ARIZONA PUBLIC SERVICE CO
Form 10-Q
August 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number	Exact Name of Each Registrant as specified in its charter; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.

1-8962 **PINNACLE WEST CAPITAL CORPORATION** **86-0512431**

(an Arizona corporation)

400 North Fifth Street, P.O. Box 53999

Phoenix, Arizona 85072-3999

(602) 250-1000

1-4473 **ARIZONA PUBLIC SERVICE COMPANY** **86-0011170**

(an Arizona corporation)

400 North Fifth Street, P.O. Box 53999

Phoenix, Arizona 85072-3999

(602) 250-1000

Indicate by check mark whether each registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

PINNACLE WEST CAPITAL CORPORATION	Yes x No o
ARIZONA PUBLIC SERVICE COMPANY	Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

PINNACLE WEST CAPITAL CORPORATION	Yes x No o
ARIZONA PUBLIC SERVICE COMPANY	Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

PINNACLE WEST CAPITAL CORPORATION

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

ARIZONA PUBLIC SERVICE COMPANY

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x	Smaller reporting company o

Indicate by check mark whether each registrant is a shell company (as defined in Exchange Act Rule 12b-2).

PINNACLE WEST CAPITAL CORPORATION	Yes o No x
ARIZONA PUBLIC SERVICE COMPANY	Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

PINNACLE WEST CAPITAL CORPORATION	Number of shares of common stock, no par value, outstanding as of July 27, 2012: 109,543,792
ARIZONA PUBLIC SERVICE COMPANY	Number of shares of common stock, $2.50 par value, outstanding as of July 27, 2012: 71,264,947

Arizona Public Service Company meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format allowed under that General Instruction.

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This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation (Pinnacle West) and Arizona Public Service Company (APS). Any use of the words Company, we, and our refer to Pinnacle West. Each registrant is providing on its own behalf a of the information contained in this Form 10-Q that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is providing any information that does not relate to such registrant, and therefore makes no representation as to any such information. The information required with respect to each company is set forth within the applicable items. Item 1 of this report includes Condensed Consolidated Financial Statements of Pinnacle West and Condensed Consolidated Financial Statements of APS. Item 1 also includes Notes to Pinnacle West s Condensed Consolidated Financial Statements, the majority of which also relate to APS, and Supplemental Notes, which only relate to APS s Condensed Consolidated Financial Statements.

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FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations. These forward-looking statements are often identified by words such as estimate, predict, may, believe, plan, expect, require, intend, assume and similar words. Because actual results ma materially from expectations, we caution readers not to place undue reliance on these statements. A number of factors could cause future results to differ materially from historical results, or from outcomes currently expected or sought by Pinnacle West or APS. In addition to the Risk Factors described in Part I, Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (2011 Form 10-K), Part II, Item 1A of this report and in Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations of this report, these factors include, but are not limited to:

- our ability to manage capital expenditures and operation and maintenance costs while maintaining reliability and customer service levels;
- variations in demand for electricity, including those due to weather, the general economy, customer and sales growth (or decline), and the effects of energy conservation measures and distributed generation;
- power plant and transmission system performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- our ability to achieve timely and adequate rate recovery of our costs, including returns on debt and equity capital;
- regulatory and judicial decisions, developments and proceedings;
- new legislation or regulation, including those relating to environmental requirements and nuclear plant operations;
- our ability to meet renewable energy and energy efficiency mandates and recover related costs;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- competition in retail and wholesale power markets;
- the duration and severity of the economic decline in Arizona and current real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- changes to our credit ratings;
- the investment performance of the assets of our nuclear decommissioning trust, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;

- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- generation, transmission and distribution facility and system conditions and operating costs;
- the ability to meet the anticipated future need for additional baseload generation and associated transmission facilities in our region;
- the willingness or ability of our counterparties, power plant participants and power plant land owners to meet contractual or other obligations or extend the rights for continued power plant operations;
- technological developments affecting the electric industry; and
- restrictions on dividends or other provisions in our credit agreements and Arizona Corporation Commission (ACC) orders.

These and other factors are discussed in the Risk Factors described in Part I, Item 1A of our 2011 Form 10-K and in Part II, Item 1A of this report, which readers should review carefully before placing any reliance on our financial statements or disclosures. Neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by law.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars and shares in thousands, except per share amounts)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
OPERATING REVENUES	$ 878,576	$ 799,799
OPERATING EXPENSES		
Fuel and purchased power	264,723	244,049
Operations and maintenance	216,236	210,590
Depreciation and amortization	100,606	106,617
Taxes other than income taxes	41,289	40,155
Other expenses	1,233	1,396
Total	624,087	602,807
OPERATING INCOME	254,489	196,992
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	5,175	5,924
Other income (Note 11)	177	557
Other expense (Note 11)	(2,669)	(3,186)
Total	2,683	3,295
INTEREST EXPENSE		
Interest charges	53,000	60,140
Allowance for borrowed funds used during construction	(3,447)	(3,856)
Total	49,553	56,284
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	207,619	144,003
INCOME TAXES	76,689	50,818
INCOME FROM CONTINUING OPERATIONS	130,930	93,185
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of $(535) and $773 (Note 13)	(819)	654
NET INCOME	130,111	93,839
Less: Net income attributable to noncontrolling interests (Note 7)	7,766	7,154
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ 122,345	$ 86,685
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC	109,491	109,044
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED	110,359	109,718
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders basic	$ 1.12	$ 0.79

Net income attributable to common shareholders basic		1.12		0.80
Income from continuing operations attributable to common shareholders diluted		1.12		0.78
Net income attributable to common shareholders diluted		1.11		0.79
DIVIDENDS DECLARED PER SHARE	$	1.05	$	1.05
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:				
Income from continuing operations, net of tax	$	123,164	$	86,001
Discontinued operations, net of tax		(819)		684
Net income attributable to common shareholders	$	122,345	$	86,685

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(dollars in thousands)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
NET INCOME	$ 130,111	$ 93,839
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX		
Derivative instruments:		
Net unrealized gain (loss), net of tax benefit (expense) of $(1,781) and $6,448	2,728	(9,875)
Reclassification of net realized loss, net of tax benefit of $9,090 and $9,988	13,925	15,299
Pension and other postretirement benefits activity, net of tax expense of $526 and $797	806	1,222
Total other comprehensive income	17,459	6,646
COMPREHENSIVE INCOME	147,570	100,485
Less: Comprehensive income attributable to noncontrolling interests	7,766	7,154
COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ 139,804	$ 93,331

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars and shares in thousands, except per share amounts)

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011	
OPERATING REVENUES	$	1,499,207	$	1,448,646
OPERATING EXPENSES				
Fuel and purchased power		481,032		456,056
Operations and maintenance		426,899		465,619
Depreciation and amortization		200,715		213,200
Taxes other than income taxes		83,764		77,779
Other expenses		4,301		3,216
Total		1,196,711		1,215,870
OPERATING INCOME		302,496		232,776
OTHER INCOME (DEDUCTIONS)				
Allowance for equity funds used during construction		9,931		11,319
Other income (Note 11)		937		2,247
Other expense (Note 11)		(6,737)		(4,927)
Total		4,131		8,639
INTEREST EXPENSE				
Interest charges		109,967		121,217
Allowance for borrowed funds used during construction		(6,598)		(7,432)
Total		103,369		113,785
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		203,258		127,630
INCOME TAXES		72,044		44,813
INCOME FROM CONTINUING OPERATIONS		131,214		82,817
INCOME (LOSS) FROM DISCONTINUED OPERATIONS				
Net of income tax expense (benefit) of $(1,040) and $906 (Note 13)		(1,584)		1,348
NET INCOME		129,630		84,165
Less: Net income attributable to noncontrolling interests (Note 7)		15,542		12,615
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$	114,088	$	71,550
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC		109,395		108,939
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED		110,183		109,540
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING				
Income from continuing operations attributable to common shareholders basic	$	1.06	$	0.64
Net income attributable to common shareholders basic		1.04		0.66
Income from continuing operations attributable to common shareholders diluted		1.05		0.64
Net income attributable to common shareholders diluted		1.04		0.65
DIVIDENDS DECLARED PER SHARE	$	1.575	$	1.575
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:				
Income from continuing operations, net of tax	$	115,681	$	70,163
Discontinued operations, net of tax		(1,593)		1,387

Net income attributable to common shareholders	$	114,088	$	71,550

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(dollars in thousands)

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011	
NET INCOME	$	129,630	$	84,165
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX				
Derivative instruments:				
Net unrealized loss, net of tax benefit of $14,770 and $6,058		(22,624)		(9,277)
Reclassification of net realized loss, net of tax benefit of $14,818 and $15,852		22,697		24,281
Pension and other postretirement benefits activity, net of tax expense of $1,157 and $1,363		1,772		2,088
Total other comprehensive income		1,845		17,092
COMPREHENSIVE INCOME		131,475		101,257
Less: Comprehensive income attributable to noncontrolling interests		15,542		12,615
COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$	115,933	$	88,642

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands)

	June 30, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 11,228	$ 33,583
Customer and other receivables	316,722	284,183
Accrued unbilled revenues	168,450	125,239
Allowance for doubtful accounts	(3,302)	(3,748)
Materials and supplies (at average cost)	217,222	204,387
Fossil fuel (at average cost)	30,177	22,000
Deferred income taxes	87,690	130,571
Income tax receivable (Note 6)	885	6,466
Assets from risk management activities (Note 8)	29,991	30,264
Deferred fuel and purchased power regulatory asset (Note 3)		27,549
Other regulatory assets (Note 3)	54,857	69,072
Other current assets	33,496	26,904
Total current assets	947,416	956,470
INVESTMENTS AND OTHER ASSETS		
Assets from risk management activities (Note 8)	43,526	49,322
Nuclear decommissioning trust (Note 15)	544,933	513,733
Other assets	64,800	64,588
Total investments and other assets	653,259	627,643
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	14,048,957	13,753,971
Accumulated depreciation and amortization	(4,843,868)	(4,709,991)
Net	9,205,089	9,043,980
Construction work in progress	458,441	496,745
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	130,929	132,864
Intangible assets, net of accumulated amortization	163,727	170,571
Nuclear fuel, net of accumulated amortization	159,493	118,098
Total property, plant and equipment	10,117,679	9,962,258
DEFERRED DEBITS		
Regulatory assets (Note 3)	1,283,322	1,352,079
Income tax receivable (Note 6)	69,508	68,633
Other	143,223	143,935
Total deferred debits	1,496,053	1,564,647
TOTAL ASSETS	$ 13,214,407	$ 13,111,018

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands)

	June 30, 2012	December 31, 2011
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 316,329	$ 326,987
Accrued taxes (Note 6)	133,766	120,289
Accrued interest	61,451	54,872
Common dividends payable	57,479	
Short-term borrowings	109,000	
Current maturities of long-term debt	57,962	477,435
Customer deposits	74,575	72,176
Liabilities from risk management activities (Note 8)	64,442	53,968
Deferred fuel and purchased power regulatory liability (Note 3)	325	
Other regulatory liabilities (Note 3)	89,433	88,362
Other current liabilities	139,561	148,616
Total current liabilities	1,104,323	1,342,705
LONG-TERM DEBT LESS CURRENT MATURITIES		
Long-term debt less current maturities	3,313,992	2,953,507
Palo Verde sale leaseback lessor notes less current maturities (Note 7)	57,420	65,547
Total long-term debt less current maturities	3,371,412	3,019,054
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,946,540	1,925,388
Regulatory liabilities (Note 3)	738,693	737,332
Liability for asset retirements	289,641	279,643
Liabilities for pension and other postretirement benefits (Note 4)	1,243,256	1,268,910
Liabilities from risk management activities (Note 8)	108,554	82,495
Customer advances	111,655	116,805
Coal mine reclamation	118,374	117,896
Unrecognized tax benefits (Note 6)	72,977	72,270
Other	209,645	217,934
Total deferred credits and other	4,839,335	4,818,673
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 9)		
Common stock, no par value	2,453,453	2,444,247
Treasury stock	(1,359)	(4,717)
Total common stock	2,452,094	2,439,530
Retained earnings	1,476,259	1,534,483
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(63,675)	(65,447)
Derivative instruments	(86,643)	(86,716)

Total accumulated other comprehensive loss		(150,318)		(152,163)
Total shareholders equity		3,778,035		3,821,850
Noncontrolling interests (Note 7)		121,302		108,736
Total equity		3,899,337		3,930,586
TOTAL LIABILITIES AND EQUITY	$	13,214,407	$	13,111,018

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 129,630	$ 84,165
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	239,743	245,700
Deferred fuel and purchased power	82,261	64,679
Deferred fuel and purchased power amortization	(54,388)	(68,762)
Allowance for equity funds used during construction	(9,931)	(11,319)
Deferred income taxes	66,142	11,945
Change in derivative instruments fair value	(2,618)	(279)
Changes in current assets and liabilities:		
Customer and other receivables	(21,424)	43,271
Accrued unbilled revenues	(43,211)	(60,390)
Materials, supplies and fossil fuel	(21,012)	(18,226)
Other current assets	(9,407)	(37,053)
Accounts payable	9,199	37,817
Accrued taxes and income tax receivable net	19,775	29,530
Other current liabilities	807	3,967
Change in margin and collateral accounts assets	124	21,185
Change in margin and collateral accounts liabilities	69,602	39,567
Change in unrecognized tax benefits		18,959
Change in other long-term assets	(1,692)	(26,225)
Change in other long-term liabilities	5,035	57,748
Net cash flow provided by operating activities	458,635	436,279
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(424,775)	(387,272)
Contributions in aid of construction	25,800	21,905
Allowance for borrowed funds used during construction	(6,598)	(7,432)
Proceeds from nuclear decommissioning trust sales	211,138	299,600
Investment in nuclear decommissioning trust	(219,762)	(308,222)
Proceeds from sale of life insurance policies		55,444
Other	(525)	(2,352)
Net cash flow used for investing activities	(414,722)	(328,329)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	351,081	175,000
Repayment of long-term debt	(421,451)	(187,962)
Short-term borrowings and payments net	109,000	(9,300)
Dividends paid on common stock	(111,297)	(112,537)
Common stock equity issuance	8,869	14,520
Distributions to noncontrolling interests	(2,630)	(2,610)
Other	160	(2,975)

Net cash flow used for financing activities		(66,268)		(125,864)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(22,355)		(17,914)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		33,583		110,188
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	11,228	$	92,274
Supplemental disclosure of cash flow information				
Cash paid during the period for:				
Income taxes, net of (refunds)	$	(649)	$	
Interest, net of amounts capitalized	$	94,680	$	110,659

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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PINNACLE WEST CAPITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Consolidation and Nature of Operations

The unaudited condensed consolidated financial statements include the accounts of Pinnacle West and our subsidiaries: APS and El Dorado Investment Company (El Dorado) and formerly SunCor Development Company (SunCor) and APS Energy Services Company, Inc. (APSES). See Note 13 for discussion of the bankruptcy filing of SunCor and the sale of APSES. Intercompany accounts and transactions between the consolidated companies have been eliminated. The unaudited condensed consolidated financial statements for APS include the accounts of APS and the Palo Verde Nuclear Generating Station (Palo Verde) sale leaseback variable interest entities (VIEs) (see Note 7 for further discussion). Our accounting records are maintained in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Weather conditions cause significant seasonal fluctuations in our revenues; therefore, results for interim periods do not necessarily represent results expected for the year.

Our condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments except as otherwise disclosed in the notes) that we believe are necessary for the fair presentation of our financial position, results of operations and cash flows for the periods presented. These condensed consolidated financial statements and notes have been prepared consistently with the 2011 Form 10-K with the exception of the reclassification of certain prior year amounts on our Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows to conform to the current year presentation.

See Note 16 for discussion of amended guidance on the presentation of comprehensive income.

The following tables show the impact of the reclassifications to prior year (previously reported) amounts (dollars in thousands):

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PINNACLE WEST CAPITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Statement of Income for the Three Months Ended June 30, 2011	As previously reported	Reclassifications to conform to current year presentation	Amount reported after reclassification to conform to current year presentation
Operating Revenues			
Regulated electricity segment	$ 798,669	$ (798,669)	$
Other revenues	1,130	(1,130)	
Operating revenues		799,799	799,799

Statement of Income for the Six Months Ended June 30, 2011	As previously reported	Reclassifications to conform to current year presentation	Amount reported after reclassification to conform to current year presentation
Operating Revenues			
Regulated electricity segment	$ 1,446,643	$ (1,446,643)	$
Other revenues	2,003	(2,003)	
Operating revenues		1,448,646	1,448,646

Statement of Cash Flows for the Six Months Ended June 30, 2011	As previously reported	Reclassifications to conform to current year presentation	Amount reported after reclassification to conform to current year presentation
Cash Flows from Operating Activities			
Expenditures for real estate investments	$ (40)	$ 40	$
Change in other long-term assets	(26,185)	(40)	(26,225)

2. Long-Term Debt and Liquidity Matters

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs.

Pinnacle West

At June 30, 2012, Pinnacle West s $200 million credit facility, which matures in November 2016, was available to refinance indebtedness of the Company and for other general corporate purposes, including credit support for its $200 million commercial paper program. Pinnacle West has the option to increase the amount of the facility up to a maximum of $300 million upon the satisfaction of certain conditions and with the consent of the lenders. At June 30, 2012, Pinnacle West had no outstanding borrowings under its credit facility, no letters of credit outstanding and no commercial paper borrowings.

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PINNACLE WEST CAPITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APS

On January 13, 2012, APS issued $325 million of 4.50% unsecured senior notes that mature on April 1, 2042. The net proceeds from the sale were used along with other funds to repay at maturity APS s $375 million aggregate principal amount of 6.50% senior notes on March 1, 2012.

On May 1, 2012, pursuant to the mandatory tender provision, APS purchased all $32 million of the Maricopa County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds (Arizona Public Service Company Palo Verde Project), 2009 Series B, due 2029. On June 1, 2012 we remarketed these bonds. Currently, the interest rate on these bonds is reset daily by a remarketing agent. The daily rate at June 30, 2012 was 0.17%. Additionally, the bonds are supported by a letter of credit. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets at June 30, 2012 and were classified as current maturities of long-term debt on our Condensed Consolidated Balance Sheets at December 31, 2011.

On June 1, 2012, pursuant to the mandatory tender provision, APS changed the interest rate mode for the approximately $38 million of Navajo County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds (Arizona Public Service Company Cholla Project), 2009 Series A. The new term rate period for these bonds commenced on June 1, 2012, and ends, subject to a mandatory tender, on May 29, 2014. During this time, the bonds will bear interest at a rate of 1.25% per annum. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets at June 30, 2012 and were classified as current maturities of long-term debt on our Condensed Consolidated Balance Sheets at December 31, 2011.

At June 30, 2012, APS had two credit facilities totaling $1 billion, including a $500 million credit facility that matures in February 2015, and a $500 million facility that matures in November 2016. APS may increase the amount of each facility up to a maximum of $700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use these facilities to refinance indebtedness and for other general corporate purposes. Interest rates are based on APS s senior unsecured debt credit ratings.

The facilities described above are available to support APS s $250 million commercial paper program, for bank borrowings or for issuances of letters of credit. At June 30, 2012, APS had commercial paper borrowings of $109 million, and no outstanding borrowings or letters of credit under these facilities.

See Financial Assurances in Note 10 for discussion of APS s separate outstanding letters of credit.

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Debt Fair Value

Our long-term debt fair value estimates are based on quoted market prices for the same or similar issues, and are classified within Level 2 of the fair value hierarchy. See Note 14 for discussion of the fair value hierarchy. The following table represents the estimated fair value of our long-term debt, including current maturities (dollars in millions):

	As of June 30, 2012		As of December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	$ 125	$ 123	$ 125	$ 123
APS	3,304	3,794	3,371	3,803
Total	$ 3,429	$ 3,917	$ 3,496	$ 3,926

Debt Provisions

An ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At June 30, 2012, APS was in compliance with this common equity ratio requirement. Its total shareholder equity was approximately $3.9 billion, and total capitalization was approximately $7.1 billion. APS would be prohibited from paying dividends if such payment would reduce its total shareholder equity below approximately $2.8 billion, assuming APS s total capitalization remains the same. Since APS was in compliance with this common equity ratio requirement, this restriction does not materially affect Pinnacle West s ability to meet its ongoing cash needs or ability to pay dividends to shareholders.

3. Regulatory Matters

Retail Rate Case Filing with the Arizona Corporation Commission

On June 1, 2011, APS filed an application with the ACC for a net retail base rate increase of $95.5 million. APS requested that the increase become effective July 1, 2012. The request would have increased the average retail customer bill approximately 6.6%. On January 6, 2012, APS and other parties to APS s pending general retail rate case entered into an agreement (the Settlement Agreement) detailing the terms upon which the parties have agreed to settle the rate case. On May 15, 2012, the ACC approved the Settlement Agreement without material modifications.

Settlement Agreement

The Settlement Agreement provides for a zero net change in base rates, consisting of: (1) a non-fuel base rate increase of $116.3 million; (2) a fuel-related base rate decrease of $153.1 million (to be implemented by a change in the base fuel rate for purchased power costs (Base Fuel Rate)) from $0.03757 to $0.03207 per kilowatt-hour (kWh); and (3) the transfer of cost recovery for certain renewable energy projects from the Arizona Renewable Energy Standard and Tariff (RES) surcharge to base rates in an estimated amount of $36.8 million.

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APS also agreed not to file its next general rate case before May 31, 2015, and not to request that its next general retail rate increase be effective prior to July 1, 2016. The Settlement Agreement allows APS to request a change to its base rates during the stay-out period in the event of an extraordinary event that, in the ACC s judgment, requires base rate relief in order to protect the public interest. Nor is APS precluded from seeking rate relief, or any other party to the Settlement Agreement precluded from petitioning the ACC to examine the reasonableness of APS s rates, in the event of significant regulatory developments that materially impact the financial results expected under the terms of the Settlement Agreement.

Other key provisions of the Settlement Agreement include the following:

- An authorized return on common equity of 10.0%;

- A capital structure comprised of 46.1% debt and 53.9% common equity;

- A test year ended December 31, 2010, adjusted to include plant that is in service as of March 31, 2012;

- Deferral for future recovery or refund of property taxes above or below a specified 2010 test year level caused by changes to the Arizona property tax rate as follows:

- Deferral of 25% in 2012, 50% in 2013 and 75% for 2014 and subsequent years if Arizona property tax rates increase; and

- Deferral of 100% in all years if Arizona property tax rates decrease;

- A procedure to allow APS to request rate adjustments prior to its next general rate case related to APS s proposed acquisition (should it be consummated) of additional interests in Units 4 and 5 and the related closure of Units 1-3 of the Four Corners Power Plant (Four Corners);

- Implementation of a Lost Fixed Cost Recovery rate mechanism to support energy efficiency and distributed renewable generation;

- Modifications to the Environmental Improvement Surcharge (EIS) to allow for the recovery of carrying costs for capital expenditures associated with government-mandated environmental controls, subject to an existing cents per kWh cap on cost recovery that could produce up to approximately $5 million in revenues annually;

- Modifications to the Power Supply Adjustor (PSA), including the elimination of the current 90/10 sharing provision;

- A limitation on the use of the RES surcharge and the Demand Side Management Adjustor Charge (DSMAC) to recoup capital expenditures not required under the terms of the 2008 rate case settlement agreement discussed below.

- Allowing a negative credit that currently exists in the PSA to continue until February 2013, rather than being reset on the anticipated July 1, 2012 rate effective date;

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- Modification of the transmission cost adjustor (TCA) to streamline the process for future transmission-related rate changes; and

- Implementation of various changes to rate schedules, including the adoption of an experimental buy-through rate that could allow certain large commercial and industrial customers to select alternative sources of generation to be supplied by APS.

The Settlement Agreement was approved by the ACC on May 15, 2012, with new rates effective on July 1, 2012. This accomplished a goal set by the parties to the 2008 rate case settlement to process subsequent rate cases within twelve months of sufficiency findings from the ACC staff, which generally occur within 30 days after the filing of a rate case.

2008 General Retail Rate Case On-Going Impacts

On December 30, 2009, the ACC issued an order approving a settlement agreement entered into by APS and twenty-one other parties in APS s prior general retail rate case, which was originally filed in March 2008. The settlement agreement contains certain on-going requirements, commitments and authorizations that will survive the 2012 Settlement Agreement, including the following:

- A commitment from APS to reduce average annual operational expenses by at least $30 million from 2010 through 2014;

- Authorization and requirements of equity infusions into APS of at least $700 million during the period beginning June 1, 2009 through December 31, 2014 ($253 million of which was infused into APS from proceeds of a Pinnacle West equity issuance in the second quarter of 2010); and

- Various modifications to the existing energy efficiency, demand side management and renewable energy programs that require APS to, among other things, expand its conservation and demand side management programs through 2012 and its use of renewable energy through 2015, as well as allow for concurrent recovery of renewable energy expenses and provide for more concurrent recovery of demand side management costs and incentives.

Cost Recovery Mechanisms

APS has received regulatory decisions that allow for more timely recovery of certain costs through the following recovery mechanisms.

Renewable Energy Standard. In 2006, the ACC approved the RES. Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include a RES surcharge as part of customer bills to recover the approved amounts for use on renewable energy projects. Each year APS is required to file a five-year implementation plan with the ACC and seek approval for funding the upcoming year s RES budget.

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On July 1, 2011, APS filed its annual RES implementation plan, covering the 2012-2016 timeframe and requesting 2012 RES funding of $129 million to $152 million. On December 14, 2011, the ACC voted to approve APS s 2012 RES Plan and authorized a total 2012 RES budget of $110 million. Within that budget, the ACC authorized APS to, among other items, (i) own an additional 100 megawatts (MW) under the AZ Sun Program, for a total of 200 MW; (ii) recover revenue requirements for the second 100 MW as APS did for the first 100 MW of the AZ Sun Program; (iii) expand APS s School and Government Program by another 6.25 MW of utility owned distributed generation; and (iv) own another 25 MW of renewable generation to be described later and installed in 2014 and 2015. In addition, the ACC ordered an initial up front incentive of $0.75 per watt for residential distributed energy and incentive level step downs throughout 2012 based upon the volume and timing of residential incentive applications. Under the ACC s order, residential incentives could fall to $0.20 or $0.10 per watt by the end of 2012 depending on demand.

On June 29, 2012, APS filed its annual RES implementation plan, covering the 2013-2017 timeframe and requesting 2013 RES funding of $92.8 million to $102.4 million. The budget range stems from options related to distributed energy; if the ACC decides to promote more distributed energy by selecting the higher budget, APS requested that the 2013 incentives for photovoltaic distributed energy begin at $0.20 and step down gradually based upon market participation. APS s filing also proposed a system of establishing compliance with distributed energy requirements that depends upon tracking and recording distributed energy, rather than acquiring and retiring renewable energy credits. Further, APS described its Community Solar program, a utility-owned 25 MW program that will be split into 3 to 7 separate projects throughout communities in APS s service territory (this is the 25 MW program described in clause (iv) of the preceding paragraph). APS expects a decision from the ACC around year end.

Demand Side Management Adjustor Charge. The ACC Electric Energy Efficiency Standards require APS to submit a Demand Side Management Implementation Plan for review by and approval of the ACC. In 2010, the DSMAC was modified to recover estimated amounts for use on certain demand side management programs over the current year. Previously, the DSMAC allowed for such recovery only on a historical or after-the-fact basis. The surcharge allows for the recovery of energy efficiency program expenses and any earned incentives.

The ACC previously approved recovery of all 2009 program costs plus incentives. The change from program cost recovery on a historical basis to recovery on a concurrent basis, as authorized in the 2008 retail rate case settlement agreement, resulted in this one-time need to address two years (2009 and 2010) of cost recovery. As requested by APS, 2009 program cost recovery is to be amortized over a three-year period, which ends in 2012.

On June 1, 2011, APS filed its 2012 Demand Side Management Implementation Plan consistent with the ACC s Electric Energy Efficiency Standards, which became effective January 1, 2011. The 2012 requirement under such standards is for cumulative energy efficiency savings of 3% of APS retail sales for the prior year. This energy savings requirement is slightly higher than the goal established by the 2008 retail rate case settlement agreement (2.75% of total energy resources for the same two-year period). The ACC issued an order on April 4, 2012 approving recovery of approximately $72 million over a twelve-month period beginning March 1, 2012. This amount does not include $10 million already being recovered in general retail base rates.

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On June 1, 2012, APS filed its 2013 Demand Side Management Implementation Plan. In 2013, the standards will require APS to achieve cumulative energy savings equal to 5% of its 2012 retail energy sales. Later this year, APS intends to file a supplement to its plan that will include a proposed budget for 2013.

PSA Mechanism and Balance. The PSA provides for the adjustment of retail rates to reflect variations in retail fuel and purchased power costs.

The following table shows the changes in the deferred fuel and purchased power regulatory asset (liability) for 2012 and 2011 (dollars in millions):

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011	
Beginning balance	$	28	$	(58)
Deferred fuel and purchased power costs current period		(82)		(65)
Amounts refunded through revenues		54		69
Ending balance	$		$	(54)

The PSA rate for the PSA year beginning February 1, 2012 is negative $0.0042 per kWh as compared to negative $0.0057 per kWh for the prior year. Any uncollected (overcollected) deferrals during the 2012 PSA year will be included in the calculation of the PSA rate for the PSA year beginning February 1, 2013.

Transmission Rates and Transmission Cost Adjustor. In July 2008, the United States Federal Energy Regulatory Commission (FERC) approved an Open Access Transmission Tariff for APS to move from fixed rates to a formula rate-setting methodology in order to more accurately reflect and recover the costs that APS incurs in providing transmission services. A large portion of the rate represents charges for transmission services to serve APS s retail customers (Retail Transmission Charges). In order to recover the Retail Transmission Charges, APS was previously required to file an application with, and obtain approval from, the ACC to reflect changes in Retail Transmission Charges through the TCA. Under the terms of the Settlement Agreement (discussed above), however, an adjustment to rates to recover the Retail Transmission Charges will be made annually each June 1 beginning in 2013 and will go into effect automatically unless suspended by the ACC.

The formula rate is updated each year effective June 1 on the basis of APS s actual cost of service, as disclosed in APS s FERC Form 1 report for the previous fiscal year. Items to be updated include actual capital expenditures made as compared with previous projections, transmission revenue credits and other items. The resolution of proposed adjustments can result in significant volatility in the revenues to be collected. APS reviews the proposed formula rate filing amounts with the ACC staff. Any items or adjustments which are not agreed to by APS and the ACC staff can remain in dispute until settled or litigated at FERC. Settlement or litigated resolution of disputed issues could require an extended period of time and could have a significant effect on the Retail Transmission Charge because any adjustment, though applied prospectively, may be calculated to account for previously over-collected amounts.

Effective June 1, 2011, APS s annual wholesale transmission rates for all users of its transmission system increased by approximately $44 million for the twelve-month period beginning

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June 1, 2011 in accordance with the FERC-approved formula as a result of higher costs and lower revenues reflected in the formula. Approximately $38 million of this revenue increase relates to Retail Transmission Charges. The ACC approved the related increase of APS s TCA rate on June 21, 2011 and it became effective on July 1, 2011.

Effective June 1, 2012, APS s annual wholesale transmission rates for all users of its transmission system increased by approximately $16 million for the twelve-month period beginning June 1, 2012 in accordance with the FERC-approved formula. Because of higher relative system demand by APS s retail customers, the approximately $16 million increase roughly reflects a $2 million decrease for wholesale customers and an $18 million increase for APS retail customers.

On May 14, 2012, APS filed an application with the ACC to implement the FERC-approved transmission rates for retail customers. On July 18, 2012, the ACC approved the application authorizing the implementation of the FERC-approved transmission rates for retail customers to be effective beginning in August 2012.

Regulatory Assets and Liabilities

The detail of regulatory assets is as follows (dollars in millions):

	June 30, 2012		December 31, 2011	
	Current	**Non-Current**	**Current**	**Non-Current**
Pension and other postretirement benefits	$	$ 954	$	$ 1,023
Income taxes allowance for funds used during construction (AFUDC) equity	3	85	3	81
Deferred fuel and purchased power mark-to-market (Note 8)	18	35	43	34
Transmission vegetation management	9	27	9	32
Coal reclamation	8	28	2	35
Palo Verde VIEs (Note 7)		37		35
Deferred compensation		34		33
Deferred fuel and purchased power (a)			28	
Tax expense of Medicare subsidy	2	18	2	18
Loss on reacquired debt	1	19	1	19
Income taxes investment tax credit basis adjustment	1	16		15
Pension and other postretirement benefits deferral	8	17		12
Demand side management (a)	4		7	1
Other	1	13	2	14
Total regulatory assets (b)	$ 55	$ 1,283	$ 97	$ 1,352

(a) See Cost Recovery Mechanisms discussion above.

(b) There are no regulatory assets for which the ACC has allowed recovery of costs but not allowed a return by exclusion from rate base. FERC rates are set using a formula rate as described in Transmission Rates and Transmission Cost Adjustor.