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December 11, 2007

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Mr. Bill Pupo
Town Manager
Town of Chino Valley
1020 W. Palomino Road
Chino Valley, AZ 86323

Mr. Steve Norwood
City Manager
City of Prescott
201 S. Cortez
Prescott, AZ 86303

RE: Big Chino Sub-basin Groundwater Importation

Gentlemen:

Thank you for meeting with Salt River Project's ("SRP") representatives on November 19 to hear our concerns regarding your community's efforts to secure additional water supplies from the Big Chino sub-basin of the Verde Watershed. At that meeting you requested a letter from SRP detailing our expectations regarding the protection of flows in the Verde River that SRP's shareholders and other downstream appropriators have relied upon for over 100 years.

For more than 20 years, SRP has raised concerns about the potential impacts to the Verde River with the proponents of projects to pump groundwater from the Big Chino sub-basin to the Prescott area. Several scientific studies have shown the link between the Big Chino aquifer and spring flows that form the headwaters of the Verde River. Even your consultants acknowledge that the Big Chino aquifer is the primary contributor to base flow in the Upper Verde River. The shareholders of SRP have a property interest in the form of vested senior water rights to the historic flows in the

Verde River, including its tributaries, which must be protected from impacts. In addition, SRP has a responsibility to protect against impacts to Verde River aquatic and riparian habitat and species of concern, especially impacts on species covered by the Horseshoe and Bartlett Habitat Conservation Plan ("Environmental Impacts").

In order to ensure that water supply impacts are avoided, any withdrawal of water from the Big Chino sub-basin by your communities must be offset by either: (1) a contemporaneous reduction in existing water uses from the Big Chino sub-basin in an amount necessary to avoid any reduction in Verde River flows to ensure the protection of habitat and water supplies for SRP's shareholders; and/or (2) the contemporaneous augmentation of Verde River flows with new sources of water from outside the Verde Watershed in an amount necessary to avoid any reduction in Verde River flows. Such measures could be implemented in combination, but the result must be a "zero loss" of water supplies to SRP's shareholders and to protect Verde River habitat from impacts resulting from the proposed pumping projects.

At the outset, let me say that the water your communities propose to import from the Big Chino sub-basin, combined with pumping associated with the development of private and State lands in the basin, necessitate the consideration of a long term water supply unrelated to the Big Chino. Even with mitigation, your planned projects are only a short term solution for the area's projected growth, with the flow of the Upper Verde River caught in the middle. Arizona Department of Water Resources' ("ADWR") Director Herb Guenther has stated on several occasions, including most recently before the Water and Agricultural Committee of the Arizona House, that if pumping exceeds recharge in the Big Chino sub-basin it will eventually impact the base flow of the Verde River. With nearly 62,000 acre feet of current and pending uses and only 23,000 acre feet of natural recharge, time will not be on your side much longer. Because of the imminent impact of pumping on the flows of the Verde River your communities must put into place a scientifically sound monitoring program and an actionable mitigation plan.

With regard to the development of a monitoring program, the following basic components should be included:

1. The communities should develop a monitoring plan that encompasses the entire Big Chino sub-basin, not just certain defined areas around the production wells.
2. Monitor wells should be established at depths and locations to detect changes in the water table in the down-gradient direction resulting from production pumping.
3. A basin-wide groundwater model should be developed, calibrated and maintained by ADWR, much like is done within Active Management Areas.

4. All monitoring wells must be in place at least one year prior to production pumping in order to collect baseline data.
5. A decline threshold in the down-gradient water table from production wells must be established to trigger certain actions to avoid impacts.
6. Base flow at the Paulden gauge must be maintained and incorporated as a compliance point that triggers more drastic actions to avoid impacts. This is the "do no harm" threshold.
7. The performance of the monitoring program should be evaluated on an annual basis and changes implemented to reflect current conditions.

An actionable mitigation plan must be developed and include a variety of alternatives to avoid impacts to stream flow.

1. As you know, SRP strongly disagrees with ADWR's substantive policy statement that allows pumping from any Historically Irrigated Acres ("HIA") lands owned or controlled by a city or town without regard to the location of the historic pumping¹. SRP has filed a petition with DWR requesting that the formal rule making procedures be followed and will argue in that process that the HIA water must be pumped from the farm that was historically irrigated. Regardless of that outcome, your communities can limit the impacts by the following:
 - a. Offset all export pumping by retiring HIA lands, with a preference for lands currently being irrigated.
 - b. Pump all HIA water from the farms historically/currently irrigated. This reflects hydrologic reality and is a prudent measure to reduce any future impacts to the Verde River.
 - c. Pump and export only that amount of water equal to the crop consumptive use, which has been shown in some cases to be less than the 3 acre feet/acre referenced in A.R.S. § 45-555(A-D).
2. Purchase and retire additional irrigated lands or other existing uses. Any retirement of an existing use will help offset new pumping. ADWR identified 3,307 acres of HIA lands in the Big Chino. Your communities currently control about two-thirds of that total.

¹ SRP recently obtained a copy of the City of Prescott's October 9, 2007 letter to ADWR, stating its position regarding the number of acre-feet of groundwater qualifying for the exemption to the groundwater transportation prohibition pursuant to A.R.S. § 45-555(E). SRP disagrees with the conclusions expressed in Prescott's letter and will be responding to those conclusions in a separate letter.

3. Within the limits of the Chino Valley Irrigation District Severance and Transfer (ST-98-001) Prescott should maximize its use of surface water from Watson and Willow Lakes by developing a surface water treatment facility to enable the direct use of surface water. We realize that Prescott has a self-imposed limitation on its diversion of surface water from the lakes based on the Lake Operating Plan, but those limitations should be revisited.
4. Yavapai County has long supported a program for the Purchase of Development Rights ("PDR") but has been unable to get the program off the ground. In order to protect your access to the new water that the Big Chino will supply, your support and participation in a PDR program that is focused on conserving private and State lands (grasslands) overlying the Big Chino aquifer is warranted.
5. Execute permanent conservation easements over the entirety of the Big Chino Water Ranch, CV Ranch and Wineglass Ranch.
6. Recharge of A+ effluent collected within the communities has been proposed as a means to supplement surface flows. SRP is skeptical of the feasibility of recharge due to the complicated geologic nature of the Verde headwaters area. A recharge project must be able to support the water table in the vicinity of the springs. This is necessary not only to maintain the spring discharge but also the riparian habitat that supports natural channel processes. SRP would need further technical information to evaluate a project of this nature. Should an acceptable project location be identified, SRP would expect that effluent from Prescott Valley also be brought back into the Verde watershed for recharge.

This list is not intended to be an exhaustive catalogue of the required mitigation, but is rather intended to be illustrative and to provoke thinking about possible solutions. Should the actions described above not be sufficient to avoid impacting downstream water rights of SRP and others or any Environmental Impacts, particularly those affecting species covered by the Horseshoe and Bartlett Habitat Conservation Plan ("HCP"), Prescott, Prescott Valley and Chino Valley must obtain an incidental take permit, and complete and implement a HCP under Section 10 of the Endangered Species Act that permanently offsets all such impacts. Any such incidental take permit and HCP would have a duration of no less than 50 years, and would ensure that the construction and operation of the proposed projects would have no impact on SRP's implementation of the Horseshoe and Bartlett HCP, or on species or their habitat covered by the Horseshoe and Bartlett HCP, or that any such impacts would be entirely and permanently offset by the three municipalities. Other measures that would be essential features of any HCP completed by the municipalities include an adequate

monitoring and adaptive management program to ensure that any changed circumstances are identified and completely addressed. Completion of the Section 10 process would entail, among other things, compliance with the National Environmental Policy Act ("NEPA"). SRP would have the opportunity to participate in all aspects of the HCP and NEPA process, including review of and comment on all proposals for minimization and mitigation measures, monitoring, and adaptive management; and attendance at meetings with the U.S. Fish and Wildlife Service.

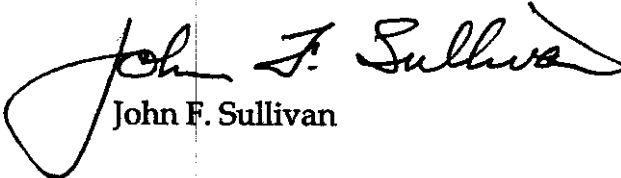
Finally, Prescott, Prescott Valley and Chino Valley must ensure that their construction of the proposed pipelines from the Big Chino Sub-basin to their municipal water treatment plants is in full compliance with the provisions of the Clean Water Act ("CWA"), and that any requirements of the CWA and NEPA are met before construction begins.

In the long term, the communities should consider developing an alternative water supply from outside the Verde Watershed. The Department of Economic Security predicts a population in Mohave, Coconino and Yavapai Counties to exceed 1 million people by 2050, with much of this development projected to take place along the I-40 corridor. Planning and implementing a project utilizing water from the Colorado River could take 20 years at a minimum but, in our opinion, will ultimately be necessary to prevent impacts to flows in the Verde River.

Although we have heard your representatives say that the various pump projects will not impact the Verde River, we disagree. Rather than debate whether or not impacts will occur, we believe your communities need to act quickly to develop and implement a scientifically sound monitoring program and an actionable mitigation plan to offset all water supply and Environmental Impacts should they occur.

We look forward to meeting with you at your earliest convenience to discuss the progress of your work on your mitigation activities. We look forward to hearing from you soon.

Sincerely,


John F. Sullivan

cc: John Williams
David Rousseau
Dick Silverman
Herb Guenther