

- **Requires resolution of multiple issues**

- Legal
- Financial
- Operational
- Political

The purpose of this effort is to develop the necessary agreements that will allow Non-Project Water supplies to be delivered through the CAP system, whether for CAGR, ADD Water contractors or other parties.

Significantly, this effort will not address *which* specific supplies will be wheeled, or *for whom* they will be delivered. Nor is this effort intended to allocate current CAP canal capacity or potential future capacity.

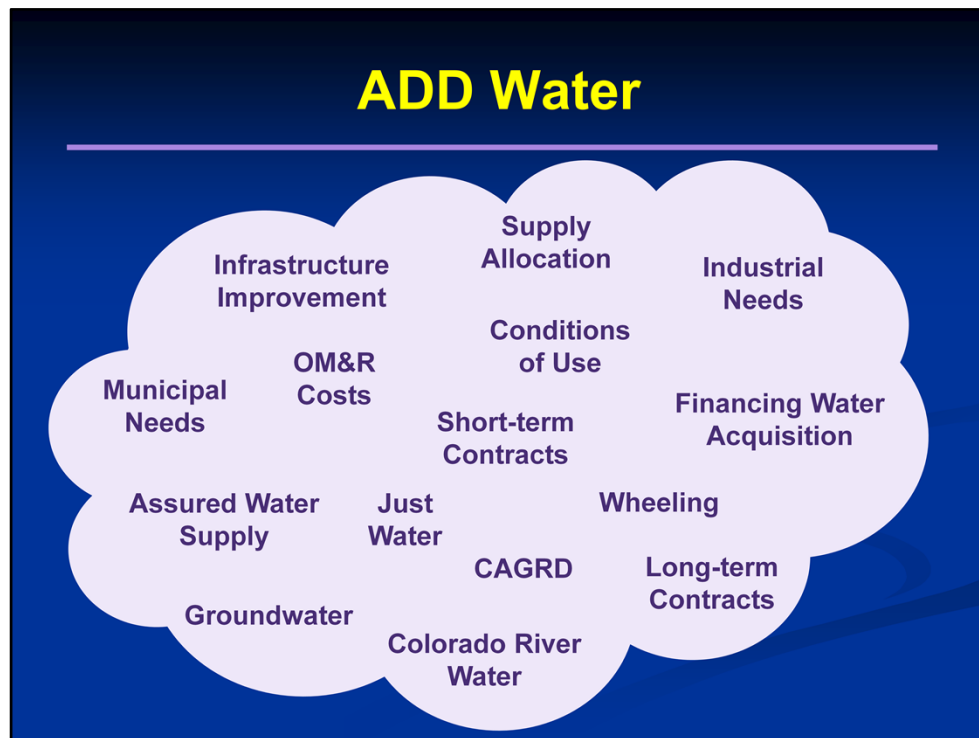
Rather, the focus is on the various contractual and operational issues that need to be resolved before any Non-Project water can be moved.

This topic has broad impacts and many interested stakeholders, but the issues at its core involve interpretation and application of the unique institutional and contractual relationships between CAP and the Bureau of Reclamation. Accordingly, initial staff activities have involved only those two organizations.

Background

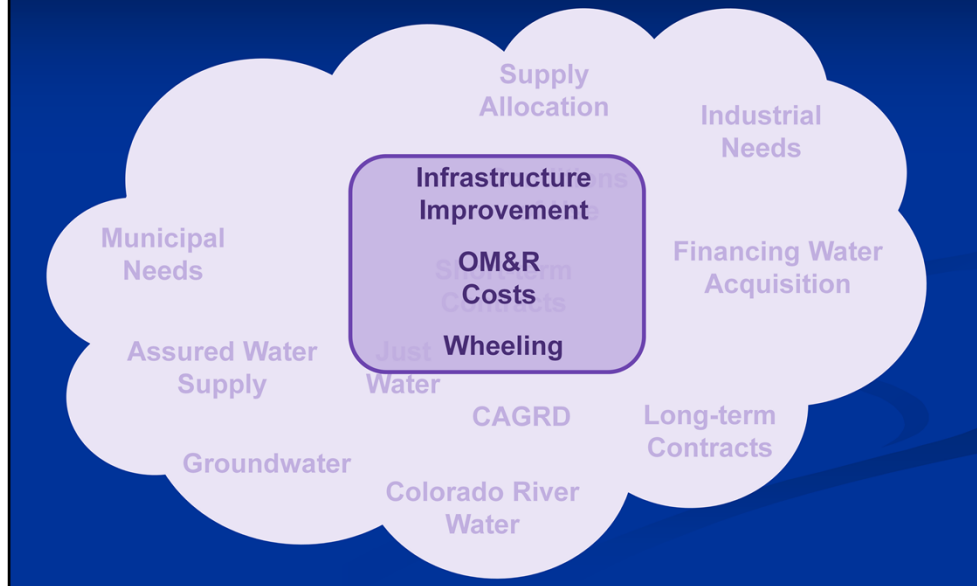
- Previous activities
 - 1983—Board Position Statement endorsing the concept of wheeling
 - 1988—Wheeling Discussion Document identifies major issues and approaches
 - 1998—Wheeling discussion related to Scottsdale water supplies
 - 2002—Project Wheel process established interim set asides
 - 2005—Water providers initiate informal discussions on new water supplies and wheeling
 - 2008—ADD Water

Wheeling is not a new issue for CAP, and there have been a series of processes and policies that have tackled aspects of the issue, beginning with a Board policy statement in 1983, leading all the way up to ADD Water, and even more recently in the CAGR D “Guiding Principles” discussions.



The ADD Water process has been about much more than just wheeling, seeking to create a programmatic approach for new water supplies in the CAP service area. Many aspects of that larger view remain under consideration, but fitting everything under a single tent has proven difficult. Furthermore, both Reclamation and ADWR have indicated that certain key aspects of ADD Water cannot be implemented as contemplated.

Focus on Wheeling



Regardless of the ultimate outcome of ADD Water discussions, it will be necessary for CAP to develop the appropriate framework and agreements needed to transport Non-Project Water through the CAP system.

In December 2011, the Board directed staff to continue work on developing appropriate wheeling agreements with Reclamation.

As will be discussed later, wheeling issues cannot be resolved without addressing improvements to CAP infrastructure, and wheeling agreements will have to provide for payment of the costs associated with those deliveries. But it is not necessary to resolve all of the other issues raised in ADD Water in order to implement wheeling.

Master Repayment Contract

- 8.18 – “Wheeling Non-Project Water”
 - After consideration of Project Water deliveries
 - Subject to availability of Project capacity
 - Pursuant to agreements between entity proposing to wheel and CAP
 - Each agreement subject to USBR approval
 - Reclamation and CAP jointly develop a “standard form of wheeling agreement”
- 8.17 – “Rights Reserved to the United States to Have Water Carried by Project Facilities”
 - CAP “shall divert, transport and carry” water for Indian and non-Indian uses pursuant to Secretarial arrangements and contracts

The 1988 Master Repayment Contract between Reclamation and CAP establishes the basic framework for wheeling Non-Project Water. In particular, Section 8.18 provides that wheeling can only occur after Project Water deliveries have been accommodated; that any wheeling agreements that CAP enters into must be approved by Reclamation; and that the two agencies are to jointly develop a standard form of wheeling agreement.

The Repayment Contract also includes section 8.17, which states that CAP “shall divert, transport and carry” water pursuant to arrangements and contracts entered into between the Secretary of the Interior, and Indian or non-Indian parties.

There are numerous complexities to each of these provisions of the Repayment Contract, but initial efforts by staff have focused on three issues...

Initial Issues

- Definition of “availability of Project capacity” under 8.18
 - How can it be quantified?
 - What affects its magnitude?
- Federal rights to have water transported under 8.17
 - What is the relationship between federal rights under 8.17 and the rights of those with wheeling contracts with CAP?
- Additional capacity associated with system improvements
 - How can it be identified and quantified?
 - How does it relate to provisions of 8.17 and 8.18 of the Repayment Contract?

1. What does “availability of Project capacity” mean, and more importantly, what affects its magnitude?
2. How would exercise of the federal right under 8.17 impact other potential wheeling activities?
3. How can system capacity be added and recognized within the context of wheeling?

These issues relate primarily to delivery capacity.

Delivery Capacity

- There is an estimated 1.8 MAF current capacity
 - Varies from year to year based on maintenance activities
- Project Water supply varies
 - Extra water during Surplus conditions
 - Arizona's on-River uses fluctuate year-to-year
 - CAP deliveries have been 1.6 to 1.7 MAF
- Available capacity varies by time and location
 - Primary availability in shoulder months
 - Infrastructure constraints limit some deliveries
 - Extraordinary maintenance can also reduce capacity

Available capacity is only knowable on a year-to-year basis and may be limited even in Normal water supply conditions

The current system can typically deliver about 1.8 million acre-feet per year. There are many operational, planning and engineering assumptions imbedded within that number, but it is a reasonable figure for planning purposes.

Past discussions of wheeling and canal capacity have tended to use 1.5 million acre-feet as an average Project Water supply, which when compared against the nominal 1.8 million acre-feet capacity, suggests additional available delivery capacity of about 300,000 acre-feet per year. Unfortunately, that doesn't fully account for the variability in the Project Water supply and CAP maintenance activities. We know that extra water should be available to CAP in Surplus years, but even under Normal conditions on the Colorado River, the capacity available after delivery of all Project Water can be much less than 300,000 AF. Indeed, due to water supply conditions and some extraordinary maintenance activities, available capacity in 2012 is only about 60,000 AF.

The bottom line is that available delivery capacity in the present CAP system may be less certain and predictable than has been previously portrayed.

Federal Rights & New Capacity

- The federal rights asserted under 8.17 add further uncertainty
 - Can claims under 8.17 displace water transported under wheeling contracts entered into by CAP pursuant to 8.18?
 - If Reclamation approves agreements under 8.18, are their rights under 8.17 diminished?
- New Capacity
 - A method to quantify capacity associated with system improvements is required
 - The “Substantial Change” modification process in the O&M Agreement may offer a method

Reclamation asserts that the United States has the right under section 8.17 of the Master Repayment Contract to enter into its own contracts for Non-Project Water and that CAP is required to transport that water. The intent and historical context of this provision is open to some debate, but it has to be considered when evaluating the risks associated with wheeling contracts that CAP enters into pursuant to section 8.18.

The potential for federal claims under 8.17 and the demands placed on the CAP system to deliver Project Water highlight the importance of expanding CAP’s delivery capacity. Expanding canal capacity has been discussed extensively in the ADD Water process, and there is general consensus that those using the system to move Non-Project Water would pay an infrastructure improvement charge to fund the canal expansion.

Staff is working with Reclamation to develop a contractual mechanism to quantify increases in canal capacity, with the understanding that the increased capacity may be used for transportation of Non-Project Water under 8.18 and is not subject to federal claims under 8.17. One concept is to tie into the process established in the O&M Agreement between CAP and Reclamation whereby Reclamation reviews proposed system modifications that are classified as a “Substantial Change.”

Agreements

- CAWCD—USBR
 - Capacity Issues
- Wheeling Party—CAWCD—USBR
 - Delivery Issues
 - Contract is for delivery, tied to a specific supply, and does not carry any reservation of capacity
 - Likely elements in standard form of wheeling agreement
 - Environmental Clearances
 - Points of Delivery and Measurement
 - Interruptions and Reductions
 - Water Quality
 - Losses
 - Scheduling
 - Administrative charges
 - OM&R charges
 - Infrastructure improvement charge

The issues related to system capacity and contract rights are global ones that require resolution between CAP and Reclamation before wheeling can occur.

Individual wheeling agreements will be between the wheeling party and CAP, with approval by Reclamation. The wheeling agreements will address the terms of delivery for Non-Project Water. These contracts will be tied to a specific water supply and will not be associated with any particular system capacity. The included provisions are likely to resemble those in our current CAP water delivery contracts. With regard to environmental clearances, it is expected that each contract will trigger a NEPA review, in part because each one requires a federal action—approval by Reclamation.

Next Steps

- Technical discussions with Reclamation
 - Capacity issues
 - Relationship between federal rights under section 8.17 and wheeling under section 8.18
- Development of standard wheeling contract
 - Reclamation delegation of authority needed
 - Possible June public meeting