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IN THE MATTER OF THE
APPLICATION OF PERKINS
MOUNTAIN WATER COMPANY
FOR A CERTIFICATE OF
CONVENIENCE AND NECESSITY
IN MOHAVE COUNTY

DOCKET NO. W-20380A-05-0490

IN THE MATTER OF THE
APPLICATION OF PERKINS
MOUNTAIN UTILITY COMPANY
FOR A CERTIFICATE OF
CONVENIENCE AND NECESSITY
IN MOHAVE COUNTY

DOCKET NO. SW-20379A-05-0489

PERKINS MOUNTAIN WATER
COMPANY'S AND PERKINS
MOUNTAIN UTILITY COMPANY'S
CLOSING BRIEF

Snell & Wilmer LLP

LAW OFFICES
One Arizona Center, 400 E. Van Buren
Phoenix, Arizona 85004-2202
(602) 382-6000

Perkins Mountain Water Company ("the Water Company") and Perkins Mountain Utility Company ("the Utility Company") (collectively "the Companies"), hereby submit their closing Brief for the Administrative Hearing that was conducted on December 5, 2005.

Background

On July 7, 2005, the Companies filed with the Arizona Corporation Commission ("Commission") applications for Certificates of Convenience and Necessity ("CC&N") to provide water and wastewater services to two proposed developments located in Mohave County, one in Golden Valley and the other in White Hills ("Applications"). On November 10, 2005, Staff prepared a Report in response to the Applications ("Staff Report").

Although Staff had recommended conditional approval of the Applications, Staff attached 31 conditions to the Staff Report. The Companies do not object to a majority of the conditions but oppose three (3) conditions for the Water Company and three (3)

1 conditions for the Utility Company, specifically, Conditions 8, 10 and 11, as not being in  
2 the public interest. The Companies also request modification to Condition 2 such that  
3 the rates submitted in the Companies' Applications are approved with hookup fees.

4 **Based Upon the Evidence, the Removal of the Companies' Hookup**  
5 **Fees is Not in the Public Interest.**

6 Under Condition 8, the end result of Staff's recommendation is to significantly  
7 increase the overall burden to ratepayers over many years by denying them the benefit of  
8 having the developers contribute to the cost of building plant during the first five years  
9 of operation. Staff had recommended that the Commission require the Companies to  
10 seek and procure other means of financing for future plant, other than contributions in  
11 aid of construction and removed the Companies' proposed hookup fees for both the  
12 Water Company and the Utility Company. To support the Companies position that the  
13 hookup fees are necessary as part of the capital structure, the Companies retained Ray  
14 Jones, a principal of the consulting firm Aricor Water Solutions, Inc. Aricor was  
15 retained through Perkins Mountain Water and Perkins Mountain Utilities' master  
16 consultant, Stanley Consultants, to be the primary witness in preparation of this case.

17 Mr. Jones explained the rationale for why the Companies incorporated hook-up  
18 fees into the capital structure. Specifically, Mr. Jones testified that:

19 [T]he Companies' rationale was to present a balanced capital structure.  
20 And we felt that the capital structure we presented balanced the investment  
21 necessary from the company as well as developers and the ratepayers at a  
22 fair and equitable balance between the three.

23 (Transcript pg 24, lines 1-6).

24 In response to Staff's concern that the developer would not have a sufficient stake  
25 in the Companies based upon the equity percentage, Mr. Jones testified:

26 We felt that the equity capital being provided by the utility companies was  
27 sufficient to show commitment by those companies and to insure, as the  
28 Staff attorney noted, that the companies would see it through.

(Transcript pg 24, lines 7-11).

1 Mr. Jones later testified:

2 We have not proposed in this case a rate structure that provides artificially  
3 low rates to spur development, which I know is a concern that Staff has  
4 had in the past that certain companies have tried to establish rates at a level  
to promote home sales as opposed to promote a healthy utility. I don't  
believe that we've done that here.

5 And also we have presented a balanced rate structure between hook-up  
6 fees, rates and equity. And I believe the equity we're proposing to fund  
the utilities is adequate to insure a healthy utility and a good rate base that  
would insure a healthy utility going forward.

7 (Transcript pg 29, lines 12-24).

8 Mr. Jones also testified that based on today's regulatory environment, it was not  
9 only appropriate to have developers finance part of the backbone facilities through hook-  
10 up fees; but necessary. Mr. Jones testified:

11 We also felt it was appropriate to have the developer funding in  
12 recognition of the amount of plant facilities, backbone plant facilities,  
13 which do need to be constructed.

14 It also recognizes that in today's regulatory environment -- here I'm  
15 speaking in the Department of Environmental Quality regulatory  
environment -- utility companies are being more and more required to  
construct plant well before it is actually needed.

16 For example, the Department of Environmental Quality will often -- well,  
17 they'll actually require sewage flows to be estimated at a flow that I think  
everybody agrees is well in excess of actual flows, and then require plant  
to be constructed to those capacities. And not only for existing homes that  
18 are actually connected, but for planned and platted homes as well. . . .

19 We felt it would be appropriate to put part of the burden on the developers  
20 through hook-up fees. And particularly in the case, as you might imagine,  
if sales that developers have promised do not materialize, it would be more  
appropriate for this, you know, unused plant to have been funded by those  
21 developers rather than by the utility company.

22 (Transcript pp 24-25, lines 12-25, 1-13).

23 In addition, Mr. Jones confirmed that by removing the hook-up fees from the  
24 capital structure, additional revenue requirements would be needed. Mr. Jones testified:

25 When you remove the hook-up fees, it has a direct increase on rate base of  
26 the company as well as, through the loss of the amortization, increases  
depreciation expense for the company, and this creates additional revenue  
27 requirement for the utilities.  
28

1 Staff recognized this in their proposal and has recommended a revenue  
2 increase of approximately 32 percent for the companies. Looking at Year  
3 5, that's about a \$2.2 million increase in revenues.

3 (Transcript pp 25-26, lines 21-25, 1-4).

4 In addition, removal of the hook-up fees would affect the rate base. Mr. Jones  
5 testified:

6 The rate base specifically is directly increased by the loss of those  
7 contributions. So for the water company it's approximately the \$2.78  
8 million that we talk about in our corrections earlier. And for the  
wastewater company, the utility company, it's approximately a \$4.6  
million increase in rate base. Again, we're talking about at Year 5.

9 (Transcript pg 26, lines 11-17).

10 The following chart was adopted by Mr. Jones as part of his sworn testimony and  
11 details the increase by service and shows the impact on average residential customers.

	5-Year Total Revenue			
	Company	Staff	Staff Proposed Increase	
Water Revenue	\$ 3,287,422.62	\$ 4,035,466.92	\$ 748,044.30	22.8%
Wastewater Revenue	\$ 3,842,720.01	\$ 5,365,238.01	\$ 1,522,518.00	39.6%
Total Revenue	\$ 7,130,142.63	\$ 9,400,704.93	\$ 2,270,562.30	31.8%

Conventional Customer	Typical Monthly Bill			
	Company	Staff	Staff Proposed Increase	
Water	\$ 52.81	\$ 65.04	\$ 12.23	23.1%
Wastewater	\$ 52.00	\$ 75.00	\$ 23.00	44.2%
Total	\$ 104.81	\$ 140.04	\$ 35.23	33.6%

Age Restricted Customer	Typical Monthly Bill			
	Company	Staff	Staff Proposed Increase	
Water	\$ 40.42	\$ 50.09	\$ 9.67	23.9%
Wastewater	\$ 52.00	\$ 75.00	\$ 23.00	44.2%
Total	\$ 92.42	\$ 125.09	\$ 32.67	35.3%

23 When you increase the rate base and revenue requirement, you must also increase  
24 rates. Mr. Jones testified:

25 The chart shows the water revenues and wastewater revenues for the two  
26 companies at both the company's proposed rates as well as the Staff's  
27 proposed rates, and then shows the calculation of the increase in those  
rates.

28 (Transcript pg 27, lines 4-8).

1 Mr. Jones further testified:

2 This reflects the typical combined or -- well, actually, the water,  
3 wastewater bill and the combined bill of a typical residential customer.

4 I would note that I believe that in our filing we used 11,400 gallons of  
5 consumption to represent that typical residential customer. And this chart  
6 shows that the company's proposed bill would have been \$104.81. Staff  
7 has recommended increasing that to \$140.04, an increase of nearly 34  
8 percent over the company's recommended rates.

9 (Transcript pg 27, lines 14-23).

10 In contrast to Staff's present capital structure, the capital structures submitted by  
11 the Companies result in rates that compare appropriately with existing water and  
12 wastewater providers in Mohave County. (See Response to Staff Report, Exhibit 1). Mr.  
13 Jones adopted Exhibit 1 as his sworn testimony and testified as follows:

14 My investigation looked at several providers in the area, both private and  
15 municipal. An investigation showed that both Staff's and the company's  
16 rates are substantially -- as proposed are substantially higher than the  
17 average of the existing rates in the area with, again, Staff's being  
18 substantially higher than the company's, but with both being higher than  
19 the current average.

20 (Transcript pg 28, lines 7-14).

21 As would be expected and desired for a new provider, the Companies' proposed  
22 water and wastewater rates are substantially above those for existing providers, with the  
23 combined water and wastewater rate for the typical residential customer of \$104.81,  
24 which is approximately 175% of the average of existing providers in Mohave County.  
25 Yet, Staff's recommendations are significantly higher than the ones proposed by the  
26 Companies and drastically higher than those of existing providers; the combined water  
27 and wastewater rate for the typical residential customer of \$140.04 would be  
28 approximately 230% of the average of existing providers in Mohave County.

The Staff attorney stated that: "Staff considers every case on a case by case  
basis . . ." (Transcript pg 99, lines 2-3). Yet, contrary to this position, the Staff witness  
testified that "[I]t's the unwritten policy of the Utilities Division that we do not grant  
hook-up fees to new CC&Ns (Transcript pg 68, lines 6-9). The Companies believe such  
policy, without supporting analysis or justification, is arbitrary and not supportable by

1 the facts of this case.

2 More appropriately, Staff policy should track the reasoned analysis conducted as  
3 part of the June 28, 2005, Staff Report for Circle City Water Company L.L.C. ("Circle  
4 City") (Docket Nos. W-03510A-05-0145 and W-03510A-05-0146) in which Staff  
5 appropriately balanced the costs of financing plant between the company and the  
6 developers. In its report, Staff stated that it "generally recommends the contributed  
7 capital not exceed 25 percent of the assets required to establish service."

8 By using the Circle City case for comparative purposes, Mr. Jones concluded:

9 Circle City is an existing company. However, they have, according to the  
10 docket in that case, only 169 customers and total assets of \$128,000. So  
11 while they're existing, they're quite a small company.

12 They had proposed to extend service to a new development that was  
13 10,000 new customers, and the plant to serve that new development was  
14 anticipated to cost \$55.4 million. The company had proposed a hook-up  
15 fee to fund a portion of those costs. Actually, I believe the company had  
16 proposed a hook-up fee to fund nearly all of those costs in terms of at least  
17 the backbone part of those costs.

18 Staff recommended and ultimately adopted a lower hook-up fee that more  
19 appropriately balanced the costs between the Circle City Water Company  
20 and the developers, but they did recommend that there would be a hook-up  
21 fee.

22 And although they are existing, I think given the size of that expansion and  
23 the cost of that expansion relative to their existing customer base and asset  
24 base, I think it's very similar to our case. I don't see how the risk and  
25 issues for that company are any different just because they happened to be  
26 existing when they made the agreement with the developer to serve that  
27 project.

28 (Transcript pp 30-31, lines 12-25, 1-12).

Considering that Circle City's current customer count represents only 1.7% of the  
expected total customers and Circle City's existing assets amount to only 0.2% of the  
proposed new plant facilities required to serve the non-contiguous CC&N, the Circle  
City case is analogous to the Companies' requests in this matter. In Decision No. 68246,  
the Commission adopted Staff's recommendation for hookup fees representing  
contributed capital of approximately 27% of total estimated required capital and 50% of

1 the backbone plant construction estimate.

2 In this case, the Water Company has requested hookup fees that represent 14% of  
3 the total estimated plant construction cost and 36% of the backbone plant construction  
4 estimate. The Utility Company has requested hookup fees that represent 24% of the  
5 total estimated plant construction cost and 49% of the backbone plant construction  
6 estimate. The requested hookup fees are consistent with Staff's recommendation and the  
7 Commission's decision in Circle City Water Company's application.

8 The Companies also sought guidance from the Interim Report of the  
9 Commission's Water Task Force (the "Water Task Force Report"), Docket No.  
10 W-00000C-98-0153, in which Staff recommended developing a generic hook-up fee  
11 policy/rule. There was no discussion in the Water Task Force Report limiting the hook-  
12 up fees to existing companies already holding a CC&N. Staff did opine that "the reason  
13 for having the hook-up fee pay for only part of the new plant is to insure that the  
14 company retains a balance between contributed plant and its own investment." Interim  
15 Report of the Arizona Corporation Commission's Water Task Force, October 28, 1999,  
16 at 16.

17 While the Company acknowledges that the Commission has not adopted the  
18 generic hook-up fee policy as recommended by Staff, no evidence was presented at the  
19 hearing that Staff has changed or modified its position of maintaining a balance between  
20 contributed plant and company investment.

21 **The Companies Debt to Equity Ratio is Reasonable.**

22 According to the Staff testimony, Staff generally recommends a bare minimum  
23 equity requirement of 40%. (Transcript p 67, lines 15-17). Yet, it is not clear whether  
24 this equity requirement is to be measured against debt or total capitalization. For  
25 example, equity divided by total capital (equity/(equity + debt + advances +  
26 contributions)) will always be a smaller number than equity divided by just debt and  
27 equity. Any company that has a significant amount of advances and contributions would  
28 need to have an equity ratio that far exceeds 40% of its total capitalization.

1 An analysis of the Circle City case may add insight into this issue. Attached as  
2 Exhibit 1 is a partial pro forma balance sheet for Circle City after 5 years of operation. It  
3 is noteworthy that the equity ratio was calculated at only 28%. We can assume such  
4 ratio was reviewed and approved by Staff.

5 **Including Land North of White Hills Road in the Companies Service**  
6 **Area is Premature.**

7 Under Condition 10, Staff has recommended that the Companies service area  
8 should include the 120 acres owned by Sports Entertainment, LLC ("SE"). The  
9 Companies oppose Staff's position because White Hills Road separated SE's land from  
10 the Companies proposed service area. As planned development to this area progresses,  
11 it is expected that significant improvements and upgrades to U.S. Highway 93 and White  
12 Hills Road will be made that will greatly impact the cost to serve the SE Property.

13 It is the Companies position that the major concern for including the SE property  
14 in the existing CC&N is that it is not in the public interest to decide now whether the  
15 ratepayers and the utility companies should be obligated to assume the speculative costs  
16 to serve the area north of White Hills Road at a time such costs are indeterminable and  
17 the need is non-existent.

18 Based upon the speculative nature of development for the SE property, Mr.  
19 Jones testified:

20 I believe our position is it would be more appropriate to wait until we had  
21 a request for service, we knew the nature of the development that was  
22 going to occur on the property, and there had been proper hydrological  
23 studies done to insure that there was adequate water supply to serve  
24 whatever that identified development was on the property.

25 Therefore, you can properly estimate costs to serve the property and  
26 prepare an appropriate line extension agreement and application to include  
27 it in the CC&N at that time.

28 (Transcript pg 36, lines 6-17).

It is the Companies' position that a determination on whether to include the  
property north of White Hills Road is premature. Mr. Jones testified:

1 The development of White Hills Road may present certain obstacles to  
2 serving the property. It may not. It depends on how that road is  
3 developed. And, again, when the property is ready to be served and it's  
4 actually submitted a request for service and the nature of the development  
is known, those impacts could be determined. And it would be better at  
that time to decide if this was the appropriate way to serve the property or  
not.

5 (Transcript pg 37, lines 2-10).

6 At hearing, Mr. Scott Fisher, member of SE, provided testimony that  
7 approximately 61-62 acres owned by SE was south of White Hills road. (Transcript pg  
8 53, line 9). In addition, Mr. Fisher testified that he is currently planning to develop that  
9 south portion and that SE contracted with Hydro Systems, Inc. to conduct a hydrology  
10 report. (Transcript pg 55, lines 7-20). The Hydrology report was not included in  
11 evidence but was produced after the hearing by counsel for SE (A copy is attached as  
12 Exhibit 2). Contrary to Mr. Fisher's testimony, Exhibit 2 is not a hydrology report for  
13 the 62 acres south of White Hills Road that provides any information necessary for  
14 developing the SE property. The Report is a general opinion that identifies and  
15 evaluates the feasibility of acquiring Colorado River surface water to meet the demands  
16 of a mixed use real estate development located within the Detrital Valley region of  
17 Northwest Arizona. Generally, the purpose of conducting a hydrological study is to  
18 determine whether there is an adequate water supply to serve the property to be  
19 developed. The report disclosed by SE in this case does not provide any information as  
20 to whether an adequate water supply exists to serve their property. Furthermore, such a  
21 report gives no indication that development in the area is imminent or even planned. In  
22 addition, SE presented no evidence at hearing or thereafter that they intend to develop  
23 the property north of White Hills road.

24 Despite Mr. Fisher's contention, SE does not appear to be in the planning stage of  
25 development and to anticipate the purported need for that area would be speculative at  
26 best. It is also possible that when SE is finally ready to develop, or sells to an entity that  
27 is, other alternative providers may be available to serve at a lesser cost. At a minimum,  
28 to require the incorporation of the SE Property in the Companies CC&N would be

1 premature.

2 The premature inclusion of the SE Property in the Companies' service territories  
3 is contradictory to Staff's stated position in other CC&N proceedings. For example,  
4 Staff had recommended denial of a CC&N expansion request by Arizona Water  
5 Company for "properties for which there was no request for service, since there was no  
6 demonstrated need for those properties." Staff's Closing Brief, In the Matter of the  
7 Application of Arizona Water Company to Extend Its Existing Certificates of  
8 Convenience and Necessity at Casa Grande and Coolidge, Pinal County, Arizona,  
9 Docket No. W-01455A-04-0755 at 8. As in the Arizona Water case, SE will not be able  
10 to demonstrate a foreseeable need for service, let alone a current one. Given the fact that  
11 a portion of SE's property lies south of White Hills Road, the Companies have no  
12 objection to including that portion of property in the certificated area.

13 **Conclusion**

14 For all the foregoing reasons, Perkins Mountain Water Company and Perkins  
15 Mountain Utility Company request that Conditions 8, 10 and 11 of Staff's Report not be  
16 adopted in the Decision and Order in this matter, and that Condition 2 be modified such  
17 that the Commission approve the Companies' rates as submitted in the Applications and  
18 not Staff's rates as shown in the Staff Report.

19 RESPECTFULLY SUBMITTED this 6th day of January, 2006.

20 SNELL & WILMER L.L.P.

21  
22 By: 

23 Kimberly A. Grouse  
24 Robert J. Metli  
25 One Arizona Center  
26 400 East Van Buren  
27 Phoenix AZ 85004-2202  
28 Attorneys for Perkins Mountain Water Company  
and Perkins Mountain Utility Company

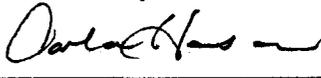
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3 Arizona Corporation Commission  
4 1200 West Washington  
5 Phoenix, AZ 85007

6 COPY mailed this 6th day of January, 2006, to:

7 Booker T. Evans, Jr.  
8 Kimberly A. Warshawski  
9 Greenberg Traurig, L.L.P.  
10 2375 East Camelback Road  
11 Suite 700  
12 Phoenix, AZ 85016

13 Scott Fisher  
14 Sports Entertainment  
15 808 Buchanan Blvd., Ste. 115-303  
16 Boulder City, NV 89005

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Exhibit 1

Circle City Water, LLC  
Docket No. W-03510A-05-0145

	[1] Partial Pro Forma Balance Sheet From Staff Schedule JJD-1	[2] Effect of Five Years Operation	[3] Partial Pro Forma Balance Sheet After Five Years of Operation
[1] Current Liabilities	\$ 8,110		\$ 8,110
[2] Advances and Meter Deposits (AIAC)	\$ 17,354	\$ 19,123,648 (1)	\$ 19,141,002
[3] Contributions in aid of Construction (CIAC)	\$ 1,601	\$ 11,475,000 (2)	\$ 11,476,601
[4] Deferred Credits	\$ 18,955		\$ 30,617,603
[5] TOTAL LIABILITIES AND CREDITS	\$ 27,065		\$ 30,625,713
[6] Proprietary Capital	\$ 101,315		\$ 101,315
[7] Refunds Made		\$ 307,352 (3)	\$ 307,352
[8] Backbone Plant Equity Financed		\$ 11,475,000 (4)	\$ 11,475,000
[9] TOTAL EQUITY CAPITAL	\$ 101,315		\$ 11,883,667
[10] TOTAL LIABILITIES AND CAPITAL	\$ 128,380		\$ 42,509,380

Equity as percent of total Capital (Line 9 / Line 10)

28.0%

% of plant cost expended at end of year five per Circle City CC&N Extension Application = 76.5%

(1) 76.5% of build-out On-site facilities less refunds

(2) 76.5 % of build-out hook-up fees

(3) 10% of first five years revenue as estimated in Circle City CC&N Extension Application

(4) 76.5% of build-out Off-Site Facilities less hook-up fees

Exhibit 2

**A PRELIMINARY REPORT ON THE  
ACQUISITION OF A  
COLORADO RIVER WATER SUPPLY**

January 25, 2005

Prepared by:

Timothy R. Bray (Southwest Community Resources)  
William H. Swan (Attorney/Consultant)

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1. Executive Summary/Recommendations
2. Preliminary Report on the Acquisition of a Colorado River Water Supply
3. Exhibit A – Existing Arizona Entitlements and Priorities for the Colorado River
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5. Exhibit C - Arizona Department of Water Resources Policy and Procedures For Transferring an Entitlement of Colorado River Water

## EXECUTIVE SUMMARY/RECOMMENDATIONS

Arizona's entitlement to Colorado River water totals 2.8 million acre feet (maf) of which 1.3 maf is allocated to water users along the River. There is 1.5 maf allocated to the Central Arizona Project. Most of the "on River" entitlements, taken individually, are not large enough, in acre feet, to meet the projected (6,000 - 7,000 a/f) annual potable water demands of the proposed project. Only the largest entitlement holders, the Colorado River Indian Tribes (662,402 a/f) and the Fort Mohave Indian Reservation (103,535 a/f) and various Yuma area agricultural users could meet the project's potable water demands.

Any transfer and re-allocation of Colorado River water will require the approval of both the Arizona Department of Water Resources and the U. S. Bureau of Reclamation. Additionally transfers of Indian water rights may require authorization from the U. S. Congress as well as approval from the Tribal government.

Based upon prior Colorado River transfers, and proposed transfers, none of the major entitlement holders have expressed an interest in relinquishing any of their water for a period that exceeds 30-40 years. There is very little opportunity to obtain a 100 year water supply to demonstrate to the Arizona Department of Water Resources that the proposed project has an Adequate Water Supply pursuant to the Assured Water Supply Rules of the State of Arizona. However, in the past, there has been an expression of interest from these major entitlement holders to lease their water for a period of time that ranges from 10-40 years.

As a result of our preliminary investigation of the feasibility of securing a Colorado River water supply for the proposed project it is recommended that consideration be given to creating an underground water storage facility. If this is feasible from a hydrologic perspective then a 100 year water supply could be stored underground over a 10-40 year period in sufficient quantities to meet the Adequate Water Supply Rules of the Arizona Department of Water Resources.

There may also be opportunities to enter into water exchanges with the Central Arizona Water Conservation District, or other irrigation districts within the State of Arizona, whereby a water supply taken from the Colorado River for the proposed project would be replaced, with a water supply located elsewhere within the State of Arizona. This report did not attempt to evaluate these opportunities.

## SCOPE OF SERVICES

The purpose of this report is to initially identify and evaluate the feasibility of acquiring Colorado River surface water supplies in an amount that is adequate to meet the potable water demands of a large scale mixed use real estate development to be located within the Detrital Valley region of Northwest Arizona. This report will include an outline of the regulatory requirements of both the State of Arizona and United States Bureau of Reclamation for acquiring and transferring existing Colorado River surface water supplies to the proposed development.

## INTRODUCTION

The Colorado River flows through seven states and Mexico prior to discharging into the Gulf of California. Its flows are managed through a series of dams and diversions. Arizona has a permanent allocation of 2.8 million acre feet from the River of which approximately 1.3 million acre feet is allocated to water users located along the River (the other 1.5 maf is committed to the Central Arizona Project). Users along the river include cities, towns, agricultural areas and Native American tribes. Colorado River water is subject to Congressional acts, interstate and international compacts as well as court decrees. Together these documents and actions are known as the "Law of the River". The "water-master," or the decision making authority for the Colorado River in the lower basin states of Arizona, California, and Nevada, is the Secretary of the Interior (Secretary), who manages the river through the U. S. Bureau of Reclamation (USBOR).

In certain areas of river management the jurisdiction of the Secretary is exclusive. For example, the Secretary generally has exclusive jurisdiction to issue contracts for water use in the lower basin (except that the Secretary must respect pre-1929 prior-perfected rights), and the Secretary has the authority to determine the terms under which contracts for water use shall be issued. In other areas of water management the three lower basin states may share jurisdictional authority, but this is an area of some confusion and has not been fully addressed by the judicial branch. Accordingly, in regard to the sale or transfer of lower basin water entitlements the Arizona Department of Water Resources (ADWR) is responsible for making recommendations to the Secretary regarding the transfer or re-allocation of Colorado River water uses within Arizona. In other words, the State of Arizona would have a consultation role in such transactions, but would ordinarily not be in a position to pass final judgment on such transactions (possible exceptions to this general rule are discussed below).

Colorado River water is allocated to all non-federal water users via contracts with the United States through the Secretary. Colorado River water is also allocated to federal establishments and Native American Tribes via administrative action or court decree. On the Arizona side of the river all Colorado River water rights are controlled and managed through a priority system of 1 thru 6. Priority rights 1-3 are the most senior rights (such as pre-1929 rights and Indian rights). Priority 4 rights are within the Arizona

apportionment of 2.8 maf per year but are subject to being reduced during times of water shortages on the Colorado River. Priorities 5-6 are beyond the Arizona apportionment of 2.8 maf per year and are usually embodied in short-term contracts, typically one year in duration, and can be terminated at any time. Priorities 5 and 6 relate to the use of unused apportionment within Arizona or surplus water allocated to Arizona.

### TASK 100

Existing Arizona Entitlements and Priorities for the Colorado River are identified in Exhibit "A". This list demonstrates that there are a significant number of individuals or entities holding rights to Colorado River water, of one form or another, within Arizona. However, many of those entitlements are small in nature and therefore do not present viable opportunities for transfer to a different location. Assuming a projected annual water demand of 6000-7000 acre feet, or greater, for the proposed project at buildout, the sources from which a water supply might be obtained are somewhat limited. For example, only the Colorado River Indian Reservation (662,402 a/f), Fort Mohave Indian Reservation (103,535 a/f), and the various Yuma area agricultural users have entitlements that are large enough to accommodate a transfer of that magnitude. In addition, Indian water sources should be viewed as short-term lease opportunities. Indian responses to prior efforts to secure their water rights through leasing (they cannot sell water under federal guidelines), although positive, have resulted in declining interest on their part when a lease term in excess of 30-40 years is requested. Accordingly, the development of a long-term water supply through the use of a lease of Indian water rights should be considered in conjunction with some sort of storage project (such as underground storage and recovery).

Yuma area agricultural water users can sell their entitlements, subject to review and approval by the State of Arizona and the U. S. Bureau of Reclamation. Obtaining these water rights would most probably result in the need to acquire, and retire, the agricultural lands that are currently using the water. This technique is known as "fallowing," or the permanent retirement of agricultural land. However, experience shows that such entities are often times unwilling to sell underlying entitlements and may therefore be more interested in some form of lease for a period of years.

As noted above, it is also important to understand the priority position of the right being obtained. On the Arizona side of the river there are six priorities, and this can be understood by reference to standard Arizona-side contract provisions which set forth these six priority positions (Exhibit "B"). In other words, because priority group 4 is subject to the first round of cut-backs if a shortage of water results in such action by the Secretary, priority 4 entitlements are somewhat less attractive than priority 1, 2, or 3 entitlements. Nevertheless, priority 4 entitlements may be sufficient if the project supply includes, for example, backup groundwater wells that can be used in times of shortage on the river.

## TASK 200

The Arizona Department of Water Resources (ADWR) Substantive Policy Statement on Policies and Procedures for Transferring an Entitlement of Colorado River Water is contained in Exhibit "C." This policy became effective on May 24, 2004. This Policy applies to the transfer or re-allocation of all non-federal Colorado River entitlements within the State of Arizona.

This regulatory policy, administered by ADWR, is supported by a statute which provides as follows: "Individuals, irrigation districts, corporations, state departments, agencies, boards, commissions and political subdivisions of the state shall cooperate, confer with and obtain the advice of the Director of ADWR as to those negotiations, contracts and subcontracts that effect the allocation and use of main stream Colorado River water or the allocation and use of Colorado River water. For a proposed contract or subcontract or a proposed amendment of a contract or subcontract that will result in a transfer of an allocation or entitlement of Colorado River Water, from a non-Indian Arizona contractor or subcontractor for a term of more that one year, the obligation to cooperate, confer with and obtain the advise of the Director of ADWR shall include the obligation to submit to the Director for review the proposed contract or subcontract or the proposed amendment, and all related exhibits and agreements, prior to its execution by the contractor or subcontractor".

Based upon this policy the Director of ADWR will review any proposed transfer by a non-federal Arizona contractor of a Colorado River entitlement for the purpose of determining the potential impacts caused by the redistribution of water. After review, the Director will make recommendations to the Secretary in regard to the appropriate redistribution of mainstream Colorado River water supplies consistent with the policies and laws of the State. Again, the ADWR role is in the nature of a consultation with the Secretary, but the Secretary, via USBOR, generally has the ultimate authority to pass judgment on such transactions. Nevertheless, from political and practical perspectives the role of ADWR should be recognized as significant and likely to present a real problem if ADWR ends up being opposed to the proposed transaction.

Although ADWR does not have similar jurisdiction over the transfer or lease of Native American Colorado River water entitlements, nonetheless, the State does maintain that they will review such proposed transactions and provide recommendations to USBOR before any final decision is issued. The State of Arizona sees that it has a role in such matters largely because the state holds a permanent water use contract with the Secretary for 2.8 maf of water per year, and this amount obviously includes the volume of water used within Arizona by the Native American tribes as well.

More significantly, the transfer of a portion of a Native American water entitlement via a multi-year lease would require approval from both USBOR and also the Bureau of Indian Affairs (and of course the tribal government involved). In addition, there is an unresolved legal issue concerning the authority to use Indian water rights at locations off the reservations. In past situations the federal government has taken the position that there is

sufficient existing statutory authority under which such transactions may be approved (by both USBOR and the BIA). However, others assert that such is not the case and therefore such transactions must be approved in advance by the Congress. Although the five Indian reservations along the Colorado River in the lower basin have firm, permanent water rights decreed by the Supreme Court of the United States, some assert that those tribes do not have the authority to lease water for use off the reservations until such action is blessed by Congress. Regardless as to the merits of this dispute, the legal uncertainty in this area is one important consideration to keep in mind if an Indian lease arrangement turns out to be one of the more attractive options for supplying water to the proposed project.

Finally, it should also be understood that ADWR takes the position that its authority to approve such water transfer transactions may depend on the nature and priority of the entitlement being transferred. As noted above, prior perfected rights are those established under state law prior to the enactment of the federal Boulder Canyon Project Act in 1929 (BCPA). The BCPA set up the arrangement whereby the Secretary would manage the lower basin reservoirs and issue contracts for water uses in the lower basin. But that act recognized that many users had, previous to that time, lawfully appropriated water from the river in accordance with state law, for example in Arizona and California. Thus, such non-federal pre-1929 rights are grounded in state law, but now are also covered by water use contracts with the Secretary. Such pre-1929 contracts are held by some of the irrigation districts in the Yuma area, and on the California side by the Imperial Irrigation District and the Palo Verde Irrigation District.

ADWR takes the position that transactions involving such pre-1929 rights would also need the express approval of ADWR (not just consultation and recommendations). ADWR asserts this position on the basis that such pre-1929 rights are really grounded in state law and therefore the state still has continuing jurisdiction over such entitlements, shared with the federal government. Accordingly, if it were to be determined that an attractive transfer option involved an entity holding a pre-1929 entitlement, it should be understood that approval of the transaction may also have to be obtained from ADWR in addition to USBOR.

### **TASK 300**

The federal government, through the U. S. Bureau of Reclamation, does not have a formal regulatory process for acquiring and transferring Colorado River water rights. USBOR presently addresses such matters on a case-by-case basis and has, in the past, indicated a willingness to engage and approve such transactions. In 1994 USBOR issued draft regulations which would have governed such transactions, among other things, but those draft regulations were never promulgated as formal federal regulations. The USBOR will rely strongly on the recommendations of local federal officials (such as in the USBOR offices in Yuma and Boulder City, Nevada), ADWR's comments and

recommendations, the perspectives of local irrigation districts and county officials (both from the area where the water would be transferred from and from the area where the water would be transferred to), and, if applicable, the desires of the Native American tribe involved in the water transfer.

Transfer of a Colorado River water entitlement will likely invoke the requirements of the National Environmental Policy Act (NEPA) and possibly the Endangered Species Act (ESA). An Environmental Assessment would likely be required under NEPA in order to determine if broader compliance action, such as the possibility of preparing a full Environmental Impact Statement, might be required before obtaining final approval of a Colorado River water transfer from the USBOR. Whether any action under the ESA would be required will depend on the presence of endangered or threatened species in the area of the transfers. However, it is important to note that the State of Arizona is a major participant in the soon-to-be-approved Multi-Species Conservation Program (MSCP) now being finalized in the lower basin. It is likely that the broad coverage of the MSCP will provide effective ESA clearance for a water transfer of this nature in the area below Hoover Dam.

Absent specific engineering data, it appears that the Point of Diversion for diverting and transporting Colorado River water would be in the Bullhead City area east along state highway 68 to 93 and north to the project area. This route may be the most expedient for obtaining the necessary right of way from the Arizona Department of Transportation. And it may offer the least amount of potential environmental impact.

Other points of Diversion between Bullhead City and Hoover Dam appear to be difficult due to land ownership in this area. Much of the land along the east side of the River appears to be set aside as the Lake Mead National Recreation Area. Land immediately east of the Recreation area appears to be under the jurisdiction of the U. S. Bureau of Reclamation. Obtaining right of way through these areas might be difficult.

# EXHIBIT "A"

## Arizona Entitlements and Priorities for the Colorado River Updated April 2004

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
<b>Federal:</b>					
Cocopah Indian Reservation (also has PPR for 1,140 af & 2,026 af 4th priority water, Total: 10,847 af)	1		7,681	PPR No. 1	09-27-1917
Cocopah Indian Reservation (formerly United States)	1		1,140	PPR No. 8	1915
Colorado River Indian Reservation	1		662,402	PPR No. 2	03-03-1865 11-22-1873 11-16-1874
Fort Mojave Indian Reservation	1		103,535	PPR No. 3	09-18-1890 1911
<b>1st Priority Federal Total:</b>			<b>774,758</b>		
<b>Water Projects:</b>					
Yuma County Water Users Association (also has water rights certificates)	1		254,200	PPR No. 4	00-00-1901
Yuma Auxiliary Project-Unit B (also has water rights certificates)	1		6,800	PPR No. 5	07-08-1905
North Gila Valley Unit (Yuma/Mesa Division)	1		24,500	PPR No. 6	07-08-1905
<b>1st Priority Water Projects Total:</b>			<b>285,500</b>		
<b>Misc. PPR's: AZ v CA 1979:</b>					
Powers	1		960	PPR No. 7	00-00-1915
Brooke Water Company, LLC (formerly Graham)- (also has 320 af 4th priority)	1		360	PPR No. 9 4-07-30-W0042	00-00-1910
Hulet (MVIDD)	1		1,080	PPR No. 10	00-00-1902
Hopal (formerly Hurschler)-(MVIDD)	1		1,050	PPR No. 11 4-07-30-W0052	00-00-1902
Miller (MVIDD)	1		240	PPR No. 12	00-00-1902
McKellips/Granite Reef Farms (MVIDD)	1		810	PPR No. 13	00-00-1902
Sherill & Lafollette (MVIDD)	1		1,080	PPR No. 14	00-00-1902
Molina	1		318	PPR No. 15	00-00-1928
Gila Monster Ranch (formerly Sturges) - (also has 6,285 af of 2nd priority and 1,435 af of 4th priority and 656 af of 5th priority)	1		780	PPR No. 16 6-07-30-W0337	00-00-1925
Zozoya (MVIDD)	1		720	PPR No. 17	00-00-1912
Swan (MVIDD)	1		960	PPR No. 18	00-00-1902
Phillips, Milton & Jean	1		42	PPR No. 19	00-00-1900
City of Parker (also has 1,030 af 4th priority and 2,000 af of 5th and/or 6th priority)	1	400	630	PPR No. 20	00-00-1905
City of Yuma (also has 48,522 af of 2nd priority)	1	1,478	2,333	PPR No. 21 14-06-W-106	00-00-1893
<b>1st Priority PPR's Total:</b>		<b>1,878</b>	<b>8,400</b>		
<b>Federal:</b>					
Ak-Chin Indian Community	2		50,000	AK-CHIN121180A	01-01-1956
Bureau of Reclamation-Davis Dam	2		100	Secretarial Reservation dated Nov. 29, 2000	04-26-1941

**Arizona Entitlements and Priorities for the Colorado River Updated April 2004**

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
Dept. of the Navy-Marine Corp Air Station	2		3,000	14-06-300-937	01-01-1959
Lake Mead NRA National Park Service	2		Unquantified	1964 Supreme Court Decision	
Salt River Pima Maricopa Indian Community	2		22,000	SRPMIC021288N	03-04-1952
Yuma Proving Ground	2		1,129	176r-696	01-01-1959
<b>2nd Priority Federal Total:</b>			<b>61,363</b>		
<b>National Wildlife Refuges:</b>					
Cibola National Wildlife Refuge	2	16,793	34,500	Secretarial Reservation	08-21-1964
Havas National Wildlife Refuge	2	37,339	41,839	1964 Supreme Court Decree/fulfill purposes of Refuge Exec Order No. 8647/Public Land Order No. 559	01-22-1941 02-11-1949
Imperial National Wildlife Refuge	2	23,000	28,000	1964 Supreme Court Decree/fulfill purposes of Refuge	02-14-1941
<b>2nd Priority Refuges Total:</b>			<b>77,132</b>	<b>104,339</b>	
<b>Water Projects:</b>					
Yuma Auxiliary-Unit "B" - (also has PPR for 6,800 af)	3			Unquantified water rights certificates 14-06-300-44	12-22-1952
Yuma County Water Users Association - (also has PPR for 254,200 af)	3			Unquantified water rights certificates 14-06-300-621	04-01-1957
Yuma-Mesa Division/Gila Project - North Gila Valley Irrigation District, Yuma Irrigation District & Yuma Mesa Irrigation & Drainage District	3	250,000		Shared Entitlement 14-06-W-54 14-06-W-102 14-06-300-1270	01-01-1956
Wellton-Mohawk/Gila Project	3	278,000		1-07-30-W0021	03-04-1952
<b>3rd Priority Water Projects Total:</b>			<b>528,000</b>		
<b>Micellaneous 3rd:</b>					
Arizona, University of	3		1,088	14-06-300-144	01-01-1954
Camille, Alec Jr.	3		120	14-06-303-528	12-23-1953
City of Yuma (Also has PPR for 1,478 af)	3	48,522		14-06-W-106	11-12-1959
City of Yuma (Cemetery)	3		60	14-06-303-1078	05-01-1956
Desert Lawn Memorial (also has 360 af 4th priority)	3		200	14-06-303-1079	05-01-1956
Gila Monster Ranch (formerly Sturges)-(several Warren Act contracts terminated by this contract)-(also has 780 af of 1st priority, 1,435 af of 4th priority and 656 af of 5th priority)	3		6,285	6-07-30-W0337	01-01-1952
Kaman Inc.	3		2	14-06-303-1555	12-02-1959
Southern Pacific Railroad	3		48	14-06-303-1524	12-21-1959

Arizona Entitlements and Priorities for the Colorado River Updated April 2004

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
Yuma-Mesa Fruit Growers	3		15	14-06-303-1196	01-01-1956
Yuma Union High School	3		200	14-06-303-179	05-03-1960
<b>3rd Priority Miscellaneous Total</b>			<b>56,540</b>		
<b>Municipal and Industrial:</b>					
Arizona-American Water Company (formerly Havasu Water Company)-(also has subcontract with MCWA for 750 af 5th priority)	4		1,420	00-XX-30-W0391	01-23-2001
Arizona State Parks Board / Windsor Beach	4		90	7-07-30-W0364	08-17-1998
Brooke Water Company, LLC (also has PPR for 360 af)	4		320	4-07-30-W0042	11-09-1983
Bullhead City (also has 5th and/or 6th priority amount not specified & subcontract with MCWA for 6,000 af 4th priority)	4		15,210	2-07-30-W0273	11-09-1994
Bureau of Land Management	4	4,010		8-07-30-W0373 dated 06-13-2000	Secretarial Reservations 08-30-1973 09-29-1981 04-27-1987
City of Parker (also has PPR for 630 af and 2,000 af of 5th and/or 6th priority)	4		1,030	2-07-30-W0025	01-06-1998
Crystal Beach Water Conservation District (also has 5th and/or 6th priority amount not specified)	4		132	6-07-30-W0352	11-21-1997
Desert Lawn Memorial Park	4		360	14-06-300-2589	05-30-1975
Ehrenberg Improvement Association	4		500	8-07-30-W0006	10-14-1977
Gold Dome Mining Company	4		7	0-07-30-W0250	06-06-1990
Gold Standard Mines Corporation	4		75	3-07-30-W0038	08-25-1983
Golden Shores Water Conservation District	4		2,000	9-07-30-W0203	06-01-1989
Hillcrest Water Company	4		84	5-07-30-W0078	03-08-1985
Lake Havasu City (also has 5th and/or 6th priority amount not specified & subcontract with MCWA for 6,000 af of 4th priority)	4		19,180	3-07-30-W0039	10-04-1995
Marble Canyon (also has 5th and/or 6th priority amount not specified)	4		70	5-07-30-W0322	05-01-1996
McAllister Subdivision	4		40	7-07-30-W0355	07-31-1998
Mohave County Water Authority (Pending amendment to change entitlement to 18,500 af) - (15,000 af subcontracted: Lake Havasu City 6,000 af, Bullhead City 6,000 af, MWCD 3,000 af) - (also has 3,500 af 5th and/or 6th Partially subcontracted to: Arizona-American 750 af and MVIDD 600 af)	4		15,000	5-07-30-W0320	11-14-1968
Mohave Valley IDD (Estimated M&I use from crop report and is part of the 41,000 af entitlement)-(also has a subcontract with MCWA for 600 af 5th priority) <sup>1</sup>	4		5,000	14-06-W-204	11-14-1968

**Arizona Entitlements and Priorities for the Colorado River Updated April 2004**

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
Mohave Water Conservation District ( <i>also has a subcontract with MWCA for 3,000 af 4th priority water</i> )	4		1,800	9-07-30-W0012	11-14-1968
Roy, Edward P.	4		1	9-07-30-W0124	02-24-1986
Smucker Park	4		33	14-06-303-2702	11-12-1969
Town of Quartzsite	4		1,070	7-07-30-W0353	01-28-1999
Verizon (Formerly Continental Telephone of CA)	4		1	14-06-300-2506	02-05-1974
Water Reserved by the Secretary for use in Indian Settlements	4		3,500		
Western States Minerals 70 Acre Feet Terminated February, 2002	4				
<b>M&amp;I 4th Priority Total:</b>			<b>70,933</b>		
<b>M&amp;I Recommendations Pending:</b>	4				
Arizona State Land Department	4		1,534		
Arizona State Parks Board / Contact Point	4		20		
Brooke Water Company, LLC	4		120		
Fisher Landing Water and Sewer	4		53		
Martinez Lake Cabin Sites-87 af ( <i>53 af to Fisher Water &amp; Sewer, 8 af to Shepard Water, 3 af to ASLD</i> )	4		23		
Mohave County Water Authority			3,500		
Shepard Water Company	4		50		
Somerton	4		750		
<b>M&amp;I 4th Priority Recommendations Total:</b>			<b>6,050</b>		
<b>Agricultural:</b>					
Arizona State Land Department ( <i>also has 9,067 af 5th and 6th priority water</i> )	4		6,607	4-07-30-W0317	06-28-1999
Cibola Valley IDD ( <i>Can use 300 af for M&amp;I)-(also has 3,000 af 5th priority water and 4,000 af 6th priority)</i>	4		24,120	2-07-30-W0028	01-31-1983
Cocopah Indian Reservation ( <i>Lands south of Morelos Dam still in question whether mainstream diversion</i> )	4		2,026	Supreme Court Decree	06-24-1974
Curtis Family Trust ( <i>Will be amending contract to include part of Dulin Farms water-Auza Farms-960 af, Dulin Farms-West portion 936 af, Youman remainder for a total of 2,100 af</i> )	4		2,100	5-07-30-W0076 Amendment No.1	12-01-1984 05-26-1992
Curtis, Armon	4		300	3-07-30-W0037	08-29-1983
Dulin Farms-2,016 ( <i>Will be terminating contract and dividing water-936 af to Curtis Family Trust and 1,080 af to Jessen Family Limited Ptnsp</i> )	4			5-07-30-W0057	10-24-1984
Gila Monster Farms, Inc. ( <i>Formerly Sturges Farm, also has a PPR for 780 af, 2nd priority for 6,285 af and 656 af 5th priority</i> )	4		1,435	6-07-30-W0337	07-28-1997
Hall, Ansel et al. 510 acre feet See Pasquinelli:	4			5-07-30-W0065	02-11-1986

**Arizona Entitlements and Priorities for the Colorado River Updated April 2004**

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
Jessen Family Ltd Partnership ( <i>Terminating Dulin Farms contract - Gleason portion to Jessen</i> )	4		1,080		
Mohave Valley IDD ( <i>41,000 af entitlement less M&amp;I for 5,000 af and PPR's for 5,940</i> )	4		30,060	14-06-W-204	11-14-1968
North Baja L.L.C. 408 af Ag and 72 af M&I ( <i>Formerly Jamar Produce</i> )	4		480	5-07-30-W0066	12-03-1984
Ogram George	4		480	01-XX-30-W0398	09-04-2003
Pasquinelli ( <i>Ansel Hall Contract Assigned &amp; amended from 510 af to 486 af</i> )	4		486	5-07-30-W0065 Assignment & Amendment No. 1	02-11-1986 03-27-03
Raynor Ranches	4		4,500	5-07-30-W0064	10-29-1984
<b>Agricultural 4th Priority Total:</b>			<b>73,674</b>		
<b>4th Ag Recommendations:</b>					
Beattie Farms Southwest ( <i>Russell Youman</i> )			1,110		
El Cajon Farming/Cameron Brothers	4			ADWR recinds 1979 recommendation for 1,290 af letter dated 08-27-2003	
Peach, John ( <i>Formerly Bruce Church</i> )	4		456		
Phillips, Milton & Jean	4		18		
GoBo Farms ( <i>Leased by Sunkist Growers</i> )	4		924		
<b>4th Priority Ag Recommendations Total:</b>			<b>2,508</b>		
<b>5th and/or 6th</b>					
Arizona Public Service Company	5 and/or 6		1,500	6-07-30-W0336	10-03-2000
Arizona State Land Department - ( <i>also has 6,607 af of 4th priority</i> )	5 and/or 6		9,067	4-07-30-W0317	06-28-1999
Bullhead City - ( <i>also has 15,210 af of 4th priority and subcontract with MCWA for 6,000 af of 4th priority</i> )	5 and/or 6		Amount not specified		
Cibola Valley Irrigation & Drainage District	5		3,000	2-07-30-W0028	01-31-1983
Cibola Valley Irrigation & Drainage District	6		4,000	2-07-30-W0028	01-31-1983
City of Parker - ( <i>also has PPR for 630 af and 1,030 af of 4th priority</i> )	5 and/or 6		2,000	2-07-30-W0025	01-06-1998
Gila Monster Farms, Inc. - ( <i>Formerly Sturges Farms</i> ) - ( <i>also has a PPR for 780 af, 2nd priority for 6,285 af and 1,435 af 4th priority</i> )	5		656	6-07-30-W0337	07-28-1997
Gila Monster Farms, Inc. ( <i>Formerly Sturges Farm, also has a PPR for 780 af, 2nd priority for 6,285 af and 1,435 af 4th priority</i> )	6		Upon request	6-07-30-W0337	07-28-1997
Lake Havasu City - ( <i>also has 19,180 af of 4th priority &amp; subcontract with MCWA for 6,000 af of 4th priority</i> )	5 and/or 6		Amount not specified	3-07-30-W0039	10-04-1995
Marble Canyon - ( <i>also has 70 af of 4th priority</i> )	5 and/or 6		Amount not specified		

**Arizona Entitlements and Priorities for the Colorado River Updated April 2004**

Entity	Priority	C.U. Acre-Feet	Diversion Acre-Feet	Contract Number	Priority Date
Mohave County Water Authority - <i>(Partially subcontracted: Arizona-American Water Company for 750 af and MVIDD for 600 af)</i>	5		3,500	5-07-30-W0320	11-14-1968
<b>5th and/or 6th Recommendations:</b>					
Bureau of Land Management	5 and/or 6		1,176		
Canyon Forest Village II Corporation	5		400		
Section 10 Backwater	5		500		
1 MVIDD has an entitlement of 41,000 af for Ag and M&I. The 41,000 includes 5,940 af of PPR water and 35,060 of 4th Priority water.					

EXHIBIT "B"

Contract No. 5-07-30-W0322

**DUPLICATE ORIGINAL**

UNITED STATES  
DEPARTMENT OF THE INTERIOR  
BUREAU OF RECLAMATION

BOULDER CANYON PROJECT

CONTRACT WITH MARBLE CANYON COMPANY, INC., ARIZONA,  
FOR DELIVERY OF COLORADO RIVER WATER

DUPLICATE ORIGINAL

UNITED STATES  
DEPARTMENT OF THE INTERIOR  
BUREAU OF RECLAMATION

BOULDER CANYON PROJECT

CONTRACT WITH MARBLE CANYON COMPANY, INC., ARIZONA  
FOR DELIVERY OF COLORADO RIVER WATER

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**DUPLICATE ORIGINAL**

UNITED STATES  
DEPARTMENT OF THE INTERIOR  
BUREAU OF RECLAMATION

BOULDER CANYON PROJECT

CONTRACT WITH MARBLE CANYON COMPANY, INC., ARIZONA  
FOR DELIVERY OF COLORADO RIVER WATER

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1           6.2     The amount of Mainstream Water consumptively used in the  
2 Marble Canyon Company Contract Service Area pursuant to this Contract shall  
3 discharge a portion of the United States obligation to deliver Mainstream Water  
4 pursuant to the 1944 Contract.

5           6.3     The use of Mainstream Water by Marble Canyon Company shall be  
6 consistent with applicable Arizona water law to the extent that State of Arizona  
7 laws are not inconsistent with the laws and regulations of the United States.  
8 In the event that State of Arizona water law conflicts with Federal law and  
9 regulations, Federal law and regulations shall control.

10    7.    PRIORITY OF MAINSTREAM WATER DELIVERED PURSUANT TO THIS CONTRACT:

11           7.1     Within the State of Arizona, the following priorities shall apply in  
12 the administration of Mainstream Water. The second and third priorities are  
13 coequal.

14           7.1.1   First Priority: Satisfaction of Present Perfected Rights as  
15 defined and provided for in the Decree.

16           7.1.2   Second Priority: Satisfaction of Secretarial Reservations  
17 and Perfected Rights established or  
18 effective prior to September 30, 1968.

19           7.1.3   Third Priority: Satisfaction of Entitlements pursuant to  
20 contracts between the United States and  
21 water users in the State of Arizona  
22 executed on or before September 30, 1968.

23           7.1.4   Fourth Priority: Satisfaction of Entitlements pursuant to:  
24 (i) contracts, Secretarial Reservations,  
25 and other arrangements between the  
26 United States and water users in the State  
27 of Arizona entered into or established  
28 subsequent to September 30, 1968, for use  
on Federal, State, or privately owned lands  
in the State of Arizona (for a total  
quantity of not to exceed 164,652 acre-feet  
of diversions annually); and (ii) Contract  
No. 14-06-W-245 dated December 15, 1972, as  
amended, between the United States and the  
Central Arizona Water Conservation District  
for the delivery of Mainstream Water for  
the Central Arizona Project, including use  
of Mainstream Water on Indian lands.

1 Entitlements having a fourth priority as  
2 defined in (i) and (ii) herein are coequal.  
3 Reductions in Entitlements having a fourth  
4 priority shall be borne by each Entitlement  
5 holder in the same proportion as its  
6 Entitlement, or as required by law,  
7 regulation, or Secretarial determination.  
8 If, however, a reduction-sharing agreement  
9 is entered into between two or more such  
10 authorized users, then the reduction shall  
11 be shared among the parties as provided in  
12 the agreement, subject to approval by the  
13 Contracting Officer after consultation with  
14 ADWR.

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7.1.5 Fifth Priority: Satisfaction of Entitlements to any Unused  
Arizona Entitlement.

Any entity with a contract for fifth-  
priority water shall utilize its fifth-  
priority Entitlement only after the  
Contracting Officer has determined that  
Mainstream Water is available under  
applicable law or regulation, and the  
Contracting Officer provides written  
notification that such Mainstream Water is  
available in a specific year, subject to  
the scheduling and the reduction provisions  
of the contract. Reduction or elimination  
of the fifth-priority water use shall be  
determined by the Contracting Officer after  
consultation with ADWR, or on the basis of  
the contract dates, or as required by law  
or regulation.

7.1.6 Sixth Priority: Satisfaction of Entitlements to surplus  
apportionment water.

Any contractor for sixth-priority water  
shall utilize its sixth-priority  
Entitlement only after the Contracting  
Officer has determined that Mainstream  
Water is available under applicable law or  
regulation, and the Contracting Officer  
provides written notification that such  
Mainstream Water is available in a specific  
year, subject to the scheduling and  
reduction provisions of the contract.  
Reduction or elimination of the sixth-  
priority water use shall be as determined  
by the Contracting Officer or on the basis  
of the contract dates, or as required by  
law or regulation.

1 7.2 In the event that the Contracting Officer determines it is necessary  
2 to enforce a system of priorities for the use of Mainstream Water within the  
3 State of Arizona, water deliveries made pursuant to this Contract shall be in  
4 accordance with the Annual Operating Plan adopted by the Secretary pursuant to  
5 the Operating Criteria.

6 7.3 The priority date of Marble Canyon Company's Entitlement is as  
7 specified in Exhibit B.

8 8. DELIVERY OF MAINSTREAM WATER BY THE UNITED STATES:

9 8.1 Subject to the terms, conditions, and provisions of this Contract and  
10 insofar as reasonable diligence will permit, the United States shall deliver from  
11 storage available in the Colorado River system fourth-priority Mainstream Water  
12 (as defined in section 7 herein) that Marble Canyon Company has ordered and is  
13 entitled to receive for Domestic Use at the points of diversion listed in  
14 Exhibit C.

15 8.2 The obligation of the United States to deliver Mainstream Water  
16 pursuant to this Contract is subject to the following conditions:

17 8.2.1 The availability of Mainstream Water for use in the State of  
18 Arizona pursuant to the provisions of the Colorado River Compact, the Boulder  
19 Canyon Project Act, the 1944 Contract, and the Decree;

20 8.2.2 The availability of Mainstream Water pursuant to the Mexican  
21 Treaty Obligation;

22 8.2.3 Section 6 of the Boulder Canyon Project Act which provides  
23 that Hoover Dam and Lake Mead will be used: first, for river regulation,  
24 improvement of navigation, and flood control; second, for irrigation use and  
25 Domestic Use and satisfaction of Present Perfected Rights pursuant to  
26 article VIII of the Colorado River Compact; and third, for power; and

27 8.2.4 The condition that the management and operation of Hoover Dam,  
28 Lake Mead, and other works and the storage, diversion, delivery and use of

**EXHIBIT "C"**

**ARIZONA DEPARTMENT OF WATER RESOURCES**  
500 North Third Street, Phoenix, Arizona 85004  
Telephone 602 417-2410  
Fax 602 417-2415



**JANET NAPOLITANO**  
Governor

**HERBERT R. GUENTHER**  
Director

**ARIZONA DEPARTMENT OF WATER RESOURCES**

**SUBSTANTIVE POLICY STATEMENT**

**Policy and Procedures for Transferring an Entitlement of Colorado River Water**

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties, you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

Policy and Procedures for Transferring an Entitlement of Colorado River Water

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## I. INTRODUCTION

This statement of policy applies to the transfer by non-federal Arizona contractors of mainstream Colorado River entitlements allocated for irrigation and municipal and industrial (M&I) purposes within the State of Arizona.

### Definition of Water Entitlements

The right or authorization to beneficially use Colorado River water is defined as an entitlement. Entitlements held by non-federal Arizona Colorado River water users are created by decree of the United States Supreme Court (Court) or through a contract with the Secretary of the Interior (Secretary) under Section 5 of the Boulder Canyon Project Act (BCPA) of December 21, 1928.

### Federal and State Authorities

The BCPA federalized the administration of Colorado River water rights by requiring a contract with the Secretary to use Colorado River water under either Section 4 or 5 of the Act. A contractual right, issued under the authority of the BCPA, is a permanent entitlement administered by the U.S. Bureau of Reclamation (Reclamation).

Pursuant to A.R.S. § 45-105, the Director of the Arizona Department of Water Resources (Department) is generally responsible for formulating plans and programs for the development, management, conservation and use of surface water and groundwater throughout the state. Consistent with this responsibility, under A.R.S. § 45-107, entities which contemplate the transfer of their entitlements are required to cooperate, confer and obtain the advice of the Director.

In 1994, the state legislature reemphasized the importance of the role of the Director in the distribution of Colorado River water within the state. The specific statutory mandate in A.R.S. § 45-107(D) states:

Individuals, irrigation districts, corporations, state departments, agencies, boards, commissions and political subdivisions of the state shall cooperate, confer with and obtain the advice of the director as to those negotiations, contracts and subcontracts described in subsection C that affect the allocation and use of main stream Colorado river water or the allocation and use of Colorado river water delivered through the central Arizona project. For a proposed contract or subcontract or a proposed amendment of a contract or subcontract that will result in a transfer of an allocation or entitlement of Colorado river water, including central Arizona project water, from a non-Indian Arizona contractor or subcontractor for a term of more than one year, the obligation to cooperate, confer with and obtain the advice of the director shall include *the obligation to submit to the director for review the proposed contract or subcontract or the proposed amendment, and all related exhibits and agreements, prior to its execution by the contractor or subcontractor.* (Emphasis added)

Pursuant to the aforementioned statutory responsibility and authority, the Director will review any proposed transfer by a non-federal Arizona contractor of a Colorado River entitlement for the purpose of determining the potential impacts caused by the redistribution of water. After review, the Director will recommend to the Secretary the appropriate redistribution of mainstream Colorado River water supplies consistent with the policies and laws of the state. The importance of the

Director's review is underscored by the fact that mainstream water is, in most cases, the only dependable supply of water for urban, industrial and agricultural water users located within the accounting surface or floodplain of the Colorado River. Therefore, due to the importance of the distribution of Colorado River water to the welfare and economy of the state, explicit policy and procedures are necessary to ensure adequate and consistent evaluation of any proposed transfer of a Colorado River entitlement.

### **Purpose of Policy**

The purposes of this policy are: 1) to establish a procedure to obtain the advice and review of the Director; and 2) to describe the criteria and analysis the Department will utilize to evaluate proposed transfers, including conveyances, leases or assignments, of mainstream Colorado River water.

The Director's advice to and consultation with the Secretary will be consistent with these policies and procedures.

## **II. SCOPE OF POLICY**

### **General Application**

This policy applies to the transfer of a Colorado River entitlement within the State of Arizona for a period of more than one year. It does not pertain to transfer actions involving the export of water to another state or to Mexico.

It is limited to non-federal Arizona entities or individuals holding a valid Colorado River water delivery contract with the Secretary. It applies to all priorities of entitlements held by this category of Colorado River water users (see Appendix A for definitions of priorities).

With the potential exception of proposed entitlement assignments, the Department will not recommend the conveyance or lease of any entitlement to unused or surplus Colorado River water apportionment. If such entitlements are not needed by a contractor, the Department will recommend that the unneeded contract be terminated and, if necessary, a new one created.

Subcontract, lease or water use conversion actions within an existing contract service area that are conducted in accordance with an existing Colorado River water delivery contract are not subject to this policy.

### **Entitlement Transfer Actions**

Conveyances, leases and assignments are separate types of entitlement transfer actions. The review and consultation process with the Director varies depending on the type of transfer action that is requested and the type of entitlement that is involved. The specific entitlement transfer actions are described below.

### *Conveyance of an Entitlement*

An entitlement transfer action is considered a conveyance when a Colorado River contractor proposes to permanently transfer all or a portion of its entitlement to another entity that will not serve the same contract service area and/or proposes to change the type of water use.

### *Lease of an Entitlement*

A lease is a temporary transfer action involving all or a portion of a Colorado River entitlement. The purpose for leasing an entitlement is to provide a temporary water supply to another party located outside of the existing contract service area without the contractor permanently relinquishing or abandoning the entitlement. Generally, leases are inappropriate for permanent municipal and industrial water uses that cannot be interrupted or discontinued. If a water entitlement lease is proposed for a period of more than five years, the applicant for the lease action must demonstrate that the existing water use will not be abandoned and explain why a long-term lease is necessary for the intended new use. The Department will review the applicant's justification for a long-term lease and may recommend a lease for more than five years duration. However, if a long-term water supply is needed, the parties should consider a permanent conveyance.

### *Assignment of an Entitlement*

An entitlement transfer action is considered an assignment when a Colorado River contractor proposes to permanently convey all or a portion of its entitlement to another entity that will serve the same type of use within the same contract service area.

### **Quantification of an Entitlement Available for Conveyance or Lease**

Contract assignment actions do not involve a change in type of use or a change in the place of use. As such, assignment actions are not subject to the following limitations that may be applied to the conveyance or lease of an entitlement.

The amount of water available for conveyance or lease will be limited to the quantity of water that will result in a consumptive use that is no greater than the maximum amount of the entitlement. During the review of an application to transfer, the Director will consider several factors. These factors include the past and reasonable future quantity of consumptive use of water associated with the entitlement, potential negative impacts to the water supplies of other Colorado River entitlement holders, water quality impacts related to return flows and other pertinent impacts that could occur as a result of the proposed transfer.

Within Arizona, the amount of water associated with a Colorado River entitlement is limited to a specific maximum amount that may be consumptively used or diverted on an annual basis. In a few instances, entitlements are limited to the amount of water that may be beneficially used.

A consumptive use entitlement limits the quantity of water that may be consumed by an entitlement holder. Consumptive use is the amount of water diverted less the amount that is returned to the mainstream by the entitlement holder. The amount of a consumptive use entitlement that may be available for conveyance or lease will be limited to the maximum amount of the entitlement.

A diversion entitlement is limited by the quantity of water that may be diverted by the entitlement holder. Any return flow that results from the use is credited to Arizona's 2.8 million acre-feet allocation and is available to other water users. A proposed conveyance or lease must not negatively impact the quantity of water available to other entitlement holders. If the new use will result in the same return flow to the mainstream as the retired use, the amount of entitlement available for conveyance or lease for the new use will be limited to the maximum amount of the diversion entitlement. If the proposed new use will result in reduced return flow, the amount of water that will be available for conveyance or lease will be limited to the consumptive use associated with the maximum amount of the diversion entitlement.

A beneficial use entitlement is limited by the quantity of water that may be beneficially used by an entitlement holder for a specific type of use in a specific place of use. To determine how much water may be available for conveyance or lease with this type of entitlement, the amount of water that is beneficially used on an annual basis must be quantified as an annual consumptive use. The consumptive use amount that may be conveyed or leased will be limited to the quantity of water that is no greater than the maximum amount of the entitlement that was consumptively used by the entitlement holder.

### **III. CONSULTATION PROCESS**

#### **Request for Consultation**

The Director must be consulted prior to the execution of a transfer of a water delivery contract. The request for consultation with the Director must be made in writing by the entity proposing to transfer its entitlement and include contact information for the parties involved in the proposed transaction.

#### **Water Management Plans**

Each request for consultation involving the conveyance or lease of an entitlement must include a water use management plan. Development of a management plan will generally not be necessary for most proposed assignment actions. The amount of information needed for a particular assignment action will be determined upon the initiation of consultation with the Director.

The Director will use the water use management plan information to evaluate the proposed transfer action and make recommendations to the Secretary. The water use management plans will also be available for public review and comment. These plans must include, at a minimum, the following information.

For the entity transferring the entitlement:

- a. A description and quantification of the proposed water use to be transferred;
- b. A map of the contract area and the location of the retired water use and associated points of diversion and return;
- c. A description of how the existing water use will be terminated;
- d. A demonstration that the transfer will not interfere or infringe upon any vested or existing water rights within its contract service area;

- e. For partial transfer of an entitlement, an explanation of all expected changes to water provider operations and deliveries to remaining customers due to the proposed transfer;
- f. An explanation of how the transfer is consistent with local area ordinances, rules and regulations;
- g. A description and quantification of the proposed new water use.

For the receiving entity:

- h. A map showing the service area, points of diversion and points of return associated with the new use;
- i. Calculations showing the amount of Colorado River water that will be diverted, consumptively used and returned to the river;
- j. A demonstration of its ability to divert, convey and consumptively use water within a reasonable timeframe;
- k. A demonstration that the transfer will not interfere or infringe upon any vested or existing water rights within its contract service area;
- l. A list that identifies and quantifies all water supplies currently available to meet its current, committed and projected municipal and industrial (M&I) water demand;
- m. An explanation showing how the conveyance is consistent with local area ordinances, rules and regulations, including those limiting the use of potable water supplies for lakes, golf courses, etc.;
- n. Entities proposing to temporarily lease an entitlement must provide information describing the intent to terminate the Colorado River water use or substitute water supplies at the conclusion of the lease.

In addition to the water management plan information, the Department will need to be provided with the necessary approvals that are signed by all parties to the proposed transfer and provided with any proposed contracts or agreements, all addendum and attachments to same and all related exhibits and agreements.

### **Other Considerations**

When considering a proposed transfer action, in addition to evaluating the required information listed above, the Department will also assess beneficial use and Mexican Treaty obligation issues.

### ***Beneficial Use and Water Demand***

The Department will not consider transfer actions for speculative purposes. Therefore, for all proposed entitlement transfer actions, the entity receiving the entitlement must demonstrate that the water will be put to beneficial use. The beneficial use may be an existing one associated with current, committed and/or projected M&I water demands or it may be a proposed new M&I use.

Applicants that do not possess the ability to immediately divert, convey and consumptively use the water will not be excluded from the application and consideration process. However, in addition to their application, they must submit a fully developed plan that describes how they will divert, convey and use the water within a reasonable timeframe.

### *1944 Mexican Treaty Obligations*

Proposed conveyance actions will be evaluated to ensure that the transaction will not negatively impact the United States' ability to meet its 1944 Treaty obligations for delivery of Colorado River water to Mexico or to meet the Minute 242 salinity control requirement.

### **Public Notice Process**

#### *Conveyances and Leases*

To initiate a consultation, the parties to a proposed transfer action shall submit water management plans and all other related exhibits and agreements to the Director at least one hundred fifty (150) days prior to contract execution.

After all of the necessary documents and information have been submitted, the Department will advertise the proposed conveyance or lease once per week for two (2) consecutive weeks in a newspaper of general circulation within the state. The Department will also provide a notice to the county planning and zoning department office within the county of origin. The contractor conveying its entitlement must provide notice of the proposed action to all water users within its contract service area. Notices may also be sent to a list of other interested parties. The list, which will be kept on file with the Department, will be composed of individuals and entities that wish to be advised of pending requests to initiate a Colorado River contract transfer action. All documents submitted to the Department will be made available to the public upon request.

The Department will accept public comment on the proposed transfer action for thirty (30) days following the second advertisement. Public comment will be considered during the Department's review. The Director will issue a recommendation regarding the conveyance or lease to the Secretary within sixty (60) days from the end of the public comment period, unless additional time is needed to resolve claims of negative impacts to third parties.

Some entities or individuals may claim that they will be negatively impacted if a conveyance or lease, as proposed, is approved. When potentially negative impacts are claimed, the Department will notify the entity giving up its entitlement and the receiving entity(s) about the claimed impacts. The Department will provide up to ninety (90) days for all parties to attempt to resolve or mitigate the claimed impacts and to provide information to the Secretary. If agreed upon by all parties, an extension may be requested if more time is needed to resolve outstanding issues.

As a result of negotiations, if the proposed agreement changes the distribution of water, the Department will review the revised transfer action and make a recommendation to the Secretary. If the parties cannot agree to resolve or mitigate the claimed impacts, the Department will make its recommendation independently from the parties at the end of the negotiation period.

#### *Assignments*

The parties to the assignment shall submit a request for consultation and supporting documentation to the Director at least forty-five (45) days prior to execution.

The Department will conduct an expedited review of the assignment of an entitlement. Because the allocation will be used to serve the same use within the same area, it will be presumed to be consistent with the state's water management objectives and will not be subject to public review and comment. The Director will issue a recommendation to the Secretary within thirty (30) days after all necessary documents have been submitted for review.

#### IV. EFFECTIVE DATE

This substantive policy statement shall become effective immediately. The Director may modify or revoke this policy at any time.

DATED this 24<sup>TH</sup> day of May, 2004.



Herbert R. Guenther

Director

Arizona Department of Water Resources

**APPENDIX A****First Priority**

Satisfaction of Present Perfected Rights as defined and provided for in the Decree.

**Second Priority**

Satisfaction of Secretarial Reservations and Perfected Rights established or effective prior to September 30, 1968.

**Third Priority**

Satisfaction of Entitlements pursuant to contracts between the United States and water users in the State of Arizona executed on or before September 30, 1968.

**Fourth Priority**

Satisfaction of entitlements pursuant to: (i) contracts, Secretarial Reservations, and other arrangements between the United States and water users in the State of Arizona entered into or established subsequent to September 30, 1968, for use on Federal, State, or privately owned lands in the State of Arizona (for a total quantity of not to exceed 164,652 acre-feet of diversions annually); and (ii) Contract No. 14-06-W-245 dated December 15, 1972, as amended, between the United States and the Central Arizona Water Conservation District for the delivery of Mainstream Water for the Central Arizona Project, including use of Mainstream Water on Indian lands.

Entitlements having fourth-priority as defined in (i) and (ii) herein are coequal. Reductions in Entitlements having a fourth priority shall be borne by each Entitlement holder in the same proportion as its Entitlement, or as required by law, regulation, or Secretarial determination. If, however, a reduction-sharing agreement is entered into between two or more such authorized users, then the reduction shall be shared among the parties as provided in the agreement, subject to approval by the Contracting Officer after consultation with ADWR.

**Fifth Priority**

Satisfaction of Entitlements to any Unused Arizona Entitlement.

Any entity with a contract for fifth-priority water shall utilize its fifth-priority Entitlement only after the Contracting Officer has determined that Mainstream Water is available under applicable law or regulation, and the Contracting Officer provides written notification that such Mainstream Water is available in a specific year, subject to the scheduling and the reduction provisions of the contract. Reduction or elimination of the fifth-priority water use shall be determined by the Contracting Officer after consultation with ADWR, or on the basis of the contract dates, or as required by law or regulation.

**Sixth Priority**

Satisfaction of Entitlements to Surplus Water.

Any contractor for sixth-priority water shall utilize its sixth-priority Entitlement only after the Contracting Officer has determined that Mainstream Water is available under applicable law or regulation, and the Contracting Officer provides written notification that such Mainstream Water is available in a specific year, subject to the scheduling and reduction provisions of the contract. Reduction or elimination of the sixth-priority water use shall be as determined by the Contracting Officer or on the basis of the contract dates, or as required by law or regulation.