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April 21, 2004

Arizona Corporation Commission

DOCKETED

APR 21 2004

The Honorable Kristin K. Mayes
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007-2996

DOCKETED BY

Re: APS Rate Case: E-01345A-03-0437/School Funding

Dear Commissioner Mayes:

As you requested on April 7, 2004 at the public comment session in this matter, Arizona Public Service Company ("APS" or "Company") is providing you with a written response to the allegation made by a public school official that APS was responsible for the phase-out in 2009 of so-called "excess utilities" property tax funding for public schools and/or the existence of the present "cap" on such funding. The short answer is that APS is not the cause of either of these circumstances. And, with that prefatory statement, APS would like to add both some background/history on the issue of "excess utilities" funding and also additional information concerning the Company's long-standing commitment to public education in Arizona.

"Excess utilities" funding allows certain public school districts to access more property tax dollars for "utilities" than would normally be permitted under the "maintenance and operations" formula set out in state law. This funding mechanism was authorized by the Legislature in the mid-1980s in response to escalating utility costs. "Utilities" are defined by law as the costs of heating, cooling, water, electricity, telephone and sanitation. The formula for determining "excess utilities" is set forth in A.R.S. § 15-910 (copy attached).

APS • APS Energy Services • Pinnacle West Energy • SunCor • El Dorado

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APS Energy Services and APS are subsidiaries of Pinnacle West Capital Corporation; however, APS Energy Services is not the same company as APS. You do not have to be an APS Energy Services customer to receive quality regulated services from APS.

By the 1990s, electric rates were generally stable or declining. Indeed, APS reduced rates by some 16% from 1992 through 2003. However, school districts were expanding their telecommunications spending for items such as cell phones and Internet, and other non-electric utility costs were not necessarily following the pattern of electric rates. Thus, overall "excess utilities" funding and spending continued to increase. Because there was neither any limit on how high such spending could go nor an explicit incentive to control utility costs, concerns were raised by state officials about the continued drain of this mechanism on state general fund revenues.

In 2000, the Legislature, at then Governor Hull's request, passed what would become Proposition 301. APS, and only as part of a broader coalition of business interests, had a very minimal role in originally drafting S.B. 1007 (Proposition 301) and had no role in its final composition. Proposition 301 called for a .6% (six mills) increase in the state sales tax, all devoted to public education, and ended "excess utilities" funding beginning in fiscal 2009. Proposition 301 was strongly supported in the general election by both the education and business communities, including APS, and was approved by Arizona voters in November 2000.

In 2002, and again at the request of Governor Hull, the Legislature imposed a two-year "cap" on "excess utilities" funding. APS neither testified in support of that "cap" nor participated in any stakeholder meetings on the legislation. This "cap" will expire in June of this year unless renewed by the Legislature. Although there are several bills before the Legislature this year to continue the "cap," and the budget proposals before the Legislature include continuation of the "cap," APS has supported only one of these bills relevant to "excess utilities" funding, and that is a bill requiring school districts to develop a plan for when "excess utilities" funding ends in 2009 per Proposition 301. APS would note, however, that it is a member of broad-based business groups such as the Arizona Chamber of Commerce that have opposed aspects of "excess utilities" funding.

With or without "excess utilities" funding, APS is one of the single largest sources of funds for public education in Arizona, paying some \$62 million in public school-related (K through 12) property taxes in 2003 and another \$14 million in Proposition 301 sales taxes. But beyond these, the Company and its employees also take an active role in directly supporting school and education-related programs. Examples include:

- Healthy Students/Healthy Schools
- Character Counts (partner with Arizona Department of Education)

- Math education program for third-graders (partner with Rodell Foundation)
- Accelerated reading program
- Substitute teaching by certified APS employee-volunteers
- Free printing services for public schools
- Professional development programs for public school teachers and staff
- Partners Advancing Student Success (partner with Motorola)
- Teachers' Energy Workshop
- Quest for Excellence (high school advanced math and science program that then becomes a college intern program at Palo Verde - also includes tuition stipends at an Arizona university for the study of engineering, business or information technology and often an offer of employment upon graduation)
- Fifty-five other scholarships to Arizona students for Arizona public universities and community colleges
- ABC's of Baseball and Life (to encourage proper attitude and commitment toward education and to promote student self-esteem - 2300 students helped to date)

Moreover, as is discussed in APS witness Thomas Hines' testimony in this proceeding (pages 14-15), the Company has plans to implement energy efficiency programs that are either targeted directly at helping schools better manage their energy usage or would be available to "institutional" general service customers such as public schools.

The Company notes these programs not to brag or out of any expectation of getting some sort of "pat on the back." As an Arizona-based business, APS believes involvement with an issue as important as public education is part of its corporate responsibility to the community. But, these efforts do show that APS is serious about its support of public education. And even back on the issue of taxes, the Company has continuously been

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sensitive to the issue of school funding and how to broaden the base of education funding in Arizona from its traditional over-reliance on property taxes.

I hope this has been responsive to your inquiry. Please feel free to contact me if you have any further questions concerning the Company's position on public school funding or desire additional information.

Sincerely,



Thomas L. Mumaw

cc: Chairman Marc Spitzer
Commissioner William A. Mundell
Commissioner Jeff Hatch-Miller
Commissioner Mike Gleason
Parties to the Docket

§ 15-910. School district budgets; excess utility costs; desegregation costs; tuition costs for bond issues; costs for registering warrants; report

A. The governing board may budget for the district's excess utility costs which are specifically exempt from the district's revenue control limit. If approved by the qualified electors voting at a statewide general election, the exemption from the revenue control limit under this subsection expires at the end of the 2008-2009 budget year. The uniform system of financial records shall specify expenditure items allowable as excess utility costs, which are limited to direct operational costs of heating, cooling, water and electricity, telephone communications and sanitation fees. The department of education and the auditor general shall include in the maintenance and operation section of the budget format, as provided in § 15-903, a separate line for utility expenditures and a special excess utility cost category. The special excess utility cost category shall contain budgeted expenditures for excess utility costs, determined as follows:

1. Determine the lesser of the total budgeted or total actual utility expenditures for fiscal year 1984-1985.
2. Multiply the amount in paragraph 1 of this subsection by the total percentage increase or decrease in the revenue control limit and the capital outlay revenue limit for the budget year over the revenue control limit and the capital outlay revenue limit for fiscal year 1984-1985 excluding monies available from a career ladder program or a teacher compensation program provided for in § 15-952.

3. The sum of the amounts in paragraphs 1 and 2 of this subsection is the amount budgeted in the utility expenditure line.

4. Additional expenditures for utilities are budgeted in the excess utility cost category.

B. The governing board shall apply the same percentage increase or decrease allowed in the revenue control limit and the capital outlay revenue limit as provided in § 15-905, subsection E or § 15-948 to the utility expenditure line of the budget.

C. The governing board may expend from the excess utility cost category only after it has expended for utility purposes the full amount budgeted in the utility expenditure line of the budget.

D. The governing board may, after notice is given and a public meeting is held as provided in § 15-905, subsection D, revise at any time before May 15 the amount budgeted in the excess utility cost category for the current year. Not later than May 18, the budget as revised shall be submitted electronically to the superintendent of public instruction.

E. If the revised excess utility cost category results in an expenditure of monies in excess of school district revenues for the current year, the county school superintendent shall include within the revenue estimate for the budget year monies necessary to meet the liabilities incurred by the school district in the current year in excess of revenues received for the current year.

F. If a school district receives a refund of utility expenditures or a rebate on energy saving devices or services, the refund or rebate shall be applied against utility expenditures for the current year as a reduction of the expenditures, except that the reduction of expenditures shall not exceed the amount of actual utility expenditures.

G. The governing board may budget for expenses of complying with or continuing to implement activities which were required or permitted by a court order of desegregation or administrative agreement with the United States department of education office for civil rights directed toward remediating alleged or proven racial discrimination which are specifically exempt in whole or in part from the revenue control limit and the capital outlay revenue limit. This exemption applies only to expenses incurred for activities which are begun before the termination of the court order or administrative agreement.

H. If a governing board chooses to budget monies outside of the revenue control limit as provided in subsection G of this section, the governing board may do one of the following:

1. Use monies from the maintenance and operation fund equal to any excess desegregation or compliance expenses beyond the revenue control limit before June 30 of the current year.

2. Notify the county school superintendent to include the cost of the excess expenses in the county school superintendent's estimate of the additional amount needed for the school district from the primary property tax as provided in § 15-991.

3. Employ the provisions of both paragraphs 1 and 2 of this subsection provided that the total amount transferred and included in the amount needed from property taxes does not exceed the total amount budgeted as prescribed in subsection J, paragraph 1 of this section.

I. Through fiscal year 2003-2004, the maximum amount which a governing board may budget outside of the capital outlay revenue limit as provided in subsection G of this section is twelve per cent of the maintenance and operation desegregation budget as provided in subsection J of this section or the amount that it budgeted pursuant to this subsection for fiscal year 2001-2002, whichever is less. If a governing board chooses to budget monies outside of the capital outlay revenue limit as provided in subsection G of this section, the governing board may notify the county school superintendent to include the cost of the excess expenses in the county school superintendent's estimate of the additional amount needed for the school district from the primary property tax as provided in § 15-991.

J. A governing board using subsections G, H and I of this section:

1. Shall prepare and employ a separate maintenance and operation desegregation budget and capital outlay desegregation budget on a form prescribed by the superintendent of public instruction in conjunction with the auditor general. The budget format shall be designed to allow a school district to plan and provide in detail for expenditures to be incurred solely as a

result of compliance with or continuing to implement activities which were required or permitted by a court order of desegregation or administrative agreement with the United States department of education office for civil rights directed toward remediating alleged or proven racial discrimination.

2. Shall prepare as a part of the annual financial report a detailed report of expenditures incurred solely as a result of compliance with or continuing to implement activities which were required or permitted by a court order of desegregation or administrative agreement with the United States department of education office for civil rights directed toward remediating alleged or proven racial discrimination, in a format prescribed by the auditor general in conjunction with the department of education as provided by § 15-904.

3. On or before September 30, 2003 and At least once every two years thereafter, shall collect and report data regarding activities related to a court order of desegregation or an administrative agreement with the united states department of education office for civil rights to the department of education in a format prescribed by the department of education. The department shall compile and submit copies of the reports to the governor, the president of the senate, the speaker of the house of representatives, and the chairpersons of the education committees of the senate and the House of Representatives. The reports shall include:

(a) A copy of the annual financial report related to desegregation activities as prescribed in this article.

(b) The cost per pupil of desegregation activities, listed separately for each school district and for each program.

(c) A summary of the results of all desegregation activities, including a demonstration of demographic and academic achievement trends. All demographic and achievement data shall be listed separately for each activity and this data shall be compared to the data for the rest of the school district.

(d) A chronological summary of all relevant court filings, pleadings and correspondence to which the school district is a party in any desegregation proceeding. If the school district has an agreement with the united states department of education office for civil rights, any changes to the agreement, any correspondence between the school district and the office of civil rights and a chronological summary of these events shall be submitted with the other information required by this subdivision.

(e) The actions currently being taken by school districts under court orders of desegregation to achieve unitary status, including an estimate of any costs that may be incurred in order to achieve unitary status.

(f) Any other information that the department of education deems necessary in order to carry out the purposes of this paragraph.

K. The governing board may budget for the bond issues portion of the cost of tuition charged the district as provided in § 15-824 for the pupils attending school in another school district, except that if the district is a common school district not within a high school district, the district may only include that part of tuition which is excluded from the revenue control limit and district support level as provided in § 15-951. The bond issues portion of the cost of tuition charged is specifically exempt from the revenue control limit of the school district of residence, and the primary property tax rate set to fund this amount shall not be included in the computation of additional state aid for education as provided in § 15-972, except as provided in § 15-972, subsection E. The department of education and the auditor general shall include in the maintenance and operation section of the budget format, as provided in § 15-903, a separate category for the bond issues portion of the cost of tuition.

L. The governing board may budget for interest expenses it incurred for registering warrants drawn against a fund of the school district or net interest expense on tax anticipation notes as prescribed in § 35-465.05, subsection C for the fiscal year preceding the current year if the county treasurer pooled all school district monies for investment as provided in § 15-996 for the fiscal year preceding the current year and, in those school districts that receive state aid, the school districts applied for an apportionment of state aid before the date set for the apportionment as provided in § 15-973 for the fiscal year preceding the current year. The governing board may budget an amount for interest

expenses for registering warrants or issuing tax anticipation notes equal to or less than the amount of the warrant interest expense or net interest expense on tax anticipation notes as prescribed in § 35-465.05, subsection C for the fiscal year preceding the current year as provided in this subsection which is specifically exempt from the revenue control limit. For the purposes of this subsection, "state aid" means state aid as determined in §§ 15-971 and 15-972.

Added by Laws 1983, Ch. 267, § 1, eff. April 25, 1983. Amended by Laws 1984, Ch. 340, § 2, eff. Aug. 3, 1984, retroactively effective to May 1, 1984; Laws 1985, Ch. 166, § 15, eff. April 18, 1985; Laws 1986, Ch. 125, § 7, eff. April 18, 1986; Laws 1986, Ch. 392, § 1, eff. May 21, 1986; Laws 1987, Ch. 188, § 1; Laws 1987, Ch. 296, § 1, eff. May 13, 1987; Laws 1988, Ch. 288, § 4, eff. July 8, 1988; Laws 1990, Ch. 83, § 1; Laws 1991, Ch. 242, § 1, eff. June 17, 1991; Laws 1992, Ch. 117, § 1; Laws 1992, Ch. 243, § 1, eff. Sept. 30, 1992, retroactively effective to July 1, 1990; Laws 1994, Ch. 254, § 1, eff. April 24, 1994; Laws 1995, Ch. 234, § 2; Laws 1998, 5th S.S., Ch. 1, § 20, eff. July 9, 1998; Laws 1999, Ch. 99, § 1, eff. Aug. 6, 1999, retroactively effective to July 1, 1996; Laws 1999, Ch. 299, § 18; Laws 2000, Ch. 342, § 9; Laws 2000, 5th S.S., Ch. 1, § 13, approved election Nov. 7, 2000, eff. Nov. 27, 2000; Laws 2002, Ch. 68, § 1.

Historical and Statutory Notes

Laws 2002, Ch. 68, § 3, provides:

"Sec. 3. Desegregation budget; limit; sunset review; recommendations

"Notwithstanding § 15-910, Arizona Revised Statutes, through fiscal year 2003-2004, a school district shall not budget more on desegregation activities in any single fiscal year than the school district budgeted for these purposes in fiscal year 2001-2002. By December 1, 2003, the committees of reference for the education committees of the senate and the house of representatives shall conduct a sunset review of the funding mechanisms for desegregation activities. The committees of reference shall make recommendations for proposed legislation for consideration during the forty-sixth legislature, second regular session."

Laws 2002, Ch. 330, § 56, provides:

"Sec. 56. School district excess utility costs;

"Notwithstanding § 15-910, Arizona Revised Statutes, the maximum amount that a school district may budget in the excess utility cost category for fiscal years 2002-2003 and 2003-2004 is the amount that it budgeted in the excess utility cost category for fiscal year 2001-2002."

Laws 2003, 1st S.S., Ch. 3, § 1, as amended by Laws 2003, Ch. 264, § 16, provides:

"Section 1. School district excess utility costs; temporary limitation

"Notwithstanding Laws 2002, chapter 330, § 56, the maximum amount that a school district may budget in the excess utility cost category for fiscal year 2003-2004 is the amount that it expended from the excess utility cost category for fiscal year 2001-2002."

Laws 2003, 1st S.S., Ch. 3, became law without the Governor's signature as provided in Arizona Constitution, Article 5, § 7.