

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

- 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 (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0512431
1-4473	ARIZONA PUBLIC SERVICE COMPANY (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0011170

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 No
ARIZONA PUBLIC SERVICE COMPANY Yes No

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 No
ARIZONA PUBLIC SERVICE COMPANY Yes No

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 Accelerated filer Non-accelerated filer Smaller reporting company
ARIZONA PUBLIC SERVICE COMPANY
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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

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 28, 2010: 108,642,028
ARIZONA PUBLIC SERVICE COMPANY Number of shares of common stock, \$2.50 par value,
outstanding as of July 28, 2010: 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 all 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 relates to APS, and Supplemental Notes, which only relate to APS’ Condensed Consolidated Financial Statements. Item 2 of this report is divided into two sections — Pinnacle West Consolidated and APS. The Pinnacle West Consolidated section describes Pinnacle West and its subsidiaries on a consolidated basis, including discussions of Pinnacle West’s regulated utility and non-utility operations.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations, and neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by applicable law. 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 may differ 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 Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (“2009 Form 10-K”) and in Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations herein, these factors include, but are not limited to:

- regulatory and judicial decisions, developments and proceedings;
- our ability to achieve timely and adequate rate recovery of our costs;
- our ability to reduce capital expenditures and other 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;
- power plant performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- new legislation or regulation relating to greenhouse gas emissions, renewable energy mandates and energy efficiency standards;
- our ability to meet renewable energy requirements and recover related costs, including returns on debt and equity capital;
- 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 credit, financial and real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- restrictions on dividends or other burdensome provisions in our credit agreements and Arizona Corporation Commission (“ACC”) orders;
- our ability, or the ability of our subsidiaries, to meet debt service obligations;
- 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;
- transmission and distribution 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 ability of our counterparties and power plant participants to meet contractual or other obligations;
- technological developments in the electric industry; and
- economic and other conditions affecting SunCor Development Company’s (“SunCor”) ability to dispose of its remaining assets and satisfy its debt obligations.

These and other factors are discussed in Risk Factors described in Item 1A of our 2009 Form 10-K, which readers should review carefully before placing any reliance on our financial statements or disclosures.

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,	
	2010	2009
OPERATING REVENUES		
Regulated electricity segment	\$ 799,416	\$ 812,510
Other revenues	21,178	6,078
Total	<u>820,594</u>	<u>818,588</u>
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	251,800	291,699
Operations and maintenance	215,104	215,545
Depreciation and amortization	103,017	100,980
Taxes other than income taxes	31,684	32,766
Other expenses	15,716	5,704
Total	<u>617,321</u>	<u>646,694</u>
OPERATING INCOME	<u>203,273</u>	<u>171,894</u>
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	5,504	4,730
Other income (Note 11)	933	6,252
Other expense (Note 11)	(5,660)	(4,187)
Total	<u>777</u>	<u>6,795</u>
INTEREST EXPENSE		
Interest charges	60,741	59,884
Allowance for borrowed funds used during construction	(3,104)	(3,225)
Total	<u>57,637</u>	<u>56,659</u>
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	146,413	122,030
INCOME TAXES	51,829	41,000
INCOME FROM CONTINUING OPERATIONS	94,584	81,030
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of \$16,281 and \$(5,213) (Note 14)	24,982	(8,184)
NET INCOME	<u>119,566</u>	<u>72,846</u>
Less: Net income attributable to noncontrolling interests (Notes 7 and 16)	4,769	4,499
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	<u>\$ 114,797</u>	<u>\$ 68,347</u>
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — BASIC	107,355	101,109
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — DILUTED	107,764	101,193
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders — basic	\$ 0.84	\$ 0.76
Net income attributable to common shareholders — basic	1.07	0.68
Income from continuing operations attributable to common shareholders — diluted	0.83	0.75
Net income attributable to common shareholders — diluted	1.07	0.68
DIVIDENDS DECLARED PER SHARE	\$ 1.05	\$ 0.525
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income from continuing operations, net of tax	\$ 89,806	\$ 76,379
Discontinued operations, net of tax	24,991	(8,032)
Net income attributable to common shareholders	<u>\$ 114,797</u>	<u>\$ 68,347</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

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

	Six Months Ended June 30,	
	2010	2009
OPERATING REVENUES		
Regulated electricity segment	\$ 1,410,841	\$ 1,415,088
Other revenues	30,108	10,878
Total	<u>1,440,949</u>	<u>1,425,966</u>
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	467,340	539,087
Operations and maintenance	422,946	412,371
Depreciation and amortization	203,670	201,058
Taxes other than income taxes	63,408	66,773
Other expenses	22,644	10,829
Total	<u>1,180,008</u>	<u>1,230,118</u>
OPERATING INCOME	<u>260,941</u>	<u>195,848</u>
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	10,893	9,722
Other income (Note 11)	1,819	3,292
Other expense (Note 11)	(7,134)	(10,529)
Total	<u>5,578</u>	<u>2,485</u>
INTEREST EXPENSE		
Interest charges	121,446	117,148
Allowance for borrowed funds used during construction	(6,151)	(6,969)
Total	<u>115,295</u>	<u>110,179</u>
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	151,224	88,154
INCOME TAXES	44,657	27,816
INCOME FROM CONTINUING OPERATIONS	106,567	60,338
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of \$7,891 and \$(90,094) (Note 14)	12,102	(153,562)
NET INCOME (LOSS)	118,669	(93,224)
Less: Net income (loss) attributable to noncontrolling interests (Notes 7 and 16)	9,886	(5,061)
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	<u>\$ 108,783</u>	<u>\$ (88,163)</u>
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — BASIC	104,431	101,048
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — DILUTED	104,857	101,048
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders — basic	\$ 0.93	\$ 0.51
Net income (loss) attributable to common shareholders — basic	1.04	(0.87)
Income from continuing operations attributable to common shareholders — diluted	0.92	0.51
Net income (loss) attributable to common shareholders — diluted	1.04	(0.87)
DIVIDENDS DECLARED PER SHARE	\$ 1.575	\$ 1.05
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income from continuing operations, net of tax	\$ 96,661	\$ 51,037
Discontinued operations, net of tax	12,122	(139,200)
Net income (loss) attributable to common shareholders	<u>\$ 108,783</u>	<u>\$ (88,163)</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	June 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 50,502	\$ 145,378
Customer and other receivables	283,991	301,915
Accrued unbilled revenues	162,441	110,971
Allowance for doubtful accounts	(6,380)	(6,153)
Materials and supplies (at average cost)	172,091	176,020
Fossil fuel (at average cost)	29,597	29,245
Deferred income taxes	187,216	53,990
Income tax receivable	—	26,005
Assets from risk management activities (Note 8)	60,111	50,619
Assets held for sale (Notes 14 and 16)	102,674	—
Other current assets	44,543	30,747
Total current assets	<u>1,086,786</u>	<u>928,737</u>
INVESTMENTS AND OTHER ASSETS		
Real estate investments — net (Note 16)	—	119,989
Assets from risk management activities (Note 8)	44,205	28,855
Nuclear decommissioning trust (Note 15)	424,260	414,576
Other assets	109,788	110,091
Total investments and other assets	<u>578,253</u>	<u>673,511</u>
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	12,932,366	12,848,138
Accumulated depreciation and amortization	(4,400,416)	(4,340,645)
Net	8,531,950	8,507,493
Construction work in progress	496,457	467,700
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	142,335	146,722
Intangible assets, net of accumulated amortization	168,233	164,380
Nuclear fuel, net of accumulated amortization	136,151	118,243
Total property, plant and equipment	<u>9,475,126</u>	<u>9,404,538</u>
DEFERRED DEBITS		
Regulatory assets	850,001	813,161
Income tax receivable (Note 6)	65,103	65,103
Other	102,931	101,274
Total deferred debits	<u>1,018,035</u>	<u>979,538</u>
TOTAL ASSETS	<u>\$ 12,158,200</u>	<u>\$ 11,986,324</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	June 30, 2010	December 31, 2009
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 261,203	\$ 240,637
Accrued taxes (Note 6)	153,552	104,011
Accrued interest	54,184	54,596
Common dividends payable	56,938	—
Short-term borrowings	4,616	153,715
Current maturities of long-term debt (Note 2)	458,756	303,476
Customer deposits	69,181	71,026
Liabilities from risk management activities (Note 8)	63,567	55,908
Other current liabilities	105,112	125,574
Total current liabilities	<u>1,227,109</u>	<u>1,108,943</u>
LONG-TERM DEBT LESS CURRENT MATURITIES		
Long-term debt less current maturities (Note 2)	3,213,145	3,370,524
Palo Verde sale leaseback lessor notes (Notes 2 and 7)	113,379	126,000
Total long-term debt less current maturities	<u>3,326,524</u>	<u>3,496,524</u>
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,696,990	1,496,095
Deferred fuel and purchased power regulatory liability (Note 3)	97,047	87,291
Other regulatory liabilities	651,146	679,072
Liability for asset retirements	317,980	301,783
Liabilities for pension and other postretirement benefits (Note 4)	728,934	811,338
Liabilities from risk management activities (Note 8)	86,580	62,443
Customer advances	133,112	136,595
Coal mine reclamation	92,557	92,060
Unrecognized tax benefits (Note 6)	76,760	142,099
Other	130,458	144,077
Total deferred credits and other	<u>4,011,564</u>	<u>3,952,853</u>
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 9)		
Common stock, no par value	2,411,597	2,153,295
Treasury stock	(2,734)	(3,812)
Total common stock	<u>2,408,863</u>	<u>2,149,483</u>
Retained earnings	1,239,865	1,298,213
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(53,421)	(50,892)
Derivative instruments	(115,759)	(80,695)
Total accumulated other comprehensive loss	<u>(169,180)</u>	<u>(131,587)</u>
Total shareholders' equity	3,479,548	3,316,109
Noncontrolling interests (Note 7)	113,455	111,895
Total equity	<u>3,593,003</u>	<u>3,428,004</u>
TOTAL LIABILITIES AND EQUITY	<u><u>\$ 12,158,200</u></u>	<u><u>\$ 11,986,324</u></u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(dollars in thousands)

	Six Months Ended June 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 118,669	\$ (93,224)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Gain on sale of district cooling business	(41,973)	—
Depreciation and amortization including nuclear fuel	229,964	222,790
Deferred fuel and purchased power	65,249	13,144
Deferred fuel and purchased power amortization	(55,494)	66,163
Allowance for equity funds used during construction	(10,893)	(9,722)
Real estate impairment charges	16,731	222,055
Deferred income taxes	50,972	77,588
Change in mark-to-market valuations	2,396	(401)
Changes in current assets and liabilities:		
Customer and other receivables	(7,133)	37,447
Accrued unbilled revenues	(51,470)	(44,309)
Materials, supplies and fossil fuel	13,577	(21,628)
Other current assets	(13,796)	(1,432)
Accounts payable	45,313	(49,711)
Accrued taxes and income tax receivable-net	75,546	(169,754)
Other current liabilities	(22,719)	(15,795)
Expenditures for real estate investments	(458)	(1,560)
Gains and other changes in real estate assets	(2,931)	7,135
Change in margin and collateral accounts — assets	656	(2,457)
Change in margin and collateral accounts — liabilities	(90,694)	(91,856)
Change in unrecognized tax benefits	(62,630)	14,386
Change in other long-term assets	(5,542)	(8,023)
Change in other long-term liabilities	(51,926)	51,560
Net cash flow provided by operating activities	<u>201,414</u>	<u>202,396</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(378,579)	(393,682)
Contributions in aid of construction	15,163	33,371
Allowance for borrowed funds used during construction	(6,395)	(7,145)
Proceeds from sale of district cooling business	100,300	—
Proceeds from nuclear decommissioning trust sales	329,796	244,858
Investment in nuclear decommissioning trust	(342,004)	(255,754)
Trust fund for bond redemptions	—	(163,975)
Other	3,850	990
Net cash flow used for investing activities	<u>(277,869)</u>	<u>(541,337)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	—	840,630
Repayment of long-term debt	(15,221)	(202,372)
Short-term borrowings and payments — net	(149,099)	(279,971)
Dividends paid on common stock	(106,522)	(102,439)
Common stock equity issuance	254,612	1,707
Noncontrolling interests	(3,286)	(3,393)
Other	1,095	(2,871)
Net cash flow (used for) provided by financing activities	<u>(18,421)</u>	<u>251,291</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(94,876)	(87,650)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>145,378</u>	<u>105,245</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 50,502</u>	<u>\$ 17,595</u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes, net of (refunds)	\$ (3,944)	\$ 17,602
Interest, net of amounts capitalized	\$ 115,722	\$ 97,524

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.



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, SunCor, APS Energy Services Company, Inc. (“APSES”), and El Dorado Investment Company (“El Dorado”). 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 sale leaseback variable interest entities (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.

In preparing the condensed consolidated financial statements, we have evaluated the events that have occurred after December 31, 2009 through the date the financial statements were issued. 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. The December 31, 2009 condensed consolidated balance sheet data was derived from audited financial statements, but does not include disclosures required by GAAP for audited annual statements. This quarterly report should be reviewed in conjunction with the audited financial statements included in the 2009 Form 10-K. These condensed consolidated financial statements and notes have been prepared consistently with the 2009 Form 10-K with the exception of the reclassification of certain prior-year amounts on our Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows in accordance with accounting requirements for reporting discontinued operations (see Note 14) and amended accounting guidance on consolidation of variable interest entities (“VIEs”) (see Note 7). The following tables show the impacts of the reclassifications to prior year (previously reported) amounts (dollars in thousands):

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	As previously reported	Reclassifications as a result of the adoption of new VIE accounting guidance	Reclassifications for discontinued operations	Amount reported after adoption of amended VIE accounting guidance and discontinued operations
Statement of Income for the Three Months				
Ended June 30, 2009				
Operating Revenues				
Real estate segment	\$ 12,680	\$ —	\$ (12,680)	\$ —
Other revenues	10,782	—	(4,704)	6,078
Operating Expenses				
Real estate segment operations	19,429	—	(19,429)	—
Real estate impairment charge	(4,062)	—	4,062	—
Operations and maintenance	226,245	(9,914)	(786)	215,545
Depreciation and amortization	100,034	1,925	(979)	100,980
Taxes other than income taxes	32,887	—	(121)	32,766
Other expenses	7,733	—	(2,029)	5,704
Other				
Other income	6,608	—	(356)	6,252
Interest Expense				
Interest charges	58,863	3,338	(2,317)	59,884
Allowance for borrowed funds used under construction	(3,311)	—	86	(3,225)
Income Taxes	39,579	—	1,421	41,000
Income From Continuing Operations	74,027	4,651	2,352	81,030
Loss From Discontinued Operations	(5,832)	—	(2,352)	(8,184)
Net Income	68,195	4,651	—	72,846
Net Income (Loss) Attributable To				
Noncontrolling Interests	(152)	4,651	—	4,499

**Statement of Income for the Six Months Ended
June 30, 2009**

Operating Revenues				
Real estate segment	\$ 27,520	\$ —	\$ (27,520)	\$ —
Other revenues	19,231	—	(8,353)	10,878
Operating Expenses				
Real estate segment operations	46,339	—	(46,339)	—
Real estate impairment charge	204,418	—	(204,418)	—
Operations and maintenance	433,776	(19,829)	(1,576)	412,371
Depreciation and amortization	199,920	3,851	(2,713)	201,058
Taxes other than income taxes	67,015	—	(242)	66,773
Other expenses	14,200	—	(3,371)	10,829
Other				
Other income	3,746	—	(454)	3,292
Interest Expense				
Interest charges	114,559	6,677	(4,088)	117,148
Allowance for borrowed funds used under construction	(7,145)	—	176	(6,969)
Income Taxes	(55,425)	—	83,241	27,816
Income (Loss) From Continuing Operations	(91,966)	9,301	143,003	60,338
Loss From Discontinued Operations	(10,559)	—	(143,003)	(153,562)
Net Loss	(102,525)	9,301	—	(93,224)
Net Loss Attributable To Noncontrolling				
Interests	(14,362)	9,301	—	(5,061)

	As previously reported	Reclassifications as a result of the adoption of new VIE accounting guidance	Amount reported after adoption of amended VIE accounting guidance
Balance Sheets — December 31, 2009			
Property, Plant and Equipment — Palo Verde sale leaseback, net of accumulated depreciation	\$ —	\$ 146,722	\$ 146,722
Deferred Debits — Regulatory assets	781,714	31,447	813,161
Current Liabilities — Current maturities of long-term debt	277,693	25,783	303,476
Long-Term Debt Less Current Maturities — Palo	—	126,000	126,000

Verde sale leaseback lessor notes			
Deferred Credits and Other — Other	200,015	(55,938)	144,077
Equity — Noncontrolling Interests	29,571	82,324	111,895

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	As previously reported	Reclassifications as a result of the adoption of the new VIE accounting guidance	Amounts reported after adoption of amended VIE accounting guidance
Statement of Cash Flows for the Six Months Ended June 30, 2009			
Cash Flows from Operating Activities			
Net loss	\$ (102,525)	\$ 9,301	\$ (93,224)
Depreciation and amortization including nuclear fuel	218,939	3,851	222,790
Other current liabilities	(7,977)	(7,818)	(15,795)
Other long-term assets	(8,025)	2	(8,023)
Other long-term liabilities	46,898	4,662	51,560
Cash Flows from Financing Activities			
Repayment and acquisition of long-term debt	(195,767)	(6,605)	(202,372)
Noncontrolling interests	—	(3,393)	(3,393)
Supplemental Disclosure of Cash Flow Information			
Cash paid for Interest, Net of Amounts Capitalized	90,847	6,677	97,524

2. Long-term Debt and Liquidity Matters

The following table shows principal payments due on Pinnacle West's and APS' total long-term debt and capitalized lease requirements as of June 30, 2010 (dollars in millions):

Year	Consolidated Pinnacle West	Consolidated APS
2010	\$ 271	\$ 181
2011	632	457
2012	478	478
2013	92	92
2014	503	503
Thereafter	1,816	1,816
Total	\$ 3,792	\$ 3,527

Credit Facilities, Debt and Equity Issuances

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs. During the first quarter of 2010, Pinnacle West and APS refinanced existing revolving credit facilities that would have otherwise matured in December 2010. Since March 2010, Pinnacle West and APS have accessed the commercial paper markets, which neither company had utilized since the third quarter of 2008 due to negative market conditions.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Pinnacle West

On February 12, 2010, Pinnacle West refinanced its \$283 million revolving credit facility that would have matured in December 2010, and decreased the size of the facility to \$200 million. The new facility matures in February 2013. 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. Pinnacle West will use the facility for general corporate purposes, commercial paper support and for the issuance of letters of credit. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings. As a result of the downsized credit facility, the Company also reduced the size of its commercial paper program to \$200 million from \$250 million.

At June 30, 2010, the \$200 million credit facility was available to support the issuance of up to \$200 million in commercial paper or for bank borrowings, including issuances of letters of credit up to \$100 million. At June 30, 2010, Pinnacle West had no outstanding borrowings under this credit facility, no commercial paper borrowings and no outstanding letters of credit.

In April 2010, Pinnacle West issued 6,900,000 shares of common stock at an offering price of \$38.00 per share, resulting in net proceeds of approximately \$253 million. Pinnacle West contributed all of the net proceeds from this offering into APS in the form of equity infusions. APS has used these contributions to repay short-term indebtedness, to finance capital expenditures and for other general corporate purposes.

In June 2010, Pinnacle West received approximately \$100 million related to the sale of APSES' district cooling business. The net proceeds were used to repay short-term indebtedness.

APS

On February 12, 2010, APS refinanced its \$377 million credit facility that would have matured in December 2010, and increased the size of the facility to \$500 million. The new credit facility terminates in February 2013. APS has the option to increase the amount of the facility up to a maximum of \$700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use the facility for general corporate purposes, commercial paper support and for the issuance of letters of credit. Interest rates are based on APS' senior unsecured debt credit ratings.

At June 30, 2010, APS had two credit facilities totaling \$989 million, including the \$500 million credit facility described above and a \$489 million facility that terminates in September 2011. These facilities are available either to support the issuance of up to \$250 million in commercial paper or for bank borrowings, including issuances of letters of credit up to \$739 million. At June 30, 2010, APS had no borrowings outstanding under any of its credit facilities and no outstanding commercial paper. A \$20 million letter of credit was issued under APS' \$489 million credit facility in the second quarter of 2010.

On July 13, 2010, APS changed the interest rate mode for the approximately \$33 million of Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Bonds (Arizona Public Service Company Navajo Project) 1994 Series A, due 2029. The rate period for the bonds changed from a daily rate mode, supported by a letter of credit, to a three-year term rate mode that will bear interest at a rate of 3.625% per annum for three years. The letter of credit was terminated in connection with this change, and there is no bank or other third-party credit support for the bonds in the term rate mode.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On January 1, 2010, due to the adoption of amended accounting guidance relating to VIEs, APS began consolidating the Palo Verde Lessor Trusts (see Note 7) and, as a result of consolidation of these VIEs, APS has reported the Lessor Trusts' long-term debt on its Condensed Consolidated Balance Sheets. Interest rates on these debt instruments are 8% and are fixed for the remaining life of the debt. As of June 30, 2010, approximately \$30 million was classified as current maturities of long-term debt and \$113 million was classified as long-term debt relating to these VIEs. These debt instruments mature on December 30, 2015 and have sinking fund features that are serviced by the lease payments. See Note 7 for additional discussion of the VIEs.

SunCor

In July, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. In connection with this sale, SunCor negotiated a restructuring of certain of its credit facilities, including its principal loan facility. The debt restructuring resulted in an after-tax gain of approximately \$9 million, which will be recognized in the third quarter of 2010.

At June 30, 2010, SunCor had approximately \$103 million of assets on its balance sheet classified as assets held for sale. These assets consisted of the \$70 million of assets sold in July as discussed above, \$25 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet.

At June 30, 2010, SunCor had \$94 million of debt outstanding under various credit facilities, all of which was in default. After the sale and debt restructuring discussed above, \$6 million remains outstanding. Neither Pinnacle West nor any of its other subsidiaries has guaranteed any SunCor indebtedness. A SunCor debt default would not result in a cross-default of any of the debt of Pinnacle West or any of its other subsidiaries. While there can be no assurances as to the ultimate outcome of this matter, Pinnacle West does not believe that SunCor's inability to repay remaining debt outstanding would have a material adverse impact on Pinnacle West's cash flows or liquidity.

As of June 30, 2010, SunCor could not transfer any cash dividends to Pinnacle West. This restriction does not affect Pinnacle West's ability to meet its ongoing capital requirements.

Debt Provisions

An existing 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 common equity divided by the sum of common equity and long-term debt, including current maturities of long-term debt. At June 30, 2010, APS' common equity ratio, as defined, was 52%. Its total shareholder equity was approximately \$3.6 billion, and total capitalization was approximately \$7.0 billion. APS would be prohibited from paying dividends if the payment would reduce its common equity below approximately \$2.8 billion, assuming APS' total capitalization remains the same. This restriction does not materially affect Pinnacle West's ability to meet its ongoing capital requirements.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Regulatory Matters

2008 General Retail Rate Case Impacts

On December 30, 2009, the ACC issued an order approving a settlement agreement (“Settlement Agreement”) entered into by APS and twenty-one other parties to its general retail rate case, which was originally filed in March 2008. The Settlement Agreement contains on-going requirements, commitments and authorizations, including the following:

- Revenue accounting treatment for line extension payments received for new or upgraded service from January 1, 2010 through year end 2012 (or until new rates are established in APS’ next general rate case, if that is before the end of 2012), which resulted in projected estimates of increased revenues of \$23 million, \$25 million and \$49 million, respectively;
- An authorized return on common equity of 11%;
- A capital structure comprised of 46.2% debt and 53.8% common equity;
- 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 (see Note 2)); 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 and its use of renewable energy, as well as allow for concurrent recovery of renewable energy expenses and provide for more concurrent recovery of demand-side management costs and incentives.

The parties also agreed to a rate case filing plan in which APS is prohibited from filing its next two general rate cases until on or after June 1, 2011 and June 1, 2013, respectively, unless certain extraordinary events occur. Subject to the foregoing, APS may not request its next general retail rate increase to be effective prior to July 1, 2012. APS currently expects it will file its next rate case in June 2011. The parties agreed to use good faith efforts to process these 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.

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 Arizona Renewable Energy Standard and Tariff (“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 on 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 the upcoming year’s RES funding amount.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

During 2009, APS filed its annual RES implementation plan, covering the 2010-2014 timeframe and requesting 2010 RES funding approval. The plan provided for the acquisition of renewable generation in compliance with requirements through 2014, and requested RES funding of \$86.7 million for 2010, which was later approved by the ACC. APS also sought various other determinations in its plan, including approval of the AZ Sun Program and the Community Power Project in Flagstaff, Arizona described below.

On March 3, 2010, the ACC approved the AZ Sun Program, which contemplates the addition of 100 megawatts ("MW") of APS-owned solar resources through 2014. Through this program, APS plans to invest up to \$500 million in solar photovoltaic projects across Arizona, which APS will acquire through competitive procurement processes. The costs associated with the first 50 MW under this program will be recovered initially through the RES until such time as the costs are recovered in base rates. The costs of the second 50 MW will be recovered through a mechanism to be determined in APS' next retail rate case.

On April 1, 2010, the ACC approved the Community Power Project, a pilot program in which APS will own, operate and receive energy from approximately 1.5 MW of solar panels on the rooftops of up to 200 residential and business customers located within a certain test area. Third party developers may also own systems that participate in the pilot. Costs of the program will be recovered through the RES until such time as the costs are recovered in base rates.

On July 1, 2010, APS filed its annual RES implementation plan, covering the 2011-2015 timeframe and requesting 2011 RES funding of \$96.4 million. The 2011 Plan includes two components to address issues that have arisen in the past year: 1) enhancements to the residential distributed energy incentive program based on high customer participation; and 2) two programs offered in response to ACC workshops on "feed-in tariffs," which provide opportunities for streamlined development of certain renewable projects. APS expects the ACC to vote on the 2011 Plan in the fourth quarter of 2010.

Demand-Side Management Adjustor Charge ("DSMAC"). The Settlement Agreement requires APS to submit an annual Energy Efficiency Implementation Plan for review by and approval of the ACC. On July 15, 2009, APS filed its initial Energy Efficiency Implementation Plan, requesting approval by the ACC of programs and program elements for which APS had estimated a budget in the amount of \$49.9 million for 2010. APS received ACC approval of all of its proposed programs and implemented the new DSMAC on March 1, 2010. A surcharge was added to customer bills in order to recover these estimated amounts for use on certain demand-side management programs. The surcharge allows for the recovery of energy efficiency expenses and any earned incentives.

The ACC 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 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 spread over a three-year period.

On June 1, 2010, APS filed its 2011 Energy Efficiency Implementation Plan. In order to meet the energy efficiency goal for 2011 established by the Settlement Agreement of annual energy savings of 1.25%, expressed as a percent of total energy resources to meet retail load, APS proposed a total budget for 2011 of \$78.9 million. If this plan is approved by the ACC as proposed, and when added to the amortization of 2009 costs discussed above less the \$10 million already being recovered in general rates, the DSMAC would recover approximately \$74.5 million over a twelve month period beginning March 1, 2011.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PSA Mechanism and Balance. The power supply adjustor (“PSA”) provides for the adjustment of retail rates to reflect variations in retail fuel and purchased power costs from the “Base Fuel Rate,” which is currently \$0.0376 per kilowatt-hour (“kWh”). The following table shows the changes in the deferred fuel and purchased power regulatory asset (liability) for the six-month periods ended June 30, 2010 and 2009 (dollars in millions):

	Six Months Ended June 30,	
	2010	2009
Beginning balance	\$ (87)	\$ 8
Deferred fuel and purchased power costs-current period	(65)	(13)
Amounts refunded (recovered)	55	(66)
Ending balance	<u>\$ (97)</u>	<u>\$ (71)</u>

The PSA rate for the current PSA Year is (\$0.0045) per kWh. Since the 2010 PSA adjustment was a reduction of the PSA rate, the ACC accelerated the 2010 adjustment from the standard PSA year start date of February 1st to January 1st to coincide with the increase in retail rates resulting from the ACC’s decision in the general retail rate case, causing a minimal net impact on residential bills. This accelerated 2010 adjustment will remain in effect until February 1, 2011. The regulatory liability at June 30, 2010 reflects lower average prices and the seasonal nature of fuel and purchased power costs. Any uncollected (overcollected) deferrals during the 2010 PSA Year will be included in the historical component of the PSA rate for the PSA Year beginning February 1, 2011.

The PSA rate for the PSA Year that began February 1, 2009 was \$0.0053 per kWh. The PSA rate may not be increased or decreased more than \$0.004 per kWh in a year without permission of the ACC.

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’ retail customers (“Retail Transmission Charges”). In order to recover the Retail Transmission Charges, APS must file an application with, and obtain approval from, the ACC under the transmission cost adjustor (“TCA”) mechanism, by which changes in Retail Transmission Charges can be reflected in APS’ retail rates.

The formula rate is updated each year effective June 1 on the basis of APS’ actual cost of service, as disclosed in APS’ 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 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.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Effective June 1, 2010, APS' annual wholesale transmission rates for all users of its transmission system were reduced by approximately \$12 million in accordance with the FERC- approved formula as a result of lower costs reflected in the formula. Approximately \$10 million of this revenue reduction relates to transmission services used for APS' retail customers. On May 20, 2010, APS filed with the ACC an application for the related reduction of its TCA rate. The ACC approved the TCA reduction on July 27, 2010.

4. Retirement Plans and Other Benefits

Pinnacle West sponsors a qualified defined benefit and account balance pension plan, a non-qualified supplemental excess benefit retirement plan, and other postretirement benefit plans for the employees of Pinnacle West and our subsidiaries. Pinnacle West uses a December 31 measurement date for its pension and other postretirement benefit plans. The market-related value of our plan assets is their fair value at the measurement date.

On March 23, 2010, the President signed into law comprehensive health care reform legislation under the Patient Protection and Affordable Care Act (the "Act"). One feature of the Act is the elimination of the tax deduction for prescription drug costs that are reimbursed as part of the Medicare Part D subsidy. Although this tax increase does not take effect until 2013, we are required to recognize the full accounting impact in our financial statements in the period in which the Act is signed. In accordance with accounting for regulated companies, the loss of this deduction is substantially offset by a regulatory asset that will be recovered through future electric revenues. In the first quarter of 2010, Pinnacle West charged regulatory assets and liabilities for a total of \$42 million, with a corresponding increase in accumulated deferred income tax liabilities, to reflect the impact of this change in tax law.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table provides details of the plans' net periodic benefit costs and the portion of these costs charged to expense (including administrative costs and excluding amounts capitalized as overhead construction or billed to electric plant participants) (dollars in millions):

	Pension Benefits				Other Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009	2010	2009	2010	2009
Service cost — benefits earned during the period	\$ 13	\$ 13	\$ 28	\$ 27	\$ 5	\$ 4	\$ 10	\$ 9
Interest cost on benefit obligation	30	30	61	59	10	9	21	19
Expected return on plan assets	(31)	(29)	(62)	(58)	(10)	(8)	(20)	(17)
Amortization of:								
Transition obligation	—	—	—	—	(1)	1	—	2
Prior service cost	—	—	1	1	—	—	—	—
Net actuarial loss	4	4	10	7	2	2	5	5
Net periodic benefit cost	<u>\$ 16</u>	<u>\$ 18</u>	<u>\$ 38</u>	<u>\$ 36</u>	<u>\$ 6</u>	<u>\$ 8</u>	<u>\$ 16</u>	<u>\$ 18</u>
Portion of cost charged to expense	<u>\$ 8</u>	<u>\$ 9</u>	<u>\$ 19</u>	<u>\$ 17</u>	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 8</u>	<u>\$ 9</u>
APS' share of cost charged to expense	<u>\$ 8</u>	<u>\$ 8</u>	<u>\$ 19</u>	<u>\$ 16</u>	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 8</u>	<u>\$ 8</u>

Contributions

The required minimum contribution to our pension plan is zero in 2010. During the first quarter of 2010, we made a voluntary contribution of \$100 million to our pension plan. The contribution to our other postretirement benefit plans in 2010 is estimated to be approximately \$15 million. APS and other subsidiaries fund their share of the contributions. APS' share is approximately 98% of both plans.

5. Business Segments

Pinnacle West's two reportable business segments are:

- our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily retail and wholesale sales supplied to traditional cost-based rate regulation ("Native Load") customers) and related activities and includes electricity generation, transmission and distribution; and
- our real estate segment, which consists of SunCor's real estate development and investment activities.

In July, SunCor sold land parcels, commercial assets and a master planned home-building community. It is expected that SunCor will dispose of its remaining assets within the next 12 months. As a result, they are classified as assets held for sale on the balance sheet at June 30, 2010 and all of SunCor's operations have been reclassified to discontinued operations. While segment reporting is not required for discontinued operations, Pinnacle West continues to provide the information below, due to the significant impacts of real estate impairments in 2009. See Note 14 — Discontinued Operations.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Financial data for the three and six months ended June 30, 2010 and 2009 and at June 30, 2010 and December 31, 2009 is provided as follows (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Operating revenues:				
Regulated electricity segment	\$ 800	\$ 813	\$ 1,411	\$ 1,415
All other (a)	21	6	30	11
Total	<u>\$ 821</u>	<u>\$ 819</u>	<u>\$ 1,441</u>	<u>\$ 1,426</u>
Net income (loss) attributable to common shareholders:				
Regulated electricity segment	\$ 88	\$ 78	\$ 95	\$ 58
Real estate segment	(1)	(9)	(15)	(140)
All other (a)	28	(1)	29	(6)
Total	<u>\$ 115</u>	<u>\$ 68</u>	<u>\$ 109</u>	<u>\$ (88)</u>
Assets:				
			As of June 30, 2010	As of December 31, 2009
Regulated electricity segment			\$ 11,974	\$ 11,691
Real estate segment			115	161
All other (a)			69	134
Total			<u>\$ 12,158</u>	<u>\$ 11,986</u>

(a) Includes activities related to APSES and El Dorado. None of the activities of either of these companies constitutes a reportable segment. All other also includes the sale of APSES' district cooling business, which resulted in an after-tax gain of \$25 million in the period ended June 30, 2010. See Note 14 — Discontinued Operations.

6. Income Taxes

Pinnacle West expects to receive approximately \$132 million of cash tax benefits related to SunCor's strategic asset sales (see Note 16), which will not be fully realized until all of the asset sales are completed. Approximately \$7 million of these benefits were recorded in the six months ended June 30, 2010 as reductions to income tax expense related to the current impairment charges. The additional \$125 million of tax benefits were recorded as reductions to income tax expense related to SunCor impairment charges recorded on or before December 31, 2009.

The \$65 million long-term income tax receivable on the Condensed Consolidated Balance Sheets represents the anticipated refunds related to an APS tax accounting method change approved by the Internal Revenue Service ("IRS") in the third quarter of 2009.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

During the first quarter of 2010, the Company reached a settlement with the IRS with regard to the examination of tax returns for the years ended December 31, 2005 through 2007. As a result of this settlement, net uncertain tax positions decreased \$62 million, including approximately \$3.5 million which decreased our effective tax rate. Additionally, the settlement resulted in the recognition of net interest benefits of approximately \$3 million through the effective tax rate.

As of June 30, 2010, the tax year ended December 31, 2008 and all subsequent tax years remain subject to examination by the IRS. With few exceptions, we are no longer subject to state income tax examinations by tax authorities for years before 1999.

7. Variable Interest Entities

On January 1, 2010 we adopted amended accounting guidance relating to VIEs. This amended guidance significantly changed the consolidation model for VIEs. Under the prior guidance the consolidation model considered risk absorption using a quantitative approach when determining the primary beneficiary. The consolidation model under the new guidance requires a qualitative assessment and focuses on the power to direct activities of the VIE when determining the primary beneficiary. As a result of applying this qualitative assessment, we have determined that APS is the primary beneficiary of certain VIEs, and is therefore required to consolidate these VIEs. Prior to adopting this new guidance, APS was not considered the primary beneficiary of these VIEs and did not consolidate these entities. We have adopted this guidance using retrospective application and have adjusted prior periods presented to reflect consolidation of the VIEs in those periods. Further discussion follows regarding the impact of the consolidation.

APS VIEs

In 1986, APS entered into agreements with three separate VIE lessor trusts in order to sell and lease back interests in Palo Verde Nuclear Generating Station ("Palo Verde") Unit 2 and related common facilities. The VIE lessor trusts are single-asset leasing entities. APS will pay approximately \$49 million per year for the years 2010 to 2015 related to these leases. The leases do not contain fixed price purchase options or residual value guarantees. However, the lease agreements include fixed rate renewal periods which may have a significant impact on the VIEs' economic performance. We have concluded that these fixed rate renewal periods may give APS the ability to utilize the asset for a significant portion of the asset's economic life, and therefore provide APS with the power to direct activities of the VIEs that most significantly impact the VIEs' economic performance. In addition to the fixed rate renewal periods, our primary beneficiary analysis also considered that we are the operating agent for Palo Verde, are obligated to decommission the leased assets and have fair value purchase options.

Under the previous quantitative VIE consolidation model, APS was not considered the primary beneficiary of the lessor trusts, as APS did not absorb the majority of the entities' expected losses or did not receive a majority of the residual returns. The arrangements were previously accounted for as operating leases.

Consolidation of these VIEs eliminates the lease accounting we previously reported and results in changes in our consolidated assets, debt, equity, and net income. Assets of the VIEs are restricted and may only be used to settle the VIEs' debt obligations and for payment to the noncontrolling interest holders. The creditors of the VIEs have no recourse to the assets of APS or Pinnacle West. As a result of consolidation we have eliminated rent expense, and have recognized depreciation and interest expense, resulting in an increase in net income for the three and six months ended June 30, 2010 of \$5 million and of \$10 million, respectively, entirely attributable to the noncontrolling interests. Income attributable to Pinnacle West shareholders remains the same. Consolidation of these VIEs also results in changes to our Condensed Consolidated Statements of Cash Flows, but does not impact net cash flows.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Our Condensed Consolidated Balance Sheets at June 30, 2010 include the following amounts relating to the VIEs (in millions):

	June 30, 2010
Property plant and equipment, net of accumulated depreciation	\$ 142
Long-term debt including current maturities	143
Equity- Noncontrolling interests	89

For regulatory ratemaking purposes the leases continue to be treated as operating leases, and as a result we have recorded a regulatory asset of \$32 million as of June 30, 2010.

APS is exposed to losses relating to these lessor trust VIEs upon the occurrence of certain events that APS does not consider to be reasonably likely to occur. Under certain circumstances (for example, the Nuclear Regulatory Commission (“NRC”) issuing specified violation orders with respect to Palo Verde or the occurrence of specified nuclear events), APS would be required to make specified payments to the VIEs’ noncontrolling equity participants, assume the VIEs’ debt, and take title to the leased Unit 2 interests, which, if appropriate, may be required to be written down in value. If such an event had occurred as of June 30, 2010, APS would have been required to pay the noncontrolling equity participants approximately \$152 million and assume \$143 million of debt. Since APS now consolidates the VIEs, the debt APS would be required to assume is already reflected in our Condensed Consolidated Balance Sheets.

We also have certain long-term purchased power agreements to purchase substantially all of an entity’s output from a specified facility for a specified period. We have evaluated these arrangements under the VIE accounting guidance and have determined that these agreements do not represent variable interests. If these agreements had been deemed variable interests, we would not be considered the primary beneficiary, as we do not have the power to direct the entities’ activities in a manner that would significantly impact their economic performance and, therefore, would not consolidate the entities. The adoption of the amended accounting guidance has not changed how we account for these arrangements.

SunCor VIEs

SunCor is the primary beneficiary of certain land development trust arrangements and, accordingly, consolidates these VIEs. We have determined that SunCor is the primary beneficiary of these VIEs because SunCor controls the activities related to the development of the land held in the trusts. Our adoption of amended VIE accounting guidance has not changed our accounting treatment of the SunCor VIEs. Our Condensed Consolidated Balance Sheets reflect \$25 million of assets and \$25 million of noncontrolling equity interests relating to these arrangements at June 30, 2010. Our Condensed Consolidated Balance Sheets reflect \$29 million of assets and \$29 million of noncontrolling equity interests related to these arrangements at December 31, 2009. The assets relating to these VIEs consist strictly of land, all of which is restricted and may only be used for payment to the noncontrolling interests. We have not provided, and are not required to provide, financing or other financial support to these entities.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. Derivative and Energy Trading Accounting

We are exposed to the impact of market fluctuations in the commodity price and transportation costs of electricity, natural gas, coal, emissions allowances and in interest rates. We manage risks associated with these market fluctuations by utilizing various derivative instruments, including futures, forwards, options and swaps. As part of our overall risk management program, we may use such instruments to hedge purchases and sales of electricity, fuels, and emissions allowances and credits. Derivative instruments that are designated as cash flow hedges are used to limit our exposure to cash flow variability on forecasted transactions. The changes in market value of such contracts have a high correlation to price changes in the hedged transactions.

Our derivative instruments are accounted for at fair value and are presented on the Condensed Consolidated Balance Sheets as “Assets/Liabilities from Risk Management Activities” (see Note 15 for a discussion of fair value measurements). Derivative instruments for the physical delivery of purchase and sale quantities transacted in the normal course of business qualify for the normal purchase and sales scope exception and are accounted for under the accrual method of accounting. Due to the scope exception, these derivative instruments are excluded from our derivative instrument discussion and disclosures below.

We enter into derivative instruments for economic hedging purposes. While we believe the economic hedges mitigate exposure to fluctuations in commodity prices, some of these instruments may not meet the specific hedge accounting requirements and are not designated as accounting hedges. Economic hedges not designated as accounting hedges are recorded at fair value on our balance sheet with changes in fair value recognized in the statement of income as incurred. These instruments are included in the “non-designated hedges” discussion and disclosure below.

Hedge effectiveness is the degree to which the derivative instrument contract and the hedged item are correlated and is measured based on the relative changes in fair value between the derivative instrument contract and the hedged item over time. We assess hedge effectiveness both at inception and on a continuing basis. These assessments exclude the time value of certain options. For accounting hedges that are deemed an effective hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (“AOCI”) and reclassified into earnings in the same period during which the hedged transaction affects earnings. We recognize in current earnings the gains and losses representing hedge ineffectiveness, and the gains and losses on any hedge components which are excluded from our effectiveness assessment. As of June 30, 2010, we hedged the majority of certain exposures to the price variability of commodities for a maximum of 39 months.

In the electricity business, some contracts to purchase energy are netted against other contracts to sell energy. This is called “book-out” and usually occurs in contracts that have the same terms (quantities and delivery points) and for which power does not flow. We net these book-outs, which reduces both revenues and fuel and purchased power costs in our Condensed Consolidated Statements of Income, but this does not impact our financial condition, net income or cash flows.

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For its regulated operations, APS defers for future rate treatment approximately 90% of unrealized gains and losses on certain derivatives pursuant to the PSA mechanism that would otherwise be recognized in income. Realized gains and losses on derivatives are deferred in accordance with the PSA to the extent the amounts are above or below the portion of APS' retail base rates attributable to fuel and purchased power costs ("Base Fuel Rate"), which is currently \$0.0376 per kWh (see Note 3). Gains and losses from derivatives in the following tables represent the amounts reflected in income before the effect of PSA deferrals.

As of June 30, 2010, we had the following outstanding gross notional amount of derivatives, which represent both purchases and sales (does not reflect net position):

Commodity	Quantity	
Power	16,004,799	megawatt hours
Gas	166,950,111	MMBTU (a)

(a) "MMBTU" is one million British thermal units.

Derivative Instruments in Designated Accounting Hedging Relationships

The following table provides information about gains and losses from derivative instruments in designated accounting hedging relationships and their impact on our Condensed Consolidated Statements of Income during the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

<u>Commodity Contracts</u>	<u>Financial Statement Location</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
		<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Amount of Gain (Loss) Recognized in AOCI on Derivative Instruments (Effective Portion)	Accumulated other comprehensive loss-derivative instruments	\$ (8,588)	\$ 5,554	\$ (100,255)	\$ (132,994)
Amount of Loss Reclassified from AOCI into Income (Effective Portion Realized)	Regulated electricity segment fuel and purchased power	(29,143)	(47,964)	(42,329)	(73,330)
Amount of Gain (Loss) Recognized in Income from Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing) (a)	Regulated electricity segment fuel and purchased power	11,899	(4,900)	1,432	(3,908)

(a) During the three and six months ended June 30, 2010 and 2009, we had no amounts reclassified from AOCI to earnings related to discontinued cash flow hedges.

During the next twelve months, we estimate that a net loss of \$101 million before income taxes will be reclassified from AOCI as an offset to the effect of market price changes for the related hedged transactions. Approximately 90% of the amounts related to derivatives subject to the PSA will be recorded as either a regulatory asset or liability and have no effect on earnings.

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Derivative Instruments Not Designated as Accounting Hedges

The following table provides information about gains and losses from derivative instruments not designated as accounting hedging instruments and their impact on our Condensed Consolidated Statements of Income during the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

Commodity Contracts	Financial Statement Location	Three Months Ended June 30,		Six Months Ended June 30,	
		2010	2009	2010	2009
Amount of Net Gain Recognized in Income from Derivative Instruments	Regulated electricity segment revenue	\$ 426	\$ 766	\$ 595	\$ 337
Amount of Net Gain (Loss) Recognized in Income from Derivative Instruments	Regulated electricity segment fuel and purchased power expense	(29,260)	22,242	(64,228)	(41,722)
Total		\$ (28,834)	\$ 23,008	\$ (63,633)	\$ (41,385)

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Fair Values of Derivative Instruments in the Condensed Consolidated Balance Sheets

The following table provides information about the fair value of our derivative instruments, margin account and cash collateral reported on a gross basis. Transactions with counterparties that have master netting arrangements are reported net on the balance sheet. These amounts are located in the assets and liabilities from risk management activities lines of our Condensed Consolidated Balance Sheets. Amounts are as of June 30, 2010 (dollars in thousands):

Commodity Contracts	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Derivatives designated as accounting hedging instruments:					
Assets	\$ 10	\$ —	\$ 14	\$ 70	\$ 94
Liabilities	(188)	(1,285)	(115,010)	(98,430)	(214,913)
Total hedging instruments	(178)	(1,285)	(114,996)	(98,360)	(214,819)
Derivatives not designated as accounting hedging instruments:					
Assets	36,271	45,490	38,470	33,213	153,444
Liabilities	(1,955)	—	(101,349)	(100,856)	(204,160)
Total non-hedging instruments	34,316	45,490	(62,879)	(67,643)	(50,716)
Total derivatives	34,138	44,205	(177,875)	(166,003)	(265,535)
Margin account	20,344	—	1,458	—	21,802
Collateral provided to counterparties	10,235	—	112,727	79,423	202,385
Collateral provided from counterparties	(4,500)	—	(1,250)	—	(5,750)
Prepaid option premiums	(106)	—	1,373	—	1,267
Balance Sheet Total	<u>\$ 60,111</u>	<u>\$ 44,205</u>	<u>\$ (63,567)</u>	<u>\$ (86,580)</u>	<u>\$ (45,831)</u>

PINNACLE WEST CAPITAL CORPORATION
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The following table provides information about the fair value of our derivative instruments, margin account and cash collateral reported on a gross basis at December 31, 2009 (dollars in thousands):

Commodity Contracts	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Derivatives designated as accounting hedging instruments:					
Assets	\$ 329	\$ —	\$ 3,242	\$ 75	\$ 3,646
Liabilities	(3,436)	(256)	(72,899)	(77,953)	(154,544)
Total hedging instruments	(3,107)	(256)	(69,657)	(77,878)	(150,898)
Derivatives not designated as accounting hedging instruments:					
Assets	31,220	29,807	34,645	44,631	140,303
Liabilities	(4,123)	(696)	(81,722)	(71,408)	(157,949)
Total non-hedging instruments	27,097	29,111	(47,077)	(26,777)	(17,646)
Total derivatives	23,990	28,855	(116,734)	(104,655)	(168,544)
Margin account	8,643	—	12,464	104	21,211
Collateral provided to counterparties	17,986	—	49,412	42,108	109,506
Collateral provided from counterparties	—	—	(1,050)	—	(1,050)
Balance Sheet Total	\$ 50,619	\$ 28,855	\$ (55,908)	\$ (62,443)	\$ (38,877)

Credit Risk and Credit-Related Contingent Features

We are exposed to losses in the event of nonperformance or nonpayment by counterparties. We have risk management contracts with many counterparties, including one counterparty for which our exposure represents approximately 34% of Pinnacle West's \$104 million of risk management assets as of June 30, 2010. This exposure relates to a long-term traditional wholesale contract with a counterparty that has very high credit quality. Our risk management process assesses and monitors the financial exposure of all counterparties. Despite the fact that the great majority of our trading counterparties' debt is rated as investment grade by the credit rating agencies, there is still a possibility that one or more of these companies could default, resulting in a material impact on consolidated earnings for a given period. Counterparties in the portfolio consist principally of financial institutions, major energy companies, municipalities and local distribution companies. We maintain credit policies that we believe minimize overall credit risk to within acceptable limits. Determination of the credit quality of our counterparties is based upon a number of factors, including credit ratings and our evaluation of their financial condition. To manage credit risk, we employ collateral requirements and standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. Valuation adjustments are established representing our estimated credit losses on our overall exposure to counterparties.

PINNACLE WEST CAPITAL CORPORATION
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Certain of our derivative instrument contracts contain credit-risk-related contingent features including, among other things, investment grade credit rating provisions, credit-related cross default provisions, and adequate assurance provisions. Adequate assurance provisions allow a counterparty with reasonable grounds for uncertainty to demand additional collateral based on subjective events and/or conditions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position on June 30, 2010 was \$390 million, for which we had posted collateral of \$192 million in the normal course of business.

For those derivative instruments in a net liability position, with investment grade credit contingencies, the counterparties could demand additional collateral if our debt credit rating were to fall below investment grade (below BBB- for Standard & Poor's Ratings Services ("Standard & Poor's") or Fitch, Inc. ("Fitch") or Baa3 for Moody's Investors Service, Inc. ("Moody's")), which would be a violation of the credit rating provisions. If the investment grade contingent features underlying these agreements had been triggered on June 30, 2010, after off-setting asset positions under master netting arrangements we would have been required to post approximately an additional \$90 million of collateral to our counterparties; this amount includes those contracts which qualify for scope exceptions, which are excluded from the derivative details in the above footnote. We also have energy related non-derivative instrument contracts with investment grade credit-related contingent features which could also require us to post additional collateral of approximately \$200 million if our debt credit ratings were to fall below investment grade.

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9. Changes in Equity

The following tables show Pinnacle West's changes in shareholders' equity and changes in equity of noncontrolling interests for the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

	Three Months Ended June 30, 2010			Three Months Ended June 30, 2009		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, April 1	\$ 3,213,933	\$ 116,067	\$3,330,000	\$ 3,162,902	\$ 116,617	\$3,279,519
Net income	114,797	4,769	119,566	68,347	4,499	72,846
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	(8,588)	—	(8,588)	5,554	—	5,554
Net reclassification of realized losses to income (b)	29,143	—	29,143	47,964	—	47,964
Reclassification of pension and other postretirement benefits to income	1,362	—	1,362	1,253	—	1,253
Net unrealized losses related to pension and other postretirement benefits	(6,933)	—	(6,933)	(4,204)	—	(4,204)
Net income tax expense related to items of other comprehensive income (loss)	(5,914)	—	(5,914)	(19,844)	—	(19,844)
Total other comprehensive income	9,070	—	9,070	30,723	—	30,723
Total comprehensive income	123,867	4,769	128,636	99,070	4,499	103,569
Issuance of capital stock	255,480	—	255,480	2,717	—	2,717
Purchase of treasury stock, net of reissuances	—	—	—	5	—	5
Other (primarily stock compensation)	140	—	140	(4,820)	—	(4,820)
Dividends on common stock	(113,872)	—	(113,872)	(53,069)	—	(53,069)
Net capital activities by noncontrolling interests	—	(7,381)	(7,381)	—	(8,439)	(8,439)
Ending balance, June 30	<u>\$ 3,479,548</u>	<u>\$ 113,455</u>	<u>\$3,593,003</u>	<u>\$ 3,206,805</u>	<u>\$ 112,677</u>	<u>\$3,319,482</u>

PINNACLE WEST CAPITAL CORPORATION
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	Six Months Ended June 30, 2010			Six Months Ended June 30, 2009		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, January 1	\$ 3,316,109	\$ 111,895	\$3,428,004	\$ 3,445,979	\$ 124,990	\$3,570,969
Net income (loss)	108,783	9,886	118,669	(88,163)	(5,061)	(93,224)
Other comprehensive income (loss):						
Net unrealized losses on derivative instruments (a)	(100,255)	—	(100,255)	(132,994)	—	(132,994)
Net reclassification of realized losses to income (b)	42,329	—	42,329	73,330	—	73,330
Reclassification of pension and other postretirement benefits to income	2,755	—	2,755	2,506	—	2,506
Net unrealized losses related to pension and other postretirement benefits	(6,933)	—	(6,933)	(4,204)	—	(4,204)
Net income tax benefit related to items of other comprehensive income (loss)	24,511	—	24,511	24,157	—	24,157
Total other comprehensive loss	(37,593)	—	(37,593)	(37,205)	—	(37,205)
Total comprehensive income (loss)	71,190	9,886	81,076	(125,368)	(5,061)	(130,429)
Issuance of capital stock	258,160	—	258,160	5,346	—	5,346
Purchase of treasury stock, net of reissuances	1,078	—	1,078	(1,546)	—	(1,546)
Other (primarily stock compensation)	142	—	142	(11,527)	—	(11,527)
Dividends on common stock	(167,131)	—	(167,131)	(106,079)	—	(106,079)
Net capital activities by noncontrolling interests	—	(8,326)	(8,326)	—	(7,252)	(7,252)
Ending balance, June 30	<u>\$ 3,479,548</u>	<u>\$ 113,455</u>	<u>\$3,593,003</u>	<u>\$ 3,206,805</u>	<u>\$ 112,677</u>	<u>\$3,319,482</u>

- (a) These amounts primarily include unrealized gains and losses on contracts used to hedge our forecasted electricity and natural gas requirements to serve Native Load. These changes are primarily due to changes in forward natural gas prices and wholesale electricity prices.
- (b) These amounts primarily include the reclassification of unrealized gains and losses to realized gains and losses for contracted commodities delivered during the period.

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10. Commitments and Contingencies

Palo Verde Nuclear Generating Station

Spent Nuclear Fuel and Waste Disposal

Nuclear power plant operators are required to enter into spent fuel disposal contracts with the United States Department of Energy ("DOE"), and the DOE is required to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by domestic power reactors. Although the Nuclear Waste Policy Act required the DOE to develop a permanent repository for the storage and disposal of spent nuclear fuel by 1998, the DOE announced that it would not be able to open the repository by 1998 and sought to excuse its performance under the contract. In November 1997, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued a decision preventing the DOE from excusing its own delay, but refused to order the DOE to begin accepting spent nuclear fuel.

Based on this decision and the DOE's delay, a number of utilities, including APS (on behalf of itself and the other Palo Verde owners), filed damages actions against the DOE in the Court of Federal Claims. APS pursued a damages claim for costs incurred through December 2006 in a trial that began on January 28, 2009. On June 18, 2010, the court awarded APS and the other Palo Verde owners approximately \$30 million. APS' share of this amount is approximately \$9 million. Because the appeal period for this decision has not yet passed, APS has not recorded this amount on its financial statements.

APS currently estimates it will incur \$132 million (in 2010 dollars) over the current life of Palo Verde for its share of the costs related to the on-site interim storage of spent nuclear fuel. At June 30, 2010, APS had a regulatory liability of \$38 million that represents amounts recovered in retail rates in excess of amounts spent for on-site interim spent fuel storage.

Fuel and Purchased Power Commitments

APS is party to various fuel and purchased power contracts with terms expiring between 2010 and 2042 that include required purchase provisions. APS estimates the contract requirements to be approximately \$637 million in 2010; \$347 million in 2011; \$377 million in 2012; \$479 million in 2013; \$506 million in 2014; and \$6.8 billion thereafter. However, these amounts may vary significantly pursuant to certain provisions in such contracts that permit us to decrease required purchases under certain circumstances. These amounts have increased since the 2009 Form 10-K due to increased solar contracts to meet our increasing renewable energy requirements.

FERC Market Issues

APS reached a settlement on previously disputed matters resulting from its involvement in the California energy market during specified time frames in the early 2000s. The settlement was approved by the FERC in an order issued on June 30, 2008. The resolution of the claims related to the parties involved in this settlement had no material adverse impact on APS' financial position, results of operations or cash flows.

PINNACLE WEST CAPITAL CORPORATION
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On July 25, 2001, the FERC ordered an evidentiary proceeding to discuss and evaluate possible refunds for wholesale sales in the Pacific Northwest. The FERC affirmed the administrative law judge's conclusion that the prices in the Pacific Northwest were not unreasonable or unjust and refunds should not be ordered in this proceeding. This decision was appealed to the U.S. Court of Appeals for the Ninth Circuit. On August 24, 2007, the Ninth Circuit issued an opinion that remanded the proceeding to the FERC for further consideration. Although the FERC has not yet determined whether any refunds will ultimately be required, we do not expect that the resolution of these issues will have a material adverse impact on our financial position, results of operations or cash flows.

Superfund

The Comprehensive Environmental Response, Compensation and Liability Act ("Superfund") establishes liability for the cleanup of hazardous substances found contaminating the soil, water or air. Those who generated, transported or disposed of hazardous substances at a contaminated site are among those who are potentially responsible parties under Superfund ("PRPs"). PRPs may be strictly, and often are jointly and severally, liable for clean-up. On September 3, 2003, the United States Environmental Protection Agency ("EPA") advised APS that the EPA considers APS to be a PRP in the Motorola 52nd Street Superfund Site, Operable Unit 3 ("OU3") in Phoenix, Arizona. APS has facilities that are within this Superfund site. APS and Pinnacle West have agreed with the EPA to perform certain investigative activities of the APS facilities within OU3. In addition, on September 23, 2009, APS agreed with the EPA and one other PRP to voluntarily assist with the funding and management of the site-wide groundwater remedial investigation and feasibility study work plan. We estimate that our costs related to this investigation and study will be approximately \$1.2 million, which is reserved as a liability on our financial statements. We anticipate incurring additional expenditures in the future, but because the overall investigation is not complete and ultimate remediation requirements are not yet finalized, at the present time we cannot accurately estimate our total expenditures.

Landlord Bankruptcy

On April 16, 2009, the landlord for our corporate headquarters building announced that it is seeking relief under Chapter 11 of the United States Bankruptcy Code. At June 30, 2010, we have several assets on our books related to our landlord, the most significant of which is an asset related to levelized rent payments for the building of approximately \$69 million which is included in other deferred debits on the Condensed Consolidated Balance Sheets. This amount will continue to increase to approximately \$94 million as a result of the lease terms until 2015, when this amount will begin to decrease over the remaining life of the lease. We are monitoring this matter and, while there can be no assurances as to the ultimate outcome of the matter due to the complexity of the bankruptcy proceedings, we currently do not expect that it will have a material adverse effect on our financial position, results of operations, or cash flows.

Nuclear Insurance

The Palo Verde participants are insured against public liability for a nuclear incident up to \$12.6 billion per occurrence. As required by the Price Anderson Nuclear Industries Indemnity Act, Palo Verde maintains the maximum available nuclear liability insurance in the amount of \$375 million, which is provided by commercial insurance carriers. The remaining balance of \$12.2 billion is provided through a mandatory industry wide retrospective assessment program. If losses at any nuclear power plant covered by the program exceed the accumulated funds, APS could be assessed retrospective premium adjustments. The maximum assessment per reactor under the program for each nuclear incident is approximately \$118 million, subject to an annual limit of \$18 million per incident, to be periodically adjusted for inflation. Based on APS' interest in the three Palo Verde units, APS' maximum potential assessment per incident for all three units is approximately \$103 million, with an annual payment limitation of approximately \$15 million.

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The Palo Verde participants maintain “all risk” (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of \$2.75 billion, a substantial portion of which must first be applied to stabilization and decontamination. APS has also secured insurance against portions of any increased cost of generation or purchased power and business interruption resulting from a sudden and unforeseen accidental outage of any of the three units. The property damage, decontamination, and replacement power coverages are provided by Nuclear Electric Insurance Limited (“NEIL”). APS is subject to retrospective assessments under all NEIL policies if NEIL’s losses in any policy year exceed accumulated funds. The maximum amount APS could incur under the current NEIL policies totals approximately \$16 million for each retrospective assessment declared by NEIL’s Board of Directors due to losses. In addition, NEIL policies contain rating triggers that would result in APS providing approximately \$44 million of collateral assurance within 20 business days of a rating downgrade to non-investment grade. The insurance coverage discussed in this and the previous paragraph is subject to certain policy conditions and exclusions.

11. Other Income and Other Expense

The following table provides detail of other income and other expense for the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Other income:				
Interest income	\$ 625	\$ 386	\$ 1,499	\$ 634
Investment gains — net	—	3,398	—	—
Miscellaneous	308	2,468	320	2,658
Total other income	\$ 933	\$ 6,252	\$ 1,819	\$ 3,292
Other expense:				
Non-operating costs	\$ (1,247)	\$ (3,248)	\$ (3,042)	\$ (4,855)
Investment losses — net	(3,561)	—	(2,339)	(3,832)
Miscellaneous	(852)	(939)	(1,753)	(1,842)
Total other expense	\$ (5,660)	\$ (4,187)	\$ (7,134)	\$ (10,529)

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12. Guarantees

We have issued parental guarantees and obtained surety bonds on behalf of our subsidiaries including credit support instruments enabling APSES to offer energy-related products and surety bonds at APS, principally related to self-insured workers' compensation. Non-performance or non-payment under the underlying contract by our subsidiaries would result in a payment liability on our part under the guarantee or surety bond. No liability is currently recorded on the Condensed Consolidated Balance Sheets related to Pinnacle West's current outstanding guarantees and surety bonds on behalf of our subsidiaries. At June 30, 2010, we had no outstanding claims for payment under any of these guarantees. Our guarantees and surety bonds have no recourse or collateral provisions to allow us to recover amounts paid under the guarantees or surety bonds from our subsidiaries. The amounts and approximate terms of our guarantees and surety bonds for each subsidiary at June 30, 2010 are as follows (dollars in millions):

	Guarantees		Surety Bonds	
	Amount	Term (in years)	Amount	Term (in years)
APSES	\$ 5	1	\$ 30	1
APS	3	1	9	1
Total	<u>\$ 8</u>		<u>\$ 39</u>	

APS has entered into various agreements that require letters of credit for financial assurance purposes. At June 30, 2010, approximately \$227 million of letters of credit were outstanding to support existing pollution control bonds of approximately \$223 million. The letters of credit are available to fund the payment of principal and interest of such debt obligations. In connection with the change of interest rate mode and termination of a corresponding letter of credit for certain pollution control bonds described in Note 2, the letters of credit outstanding have decreased since June 30, 2010. Currently, there are approximately \$194 million of letters of credit outstanding to support existing pollution control bonds of approximately \$190 million. These letters of credit expire in 2010 and 2011. APS has also entered into approximately \$62 million of letters of credit to support certain equity lessors in the Palo Verde sale leaseback transactions (see Note 7 for further details on the Palo Verde sale leaseback transactions). These letters of credit were amended and extended in April 2010, and will expire in 2013.

We enter into agreements that include indemnification provisions relating to liabilities arising from or related to certain of our agreements; most significantly, APS has agreed to indemnify the equity participants and other parties in the Palo Verde sale leaseback transactions with respect to certain tax matters. Generally, a maximum obligation is not explicitly stated in the indemnification provisions and, therefore, the overall maximum amount of the obligation under such indemnification provisions cannot be reasonably estimated. Based on historical experience and evaluation of the specific indemnities, we do not believe that any material loss related to such indemnification provisions is likely.

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13. Earnings Per Share

The following table presents earnings per weighted average common share outstanding for the three and six months ended June 30, 2010 and 2009:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Basic earnings per share:				
Income from continuing operations attributable to common shareholders	\$ 0.84	\$ 0.76	\$ 0.93	\$ 0.51
Income (loss) from discontinued operations	0.23	(0.08)	0.11	(1.38)
Earnings per share — basic	<u>\$ 1.07</u>	<u>\$ 0.68</u>	<u>\$ 1.04</u>	<u>\$ (0.87)</u>
Diluted earnings per share:				
Income from continuing operations attributable to common shareholders	\$ 0.83	\$ 0.75	\$ 0.92	\$ 0.51
Income (loss) from discontinued operations	0.24	(0.07)	0.12	(1.38)
Earnings per share — diluted	<u>\$ 1.07</u>	<u>\$ 0.68</u>	<u>\$ 1.04</u>	<u>\$ (0.87)</u>

Dilutive stock options and performance shares (which are contingently issuable) increased average diluted common shares outstanding by approximately 409,000 shares and 84,000 shares for the three months ended June 30, 2010 and 2009, respectively, and by approximately 426,000 shares for the six months ended June 30, 2010. For the six months ended June 30, 2009 the weighted average common shares outstanding were the same for both basic and diluted shares.

Options to purchase 387,800 shares of common stock for the three-month period ended June 30, 2010, and 599,324 shares for the three-month period ended June 30, 2009 were outstanding but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares. Options to purchase 387,800 shares and 612,424 shares of common stock for the six-month periods ended June 30, 2010 and June 30, 2009, respectively, were outstanding but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

14. Discontinued Operations

SunCor (real estate segment) — In July, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. At June 30, 2010, SunCor had approximately \$103 million of assets on its balance sheet classified as assets held for sale. These assets consist of the \$70 million of assets sold in July as discussed above, \$25 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet. As a result, for the three and six months ended June 30, 2010, all of SunCor's operations have been reclassified to discontinued operations. Prior comparative period income statement amounts related to these properties were reclassified from continuing operations to discontinued operations. In addition, see Note 16 — Real Estate Impairment Charge.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APSES (other) — On June 22, 2010, our subsidiary, APSES, sold its district cooling business consisting of operations in downtown Phoenix, Tucson, and on certain Arizona State University campuses. As a result of the sale, we recorded an after-tax gain from discontinued operations of approximately \$25 million. Prior period income statement amounts related to this sale and the associated revenues and costs were reclassified to discontinued operations in 2010 and 2009.

The following table provides revenue, income (loss) before income taxes and income (loss) after taxes classified as discontinued operations in Pinnacle West's Condensed Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009 (dollars in millions):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Revenue:				
SunCor	\$ 11	\$ 17	\$ 21	\$ 36
APSES	4	5	7	8
Total revenue	<u>\$ 15</u>	<u>\$ 22</u>	<u>\$ 28</u>	<u>\$ 44</u>
Income (loss) before taxes:				
SunCor	\$ (2)	\$ (14)	\$ (24)	\$ (231)
APSES	43	1	44	2
Total income (loss) before taxes	<u>\$ 41</u>	<u>\$ (13)</u>	<u>\$ 20</u>	<u>\$ (229)</u>
Income (loss) after taxes:				
SunCor (a)	\$ (1)	\$ (9)	\$ (15)	\$ (140)
APSES	26	1	27	1
Total income (loss) after taxes	<u>\$ 25</u>	<u>\$ (8)</u>	<u>\$ 12</u>	<u>\$ (139)</u>

- (a) Includes a tax benefit recognized by the parent company in accordance with an intercompany tax sharing agreement of \$1 million and \$5 million for the three months ended June 30, 2010, and 2009, respectively; \$9 million and \$93 million for the six months ended June 30, 2010 and 2009, respectively.

15. Fair Value Measurements

We disclose the fair value of certain assets and liabilities according to a fair value hierarchy. This hierarchy ranks the quality and reliability of the inputs used to determine fair values, which are then classified and disclosed in one of three categories. The three levels of the fair value hierarchy are:

Level 1 — Quoted prices in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide information on an ongoing basis. This category includes derivative instruments that are exchange-traded such as futures, cash equivalents invested in exchange-traded money market funds, exchange-traded equities, and investments in Treasury securities.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Level 2 — Quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; and model-derived valuations whose inputs are observable. This category includes nonexchange-traded derivative instruments such as forwards, options, and swaps. This category also includes investments in common and commingled funds that are redeemable and valued based on the funds' net asset values.

Level 3 — Model-derived valuations with significant unobservable inputs that are supported by little or no market activity. Instruments in this category include long-dated derivative transactions where models are required due to the length of the transaction, certain options, transactions in locations where observable market data does not exist, and common and collective trusts with significant restrictions on our ability to transact in the fund. The valuation models we employ utilize spot prices, forward prices, historical market data and other factors to forecast future prices. The primary valuation technique we use to calculate the fair value of contracts where price quotes are not available is based on the extrapolation of forward pricing curves using observable market data for more liquid delivery points in the same region and actual transactions at the more illiquid delivery points.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. We maximize the use of observable inputs and minimize the use of unobservable inputs. If market data is not readily available, inputs may reflect our own assumptions about the inputs market participants would use. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. Thus, a valuation may be classified in Level 3 even though the valuation may include significant inputs that are readily observable. We assess whether a market is active by obtaining observable broker quotes, reviewing actual market transactions, and assessing the volume of transactions. We consider broker quotes observable inputs when the quote is binding on the broker, we can validate the quote with market transactions, or we can determine that the inputs the broker used to arrive at the quoted price are observable.

Recurring Fair Value Measurements

We apply recurring fair value measurements to derivative instruments, nuclear decommissioning trusts, certain cash equivalents and plan assets held in our retirement and other benefit plans.

Cash Equivalents

Cash equivalents represent short-term investments in exchange-traded money market funds that are valued using quoted prices in active markets.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Risk Management Activities

Exchange-traded contracts are valued using quoted prices in active markets. For non-exchange traded contracts, we calculate fair market value based on the average of the bid and offer price, discounted to reflect net present value. We maintain certain valuation adjustments for a number of risks associated with the valuation of future commitments. These include valuation adjustments for liquidity and credit risks based on the financial condition of counterparties. The liquidity valuation adjustment represents the cost that would be incurred if all unmatched positions were closed-out or hedged.

The credit valuation adjustment represents estimated credit losses on our overall exposure to counterparties, taking into account netting arrangements, expected default experience for the credit rating of the counterparties and the overall diversification of the portfolio. Counterparties in the portfolio consist principally of major energy companies, municipalities, local distribution companies and financial institutions. We maintain credit policies that management believes minimize overall credit risk. Determination of the credit quality of counterparties is based upon a number of factors, including credit ratings, financial condition, project economics and collateral requirements. When applicable, we employ standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty.

Some of our derivative instrument transactions are valued based on unobservable inputs due to the long-term nature of contracts or the unique location of the transactions. Our long-dated energy transactions consist of observable valuations for the near-term portion and unobservable valuations for the long-term portions of the transaction. When the unobservable portion is significant to the overall valuation of the transaction, the entire transaction is classified as Level 3. Our classification of instruments as Level 3 is primarily reflective of the long-term nature of our energy transactions, and is not reflective of material inactive markets.

Nuclear Decommissioning Trust

The nuclear decommissioning trust invests in fixed income securities directly and equity securities indirectly through commingled funds. The commingled equity funds are valued based on the fund's net asset value and are classified within Level 2. We may transact in the fund on a semi-monthly basis. Our trustee provides valuation of our nuclear decommissioning trust assets by using pricing services to determine fair market value. We assess these valuations and verify that pricing can be supported by actual recent market transactions. The trust fund investments have been established to satisfy APS' nuclear decommissioning obligations.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Tables

The following table presents the fair value at June 30, 2010 of our assets and liabilities that are measured at fair value on a recurring basis (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (a) (Level 3)	Counterparty Netting & Other (b)	Balance at June 30, 2010
Assets					
Risk management activities:					
Commodity contracts	\$ —	\$ 97	\$ 56	\$ (49)	\$ 104
Nuclear decommissioning trust:					
Equity securities:					
U.S. commingled funds	—	136	—	—	136
Fixed income securities:					
U.S. Treasury	56	—	—	—	56
Corporate	—	57	—	—	57
Mortgage-backed	—	61	—	—	61
Municipality	—	68	—	—	68
Other	—	57	—	(11)	46
Total	\$ 56	\$ 476	\$ 56	\$ (60)	\$ 528
Liabilities					
Risk management activities:					
Commodity contracts	\$ (2)	\$ (319)	\$ (98)	\$ 269	\$ (150)

(a) Primarily consists of long-dated electricity contracts.

(b) Primarily represents netting under master netting arrangements, including margin and collateral. See Note 8.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the fair value at December 31, 2009 of our assets and liabilities that are measured at fair value on a recurring basis (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (a) (Level 3)	Counterparty Netting & Other (b)	Balance at December 31, 2009
Assets					
Cash equivalents	\$ 97	\$ —	\$ —	\$ —	\$ 97
Risk management activities:					
Commodity contracts	1	100	42	(64)	79
Nuclear decommissioning trust:					
Equity securities:					
U.S. commingled funds	—	167	—	—	167
Fixed income securities:					
U.S. Treasury	55	—	—	—	55
Corporate	—	62	—	—	62
Mortgage-backed	—	60	—	—	60
Municipality	—	49	—	—	49
Other	—	21	—	1	22
Total	<u>\$ 153</u>	<u>\$ 459</u>	<u>\$ 42</u>	<u>\$ (63)</u>	<u>\$ 591</u>
Liabilities					
Risk management activities:					
Commodity contracts	<u>\$ (14)</u>	<u>\$ (246)</u>	<u>\$ (52)</u>	<u>\$ 194</u>	<u>\$ (118)</u>

(a) Primarily consists of long-dated electricity contracts.

(b) Primarily represents netting under master netting arrangements, including margin and collateral. See Note 8.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table shows the changes in fair value for assets and liabilities that are measured at fair value on a recurring basis using Level 3 inputs for the three and six months ended June 30, 2010 and 2009 (dollars in millions):

Commodity Contracts	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net derivative balance at beginning of period	\$ (31)	\$ (23)	\$ (10)	\$ (7)
Total net gains (losses) realized/unrealized:				
Included in earnings	(1)	—	(2)	2
Included in OCI	(3)	—	(9)	(1)
Deferred as a regulatory asset or liability	(12)	9	(24)	6
Settlements	3	3	3	3
Transfers into Level 3 from Level 2	8	(7)	8	(21)
Transfers from Level 3 into Level 2	(6)	2	(8)	2
Net derivative balance at end of period	<u>\$ (42)</u>	<u>\$ (16)</u>	<u>\$ (42)</u>	<u>\$ (16)</u>
Net unrealized gains (losses) included in earnings related to instruments still held at end of period	\$ —	\$ —	\$ (1)	\$ 2

Amounts included in earnings are recorded in either regulated electricity segment revenue or regulated electricity segment fuel and purchased power depending on the nature of the underlying contract.

Transfers reflect the fair market value at the beginning of the period and are triggered by a change in the lowest significant input as of the end of the period. We had no significant Level 1 transfers to or from any other hierarchy level. Transfers in or out of Level 3 are typically related to our long-dated energy transactions that extend beyond available quoted periods.

Nonrecurring Fair Value Measurements

We may be required to record other assets at fair value on a nonrecurring basis. These nonrecurring fair value measurements typically involve write-downs of individual assets due to impairment.

We apply nonrecurring fair value measurements to certain real estate assets. These adjustments to fair value are the result of write-downs of individual assets due to impairment. Our real estate assets have been impaired due to the distressed real estate market. The majority of our real estate assets reflect the expected sales price less cost to sell at June 30, 2010. Due to these unobservable inputs, the valuation of real estate assets are considered Level 3 measurements.

As of June 30, 2010, the fair value of our impaired real estate assets that are measured at fair value on a nonrecurring basis was \$68 million, all of which was valued using significant unobservable inputs (Level 3). Total impairment charges included in net income for the three and six months ended June 30, 2010 were approximately \$2 million and \$17 million, respectively. See Note 16 for additional information.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Financial Instruments Not Carried at Fair Value

The carrying value of our net accounts receivable, accounts payable and short-term borrowings approximate fair value. Our long-term debt fair value estimates are based on quoted market prices of the same or similar issues. Certain of our debt instruments contain third-party credit enhancements and, in accordance with GAAP, we do not consider the effect of these credit enhancements when determining fair value.

The following table represents the carrying amount and estimated fair value of our long-term debt, including current maturities (dollars in millions):

	As of June 30, 2010		As of December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	\$ 175	\$ 179	\$ 175	\$ 180
APS	3,521	3,821	3,530	3,667
SunCor (a)	89	89	95	95
Total	<u>\$ 3,785</u>	<u>\$ 4,089</u>	<u>\$ 3,800</u>	<u>\$ 3,942</u>

(a) See Note 2 for further discussion related to SunCor's debt and liquidity matters.

Nuclear Decommissioning Trust

To fund the costs APS expects to incur to decommission Palo Verde, APS established external decommissioning trusts in accordance with NRC regulations. Third-party investment managers are authorized to buy and sell securities per their stated investment guidelines. The trust funds are invested in a tax efficient manner in fixed income securities and domestic equity securities. APS classifies investments in decommissioning trust funds as available for sale, and therefore, we record the decommissioning trust funds at their fair value on our Condensed Consolidated Balance Sheets. Because of the ability of APS to recover decommissioning costs in rates and in accordance with the regulatory treatment for decommissioning trust funds, we have recorded the offsetting amount of gains or losses on investment securities in other regulatory liabilities or assets. The following table summarizes the fair value of APS' nuclear decommissioning trust fund assets at June 30, 2010 and December 31, 2009 (dollars in millions):

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
June 30, 2010			
Equity securities	\$ 136	\$ 22	\$ (10)
Fixed income securities	299	15	—
Net payables (a)	(11)	—	—
Total	<u>\$ 424</u>	<u>\$ 37</u>	<u>\$ (10)</u>

(a) Net payables relate to pending securities sales and purchases.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
December 31, 2009			
Equity securities	\$ 167	\$ 37	\$ (6)
Fixed income securities	247	11	(1)
Net receivables (a)	1	—	—
Total	\$ 415	\$ 48	\$ (7)

(a) Net receivables relate to pending securities sales and purchases.

The costs of securities sold are determined on the basis of specific identification. The following table sets forth approximate realized gains and losses and proceeds from the sale of securities by the nuclear decommissioning trust funds (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Realized gains	\$ 2	\$ 3	\$ 14	\$ 5
Realized losses	(1)	(3)	(3)	(5)
Proceeds from the sale of securities (a)	171	115	330	245

(a) Proceeds are reinvested in the trust.

The fair value of fixed income securities, summarized by contractual maturities, at June 30, 2010 is as follows (dollars in millions):

	Fair Value
Less than one year	\$ 27
1 year - 5 years	64
5 years - 10 years	88
Greater than 10 years	120
Total	\$ 299

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

16. Real Estate Impairment Charge

In 2009, SunCor undertook and completed a review of its assets and strategies within its various markets as a result of the distressed conditions in real estate and credit markets. Based on the results of the review, on March 27, 2009, SunCor's Board of Directors authorized a series of strategic transactions to dispose of SunCor's homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce SunCor's outstanding debt. In July, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. It is expected that SunCor will dispose of its other assets within the next 12 months. As a result, they are classified as assets held for sale on the balance sheet at June 30, 2010. As a result of the discussion above, as of June 30, 2010, all of SunCor's operations have been reclassified to discontinued operations. The detail of the impairment charges are as follows (dollars in millions, and before income taxes):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Discontinued Operations:				
Homebuilding and master-planned communities	\$ —	\$ 4	\$ 1	\$ 150
Land parcels and commercial assets	2	2	11	54
Golf courses	—	—	1	18
Other	—	—	4	—
Subtotal	2	6	17	222
Less noncontrolling interests	—	—	—	(14)
Total	<u>\$ 2</u>	<u>\$ 6</u>	<u>\$ 17</u>	<u>\$ 208</u>

See Note 2 for a discussion of SunCor's debt and liquidity matters.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(dollars in thousands)

	Three Months Ended	
	June 30,	
	2010	2009
ELECTRIC OPERATING REVENUES	\$ 799,467	\$ 812,587
OPERATING EXPENSES		
Fuel and purchased power	251,800	291,699
Operations and maintenance	211,310	211,214
Depreciation and amortization	102,970	100,923
Income taxes	55,688	45,862
Taxes other than income taxes	31,450	32,515
Total	<u>653,218</u>	<u>682,213</u>
OPERATING INCOME	<u>146,249</u>	<u>130,374</u>
OTHER INCOME (DEDUCTIONS)		
Income taxes	1,654	1,432
Allowance for equity funds used during construction	5,504	4,730
Other income (Note S-2)	1,827	4,958
Other expense (Note S-2)	(6,091)	(4,973)
Total	<u>2,894</u>	<u>6,147</u>
INTEREST EXPENSE		
Interest on long-term debt	53,220	53,994
Interest on short-term borrowings	2,879	1,293
Debt discount, premium and expense	1,118	1,256
Allowance for borrowed funds used during construction	(3,072)	(3,217)
Total	<u>54,145</u>	<u>53,326</u>
NET INCOME	94,998	83,195
Less: Net income attributable to noncontrolling interests (Note 7)	<u>4,778</u>	<u>4,651</u>
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDER	<u>\$ 90,220</u>	<u>\$ 78,544</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(dollars in thousands)

	Six Months Ended June 30,	
	2010	2009
ELECTRIC OPERATING REVENUES	\$ 1,410,943	\$ 1,415,247
OPERATING EXPENSES		
Fuel and purchased power	467,340	539,087
Operations and maintenance	415,191	402,399
Depreciation and amortization	203,579	200,860
Income taxes	50,248	39,118
Taxes other than income taxes	62,901	66,295
Total	1,199,259	1,247,759
OPERATING INCOME	<u>211,684</u>	<u>167,488</u>
OTHER INCOME (DEDUCTIONS)		
Income taxes	2,497	2,614
Allowance for equity funds used during construction	10,893	9,722
Other income (Note S-2)	2,445	4,050
Other expense (Note S-2)	(8,552)	(8,008)
Total	<u>7,283</u>	<u>8,378</u>
INTEREST EXPENSE		
Interest on long-term debt	107,972	103,728
Interest on short-term borrowings	3,721	4,268
Debt discount, premium and expense	2,255	2,445
Allowance for borrowed funds used during construction	(6,091)	(6,941)
Total	<u>107,857</u>	<u>103,500</u>
NET INCOME	111,110	72,366
Less: Net income attributable to noncontrolling interests (Note 7)	<u>9,906</u>	<u>9,301</u>
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDER	<u>\$ 101,204</u>	<u>\$ 63,065</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	June 30, 2010	December 31, 2009
ASSETS		
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	\$ 12,927,660	\$ 12,781,256
Accumulated depreciation and amortization	(4,396,895)	(4,326,908)
Net	8,530,765	8,454,348
Construction work in progress	496,457	460,748
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	142,335	146,722
Intangible assets, net of accumulated amortization	168,078	164,183
Nuclear fuel, net of accumulated amortization	136,151	118,243
Total property, plant and equipment	9,473,786	9,344,244
INVESTMENTS AND OTHER ASSETS		
Nuclear decommissioning trust (Note 15)	424,260	414,576
Assets from risk management activities (Note 8)	44,205	28,855
Other assets	67,765	68,839
Total investments and other assets	536,230	512,270
CURRENT ASSETS		
Cash and cash equivalents	35,602	120,798
Customer and other receivables	263,201	280,226
Accrued unbilled revenues	162,441	110,971
Allowance for doubtful accounts	(6,223)	(6,063)
Materials and supplies (at average cost)	172,091	176,020
Fossil fuel (at average cost)	29,597	39,245
Assets from risk management activities (Note 8)	60,111	50,619
Deferred income taxes	74,134	53,990
Other current assets	41,966	25,724
Total current assets	832,920	851,530
DEFERRED DEBITS		
Regulatory assets	850,001	813,161
Income tax receivable (Note 6)	65,498	65,498
Unamortized debt issue costs	19,679	20,959
Other	79,263	73,909
Total deferred debits	1,014,441	973,527
TOTAL ASSETS	\$ 11,857,377	\$ 11,681,571

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	June 30, 2010	December 31, 2009
LIABILITIES AND EQUITY		
CAPITALIZATION		
Common stock	\$ 178,162	\$ 178,162
Additional paid-in capital	2,379,696	2,126,863
Retained earnings	1,195,031	1,250,126
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(31,858)	(29,114)
Derivative instruments	(115,739)	(80,682)
Total shareholder equity	3,605,292	3,445,355
Noncontrolling interests (Note 7)	88,944	82,324
Total equity	3,694,236	3,527,679
Long-term debt less current maturities (Note 2)	3,213,109	3,180,406
Palo Verde sale leaseback lessor notes (Notes 2 and 7)	113,379	126,000
Total capitalization	7,020,724	6,834,085
CURRENT LIABILITIES		
Current maturities of long-term debt (Note 2)	194,082	222,959
Accounts payable	232,537	213,833
Accrued taxes (Note 6)	155,452	158,051
Common dividends payable	56,900	—
Accrued interest	53,215	54,099
Customer deposits	69,088	70,780
Liabilities from risk management activities (Note 8)	63,567	55,908
Other current liabilities	100,241	124,995
Total current liabilities	925,082	900,625
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,677,864	1,582,945
Deferred fuel and purchased power regulatory liability (Note 3)	97,047	87,291
Other regulatory liabilities	651,146	679,072
Liability for asset retirements	317,980	301,783
Liabilities for pension and other postretirement benefits (Note 4)	688,012	766,378
Customer advances	133,112	136,595
Liabilities from risk management activities (Note 8)	86,580	62,443
Coal mine reclamation	92,557	92,060
Unrecognized tax benefits (Note 6)	75,796	140,638
Other	91,477	97,656
Total deferred credits and other	3,911,571	3,946,861
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
TOTAL LIABILITIES AND EQUITY	\$ 11,857,377	\$ 11,681,571

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(dollars in thousands)

	Six Months Ended June 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 111,110	\$ 72,366
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	228,513	219,815
Deferred fuel and purchased power	65,249	13,144
Deferred fuel and purchased power amortization	(55,494)	66,163
Allowance for equity funds used during construction	(10,893)	(9,722)
Deferred income taxes	58,225	75,096
Change in mark-to-market valuations	2,396	(401)
Changes in current assets and liabilities:		
Customer and other receivables	(4,062)	23,252
Accrued unbilled revenues	(51,470)	(44,309)
Materials, supplies and fossil fuel	13,577	(21,628)
Other current assets	(16,242)	(4,687)
Accounts payable	43,451	(44,577)
Accrued taxes	(2,599)	(60,839)
Other current liabilities	(27,330)	(16,412)
Change in margin and collateral accounts — assets	656	(2,856)
Change in margin and collateral accounts — liabilities	(90,694)	(91,856)
Change in unrecognized tax benefits	(62,198)	14,639
Change in other long-term assets	(7,203)	(21,693)
Change in other long-term liabilities	(40,738)	51,624
Net cash flow provided by operating activities	<u>154,254</u>	<u>217,119</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Trust fund for bond redemptions	—	(163,975)
Capital expenditures	(378,239)	(388,526)
Contributions in aid of construction	15,163	33,371
Allowance for borrowed funds used during construction	(6,091)	(6,941)
Proceeds from nuclear decommissioning trust sales	329,796	244,858
Investment in nuclear decommissioning trust	(342,004)	(255,754)
Other	1,074	990
Net cash flow used for investing activities	<u>(380,301)</u>	<u>(535,977)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	—	837,193
Repayment of long-term debt	(9,296)	(186,105)
Short-term borrowings and payments-net	—	(312,464)
Equity infusion	252,833	—
Dividends paid on common stock	(99,400)	(85,000)
Noncontrolling interests	(3,286)	(3,393)
Net cash flow provided by financing activities	<u>140,851</u>	<u>250,231</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(85,196)	(68,627)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	120,798	71,544
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 35,602</u>	<u>\$ 2,917</u>

Supplemental disclosure of cash flow information

Cash paid during the period for:		
Income taxes, net of (refunds)	\$ 65,498	\$ 13,704
Interest, net of amounts capitalized	\$ 106,485	\$ 86,943

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

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Certain notes to APS' Condensed Consolidated Financial Statements are combined with the Notes to Pinnacle West's Condensed Consolidated Financial Statements. Listed below are the Condensed Consolidated Notes to Pinnacle West's Condensed Consolidated Financial Statements, the majority of which also relate to APS' Condensed Consolidated Financial Statements. In addition, listed below are the Supplemental Notes that are required disclosures for APS and should be read in conjunction with Pinnacle West's Condensed Consolidated Notes.

	Condensed Consolidated Note Reference	APS' Supplemental Note Reference
Consolidation and Nature of Operations	Note 1	—
Long-term Debt and Liquidity Matters	Note 2	—
Regulatory Matters	Note 3	—
Retirement Plans and Other Benefits	Note 4	—
Business Segments	Note 5	—
Income Taxes	Note 6	—
Variable Interest Entities	Note 7	—
Derivative and Energy Trading Accounting	Note 8	—
Changes in Equity	Note 9	Note S-1
Commitments and Contingencies	Note 10	—
Other Income and Other Expense	Note 11	Note S-2
Guarantees	Note 12	—
Earnings Per Share	Note 13	—
Discontinued Operations	Note 14	—
Fair Value Measurements	Note 15	—
Real Estate Impairment Charge	Note 16	—

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

S-1. Changes in Equity

The following tables show APS' changes in shareholder equity and changes in equity of noncontrolling interests for the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

	Three Months Ended June 30, 2010			Three Months Ended June 30, 2009		
	Shareholder Equity	Noncontrolling Interests	Total	Shareholder Equity	Noncontrolling Interests	Total
Beginning balance, April 1	\$ 3,366,986	\$ 87,452	\$3,454,438	\$ 3,217,841	\$ 82,251	\$3,300,092
Net income	90,220	4,778	94,998	78,544	4,651	83,195
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	(8,588)	—	(8,588)	5,554	—	5,554
Net reclassification of realized gains to income (b)	29,143	—	29,143	47,964	—	47,964
Reclassification of pension and other postretirement benefits to income	1,264	—	1,264	1,005	—	1,005
Net unrealized losses related to pension benefits	(6,862)	—	(6,862)	(3,774)	—	(3,774)
Net income tax expense related to items of other comprehensive income (loss)	(5,905)	—	(5,905)	(20,066)	—	(20,066)
Total other comprehensive income	9,052	—	9,052	30,683	—	30,683
Total comprehensive income	99,272	4,778	104,050	109,227	4,651	113,878
Dividends on common stock	(113,800)	—	(113,800)	(42,500)	—	(42,500)
Equity infusion	252,833	—	252,833	—	—	—
Other	1	(3,286)	(3,285)	—	(3,393)	(3,393)
Ending balance, June 30	\$ 3,605,292	\$ 88,944	\$3,694,236	\$ 3,284,568	\$ 83,509	\$3,368,077

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Six Months Ended June 30, 2010			Six Months Ended June 30, 2009		
	Shareholder Equity	Noncontrolling Interests	Total	Shareholder Equity	Noncontrolling Interests	Total
Beginning balance, January 1	\$ 3,445,355	\$ 82,324	\$3,527,679	\$ 3,339,150	\$ 77,601	\$3,416,751
Net income	101,204	9,906	111,110	63,065	9,301	72,366
Other comprehensive income (loss):						
Net unrealized losses on derivative instruments						
(a)	(100,255)	—	(100,255)	(132,994)	—	(132,994)
Net reclassification of realized losses to income (b)	42,329	—	42,329	73,330	—	73,330
Reclassification of pension and other postretirement benefits to income	2,328	—	2,328	1,993	—	1,993
Net unrealized losses related to pension benefits	(6,862)	—	(6,862)	(3,774)	—	(3,774)
Net income tax benefit related to items of other comprehensive income (loss)	24,659	—	24,659	24,295	—	24,295
Total other comprehensive loss	(37,801)	—	(37,801)	(37,150)	—	(37,150)
Total comprehensive income	63,403	9,906	73,309	25,915	9,301	35,216
Dividends on common stock	(156,300)	—	(156,300)	(85,000)	—	(85,000)
Equity infusion	252,833	—	252,833	4,503	—	4,503
Other	1	(3,286)	(3,285)	—	(3,393)	(3,393)
Ending balance, June 30	<u>\$ 3,605,292</u>	<u>\$ 88,944</u>	<u>\$3,694,236</u>	<u>\$ 3,284,568</u>	<u>\$ 83,509</u>	<u>\$3,368,077</u>

- (a) These amounts primarily include unrealized gains and losses on contracts used to hedge our forecasted electricity and natural gas requirements to serve Native Load. These changes are primarily due to changes in forward natural gas prices and wholesale electricity prices.
- (b) These amounts primarily include the reclassification of unrealized gains and losses to realized gains and losses for contracted commodities delivered during the period.

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

S-2. Other Income and Other Expense

The following table provides detail of APS' other income and other expense for the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Other income:				
Interest income	\$ 143	\$ 159	\$ 211	\$ 342
Investment gains — net	—	3,062	—	1,739
Miscellaneous	1,684	1,737	2,234	1,969
Total other income	<u>\$ 1,827</u>	<u>\$ 4,958</u>	<u>\$ 2,445</u>	<u>\$ 4,050</u>
Other expense:				
Non-operating costs (a)	\$ (1,751)	\$ (3,177)	\$ (3,708)	\$ (4,512)
Investment losses — net	(2,700)	—	(1,535)	—
Miscellaneous	(1,640)	(1,796)	(3,309)	(3,496)
Total other expense	<u>\$ (6,091)</u>	<u>\$ (4,973)</u>	<u>\$ (8,552)</u>	<u>\$ (8,008)</u>

(a) As defined by the FERC, includes below-the-line non-operating utility income and expense (items excluded from utility rate recovery).

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The following discussion should be read in conjunction with Pinnacle West's Condensed Consolidated Financial Statements and Arizona Public Service Company's Condensed Consolidated Financial Statements and the related Notes that appear in Item 1 of this report. For purposes of this report, a "Note" refers to a Note to Pinnacle West's Condensed Consolidated Financial Statements in Item 1 of this report. For information on the broad factors that may cause our actual future results to differ from those we currently seek or anticipate, see "Forward-Looking Statements" at the front of this report and "Risk Factors" in Item 1A of the 2009 Form 10-K.

OVERVIEW

Pinnacle West owns all of the outstanding common stock of APS. APS is a vertically-integrated electric utility that provides retail and wholesale electric service to most of the state of Arizona, with the major exceptions of about one-half of the Phoenix metropolitan area, the Tucson metropolitan area and Mohave County in northwestern Arizona. APS accounts for substantially all of our revenues and earnings, and is expected to continue to do so.

Areas of Business Focus

Nuclear. APS operates and is a joint-owner of the Palo Verde Nuclear Generating Station. With a focus on safely and efficiently generating electricity for the long-term, APS applied for twenty-year renewals of its operating licenses for each of the three Palo Verde units, and is making preparations to secure necessary resources to operate the plant during this extended period of time.

Coal and Related Environmental Matters. APS is a joint-owner of three coal-fired power plants and acts as operating agent for two of the plants. APS is focused on the impacts on its coal fleet that may result from potential legislation and increased regulation concerning greenhouse gas emissions. Recent concern over climate change and other emission-related issues could have a significant impact on APS' capital expenditures and operating costs in the form of taxes, emissions allowances or required equipment upgrades for these plants. APS is closely monitoring its long range capital management plans, understanding that the resulting legislation and regulation could impact the economic viability of certain plants, as well as the willingness or ability of power plant participants to fund any such equipment upgrades. In particular, Southern California Edison, a participant in the Four Corners Power Plant ("Four Corners"), has indicated that certain California legislation may prohibit it from making emission control expenditures at the plant.

Transmission and Delivery. APS' 2010 transmission plan projects that it will invest approximately \$520 million in new transmission over the next ten years, which includes 270 miles of new lines. APS is working closely with regulators to identify and plan for transmission needs resulting from the current focus on renewable energy. APS is also working to establish and expand smart grid technology throughout its service territory designed to provide a variety of benefits both to APS and its customers. This technology is designed to allow customers to better monitor their energy use and needs, minimize system outage durations and the number of customers that experience outages, and facilitate cost savings to APS through improved reliability and the automation of certain distribution functions, including remote meter reading and remote connects and disconnects.

Renewable Energy. APS is committed to increasing the amount of energy produced by renewable energy resources. The ACC adopted a renewable energy standard several years ago, recognizing the importance of renewable energy to our state. In the Settlement Agreement for the 2008 general retail rate case, APS agreed to exceed these standards, committing that approximately 10% of APS' energy will come from renewable resources by the year 2015. A variety of other provisions in the Settlement Agreement reinforce APS' dedication to renewable energy through initiatives such as building photovoltaic solar plants, installing solar rooftop panels on schools and government buildings and seeking an Arizona wind generation project.

On March 3, 2010, the ACC approved the AZ Sun Program, under which APS plans to own 100 MW of photovoltaic power plants across Arizona by investing up to \$500 million through 2014. APS expects to acquire these resources through competitive procurement processes, with projects being placed into service in the 2011 to 2014 timeframe. The ultimate timing depends on the outcome of current and future procurement processes. See Note 3 for additional details of this program, including the related cost recovery.

In the first half of 2010, APS issued three requests for proposals ("RFPs") for renewable resources. These RFPs are part of the process for procuring the additional renewable resources required under the rate case settlement. The first RFP is for wind projects between 15 and 100 MW to be located within Arizona. As a result of this RFP, on July 22, 2010, APS signed a long-term power purchase agreement for all of the energy from a 99 MW wind farm to be located near Williams, Arizona. This energy will help APS meet the ACC-mandated Renewable Energy Standard, as well as the Arizona-based wind provision included in APS' rate case settlement. The agreement is subject to various conditions, including ACC approval of the agreement and successful siting, permitting and interconnection of the project to the state's electric grid. If these conditions are met, commercial operation is expected in late 2011 or 2012.

The second RFP is for utility-scale solar photovoltaic projects between 15 and 50 MW. This RFP serves as the first procurement step for implementing the AZ Sun Program. APS is currently in formal negotiations regarding this RFP. The third RFP, the 2010 Small Generation RFP, serves as the first in a series of solicitations that will define APS' Small Generation Program. This program will focus on renewable projects between 2 and 15 MW.

Energy Efficiency. Arizona regulators are placing an increased focus on energy efficiency and demand side management programs to encourage customers to conserve energy, while incentivizing utilities to aid in these efforts that ultimately reduce the demand for energy. In December 2009, the ACC initiated Energy Efficiency rulemaking, with a proposed Energy Efficiency Standard of 22% annual energy savings by 2020. The 22% figure represents the cumulative reduction in future energy usage through 2020 attributable to energy efficiency initiatives. On July 27, 2010, the proposed Energy Efficiency Standard was approved by the ACC subject to review and approval by the Arizona Attorney General, which should be completed before the end of 2010. An ambitious standard, such as that approved by the ACC, will increase participation by APS customers in these conservation and energy efficiency programs, which in turn will impact Arizona's future energy resource needs.

Rate Matters. APS needs timely recovery through rates of its capital and operating expenditures to maintain adequate financial health. APS' retail rates are regulated by the ACC and its wholesale electric rates (primarily for transmission) are regulated by the FERC. At the end of 2009, the ACC approved a settlement agreement entered into by APS and twenty-one of the twenty-three other parties to APS' general retail rate case, with modifications that did not materially affect the overall economic terms of the agreement. The rate case settlement should strengthen APS' financial condition by allowing for rate stability and a greater level of cost recovery and return on investment. It also authorizes and requires equity infusions into APS of at least \$700 million prior to the end of 2014 (\$253 million of which was infused into APS from proceeds of a Pinnacle West equity issuance in the second quarter of 2010 (see Note 2)). The settlement demonstrates cooperation among APS, the ACC staff, the Residential Utility Consumer Office and other intervenors to the rate case, and establishes a future rate case filing plan that allows APS the opportunity to help shape Arizona's energy future outside of continual rate cases. See Note 3 for a discussion of the Settlement Agreement terms and information on APS' FERC rates.

APS has several recovery mechanisms in place that provide more timely recovery to APS of its fuel and transmission costs, and costs associated with the promotion and implementation of its energy efficiency, demand-side management and renewable energy efforts and customer programs. These mechanisms are described more fully in Note 3.

Financial Strength and Flexibility. Pinnacle West and APS currently have ample borrowing capacity under their respective credit facilities and have been able to access these facilities as well as the commercial paper market, ensuring adequate liquidity for each company. In early February 2010, APS entered into a \$500 million revolving credit facility, replacing its \$377 million facility that would have otherwise terminated in December 2010. At that same time, Pinnacle West entered into a \$200 million revolving credit facility that replaced its \$283 million facility that also would have otherwise terminated in December 2010. Since March 2010, Pinnacle West and APS have accessed the commercial paper markets, which neither company had utilized since the third quarter of 2008 due to negative market conditions.

In April 2010, Pinnacle West issued 6,900,000 shares of common stock at an offering price of \$38.00 per share, resulting in net proceeds of approximately \$253 million. Pinnacle West contributed all of the net proceeds from this offering into APS in the form of equity infusions. APS has used these capital contributions to repay short-term indebtedness, to finance capital expenditures and for other general corporate purposes.

SunCor Real Estate Operations. As a result of the distressed conditions in the real estate markets, during 2009 SunCor undertook a program to dispose of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce its outstanding debt. In July, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. In connection with this sale, SunCor negotiated a restructuring of certain of its credit facilities, including its principal loan facility. The debt restructuring resulted in an after-tax gain of approximately \$9 million, which will be recognized in the third quarter of 2010. At June 30, 2010, SunCor had approximately \$103 million of assets on its balance sheet classified as assets held for sale. These assets consisted of the \$70 million of assets sold in July as discussed above, \$25 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet. See "Pinnacle West Consolidated — Liquidity and Capital Resources — Other Subsidiaries — SunCor" below for a discussion of SunCor's outstanding debt and related matters and Note 16 for a discussion of related impairment charges.

District Cooling Business Sale. On June 22, 2010, our subsidiary, APSES, sold its district cooling business consisting of operations in downtown Phoenix, Tucson, and on certain Arizona State University campuses. The sale resulted in an after-tax gain of approximately \$25 million. Following this sale, APSES plans to focus on its core business of energy conservation and renewable energy contracting services.

Other Subsidiary Matters. The operations of APSES and our other first tier subsidiary, El Dorado, are not expected to have any material impact on our financial results, or to require any material amounts of capital, over the next three years.

Key Financial Drivers

In addition to the continuing impact of the matters described above, many factors influence our financial results and our future financial outlook, including those listed below. We closely monitor these factors to plan for the Company's current needs, and to adjust our expectations, financial budgets and forecasts appropriately.

Regulated Electricity Segment Revenues. For the years 2007 through 2009, retail electric revenues comprised approximately 94% of our total electric operating revenues. Our electric operating revenues are affected by customer growth, variations in weather from period to period, customer mix, average usage per customer and the impacts of energy efficiency programs, electricity rates and tariffs, the recovery of PSA deferrals and the operation of other recovery mechanisms. Off-system sales of excess generation output, purchased power and natural gas are included in regulated electricity segment revenues and related fuel and purchased power because they are credited to APS' retail customers through the PSA. These revenue transactions are affected by the availability of excess generation or other energy resources and wholesale market conditions, including competition, demand and prices.

Customer and Sales Growth. Customer growth in APS' service territory for the six-month period ended June 30, 2010 was 0.6% compared with the prior year period. For the three years 2007 through 2009, APS' customer growth averaged 1.8% per year. We currently expect annual customer growth to average about 1% for 2010 through 2012 due to economic conditions both nationally and in Arizona. Retail sales in kilowatt-hours, adjusted to exclude the effects of weather variations, for the six-month period ended June 30, 2010 declined 0.4% compared to the same period in the prior year, reflecting the poor economic conditions and the effects of our energy efficiency programs. For the three years 2007 through 2009, APS' actual retail electricity sales in kilowatt-hours, adjusted to exclude the effects of weather variations, grew at an average annual rate of 0.2%. We currently estimate that total annual retail electricity sales in kilowatt-hours will remain flat on average during 2010 through 2012, including the effects of APS' energy efficiency programs, but excluding the effects of weather variations. A continuation of the economic downturn, or the failure of the Arizona economy to rebound in the near future, could further impact these estimates. The customer and sales growth referred to in this paragraph apply to Native Load customers.

Actual sales growth, excluding weather-related variations, may differ from our projections as a result of numerous factors, such as economic conditions, customer growth, usage patterns, impacts of energy efficiency programs and responses to retail price changes. Our experience indicates that a reasonable range of variation in our kilowatt-hour sales projection attributable to such economic factors under normal business conditions can result in increases or decreases in annual net income of up to \$10 million.

Weather. In forecasting the retail sales growth numbers provided above, we assume normal weather patterns based on historical data. Historical extreme weather variations have resulted in annual variations in net income in excess of \$20 million. However, our experience indicates that the more typical variations from normal weather can result in increases or decreases in annual net income of up to \$10 million.

Fuel and Purchased Power Costs. Fuel and purchased power costs included on our Condensed Consolidated Statements of Income are impacted by our electricity sales volumes, existing contracts for purchased power and generation fuel, our power plant performance, transmission availability or constraints, prevailing market prices, new generating plants being placed in service in our market areas, our hedging program for managing such costs and PSA deferrals and the related amortization.

Operations and Maintenance Expenses. Operations and maintenance expenses are impacted by growth, power plant operations, maintenance of utility plant (including generation, transmission, and distribution facilities), inflation, outages, higher-trending pension and other postretirement benefit costs, renewable energy and demand side management related expenses (which are offset by the same amount of regulated electricity segment operating revenues) and other factors. In its retail rate case settlement, APS committed to operational expense reductions from 2010 through 2014 and received approval to defer certain pension and other postretirement benefit cost increases to be incurred in 2011 and 2012.

Depreciation and Amortization Expenses. Depreciation and amortization expenses are impacted by net additions to utility plant and other property (such as new generation, transmission, and distribution facilities), and changes in depreciation and amortization rates. The “Capital Expenditures” section below provides information regarding the planned additions to our facilities. We have also applied to the NRC for renewed operating licenses for each of the Palo Verde units. If the NRC grants the extension, we estimate that our annual pretax depreciation expense will decrease by approximately \$34 million at the later of the license extension date or January 1, 2012.

Property Taxes. Taxes other than income taxes consist primarily of property taxes, which are affected by the value of property in-service and under construction, assessment ratios, and tax rates. The average property tax rate for APS, which currently owns the majority of our property, was 7.5% of the assessed value for 2009 and 7.8% of the assessed value for 2008. We expect property taxes to increase as we add new utility plant (including new generation, transmission and distribution facilities described below under “Capital Additions”) and as we improve our existing facilities.

Income Taxes. Income taxes are affected by the amount of pre-tax book income, income tax rates, and certain non-taxable items, such as the allowance for equity funds used during construction. In addition, income taxes may also be affected by the settlement of issues with taxing authorities.

Interest Expense. Interest expense is affected by the amount of debt outstanding and the interest rates on that debt (see Note 2.) The primary factors affecting borrowing levels are expected to be our capital expenditures, long-term debt maturities, and internally generated cash flow. An allowance for borrowed funds offsets a portion of interest expense while capital projects are under construction. We stop accruing the allowance for borrowed funds on a project when it is placed in commercial operation.

PINNACLE WEST CONSOLIDATED — RESULTS OF OPERATIONS

Our results of operations, provided below, are based upon our two reportable business segments:

- our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily retail and wholesale sales supplied to traditional cost-based rate regulation (“Native Load”) customers) and related activities and includes electricity generation, transmission and distribution; and
- our real estate segment, which consists of SunCor’s real estate development and investment activities. As of June 30, 2010, all of SunCor’s operations have been reclassified to discontinued operations (see Notes 5 and 14). The real estate segment activities are presented separately in the period-over-period discussions that follow.

Operating Results — Three-month period ended June 30, 2010 compared with three-month period ended June 30, 2009

Our consolidated net income attributable to common shareholders for the three months ended June 30, 2010 was \$115 million, compared with net income of \$68 million for the comparable prior-year period. The improved results reflect an increase of approximately \$10 million in regulated electricity segment net income primarily due to increased revenues related to APS’ retail rate increases and other factors, partially offset by milder weather in 2010.

In addition, our consolidated results for 2010 include a gain of \$25 million after income taxes related to the sale of APSES’ district cooling business.

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The following table presents net income attributable to common shareholders by business segment compared with the prior-year period:

	Three Months Ended June 30,		Increase (Decrease) in Net Income Attributable to Common Shareholders
	2010	2009	
(dollars in millions)			
Regulated Electricity Segment:			
Operating revenues less fuel and purchased power expenses	\$ 548	\$ 521	\$ 27
Operations and maintenance	(213)	(213)	—
Depreciation and amortization	(103)	(101)	(2)
Taxes other than income taxes	(32)	(33)	1
Other income (expenses), net	(3)	3	(6)
Interest charges, net of capitalized financing costs	(53)	(52)	(1)
Income taxes	(51)	(42)	(9)
Noncontrolling interests (Note 7)	(5)	(5)	—
Regulated electricity segment net income	<u>88</u>	<u>78</u>	<u>10</u>
All Other (a)	<u>2</u>	<u>(2)</u>	<u>4</u>
Income from Continuing Operations Attributable to Common Shareholders	<u>90</u>	<u>76</u>	<u>14</u>
Real Estate Segment:			
Real estate impairment charges (Note 16)	(2)	(6)	4
Other real estate operations	—	(9)	9
Income taxes	<u>1</u>	<u>6</u>	<u>(5)</u>
Real estate segment net loss	<u>(1)</u>	<u>(9)</u>	<u>8</u>
All other (a)	<u>26</u>	<u>1</u>	<u>25</u>
Income (Loss) from Discontinued Operations Attributable to Common Shareholders	<u>25</u>	<u>(8)</u>	<u>33</u>
Net Income Attributable to Common Shareholders	<u>\$ 115</u>	<u>\$ 68</u>	<u>\$ 47</u>

(a) Includes activities related to APSES and El Dorado. None of the activities of either of these companies constitutes a reportable segment. Income from discontinued operations for the period ended June 30, 2010 includes a gain of \$25 million after income taxes related to the sale of APSES' district cooling business.

Regulated electricity segment

This section includes a discussion of major variances in income and expense amounts for the regulated electricity segment.

Operating revenues less fuel and purchased power expenses

Regulated electricity segment operating revenues less fuel and purchased power expenses were \$27 million higher for the three months ended June 30, 2010 compared with the prior-year period. The following table describes the major components of this change:

	Increase (Decrease)		
Operating revenues	Purchased power and fuel expenses		Net change
	(dollars in millions)		
Retail regulatory settlement effective January 1, 2010:			
Retail base rate increases, net of deferrals	\$ 68	\$ 31	\$ 37
Line extension revenues (Note 3)	4		4
Transmission rate increases	5		5
Higher demand-side management and renewable energy surcharges (substantially offset in operations and maintenance expense)	8		8
Lower retail revenues related to recovery of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(67)	(68)	1
Effects of weather on retail sales, primarily due to milder weather in 2010	(39)	(12)	(27)
Miscellaneous items, net	8	9	(1)
Total	<u>\$ (13)</u>	<u>\$ (40)</u>	<u>\$ 27</u>

Operations and maintenance Operations and maintenance expense variances for the three months ended June 30, 2010 compared with the prior-year period include:

- An increase of \$7 million related to demand-side management and renewable energy programs, which are primarily offset in operating revenues; and
- A decrease of \$7 million due to miscellaneous adjustments related primarily to employee benefits.

Other income (expenses), net Other income (expenses), net, decreased earnings by \$7 million for the three months ended June 30, 2010 compared with the prior-year period primarily due to net investment losses related to certain nonqualified employee benefit plans. Other income (expenses), net, is comprised of the regulated electricity segment portions of the line items other income and other expense from the Condensed Consolidated Statements of Income.

Income taxes Income taxes were \$9 million higher for the three months ended June 30, 2010 compared with the prior-year period primarily because of higher pretax income in the current-year period.

Real estate segment

As of June 30, 2010, all of SunCor's operations have been reclassified to discontinued operations. The real estate segment net loss attributable to common shareholders was \$8 million lower for the three months ended June 30, 2010 compared with the prior-year period primarily because of:

- A decrease in real estate impairment charges of \$4 million;
- A decrease in the loss from other real estate operations of \$9 million; and
- A decrease in income tax benefits of \$5 million primarily because of a lower net loss for the 2010 period.

All Other

All other earnings from discontinued operations were \$25 million higher for the three months ended June 30, 2010 compared to the prior-year period primarily because of a gain of \$25 million after income taxes related to the sale of APSES' district cooling business in 2010.

Operating Results — Six-month period ended June 30, 2010 compared with six-month period ended June 30, 2009

Our consolidated net income attributable to common shareholders for the six months ended June 30, 2010 was \$109 million, compared with a net loss of \$88 million for the comparable prior-year period. The improved results were primarily due to lower real estate impairment charges recorded in 2010 compared with the prior-year period by SunCor, the Company's real estate subsidiary.

In addition, regulated electricity segment net income increased approximately \$37 million from the prior-year period primarily due to increased revenues related to APS' retail rate increases and other factors, partially offset by milder weather in 2010. Our consolidated results for 2010 also include a gain of \$25 million after income taxes related to the sale of APSES' district cooling business.

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The following table presents net income (loss) attributable to common shareholders by business segment compared with the prior-year period:

	Six Months Ended June 30,		Increase (Decrease) in Net Income Attributable to Common Shareholders
	2010	2009	
(dollars in millions)			
Regulated Electricity Segment:			
Operating revenues less fuel and purchased power expenses	\$ 944	\$ 876	\$ 68
Operations and maintenance	(420)	(408)	(12)
Depreciation and amortization	(204)	(201)	(3)
Taxes other than income taxes	(63)	(67)	4
Other income (expenses), net	(5)	(1)	(4)
Interest charges, net of capitalized financing costs	(104)	(100)	(4)
Income taxes	(43)	(32)	(11)
Noncontrolling interests (Note 7)	(10)	(9)	(1)
Regulated electricity segment net income	<u>95</u>	<u>58</u>	<u>37</u>
All Other (a)	<u>2</u>	<u>(7)</u>	<u>9</u>
Income from Continuing Operations Attributable to Common Shareholders	<u>97</u>	<u>51</u>	<u>46</u>
Real Estate Segment:			
Real estate impairment charges (Note 16)	(17)	(208)	191
Other real estate operations	(7)	(23)	16
Income taxes	<u>9</u>	<u>91</u>	<u>(82)</u>
Real estate segment net loss	<u>(15)</u>	<u>(140)</u>	<u>125</u>
All other (a)	<u>27</u>	<u>1</u>	<u>26</u>
Income from Discontinued Operations Attributable to Common Shareholders	<u>12</u>	<u>(139)</u>	<u>151</u>
Net Income (Loss) Attributable to Common Shareholders	<u>\$ 109</u>	<u>\$ (88)</u>	<u>\$ 197</u>

- (a) Includes activities related to APSES and El Dorado. None of the activities of either of these companies constitutes a reportable segment. Income from discontinued operations for the period ended June 30, 2010 includes a gain of \$25 million after income taxes related to the sale of APSES' district cooling business.

Regulated electricity segment

This section includes a discussion of major variances in income and expense amounts for the regulated electricity segment.

Operating revenues less fuel and purchased power expenses

Regulated electricity segment operating revenues less fuel and purchased power expenses were \$68 million higher for the six months ended June 30, 2010 compared with the prior-year period. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating	Purchased	Net change
	revenues	power and fuel	
		expenses	
		(dollars in millions)	
Retail regulatory settlement effective January 1, 2010:			
Retail base rate increases, net of deferrals	\$ 119	\$ 57	\$ 62
Line extension revenues (Note 3)	8		8
Transmission rate increases	9		9
Higher demand-side management and renewable energy surcharges (substantially offset in operations and maintenance expense)	15		15
Lower retail revenues related to recovery of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(122)	(125)	3
Effects of weather on retail sales, primarily due to milder weather in the second quarter 2010	(33)	(10)	(23)
Miscellaneous items, net	—	6	(6)
Total	<u>\$ (4)</u>	<u>\$ (72)</u>	<u>\$ 68</u>

Operations and maintenance Operations and maintenance expenses increased \$12 million for the six months ended June 30, 2010 compared with the prior-year period primarily because of:

- An increase of \$13 million related to demand-side management and renewable energy programs, which are primarily offset in operating revenues;
- An increase of \$7 million related to customer service and other costs; and
- A decrease of \$8 million in generation costs, including timing of fossil-plant planned maintenance.

Income taxes Income taxes were \$11 million higher for the six months ended June 30, 2010 compared with the prior-year period primarily because of higher pretax income in the current-year period, partially offset by \$9 million related to a reduction in the Company's 2010 effective income tax rate. See Note 6.

All Other

All other earnings from continuing operations were \$9 million higher for the six months ended June 30, 2010 compared to the prior-year period primarily because of improved margins from APSES' products and services business and investment losses at El Dorado in 2009.

Real estate segment

During the first quarter of 2009, SunCor's Board of Directors authorized a series of strategic transactions to dispose of SunCor's assets. This decision resulted in impairment charges of approximately \$208 million pretax in the first six months of 2009. As of June 30, 2010, all of SunCor's operations have been reclassified to discontinued operations (see Note 2). The real estate segment net loss attributable to common shareholders was \$125 million lower for the six months ended June 30, 2010 compared with the prior-year period primarily because of:

- A decrease in real estate impairment charges of \$191 million;
- A decrease in the loss from other real estate operations of \$16 million; and
- A decrease in income tax benefits of \$82 million primarily because of a lower net loss for the 2010 period.

All Other

All other earnings from discontinued operations were \$26 million higher for the six months ended June 30, 2010 compared to the prior-year period primarily because of a gain of \$25 million after income taxes related to the sale of APSES' district cooling business in 2010.

PINNACLE WEST CONSOLIDATED — LIQUIDITY AND CAPITAL RESOURCES**Cash Flows**

The following table presents net cash provided by (used for) operating, investing and financing activities for the six months ended June 30, 2010 and 2009 (dollars in millions):

	Six Months Ended	
	June 30,	
	2010	2009
Net cash flow provided by operating activities	\$ 201	\$ 202
Net cash flow used for investing activities	(278)	(541)
Net cash flow provided by (used for) financing activities	(18)	251

The decrease of approximately \$1 million in net cash provided by operating activities is primarily due to a voluntary pension contribution in 2010 of approximately \$100 million partially offset by changes in working capital.

The decrease of approximately \$263 million in net cash used for investing activities is primarily due to the timing of APS' \$164 million of pollution control auction rate securities redemptions in 2009 (related to a corresponding amount in the financing activities' section) and approximately \$100 million of proceeds from the sale of the district cooling business in June 2010.

The decrease of approximately \$269 million in net cash provided by financing activities is primarily due to APS' issuance of \$500 million of unsecured senior notes in 2009 and APS' issuance of \$343 million of pollution control bonds in 2009 (a portion of which was used to redeem \$179 million of APS' existing pollution control bonds, with the remainder deposited in a restricted trust fund for redemption of auction rate securities in 2009, as noted above). This was partially offset by proceeds of approximately \$253 million from the issuance of equity in April 2010 and lower levels of repayment of short-term borrowings in 2010.

Liquidity

Capital Expenditure Requirements

The following table summarizes the actual capital expenditures for the six months ended June 30, 2009 and 2010 and the estimated capital expenditures for the next three years:

CAPITAL EXPENDITURES
(dollars in millions)

	Six Months Ended June 30,		Estimated for the Year Ended December 31,		
	2009	2010	2010	2011	2012
APS					
Generation:					
Nuclear Fuel	\$ 39	\$ 51	\$ 63	\$ 68	\$ 65
Renewables (a)	—	—	7	151	100
Environmental	28	2	20	80	220
Other Generation	64	71	178	147	134
Distribution	121	120	268	333	328
Transmission	93	61	142	160	192
Other (b)	15	26	77	60	49
Subtotal	360	331	755	999	1,088
Other	7	3	3	—	—
Total	\$ 367	\$ 334	\$ 758	\$ 999	\$ 1,088

- (a) Estimated 2010 capital expenditures are lower than the estimate in the 2009 Form 10-K, primarily due to the timing of renewable expenditures.
- (b) Primarily information systems and facilities projects.

Generation capital expenditures are comprised of various improvements to APS' existing fossil and nuclear plants. Examples of the types of projects included in this category are additions, upgrades and capital replacements of various power plant equipment, such as turbines, boilers and environmental equipment. We are also monitoring the status of certain environmental matters, which, depending on their final outcome, could require modification to our environmental expenditures. (See "Business of Arizona Public Service Company — Environmental Matters — EPA Environmental Regulation — Regional Haze Rules in Item 1 of the 2009 Form 10-K and "Environmental Matters — Mercury and Other Hazardous Air Pollutants" in Part II, Item 5 below.)

Distribution and transmission capital expenditures are comprised of infrastructure additions and upgrades, capital replacements, new customer construction, related information systems and facility costs. Examples of the types of projects included in the forecast include power lines, substations, line extensions to new residential and commercial developments and upgrades to customer information systems.

Capital expenditures will be funded with internally generated cash and external financings, which may include issuances of long-term debt and Pinnacle West common stock.

Pinnacle West (Parent Company)

Our primary cash needs are for dividends to our shareholders and principal and interest payments on our short-term and long-term debt. The level of our common stock dividends and future dividend growth will be dependent on a number of factors including, but not limited to, payout ratio trends, free cash flow and financial market conditions.

On June 22, 2010, the Pinnacle West Board of Directors declared a quarterly dividend of \$0.525 per share of common stock, payable on September 1, 2010, to shareholders of record on August 2, 2010.

An existing 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 common equity divided by the sum of common equity and long-term debt, including current maturities of long-term debt. At June 30, 2010, APS' common equity ratio, as defined, was 52%. Its total common equity was approximately \$3.6 billion, and total capitalization was approximately \$7.0 billion. APS would be prohibited from paying dividends if the payment would reduce its common equity below approximately \$2.8 billion, assuming APS' total capitalization remains the same.

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs. During the first quarter of 2010, Pinnacle West and APS refinanced existing credit facilities that would have otherwise matured in December 2010.

On February 12, 2010, Pinnacle West refinanced its \$283 million revolving credit facility that would have matured in December 2010, and decreased the size of the facility to \$200 million. The new facility matures in February 2013. 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. Pinnacle West will use the facility for general corporate purposes, commercial paper support and for the issuance of letters of credit. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings. As a result of the downsized credit facility, the Company also reduced the size of its commercial paper program to \$200 million from \$250 million.

At June 30, 2010, the \$200 million credit facility was available to support the issuance of up to \$200 million in commercial paper or for bank borrowings, including issuances of letters of credit up to \$100 million. At June 30, 2010, Pinnacle West had no outstanding borrowings under its revolving credit facility, no commercial paper borrowings and no outstanding letters of credit.

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In April 2010, Pinnacle West issued 6,900,000 shares of common stock at an offering price of \$38.00 per share, resulting in net proceeds of approximately \$253 million. Pinnacle West contributed all of the net proceeds from this offering into APS in the form of equity infusions. APS has used these contributions to repay short-term indebtedness to finance capital expenditures and for other general corporate purposes. Pinnacle West intends to issue equity to provide most of the funds for the equity infusions into APS required by the retail rate case settlement. Such equity issuances may occur at any time in the period through 2014, in Pinnacle West's discretion. See Note 3.

In June 2010, Pinnacle West received approximately \$100 million related to the sale of APSES' district cooling business. The net proceeds were used to repay short-term indebtedness.

Pinnacle West expects to receive approximately \$132 million of cash tax benefits related to SunCor's strategic asset sales (see Note 16), which will not be fully realized until all of the asset sales are completed. Approximately \$7 million of these benefits were recorded in the six months ended June 30, 2010 as reductions to income tax expense related to the current impairment charges. The additional \$125 million of tax benefits were recorded as reductions to income tax expense related to SunCor impairment charges recorded on or before December 31, 2009.

The \$65 million long-term income tax receivable on the Condensed Consolidated Balance Sheets represents the anticipated refunds related to an APS tax accounting method change approved by the IRS in the third quarter of 2009.

Pinnacle West sponsors a qualified defined benefit and account balance pension plan and a non-qualified supplemental excess benefit retirement plan for the employees of Pinnacle West and our subsidiaries. IRS regulations require us to contribute a minimum amount to the qualified plan. We contribute at least the minimum amount required under IRS regulations, but no more than the maximum tax-deductible amount. The minimum required funding takes into consideration the value of plan assets and our pension obligation. The assets in the plan are comprised of fixed-income, equity and short-term investments. Future year contribution amounts are dependent on plan asset performance and plan actuarial assumptions. We made no contribution to our pension plan in 2009. We currently estimate that our pension contributions could average around \$100 million for several years, assuming the discount rate remains at approximately current levels. During the first quarter of 2010, we made a voluntary contribution of approximately \$100 million to our pension plan. The contribution to our other postretirement benefit plans in 2010 is estimated to be approximately \$15 million. APS and other subsidiaries fund their share of the contributions. APS' share is approximately 98% of both plans.

APS

APS' capital requirements consist primarily of capital expenditures and maturities of long-term debt. APS funds its capital requirements with cash from operations and, to the extent necessary, equity infusions from Pinnacle West and external financings. See "Pinnacle West (Parent Company)" above for a discussion of the common equity ratio that APS must maintain in order to pay dividends to Pinnacle West.

On February 12, 2010, APS refinanced its \$377 million credit facility that would have matured in December 2010, and increased the size of the facility to \$500 million. The new credit facility terminates in February 2013. APS has the option to increase the amount of the facility up to a maximum of \$700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use the facility for general corporate purposes, commercial paper support and for the issuance of letters of credit. Interest rates are based on APS' senior unsecured debt credit ratings.

At June 30, 2010, APS had two credit facilities totaling \$989 million, including the \$500 million credit facility described above and a \$489 million facility that terminates in September 2011. These facilities are available either to support the issuance of up to \$250 million in commercial paper or for bank borrowings, including issuances of letters of credit up to \$739 million. At June 30, 2010, APS had no borrowings outstanding under any of its credit facilities and no outstanding commercial paper. A \$20 million letter of credit was issued under APS' \$489 million credit facility in the second quarter of 2010.

On July 13, 2010, APS changed the interest rate mode for the approximately \$33 million of Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Bonds (Arizona Public Service Company Navajo Project) 1994 Series A, due 2029. The rate period for the bonds changed from a daily-rate mode, supported by a letter of credit, to a three-year term rate mode that will bear interest at a rate of 3.625% per annum for three years. The letter of credit was terminated in connection with this change, and there is no bank or other third-party credit support for the bonds in the term rate mode.

On January 1, 2010, due to the adoption of amended accounting guidance relating to VIEs, APS began consolidating the Palo Verde Lessor Trusts (see Note 7) and, as a result of consolidation of these VIEs, APS has reported the Lessor Trusts' long-term debt on its Condensed Consolidated Balance Sheets. Interest rates on these debt instruments are 8% and are fixed for the remaining life of the debt. As of June 30, 2010 approximately \$30 million was classified as current maturities of long-term debt and \$113 million was classified as long-term debt relating to these VIEs. These debt instruments mature on December 30, 2015 and have sinking fund features that are serviced by the lease payments. See Note 7 for additional discussion of the VIEs.

Other Financing Matters — See Note 3 for information regarding the PSA approved by the ACC. Although APS defers actual retail fuel and purchased power costs on a current basis, APS' recovery of the deferrals from its ratepayers is subject to annual and, if necessary, periodic PSA adjustments.

See Note 3 for information regarding the retail rate case settlement, which includes ACC authorization and requires equity infusions into APS of at least \$700 million by December 31, 2014.

See Note 8 for information related to the change in our margin accounts.

Other Subsidiaries

SunCor — In July, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. In connection with this sale, SunCor negotiated a restructuring of certain of its credit facilities, including its principal loan facility. The debt restructuring resulted in an after-tax gain of approximately \$9 million, which will be recognized in the third quarter of 2010.

At June 30, 2010, SunCor had approximately \$103 million of assets on its balance sheet classified as assets held for sale. These assets consist of the \$70 million of assets sold in July as discussed above, \$25 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet.

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At June 30, 2010, SunCor had \$94 million outstanding debt under various credit facilities, all of which was in default. After the sale discussed above, \$6 million remains outstanding. Neither Pinnacle West nor any of its other subsidiaries has guaranteed any SunCor indebtedness. A SunCor debt default would not result in a cross-default of any of the debt of Pinnacle West or any of its other subsidiaries. While there can be no assurances as to the ultimate outcome of this matter, Pinnacle West does not believe that SunCor's inability to repay remaining debt outstanding would have a material adverse impact on Pinnacle West's cash flows or liquidity.

As of June 30, 2010, SunCor could not transfer any cash dividends to Pinnacle West. This restriction does not affect Pinnacle West's ability to meet its ongoing capital requirements.

El Dorado — El Dorado expects minimal capital requirements over the next three years and intends to focus on prudently realizing the value of its existing investments.

APSES — APSES expects minimal capital expenditures over the next three years.

Debt Provisions

Pinnacle West's and APS' debt covenants related to their respective bank financing arrangements include maximum debt to capitalization ratios. Certain of APS' bank financing arrangements also include an interest coverage test. Pinnacle West and APS comply with these covenants and each anticipates it will continue to meet these and other significant covenant requirements. For both Pinnacle West and APS, these covenants require that the ratio of consolidated debt to total consolidated capitalization not exceed 65%. At June 30, 2010, the ratio was approximately 51% for Pinnacle West and 50% for APS. The provisions regarding interest coverage require minimum cash coverage of two times the interest requirements. The interest coverage was approximately 4.4 times as of June 30, 2010. Failure to comply with such covenant levels would result in an event of default which, generally speaking, would require the immediate repayment of the debt subject to the covenants and could cross-default other debt. See further discussion of "cross-default" provisions below.

Neither Pinnacle West's nor APS' financing agreements contain "rating triggers" that would result in an acceleration of the required interest and principal payments in the event of a rating downgrade. However, our bank financial agreements contain a pricing grid in which the interest costs we pay for borrowings thereafter are determined by our current credit ratings.

All of Pinnacle West's loan agreements contain "cross-default" provisions that would result in defaults and the potential acceleration of payment under these loan agreements if Pinnacle West or APS were to default under certain other material agreements. All of APS' bank agreements contain cross-default provisions that would result in defaults and the potential acceleration of payment under these bank agreements if APS were to default under certain other material agreements. Pinnacle West and APS do not have a material adverse change restriction for credit facility borrowings.

See Note 2 for further discussions of liquidity matters.

Credit Ratings

The ratings of securities of Pinnacle West and APS as of August 2, 2010 are shown below. The ratings reflect the respective views of the rating agencies, from which an explanation of the significance of their ratings may be obtained. There is no assurance that these ratings will continue for any given period of time. The ratings may be revised or withdrawn entirely by the rating agencies if, in their respective judgments, circumstances so warrant. Any downward revision or withdrawal may adversely affect the market price of Pinnacle West's or APS' securities and serve to increase the cost of and limit access to capital. It may also require substantial additional cash or other collateral requirements related to certain derivative instruments, insurance policies, natural gas transportation, fuel supply, and other energy-related contracts. At this time, we believe we have sufficient liquidity to cover a downward revision to our credit ratings.

	<u>Moody's</u>	<u>Standard & Poor's</u>	<u>Fitch</u>
Pinnacle West			
Senior unsecured (a)	Baa3 (P)	BB+ (prelim)	N/A
Commercial paper	P-3	A-3	F3
Outlook	Stable	Positive	Stable
APS			
Senior unsecured	Baa2	BBB-	BBB
Secured lease obligation bonds	Baa2	BBB-	BBB
Commercial paper	P-2	A-3	F3
Outlook	Stable	Positive	Stable

- (a) Pinnacle West has a shelf registration under SEC Rule 415. Pinnacle West currently has no outstanding, rated senior unsecured securities. However, Moody's assigned a provisional (P) rating and Standard & Poor's assigned a preliminary (prelim) rating to the senior unsecured securities that can be issued under such shelf registration.

Off-Balance Sheet Arrangements

On January 1, 2010 we adopted amended accounting guidance relating to VIEs and, as a result, we have consolidated certain entities which were previously not consolidated. The consolidation of these entities has impacted our consolidated financial statement results. See Note 7 for a discussion of these impacts.

Guarantees and Letters of Credit

We have issued parental guarantees and obtained surety bonds on behalf of our subsidiaries including credit support instruments enabling APSES to offer energy-related products and surety bonds at APS, principally related to self-insured workers' compensation. Non-performance or non-payment under the underlying contract by our subsidiaries would result in a payment liability on our part under the guarantee or surety bond. No liability is currently recorded on the Condensed Consolidated Balance Sheets related to Pinnacle West's current outstanding guarantees and surety bonds on behalf of our subsidiaries. At June 30, 2010, we had no outstanding claims for payment under any of these guarantees. Our guarantees and surety bonds have no recourse or collateral provisions to allow us to recover amounts paid under the guarantees or surety bonds from our subsidiaries. We generally agree to indemnification provisions related to liabilities arising from or related to certain of our agreements, with limited exceptions depending on the particular agreement. See Note 12 for additional information regarding guarantees and letters of credit.

Contractual Obligations

Our future contractual obligations, including contingent obligations, related to purchased power and fuel contracts, have increased from approximately \$8.4 billion at December 31, 2009 to \$9.1 billion at June 30, 2010 as follows (dollars in billions):

<u>2010</u>	<u>2011-2012</u>	<u>2013-2014</u>	<u>Thereafter</u>	<u>Total</u>
\$ 0.6	\$ 0.7	\$ 1.0	\$ 6.8	\$ 9.1

These amounts have increased since the 2009 Form 10-K primarily due to increased solar contracts associated with meeting the Renewable Energy Standards.

See Note 2 for a list of payments due on total long-term debt and capitalized lease requirements.

CRITICAL ACCOUNTING POLICIES

In preparing the financial statements in accordance with GAAP, management must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex, and actual results could differ from those estimates. There have been no changes to our critical accounting policies since our 2009 Form 10-K. See "Critical Accounting Policies" in Item 7 of the 2009 Form 10-K for further details about our critical accounting policies.

OTHER ACCOUNTING MATTERS

On January 1, 2010 we adopted amended accounting guidance relating to VIEs, and as a result we have consolidated certain entities which were previously not consolidated. The consolidation of these entities has impacted our consolidated financial statement results. See Notes 1 and 7 for a discussion of these impacts.

MARKET AND CREDIT RISKS

Market Risks

Our operations include managing market risks related to changes in interest rates, commodity prices and investments held by our nuclear decommissioning trust fund.

Interest Rate and Equity Risk

We have exposure to changing interest rates. Changing interest rates will affect interest paid on variable-rate debt and the market value of fixed income securities held by our nuclear decommissioning trust fund (see Note 15). The nuclear decommissioning trust fund also has risks associated with the changing market value of its investments. Nuclear decommissioning costs are recovered in regulated electricity prices.

Commodity Price Risk

We are exposed to the impact of market fluctuations in the commodity price and transportation costs of electricity and natural gas. Our risk management committee, consisting of officers and key management personnel, oversees company-wide energy risk management activities to ensure compliance with our stated energy risk management policies. We manage risks associated with these market fluctuations by utilizing various commodity instruments that qualify as derivatives, including exchange-traded futures and options and over-the-counter forwards, options and swaps. As part of our risk management program, we use such instruments to hedge purchases and sales of electricity and fuels. The changes in market value of such contracts have a high correlation to price changes in the hedged commodities.

The following table shows the net pretax changes in mark-to-market of our derivative positions for the six months ended June 30, 2010 and 2009 (dollars in millions):

	Six Months Ended June 30,	
	2010	2009
Mark-to-market of net positions at beginning of period	\$ (169)	\$ (282)
Recognized in earnings:		
Change in mark-to-market losses for future period deliveries	(4)	(4)
Mark-to-market losses realized including ineffectiveness during the period	2	5
Increase in regulatory asset	(37)	—
Recognized in other comprehensive income (OCI):		
Change in mark-to-market losses for future period deliveries (a)	(100)	(133)
Mark-to-market losses realized during the period	42	73
Change in valuation techniques	—	—
Mark-to-market of net positions at end of period	<u>\$ (266)</u>	<u>\$ (341)</u>

(a) The changes in mark-to-market recorded in OCI are due primarily to changes in forward natural gas prices.

The table below shows the fair value of maturities of our derivative contracts (dollars in millions) at June 30, 2010 by maturities and by the type of valuation that is performed to calculate the fair values. See Note 1, "Derivative Accounting" and "Fair Value Measurements," in Item 8 of our 2009 Form 10-K and Note 15 for more discussion of our valuation methods.

Source of Fair Value	2010	2011	2012	2013	2014	Years thereafter	Total fair value
Prices actively quoted	\$ (1)	\$ (1)	\$ —	\$ —	\$ —	\$ —	\$ (2)
Prices provided by other external sources	(89)	(100)	(27)	(6)	—	—	(222)
Prices based on models and other valuation methods	(8)	(8)	(4)	(6)	(5)	(11)	(42)
Total by maturity	<u>\$ (98)</u>	<u>\$ (109)</u>	<u>\$ (31)</u>	<u>\$ (12)</u>	<u>\$ (5)</u>	<u>\$ (11)</u>	<u>\$ (266)</u>

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The table below shows the impact that hypothetical price movements of 10% would have on the market value of our risk management assets and liabilities included on Pinnacle West's Condensed Consolidated Balance Sheets at June 30, 2010 and December 31, 2009 (dollars in millions):

	June 30, 2010		December 31, 2009	
	Gain (Loss)		Gain (Loss)	
	Price Up 10%	Price Down 10%	Price Up 10%	Price Down 10%
Mark-to-market changes reported in:				
Earnings				
Electricity	\$ 1	\$ (1)	\$ 1	\$ (1)
Natural gas	1	(1)	1	(1)
Regulatory asset, liability or OCI (a)				
Electricity	21	(21)	21	(21)
Natural gas	48	(48)	59	(59)
Total	\$ 71	\$ (71)	\$ 82	\$ (82)

(a) These contracts are hedges of our forecasted purchases of natural gas and electricity. The impact of these hypothetical price movements would substantially offset the impact that these same price movements would have on the physical exposures being hedged. To the extent the amounts are eligible for inclusion in the PSA, the amounts are recorded as either a regulatory asset or liability.

Credit Risk

We are exposed to losses in the event of non-performance or non-payment by counterparties. See Note 15 — "Fair Value Measurements" for a discussion of our credit valuation adjustment policy. See Note 8 for a further discussion of credit risk.

ARIZONA PUBLIC SERVICE COMPANY — RESULTS OF OPERATIONS

Operating Results — Three-month period ended June 30, 2010 compared with three-month period ended June 30, 2009

APS' consolidated net income attributable to common shareholder for the three months ended June 30, 2010 was \$90 million, compared with net income of \$79 million for the comparable prior-year period. Net income increased approximately \$11 million from the prior-year period primarily due to increased revenues related to APS' retail rate increases and other factors, partially offset by milder weather in 2010.

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The following table presents net income attributable to common shareholder compared with the prior-year period:

	Three Months Ended June 30,		Increase (Decrease) in Net Income Attributable to Common Shareholder
	2010	2009	
	(dollars in millions)		
Operating revenues less fuel and purchased power expenses	\$ 548	\$ 521	\$ 27
Operations and maintenance	(211)	(211)	—
Depreciation and amortization	(103)	(101)	(2)
Taxes other than income taxes	(32)	(33)	1
Other income (expenses), net	(4)	—	(4)
Interest charges, net of capitalized financing costs	(49)	(48)	(1)
Income taxes	(54)	(44)	(10)
Noncontrolling interests (Note 7)	(5)	(5)	—
Net Income Attributable to Common Shareholder	\$ 90	\$ 79	\$ 11

Operating revenues less fuel and purchased power expenses

Electric operating revenues less fuel and purchased power expenses were \$27 million higher for the three months ended June 30, 2010 compared with the prior-year period. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating revenues	Purchased power and fuel expenses	Net change
	(dollars in millions)		
Retail regulatory settlement effective January 1, 2010:			
Retail base rate increases, net of deferrals	\$ 68	\$ 31	\$ 37
Line extension revenues (Note 3)	4		4
Transmission rate increases	5		5
Higher demand-side management and renewable energy surcharges (substantially offset in operations and maintenance expense)	8		8
Lower retail revenues related to recovery of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(67)	(68)	1
Effects of weather on retail sales, primarily due to milder weather in 2010	(39)	(12)	(27)
Miscellaneous items, net	8	9	(1)
Total	\$ (13)	\$ (40)	\$ 27

Operations and maintenance Operations and maintenance variances for the three months ended June 30, 2010 compared with the prior-year period primarily include:

- An increase of \$7 million related to demand-side management and renewable energy programs, which are primarily offset in operating revenues; and
- A decrease of \$7 million due to miscellaneous adjustments related primarily to employee benefits.

Other income (expenses), net Other income (expenses), net, decreased earnings by \$4 million for the three months ended June 30, 2010 compared with the prior-year period primarily due to net investment losses related to certain nonqualified employee benefit plans. Other income (expenses), net, is comprised of the line items other income and other expense from the Condensed Consolidated Statements of Income.

Income taxes Income taxes were \$10 million higher for the three months ended June 30, 2010 compared with the prior-year period primarily because of higher pretax income in the current-year period.

Operating Results — Six-month period ended June 30, 2010 compared with six-month period ended June 30, 2009

APS' consolidated net income attributable to common shareholder for the six months ended June 30, 2010 was \$101 million, compared with a net income of \$63 million for the comparable prior-year period.

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Net income increased approximately \$38 million from the prior-year period primarily due to increased revenues related to APS' retail rate increases and other factors, partially offset by milder weather in 2010.

The following table presents net income attributable to common shareholder compared with the prior-year period:

	Six Months Ended June 30,		Increase (Decrease) in Net Income Attributable to Common Shareholder
	2010	2009	
	(dollars in millions)		
Operating revenues less fuel and purchased power expenses	\$ 944	\$ 876	\$ 68
Operations and maintenance	(415)	(402)	(13)
Depreciation and amortization	(204)	(201)	(3)
Taxes other than income taxes	(63)	(66)	3
Other income (expenses), net	(6)	(4)	(2)
Interest charges, net of capitalized financing costs	(97)	(94)	(3)
Income taxes	(48)	(37)	(11)
Noncontrolling interests (Note 7)	(10)	(9)	(1)
Net Income Attributable to Common Shareholder	\$ 101	\$ 63	\$ 38

Operating revenues less fuel and purchased power expenses

Electric operating revenues less fuel and purchased power expenses were \$68 million higher for the six months ended June 30, 2010 compared with the prior-year period. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating revenues	Purchased power and fuel expenses	Net change
	(dollars in millions)		
Retail regulatory settlement effective January 1, 2010:			
Retail base rate increases, net of deferrals	\$ 119	\$ 57	\$ 62
Line extension revenues (Note 3)	8		8
Transmission rate increases	9		9
Higher demand-side management and renewable energy surcharges (substantially offset in operations and maintenance expense)	15		15
Lower retail revenues related to recovery of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(122)	(125)	3
Effects of weather on retail sales, primarily due to milder weather in the second quarter 2010	(33)	(10)	(23)
Miscellaneous items, net	—	6	(6)
Total	\$ (4)	\$ (72)	\$ 68

Operations and maintenance Operations and maintenance expenses increased \$13 million for the six months ended June 30, 2010 compared with the prior-year period primarily because of:

- An increase of \$13 million related to demand-side management and renewable energy programs, which are primarily offset in operating revenues;
- An increase of \$8 million related to customer service and other costs; and
- A decrease of \$8 million in generation costs, including timing of fossil-plant planned maintenance.

Income taxes Income taxes were \$11 million higher for the six months ended June 30, 2010 compared with the prior-year period primarily because of higher pretax income in the current-year period, partially offset by \$9 million related to a reduction in the Company's 2010 effective income tax rate. See Note 6.

ARIZONA PUBLIC SERVICE COMPANY — LIQUIDITY AND CAPITAL RESOURCES**Cash Flows**

The following table presents net cash provided by (used for) operating, investing and financing activities for the six months ended June 30, 2010 and 2009 (dollars in millions):

	Six Months Ended June 30,	
	2010	2009
Net cash flow provided by operating activities	\$ 154	\$ 217
Net cash flow used for investing activities	(380)	(536)
Net cash flow provided by financing activities	141	250

The decrease of approximately \$63 million in net cash provided by operating activities is primarily due to the payment of income taxes in 2010 and a voluntary pension contribution in 2010 of approximately \$100 million, partially offset by other changes in working capital.

The decrease of approximately \$156 million in net cash used for investing activities is primarily due to APS' timing of \$164 million of pollution control auction rate securities redemptions in 2009 (related to a corresponding amount in the financing activities' section).

The decrease of approximately \$109 million in net cash provided by financing activities is primarily due to APS' issuance of \$500 million of unsecured senior notes in 2009 and APS' issuance of \$343 million of pollution control bonds in 2009 (a portion of which was used to redeem \$179 million of APS' existing pollution control bonds, with the remainder deposited in a restricted trust fund for bond redemption of auction rate securities in 2009, as noted above). This was partially offset by the reduction of short-term borrowings in 2009 and proceeds of approximately \$253 million from the infusion of equity from Pinnacle West in 2010.

Contractual Obligations

APS' future contractual obligations, including contingent obligations, related to purchased power and fuel contracts have increased from approximately \$8.4 billion at December 31, 2009 to \$9.1 billion at June 30, 2010 as follows (dollars in billions):

2010	2011-2012	2013-2014	Thereafter	Total
\$ 0.6	\$ 0.7	\$ 1.0	\$ 6.8	\$ 9.1

These amounts have increased since the 2009 Form 10-K primarily due to increased solar contracts associated with meeting the Renewable Energy Standard.

See Note 2 for a list of payments due on total long-term debt and capitalized lease requirements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Key Financial Drivers” and “Market and Credit Risks” in Item 2 above for a discussion of quantitative and qualitative disclosures about market risks.

Item 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

The term “disclosure controls and procedures” means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) (15 U.S.C. 78a *et seq.*), is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Pinnacle West’s management, with the participation of Pinnacle West’s Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of Pinnacle West’s disclosure controls and procedures as of June 30, 2010. Based on that evaluation, Pinnacle West’s Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, Pinnacle West’s disclosure controls and procedures were effective.

APS’ management, with the participation of APS’ Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of APS’ disclosure controls and procedures as of June 30, 2010. Based on that evaluation, APS’ Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, APS’ disclosure controls and procedures were effective.

(b) Changes in Internal Control Over Financial Reporting

The term “internal control over financial reporting” (defined in SEC Rule 13a-15(f)) refers to the process of a company that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

No change in Pinnacle West’s or APS’ internal control over financial reporting occurred during the fiscal quarter ended June 30, 2010 that materially affected, or is reasonably likely to materially affect, Pinnacle West’s or APS’ internal control over financial reporting.

Part II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

See “Environmental Matters” in Item 5 below and in Part II, Item 5 of the Pinnacle West/APS Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 (“First Quarter 10-Q”) and “Business of Arizona Public Service Company — Environmental Matters” in Item 1 of the 2009 Form 10-K in regard to pending or threatened litigation or other disputes.

See Note 10 with regard to a lawsuit brought by APS on behalf of itself and the other Palo Verde owners against the DOE, for information relating to FERC proceedings on California and Pacific Northwest energy market issues and for information regarding bankruptcy proceedings involving the landlord for our corporate headquarters building.

Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. — Risk Factors in the 2009 Form 10-K, which could materially affect the business, financial condition, cash flows or future results of Pinnacle West and APS. The risks described in the 2009 Form 10-K are not the only risks facing Pinnacle West and APS. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect the business, financial condition, cash flows and/or operating results of Pinnacle West and APS.

Item 5. OTHER INFORMATION

Environmental Matters

Superfund

See “Superfund” in Note 10 for a discussion of a Superfund site.

Climate Change

See “Environmental Matters — Climate Change” in Part II, Item 5 of the First Quarter 10-Q for a discussion of recent climate change matters, including legislative and regulatory initiatives, regional initiatives, and the Company’s response to climate change initiatives. Updates to certain regulatory matters and climate change related lawsuits are discussed below.

Regulatory Initiative — EPA Endangerment Finding and Tailoring Rule. In December 2009, the EPA determined that greenhouse gas emissions endanger public health and welfare. This determination was made in response to a 2007 United States Supreme Court ruling that greenhouse gases fit within the Clean Air Act’s broad definition of “air pollutant” and, as a result, the EPA has the authority to regulate greenhouse gas emissions of new motor vehicles under the Clean Air Act. As a result of the endangerment finding, the EPA determined that the Clean Air Act required new regulatory requirements for new and modified major greenhouse gas emitting sources, including power plants. On June 3, 2010, the EPA issued a rule under the Clean Air Act, known as the “tailoring rule,” establishing new greenhouse gas emissions thresholds that determine when sources, including power plants, must obtain air operating permits or New Source Review permits. The tailoring rule became effective on August 2, 2010 and will apply to power plants starting January 1, 2011. Several groups have filed lawsuits challenging the EPA’s endangerment finding and the tailoring rule.

APS does not expect the tailoring rule to have a significant impact on its current operations. The rule will require APS to consider the impact of greenhouse gas emissions as part of its traditional New Source Review analysis for new sources and major modifications to existing plants. At the present time, APS cannot predict what other rules or regulations may ultimately result from the EPA's endangerment finding, whether the parties challenging the endangerment finding or the tailoring rule will be successful, and what impact other potential rules or regulations will have on APS' operations.

Climate Change Lawsuits. In February 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in federal court in the Northern District of California against nine oil companies, fourteen power companies (including Pinnacle West), and a coal company, alleging that the defendants' emissions of carbon dioxide contribute to global warming and constitute a public and private nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village and they are seeking an unspecified amount of monetary damages. In June 2008, the defendants filed motions to dismiss the action, which were granted. The plaintiffs filed an appeal with the court in November 2009 and Pinnacle West filed its reply on June 30, 2010. We believe the action is without merit and intend to continue to defend against the claims.

A similar nuisance lawsuit is currently pending in the 2nd Circuit and another such lawsuit was recently dismissed by the 5th Circuit on procedural grounds. These climate change lawsuits raise political and legal considerations, including whether the courts can or should be making climate change policy decisions. We are not a party to either of these two lawsuits, but will monitor these developments and their potential industry impacts.

Mercury and Other Hazardous Air Pollutants

In early 2008, the U.S. Court of Appeals for the D.C. Circuit vacated the Clean Air Mercury Rule ("CAMR"), which was adopted by the EPA to regulate mercury emissions from coal fired power plants. As a result, the law in effect prior to the adoption of the CAMR became the applicable law, and the EPA is now required to adopt final maximum achievable control technology emissions ("MACT") standards. Under a consent decree that was finalized on April 15, 2010, the EPA has agreed to issue final MACT standards for mercury and other hazardous air pollutants by November 2011. Under the terms of the consent decree, APS will have three years after the EPA issues its final rule to achieve compliance, which would likely require APS to install additional pollution control equipment.

APS has installed, and continues to install, certain of the equipment necessary to meet the anticipated standards. The estimated costs expected to be incurred over the next three years for such equipment are included in our environmental expenditure estimates (see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Pinnacle West Consolidated — Liquidity and Capital Resources — Capital Expenditure Requirements" in Item 2).

Federal Implementation Plan (“FIP”)

In September 1999, the EPA proposed FIPs to set air quality standards at certain power plants, including Four Corners and the Navajo Plant, which it later revised in 2006. The FIP for Four Corners was finalized in 2009 and the FIP for the Navajo Plant was finalized in April 2010. We do not believe compliance with the required limits established in either FIP will have a material adverse impact on our financial position, results of operations or cash flows.

Coal Combustion Waste

On June 21, 2010, the EPA released its proposed regulations governing the handling and disposal of coal combustion residuals (“CCRs”), such as fly ash and bottom ash. APS currently disposes of CCRs in ash ponds and dry storage areas at Cholla and Four Corners, and also sells a portion of its fly ash for beneficial reuse as a constituent in concrete production. The EPA proposes regulating CCRs as either non-hazardous waste or hazardous waste and is seeking comment on three different alternatives. The hazardous waste proposal would phase out the use of ash ponds for disposal of CCRs. The other two proposals regulate CCRs as non-hazardous waste and impose performance standards for ash disposal. One of these proposals would require retrofitting or closure of currently unlined ash ponds, while the other proposal would not require the installation of liners or pond closures. The EPA has not yet indicated a preference for any of the alternatives.

APS intends to file comments on the proposed rule during a 90-day comment period. We do not know when the EPA will issue a final rule, including required compliance dates. We cannot currently predict the outcome of the EPA’s actions or whether such actions will have a material adverse impact on our financial position, results of operations or cash flows.

Notice of Intent to Sue

As disclosed in the 2009 Form 10-K, on April 6, 2009, APS received a request from the EPA under Section 114 of the Clean Air Act for information regarding projects at and operations of Four Corners. This request was part of an EPA enforcement initiative under the New Source Review provisions of the Clean Air Act. APS responded to the request in August 2009. On May 7, 2010, APS received a Notice of Intent to Sue from Earthjustice, on behalf of several environmental organizations, related to alleged violations of the Clean Air Act at Four Corners (the “Notice”). The Notice alleges New Source Review-related violations and New Source Performance Standard violations. Under the Clean Air Act, a citizens group is required to provide 60 days advance notice of its intent to file a lawsuit. Within that 60-day time period, the EPA may step in and file a lawsuit regarding the allegations. If the EPA does so, the citizens group is precluded from filing its own lawsuit, but it may still intervene in the EPA’s lawsuit, if it so desires. The 60-day period lapsed in early July, and the EPA did not take any action. At this time, we cannot predict whether or when Earthjustice might file a lawsuit.

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(a) Exhibits

<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>
3.1	Pinnacle West	Pinnacle West Capital Corporation Bylaws, amended as of May 19, 2010
10.1	Pinnacle West	Form of Performance Share Agreement under the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan
10.2	Pinnacle West	Form of Restricted Stock Unit Agreement under the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan
12.1	Pinnacle West	Ratio of Earnings to Fixed Charges
12.2	APS	Ratio of Earnings to Fixed Charges
12.3	Pinnacle West	Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividend Requirements
31.1	Pinnacle West	Certificate of Donald E. Brandt, Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.2	Pinnacle West	Certificate of James R. Hatfield, Senior Vice President and Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.3	APS	Certificate of Donald E. Brandt, Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.4	APS	Certificate of James R. Hatfield, Senior Vice President and Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
32.1*	Pinnacle West	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>
32.2*	APS	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	Pinnacle West APS**	XBRL Instance Document
101.SCH*	Pinnacle West APS**	XBRL Taxonomy Extension Schema Document
101.CAL*	Pinnacle West APS**	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	Pinnacle West APS**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	Pinnacle West APS**	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	Pinnacle West APS**	XBRL Taxonomy Definition Linkbase Document

* Furnished herewith as an Exhibit.

** Furnished voluntarily.

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In addition, Pinnacle West hereby incorporates the following Exhibits pursuant to Exchange Act Rule 12b-32 and Regulation §229.10(d) by reference to the filings set forth below:

<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>	<i>Previously Filed as Exhibit¹</i>	<i>Date Filed</i>
3.2	Pinnacle West	Articles of Incorporation, restated as of May 21, 2008	3.1 to Pinnacle West/APS June 30, 2008 Form 10-Q Report, File Nos. 1-8962 and 1-4473	8-7-08
3.3	APS	Articles of Incorporation, restated as of May 25, 1988	4.2 to APS' Form S-3 Registration Nos. 33-33910 and 33-55248 by means of September 24, 1993 Form 8-K Report, File No. 1-4473	9-29-93
3.4	APS	Arizona Public Service Company Bylaws, amended as of December 16, 2008	3.4 to Pinnacle West/APS December 31, 2008 Form 10-K, File Nos. 1-8962 and 1-4473	2-20-09

¹ Reports filed under File Nos. 1-4473 and 1-8962 were filed in the office of the Securities and Exchange Commission located in Washington, D.C.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PINNACLE WEST CAPITAL CORPORATION
(Registrant)

Dated: August 3, 2010

By: /s/ James R. Hatfield
James R. Hatfield
Sr. Vice President and Chief Financial Officer
(Principal Financial Officer and
Officer Duly Authorized to sign this Report)

ARIZONA PUBLIC SERVICE COMPANY
(Registrant)

Dated: August 3, 2010

By: /s/ James R. Hatfield
James R. Hatfield
Sr. Vice President and Chief Financial Officer
(Principal Financial Officer and
Officer Duly Authorized to sign this Report)

BYLAWS
OF
PINNACLE WEST CAPITAL CORPORATION
(Amended as of May 19, 2010)

I. REFERENCES; SENIORITY

1.01. References. Any reference herein made to law will be deemed to refer to the law of the State of Arizona, including any applicable provision or provisions of Chapters 1-17 and Chapter 23 of Title 10, Arizona Revised Statutes (or its successor), as at any given time in effect. Any reference herein made to the Articles will be deemed to refer to the applicable provision or provisions of the Articles of Incorporation of the Company, and all amendments thereto, as at any given time on file with the Arizona Corporation Commission (this reference to that Commission being intended to include any successor to the incorporating and related functions being performed by that Commission at the date of the initial adoption of these Bylaws).

1.02. Seniority. Except as indicated in Part X of these Bylaws, the law and the Articles (in that order of precedence) will in all respects be considered senior and superior to these Bylaws, with any inconsistency to be resolved in favor of the law and the Articles (in that order of precedence), and with these Bylaws to be deemed automatically amended from time to time to eliminate any such inconsistency which may then exist.

1.03. Shareholders of Record. Except as otherwise required by law and subject to any procedure established by the Company pursuant to Arizona Revised Statutes Section 10-723 (or any comparable successor provision), the word "shareholder" as used herein shall mean one who is a holder of record of shares of capital stock in the Company.

II. SHAREHOLDERS MEETINGS

2.01. Annual Meetings. An annual meeting of shareholders shall be held for the election of directors at such date, time and place, either within or without the State of Arizona, as may be designated by resolution of the Board of Directors from time to time. Any other proper business may be transacted at the annual meeting. A special meeting may be called and held in lieu of an annual meeting pursuant to the provisions of Section 2.02 below, and the same proceedings (including the election of directors) may be conducted thereat as at a regular meeting. Any director elected at any annual meeting, or special meeting in lieu of an annual meeting, will continue in office until the election of his or her successor, subject to his or her (a) earlier resignation pursuant to Section 6.01 below, (b) removal pursuant to Section 3.13 below, or (c) death or disqualification.

2.02. Special Meetings.

(a) Except as otherwise required by law, special meetings of the shareholders may be held whenever and wherever called by the Chairman of the Board; the President; a majority of the Board of Directors; or shareholders as provided below. Subject to subsections (b) through (d) of this Section 2.02 and Section 2.05(b), a special meeting of shareholders shall be called by the Secretary upon the written request (a "Special Meeting Request") of shareholders who, as of the date of the Secretary's receipt of the Special Meeting Request, hold in the aggregate at least 25% (the "Requisite Percent") of the voting power of the outstanding capital stock of the Company entitled to vote on the matter or matters to be brought before the proposed special meeting (each, a "Requesting Shareholder" and, collectively, the "Requesting Shareholders"). A Requesting Shareholder may revoke the Requesting Shareholder's participation in a Special Meeting Request at any time by written revocation delivered to the Secretary and, if following such revocation, the remaining un-revoked requests are from Requesting Shareholders holding in the aggregate less than the Requisite Percent, the Board, in its discretion, may cancel the special meeting.

(b) The Secretary shall not be required to call a special meeting upon a shareholder request if (i) an annual or special meeting of shareholders that included an identical or substantially similar item of business, as determined in good faith by the Board of Directors ("Similar Business"), was held not more than ninety (90) days before the Special Meeting Request was received by the Secretary; (ii) the Board of Directors has called or calls for an annual or special meeting of shareholders to be held within ninety (90) days after the Secretary receives the Special Meeting Request and the Board of Directors determines in good faith that the business to be conducted at such meeting includes Similar Business (for purposes of this Section 2.02(b), the election of directors shall be deemed to be Similar Business with respect to all items of business involving the election or removal of directors, changing the size of the Board of Directors and the filling of vacancies and/or newly created directorships resulting from any increase in the authorized number of directors); (iii) the Special Meeting Request relates to an item of business that is not a proper subject for shareholder action under applicable law; or (iv) such Special Meeting Request was made in a manner that involved a violation of Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act") or other applicable law.

(c) A special meeting requested pursuant to a properly submitted Special Meeting Request shall be held at such date, time, and place within or without the State of Arizona as may be fixed by the Board of Directors; provided, however, that (1) the date of any such special meeting shall be not more than ninety (90) days after the Secretary's receipt of the properly submitted Special Meeting Request in the case of a Special Meeting Request relating to matters other than the election of directors and (2) as required by Article Fifth of the Articles, the date of any such special meeting shall be not more than one hundred and eighty (180) days after the Secretary's receipt of the properly submitted Special Meeting Request in the case of a Special Meeting Request relating to the election of directors.

(d) Business transacted at any special meeting requested by the shareholders shall be limited to the purpose(s) stated in the Special Meeting Request; provided, however, that the Board of Directors shall have the authority in its discretion to submit additional matters to the shareholders, and to cause other business to be transacted, at any special meeting of shareholders.

2.03. Notice. Notice of any meeting of the shareholders will be given as provided by law to each shareholder entitled to vote at such meeting and, if required by law, to each other shareholder of the Company. Any such notice may be waived as provided by law.

2.04. Right to Vote. For each meeting of the shareholders, the Board of Directors will fix in advance a record date as contemplated by law, and the shares of stock and the shareholders "entitled to vote" (as that or any similar term is herein used) at any meeting of the shareholders will be determined as of the applicable record date. The Secretary (or in his or her absence an Assistant Secretary) will see to the making and production of any record of shareholders entitled to vote or otherwise entitled to notice of shareholders meetings, in either case which is required by law. Any voting entitlement may be exercised through proxy, or in such other manner as specifically provided by law, in accordance with the applicable law. In the event of contest, the burden of proving the validity of any undated or irrevocable proxy will rest with the person seeking to exercise the same. A telegram, cablegram, or facsimile appearing to have been transmitted by a shareholder (or by his or her duly authorized attorney-in-fact) or other means of voting by telephone or electronic transmission may be accepted as a sufficiently written and executed proxy if otherwise permitted by law.

2.05. Notice of Shareholder Business and Nominations.

(a) Annual Meetings of Shareholders.

(1) Nominations of persons for election to the Board of Directors of the Company and the proposal of business to be considered by the shareholders may be made at an annual meeting of shareholders only (a) pursuant to the Company's notice of meeting (or any supplement thereto), (b) by or at the direction of the Board of Directors, or (c) by any shareholder of the Company who was a shareholder at the time the notice provided for in this Section 2.05 is delivered to the Secretary of the Company, who is entitled to vote at the meeting and who complies with the notice procedures set forth in this Section 2.05.

(2) For nominations or other business to be properly brought before an annual meeting by a shareholder pursuant to clause (c) of paragraph (a)(1) of this Section 2.05, the shareholder must have given timely notice thereof in writing to the Secretary of the Company and any such proposed business other than the nominations of persons for election to the Board of Directors must constitute a proper matter for shareholder action. To be timely, a shareholder notice shall be delivered to the Secretary at the principal executive offices of the Company not later than the close of business (a) with respect to business to be brought before the meeting, on the ninetieth (90th) day nor earlier than the close of business on the one hundred twentieth (120th) day prior to the first anniversary of the preceding year's annual meeting (provided, however, that in the event that the date of the annual meeting is changed by more than thirty (30) days from such anniversary date, notice by the shareholder must be so delivered not earlier than the close of business on the one hundred twentieth (120th) day prior to such annual meeting and not later than the close of business on the later of the ninetieth (90th) day prior to such annual meeting or the tenth (10th) day following the day on which public announcement of the date of such meeting is first made by the Company), and (b) with respect to nominations of persons to be elected to the Board of Directors, the one-hundred eightieth (180th) day prior to the date of the meeting at which the election is to occur. In no event shall the public announcement of an adjournment or postponement of an annual meeting commence a new time period (or extend any time period) for the giving of a shareholder's notice as described above.

(3) In addition to meeting the timely notice requirements of paragraph (a)(2) of this Section 2.05, in order for nominations or other business to be properly brought before an annual meeting by a shareholder pursuant to clause (c) of paragraph (a)(1) of this Section 2.05, such shareholder's notice shall set forth: (a) as to each person whom the shareholder proposes to nominate for election as a director, (i) all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to and in accordance with Regulation 14A under the Exchange Act, and (ii) such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (b) as to any other business that the shareholder proposes to bring before the meeting, a brief

description of the business desired to be brought before the meeting, the text of the proposal or business (including the text of any resolutions proposed for consideration and, in the event that such business includes a proposal to amend the Bylaws of the Company, the language for the proposed amendment), the reasons for conducting such business at the meeting, and any material interest in such business of such shareholder and the beneficial owner, if any, on whose behalf the proposal is made; and (c) as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, (i) the name and address of such shareholder, as they appear on the Company's books, and of such beneficial owner, (ii) the class and number of shares of capital stock of the Company that are owned beneficially and of record by such shareholder and such beneficial owner, (iii) a representation that the shareholder is a holder of record of stock of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to propose such business or nomination, and (iv) a representation whether the shareholder or the beneficial owner, if any, intends or is part of a group that intends (A) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding capital stock required to approve or adopt the proposal or elect the nominee and/or (B) otherwise to solicit proxies from shareholders in support of such proposal or nomination. The foregoing notice requirements of clauses (b) and (c) of paragraph (a)(3) of this Section 2.05 shall be deemed satisfied by a shareholder if the shareholder has notified the Company of his or her intention to present a proposal at an annual meeting in compliance with Rule 14a-8 (or any successor thereof) promulgated under the Exchange Act and such shareholder's proposal has been included in a proxy statement that has been prepared by the Company to solicit proxies for such annual meeting. The Company may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as a director of the Company.

(b) Special Meetings of Shareholders.

(1) Nominations of persons for election to the Board of Directors of the Company and the proposal of business to be considered by the shareholders may be made at a special meeting of shareholders only (a) pursuant to the Company's notice of meeting (or any supplement thereto), (b) by or at the direction of the Board of Directors, or (c) by Requesting Shareholders in compliance with Section 2.02 and this Section 2.05.

(2) For nominations or other business to be properly brought before a special meeting pursuant to clause (c) of paragraph (b)(1) of this Section 2.05, the Special Meeting Request must be signed and dated by each of the Requesting Shareholders (or their duly authorized agents) and delivered to the Secretary. The Special Meeting Request must be sent to the Secretary at the principal executive offices of the Company by registered mail, return receipt requested. The Special Meeting Request shall set forth: (a) as to each person proposed to be nominated for election as a director, (i) all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to and in accordance with Regulation 14A under the Exchange Act, and (ii) such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (b) as to any other business proposed to be brought before the meeting, a brief description of the business desired to be brought before the meeting, the text of the proposal or business (including the text of any resolutions proposed for consideration and, in the event that such business includes a proposal to amend the Bylaws of the Company, the language for the proposed amendment), the reasons for conducting such business at the meeting, and any material interest in such business of the Requesting Shareholder and the beneficial owner, if any, on whose behalf the proposal is made; and (c) as to each Requesting Shareholder and the beneficial owner, if any, on whose behalf the nomination or proposal is made, (i) the name and address of such Requesting Shareholder, as they appear on the Company's books, and of such beneficial owner, (ii) the class and number of shares of capital stock of the Company that are owned beneficially and of record by such Requesting Shareholder and such beneficial owner, (iii) a representation that the Requesting Shareholder is a holder of record of stock of the Company entitled to vote at such meeting (and intends to continue to be such a holder at the date of the meeting) and that at least one of the Requesting Shareholders (or a qualified representative of least one of the Requesting Shareholders) intends to appear in person or by proxy at the meeting to propose such business or nomination, (iv) a representation that the Requesting Shareholder owns the stock of the Company in compliance with applicable law, including without limitation, that the Requesting Shareholder has received all necessary regulatory approvals to own and/or vote (or direct the voting of) the stock of the Company, (v) an acknowledgment by the Requesting Shareholder that any disposition of shares of stock of the Company held of record by such Requesting Shareholder as of the date of delivery of the Special Meeting Request and prior to the date of the special meeting of shareholders requested by such Requesting Shareholder shall constitute a revocation of such request

with respect to such shares and if following such revocation, the remaining un-revoked requests are from Requesting Shareholders holding in the aggregate less than the Requisite Percent, the Board, in its discretion, may cancel the special meeting, and (vi) a representation whether the Requesting Shareholder or the beneficial owner, if any, intends or is part of a group that intends (A) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding capital stock required to approve or adopt the proposal or elect the nominee and/or (B) otherwise to solicit proxies from shareholders in support of such proposal or nomination. The Company may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as a director of the Company. This Section 2.05(b) is the exclusive means by which a shareholder may nominate persons for election to the Board of Directors and/or present other business at a special meeting of shareholders.

(c) General.

(1) Only such persons who are nominated in accordance with the procedures set forth in this Section 2.05 shall be eligible to be elected at an annual or special meeting of shareholders of the Company to serve as directors and only such business shall be conducted at a meeting of shareholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 2.05. Except as otherwise provided by law, the Chairman of the meeting shall have the power and duty (a) to determine whether a nomination or any business proposed to be brought before the meeting was made or proposed, as the case may be, in accordance with the procedures set forth in this Section 2.05 (including whether the shareholder or beneficial owner, if any, on whose behalf the nomination or proposal is made or solicited (or is part of a group that solicited) or did not so solicit, as the case may be, proxies in support of such shareholder's nominee or proposal in compliance with such shareholder's representation as required by clause (a)(2)(c)(iv) of this Section 2.05) and (b) if any proposed nomination or business was not made or proposed in compliance with this Section 2.05, to declare that such nomination shall be disregarded or that such proposed business shall not be transacted. Notwithstanding the foregoing provisions of this Section 2.05, (i) if the shareholder, including a Requesting Shareholder (or a qualified representative of the shareholder) does not appear at the annual or a special meeting of shareholders of the Company to present a nomination or business

such nomination shall be disregarded and such business shall not be transacted, notwithstanding that proxies in respect of such vote may have been received by the Company and (ii) if requested by the Chairman in the case of a special shareholders meeting, the Requesting Shareholders (or a qualified representative of the Requesting Shareholders) shall provide documentary evidence to the Company that the Requesting Shareholders have not made a disposition of shares of stock of the Company held of record by such Requesting Shareholders as of the date of delivery of the Special Meeting Request and prior to the date of the special meeting of shareholders requested by such Requesting Shareholders such that the remaining un-revoked requests as of the date of the special meeting are from Requesting Shareholders holding in the aggregate less than the Requisite Percent. For purposes of this Section 2.05, to be considered a qualified representative of the shareholder, a person must be authorized by a writing executed by such shareholder or an electronic transmission delivered by such shareholder to act for such shareholder as proxy at the meeting of shareholders and such person must produce such writing or electronic transmission, or a reliable reproduction of the writing or electronic transmission, at the meeting of shareholders.

(2) For purposes of this Section 2.05, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press, or comparable national news service or in a document publicly filed by the Company with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Exchange Act.

(3) Notwithstanding the foregoing provisions of this Section 2.05, a shareholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this Section 2.05. Nothing in this Section 2.05 shall be deemed to affect any rights (a) of shareholders to request inclusion of proposals in the Company's proxy statement pursuant to Rule 14a-8 of the Exchange Act or (b) of the holders of any series of Preferred Stock to elect directors pursuant to any applicable provisions of the Articles.

2.06. Right to Attend. Except only to the extent of persons designated by the Board of Directors or the Chairman of the meeting to assist in the conduct of the meeting (as referred to in Sections 2.08 and 2.09 below) and except as otherwise permitted by the Board or such Chairman, the persons entitled to attend any meeting of shareholders may be confined to (i) shareholders entitled to vote thereat and other shareholders entitled to notice of the meeting and (ii) the persons upon whom proxies valid for purposes of the meeting have been conferred or their duly appointed substitutes (if the related proxies confer a power of substitution); provided, however, that the Board of Directors or the Chairman of the meeting may establish rules limiting the number of persons referred to in clause (ii) as being entitled to attend on behalf of any shareholder so as to preclude such an excessively large representation of such shareholder at the meeting as, in the judgment of the Board or such Chairman, would be unfair to other shareholders represented at the meeting or be unduly disruptive of the orderly conduct of business at such meeting (whether such representation would result from fragmentation of the aggregate number of shares held by such shareholder for the purpose of conferring proxies, from the naming of an excessively large proxy delegation by such shareholder or from employment of any other device). A person otherwise entitled to attend any such meeting will cease to be so entitled if, in the judgment of the Chairman of the meeting, such person engages thereat in disorderly conduct impeding the proper conduct of the meeting in the interests of all shareholders as a group.

2.07. Quorum. Except as otherwise provided by law, the Articles or these Bylaws, at each meeting of shareholders the presence in person or by proxy of the holders of a majority in voting power of the outstanding shares of stock entitled to vote at the meeting shall be necessary and sufficient to constitute a quorum.

2.08. Election Inspectors. The Board of Directors, in advance of any shareholders meeting may appoint an election inspector or inspectors to act at such meeting (and any adjournment thereof). If an election inspector or inspectors are not so appointed, the Chairman of the meeting may or, upon the request of any person entitled to vote at the meeting will, make such appointment. If any person appointed as an inspector fails to appear or to act, a substitute may be appointed by the Chairman of the meeting. If appointed, the election inspector or inspectors (acting through a majority of them if there be more than one) will determine the number of shares outstanding, the authenticity, validity and effect of proxies, the credentials of persons purporting to be shareholders or persons named or referred to in proxies, and the number of shares represented at the meeting in person and by proxy; they will receive and count votes, ballots and consents and announce the results thereof; they will hear and determine all challenges and questions pertaining to proxies and voting; and, in general, they will perform such acts as may be proper to conduct elections and voting with complete fairness to all shareholders. No such election inspector need be a shareholder of the Company.

2.09. Organization and Conduct of Meetings. Each shareholders meeting will be called to order and thereafter chaired by the Chairman of the Board if there then is one; or, if not, or if the Chairman of the Board is absent or so requests, then by the President; or if both the Chairman of the Board and the President are unavailable, then by such other officer of the Company or such shareholder as may be appointed by the Board of Directors. The Secretary (or in his or her absence an Assistant Secretary) of the Company will act as secretary of each shareholders meeting; if neither the Secretary nor an Assistant Secretary is in attendance, the Chairman of the meeting may appoint any person (whether a shareholder or not) to act as secretary thereat. After calling a meeting to order, the Chairman thereof may require the registration of all shareholders intending to vote in person, and the filing of all proxies, with the election inspector or inspectors, if one or more have been appointed (or, if not, with the secretary of the meeting). After the announced time for such filing of proxies has ended, no further proxies or changes, substitutions or revocations of proxies will be accepted. If directors are to be elected, a tabulation of the proxies so filed will, if any person entitled to vote in such election so requests, be announced at the meeting (or adjournment thereof) prior to the closing of the election polls.

Absent a showing of bad faith on his or her part, the Chairman of a meeting will, among other things, have absolute authority to determine the order of business to be conducted at such meeting and to establish rules for, and appoint personnel to assist in, preserving the orderly conduct of the business of the meeting (including any informal, or question and answer, portions thereof). Rules, regulations or procedures regarding the conduct of the business of a meeting, whether adopted by the Board of Directors or prescribed by the Chairman of the meeting, may include, without limitation, the following: (i) the establishment of an agenda or order of business for the meeting; (ii) rules and procedures for maintaining order at the meeting and the safety of those present; (iii) limitations on attendance at or participation in the meeting to shareholders of record of the Company, their duly authorized and constituted proxies (subject to Section 2.06) or such other persons as the Chairman of the meeting shall determine; (iv) restrictions on entry to the meeting after the time fixed for the commencement thereof; and (v) limitations on the time allotted to questions or comments by participants. Unless and to the extent determined by the Board of Directors or the Chairman of the meeting, meetings of shareholders shall not be required to be held in accordance with the rules of parliamentary procedure. Any informational or other informal session of shareholders conducted under the auspices of the Company after the conclusion of or otherwise in conjunction with any formal business meeting of the shareholders will be chaired by the same person who chairs the formal meeting, and the foregoing authority on his or her part will extend to the conduct of such informal session.

2.10. Voting. The number of shares voted on any matter submitted to the shareholders which is required to constitute their action thereon or approval thereof will be determined in accordance with applicable law, the Articles, and these Bylaws, if applicable. No ballot or change of vote will be accepted after the polls have been declared closed following the ending of the announced time for voting.

2.11. Shareholder Approval or Ratification. The Board of Directors may submit any contract or act for approval or ratification at any duly constituted meeting of the shareholders, the notice of which either includes mention of the proposed submittal or is waived as provided in Section 2.03 above. Except as otherwise required by law (e.g., Arizona Revised Statutes Section 10-863), if any contract or act so submitted is approved or ratified by a majority of the votes cast thereon at such meeting, the same will be valid and as binding upon the Company and all of its shareholders as it would be if approved and ratified by each and every shareholder of the Company.

2.12. Control Share Act. The provisions of Section 10-2721 through and including Section 10-2727 of the Arizona Revised Statutes shall not apply to the Company.

2.13. Adjournments. Any meeting of shareholders, annual or special, may adjourn from time to time to reconvene at the same or some other place, and notice need not be given of any such adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting the Company may transact any business that might have been transacted at the original meeting. If the adjournment is for more than one hundred and twenty days, or if after the adjournment a new record date is fixed for the adjourned meeting, notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting.

III. BOARD OF DIRECTORS

3.01. Membership. The Board of Directors of the corporation shall consist of not less than nine (9) nor more than twenty-one (21) shareholders of the Company or of any parent corporation thereof. Each director shall be elected annually and hold office in the manner provided by law and in the Articles (Art. Fifth). The Board will have the exclusive power to increase or decrease its size within such limits. Any vacancy occurring in the Board, whether by reason of death, resignation, disqualification or otherwise, may be filled by the directors as contemplated by law and as provided in the Articles (Art. Fifth). Any such increase in the size of the Board, and the filling of any vacancy created thereby, will require action by a majority of the whole membership of the Board as comprised immediately before such increase.

3.02. Qualifications. In order to qualify as a director, a person must be the owner of one or more shares of the capital stock of the Company or of any parent corporation thereof at the time of assuming office (except as may otherwise be provided in these Bylaws or in the Articles) and for so long thereafter as such person remains in office. A person will cease to qualify as a director if he or she (i) is in good faith determined by a majority of the other directors then in office to be physically or mentally incapable of competent performance as a director for a period, starting with inception of the incapacity, that has extended or is likely to extend for more than six months or (ii) has failed to attend six successive regular meetings of the Board (as determined in accordance with Section 3.03 below) unless and to the extent such failure is waived by a majority of the other directors then in office; however, disqualification pursuant to clause (i) or (ii) of this sentence will not preclude the subsequent election or appointment of such person as a director by the shareholders or the Board if a majority of the directors in office immediately prior to the submission of such person for election or appointment shall determine that his or her prior incapacity or principal reason for prior non-attendance no longer exists. A person who has been a full-time employee of the Company within twelve months prior to the date of any election will not qualify for election as a director on that date unless he or she then remains a full-time employee of the Company or unless the Board of Directors specifically authorizes the election of such person. A person who has qualified by employment status for his or her most recent election as a director may serve throughout the term for which such person was elected, notwithstanding the cessation of full-time employment by the Company between the date of such election and the end of such term, subject, however, to his or her otherwise remaining qualified for such office.

3.03. Regular Meetings. A regular annual meeting of the directors is to be held as soon as practicable after the adjournment of each annual shareholders meeting either at the place of the shareholders meeting or at such other place as the directors elected at the shareholders meeting may have been informed of at or before the time of their election. Regular meetings, other than the annual ones, may be held at such intervals at such places and at such times as the Board of Directors may provide.

3.04. Special Meetings. Special meetings of the Board of Directors may be held whenever and wherever called for by the Chairman of the Board, the President or the number of directors which would be required to constitute a quorum.

3.05. Notice. No notice need be given of regular meetings of the Board of Directors. Notice of the time and place (but not necessarily the purpose or all of the purposes) of any special meeting will be given to each director in person or by telephone, or via mail, telegram, facsimile, or other electronic transmission addressed in the manner appearing on the Company's records. Notice to any director of any such special meeting will be deemed given sufficiently in advance when (i) if given by mail, the same is deposited in the United States mail at least four days before the meeting date, with postage thereon prepaid, (ii) if given by telegram, the same is delivered to the telegraph office for fast transmittal at least 48 hours prior to the convening of the meeting, (iii) if given by facsimile or other electronic transmission, the same is received by the director or an adult member of his or her office staff or household, at least 24 hours prior to the convening of the meeting, or (iv) if personally delivered or given by telephone, the same is handed, or the substance thereof is communicated over the telephone to the director or to an adult member of his or her office staff or household, at least 24 hours prior to the convening of the meeting. Any such notice may be waived as provided by law. No call or notice of a meeting of directors will be necessary if each of them waives the same in writing or by attendance. Any meeting, once properly called and noticed (or as to which call and notice have been waived as aforesaid) and at which a quorum is formed, may be adjourned to another time and place by a majority of those in attendance.

3.06. Quorum; Voting. A quorum for the transaction of business at any meeting or adjourned meeting of the directors will consist of a majority of those then in office. Any matter submitted to a meeting of the directors will be resolved by a majority of the votes cast thereon, except as otherwise required by these Bylaws (§§ 3.01 and 3.02 above and § 3.07 below), by law or by any applicable Article. Where action by a majority of the whole membership is required, such requirement will be deemed to relate to a majority of the directors in office at the time the action is taken. In computing any such majority, whether for purposes of determining the presence of a quorum or the adequacy of the vote on any proposed action, any unfilled vacancies at the time existing in the membership of the Board will be excluded from the computation.

3.07. Executive Committee. The Board of Directors may, by resolution adopted by a majority of the whole Board, name three or more of its members as an Executive Committee. Such Executive Committee will have and may exercise the powers of the Board of Directors in the management of the business and affairs of the Company while the Board is not in session, except only as precluded by law or where action other than by a majority of the votes cast is required by these Bylaws, or the law (all as referred to in Section 3.06 above), and subject to such limitations as may be included in any applicable resolution passed by a majority of the whole membership of the Board. A majority of those named to the Executive Committee will constitute a quorum.

3.08. Other Committees. The Board of Directors may designate one or more additional committees, each committee to consist of one or more of the directors of the Company. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. Any such committee, to the extent permitted by law and to the extent provided in the resolution of the Board of Directors, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Company, and may authorize the seal of the Company to be affixed to all papers that may require it.

3.09. Committee Functioning. Notice requirements and related waiver provisions for meetings of the Executive Committee and other committees of the Board will be the same as those set forth in Section 3.05 above for meetings of the Board of Directors. Except as provided in the next two succeeding sentences, a majority of those named to the Executive Committee or any other committee of the Board will constitute a quorum at any meeting thereof (with the effect of departure of committee members from a meeting and the computation of a majority of committee members to be in accordance with the applicable policies of Section 3.06 above), and any matter submitted to a meeting of any such committee will be resolved by a majority of the votes cast thereon. No distinction will be made among ex-officio or other members of any such committee for quorum, voting or other purposes, except that the membership of any committee (including the Executive Committee), in performing any function vested in it as herein contemplated, may be deemed to exclude any officer or employee of the Company, in either case, or other person having a direct or indirect personal interest in any proposed exercise of such function, whose exclusion for that purpose is deemed appropriate by a majority of the other members of such committee proposing to perform such function. All committees are to keep regular minutes of the transactions of their meetings.

3.10. Action by Telephone or Consent. Any meeting of the Board or any committee thereof may be held by conference telephone or similar communications equipment as permitted by law, in which case any required notice of such meeting may generally describe the arrangements (rather than the place) for the holding thereof, and all other provisions herein contained or referred to will apply to such meeting as though it were physically held at a single place. Action may also be taken by the Board or any committee thereof without a meeting if the members thereof consent in writing thereto as contemplated by law.

3.11. Presumption of Assent. A director of the Company who is present at a meeting of the Board of Directors, or of any committee when corporate action is taken is deemed to have assented to the action taken unless either (i) the director objects at the beginning of the meeting or promptly on the director's arrival to holding it or transacting business at the meeting; (ii) the director's dissent or abstention from the action taken is entered in the minutes of the meeting; or (iii) the director delivers written notice of the director's dissent or abstention to the presiding officer of the meeting before its adjournment or to the Company before 5:00 P.M. on the next business day after the meeting. The right of dissent or abstention is not available to a director who votes in favor of the action taken.

3.12. Compensation. By resolution of the Board, the directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors, or of any committee, and may be paid a fixed sum for attendance at each such meeting and/or a stated salary as a director or committee member. No such payment will preclude any director from serving the Company in any other capacity and receiving compensation therefor.

3.13. Removal. Any director or the entire Board of Directors may be removed, with or without cause, only at a special meeting of shareholders called for that purpose, if the votes cast in favor of such removal exceed the votes cast against such removal, except that if less than the entire Board of Directors is to be removed, no one of the directors may be removed if the votes cast against the director's removal would be sufficient to elect the director if then cumulatively voted at an election for the class of directors of which the director is a part.

IV. OFFICERS — GENERAL

4.01. Elections and Appointments. The directors may elect or appoint one or more of the officers of the Company contemplated in Part V below. Any such election or appointment will regularly take place at the annual meeting of the directors, but elections of officers may be held at any other meeting of the Board. A person elected or appointed to any office will continue to hold that office until the election or appointment of his or her successor, subject to action earlier taken pursuant to Section 4.04 or 6.01 below. Any person may hold more than one office.

4.02. Additional Appointments. In addition to the officers contemplated in Part V below, the Board of Directors may create other corporate positions, and appoint persons thereto, with such authority to perform such duties as may be prescribed from time to time by the Board of Directors, by the President or by the superior officer of any person so appointed. Notwithstanding such additional appointments, only those persons whose offices are described in Part V are to be considered an officer of the Company unless the resolution or other Board action appointing such person expressly states that such person is to be considered an officer of the Company. Each of such persons (in the order designated by the Board or the superior officer of such person) will be vested with all of the powers and charged with all of the duties of his or her superior officer in the event of such superior officer's absence or disability.

4.03. Bonds and Other Requirements. The Board of Directors may require any officer or other appointee to give bond to the Company (with sufficient surety, and conditioned upon the faithful performance of the duties of his or her office or position) and to comply with such other conditions as may from time to time be required of him or her by the Board.

4.04. Removal or Delegation. Provided that a majority of the whole membership thereof concurs therein, the Board of Directors may remove any officer of the Company as provided by law and declare his or her office or offices vacant or abolished or, in the case of the absence or disability of any officer or for any other reason considered sufficient, may temporarily delegate his or her powers and duties to any other officer or to any director. Similar action may be taken by the Board of Directors in regard to appointees designated pursuant to Section 4.02 above.

4.05. Salaries. Officer salaries may from time to time be fixed by the Board of Directors or (except as to his or her own) be left to the discretion of the Chief Executive Officer or the President. No officer will be prevented from receiving a salary by reason of the fact that he or she is also a director of the Company.

V. SPECIFIC OFFICERS, FUNCTIONS AND POWERS

5.01. Chairman of the Board. The Board of Directors may elect a Chairman to serve as a general executive officer of the Company and, if specifically designated as such by the Board, as the Chief Executive Officer of the Company. If elected, the Chairman will preside at all meetings of the directors and be vested with such other powers and duties as the Board may from time to time delegate to him or her.

5.02. Chief Executive Officer. Subject to the control of the Board of Directors exercised as hereinafter provided, the Chief Executive Officer of the Company will supervise its business and affairs and the performance of their respective duties by all other officers, by appointees designated pursuant to Section 4.02 above, and by such additional appointees to such additional positions (corporate, divisional or otherwise) as the Chief Executive Officer may designate, with authority on his or her part to delegate the foregoing duty of supervision to such extent and to such person or persons as may be determined by the Chief Executive Officer. Except as otherwise indicated from time to time by resolution of the Board of Directors, its management of the business and affairs of the Company will be implemented through the office of the Chief Executive Officer.

5.03. President and Vice Presidents. Unless specified to the contrary by resolution of the Board of Directors, the President will be the Chief Executive Officer of the Company. In addition to the supervisory functions above set forth on the part of the Chief Executive Officer or in lieu thereof if a contrary specification is made by the Board relative to the Chief Executive Officer, the President will be vested with such powers and duties as the Board may from time to time designate. Vice Presidents may be elected by the Board of Directors to perform such duties as may be designated by the Board or be assigned or delegated to them by their respective superior officers. The Board may identify (i) one or more Vice Presidents as "Executive" or "Senior" Vice Presidents and (ii) the President or any Vice President as "General Manager" of the Company and the title of any Vice President may include words indicative of his or her particular area of responsibility and authority. Vice Presidents will succeed to the responsibilities and authority of the President, in the event of his or her absence or disability, in the order consistent with their respective titles or regular duties or as specifically designated by the Board of Directors.

5.04. Treasurer and Secretary. The Treasurer and Secretary each will perform all such duties normally associated with his or her office (including, in the case of the Secretary, the giving of notice and the preparation and retention of minutes of corporate proceedings and the custody of corporate records and the seal of the Company) as are not assigned to a Vice President of the Company, along with such other duties as may be designated by the Board or be assigned or delegated to them by their respective superior officers. The Board may appoint one or more Assistant Treasurers or Assistant Secretaries, each of whom (in the order designated by the Board or their respective superior officers) will be vested with all of the powers and charged with all of the duties of the Treasurer or the Secretary (as the case may be) in the event of his or her absence or disability.

5.05. Specific Powers. Except as may otherwise be specifically provided in a resolution of the Board of Directors, any of the officers referred to in this Part V will be a proper officer to authenticate records of the Company and to sign on behalf of the Company any deed, bill of sale, assignment, option, mortgage, pledge, note, bond, debenture, evidence of indebtedness, application, consent (to service of process or otherwise), agreement, indenture or other instrument of importance to the Company. Any such officer may represent the Company at any meeting of the shareholders or members of any corporation, association, partnership, joint venture or other entity in which this Company then has an interest, and may vote such interest in person or by proxy appointed by him or her, provided that the Board of Directors may from time to time confer the foregoing authority upon any other person or persons.

VI. RESIGNATIONS AND VACANCIES

6.01. Resignations.

- (a) Any director, committee member or officer may resign from his or her office at any time by written notice as specified in accordance with Arizona Revised Statutes Sections 10-807 and 10-843. The acceptance of a resignation will not be required to make it effective.

- (b) Except as prohibited by law or by the Articles, any nominee for election as a director at a meeting of shareholders duly called and at which a quorum is present, in an uncontested election, who receives a greater number of votes cast "withheld" for his or her election than "for" such election shall promptly tender his or her resignation for consideration to the Corporate Governance Committee or its successor. The Corporate Governance Committee or its successor shall evaluate the director's tendered resignation taking into account the best interests of the Company and its shareholders and shall recommend to the Board of Directors whether to accept or reject such resignation. In making its recommendation, the Corporate Governance Committee or its successor may consider, among other things, the effect of the exercise of cumulative voting in the election. The Board of Directors shall act within 120 days following certification of the shareholder vote and publicly disclose its decision and the underlying rationale. Any director who tenders his or her resignation pursuant to this provision shall not participate in any committee or Board of Director consideration thereof.

6.02. Vacancies. If the office of any director, committee member or officer becomes vacant by reason of his or her death, resignation, disqualification, removal or otherwise, the Board of Directors may choose a successor to hold office for the unexpired term.

VII. INDEMNIFICATION AND RATIFICATION

7.01. Indemnification. In order to induce qualified persons to serve the Company (and any other corporation, joint venture, partnership, trust or other enterprise at the request of the Company) as directors and officers, the Company shall indemnify any and all of its directors and officers, or former directors and officers to the fullest extent permitted by applicable law as it presently exists or may hereafter be amended.

7.02. Ratification; Special Committee. Any transaction involving the Company, any of its subsidiary corporations or any of its directors, officers, employees or agents which at any time is questioned in any manner or context (including a shareholders derivative suit), on the ground of lack of authority, conflict of interest, misleading or omitted statement of fact or law, nondisclosure, miscomputation, improper principles or practices of accounting, inadequate records, defective or irregular execution or any similar ground, may be investigated and/or ratified (before or after judgment), or an election may be made not to institute or pursue a claim or legal proceedings on account thereof or to accept or approve a negotiated settlement with respect thereto (before or after the institution of legal proceedings), by the Board of Directors or by a special committee thereof comprised of one or more disinterested directors (that is, a director or directors who did not participate in the questioned transaction with actual knowledge of the questioned aspect or aspects thereof). Such a special committee may be validly formed and fully empowered to act, in accordance with the purposes and duties assigned thereto, by resolution or resolutions of the Board of Directors, notwithstanding (i) the inclusion of Board members who are not disinterested as aforesaid among those who form a quorum at the meeting or meetings at which one or more members of such special committee are elected or appointed to the Board or to such special committee or at which such committee is formed or empowered, or their inclusion among the directors who vote upon or otherwise participate in taking any of the foregoing actions, or (ii) the taking of any of such actions by the disinterested members of the Board (or a majority of such members) whose

number is not sufficient to constitute a quorum or a majority of the membership of the full Board. Any such special committee so comprised will, to the full extent consistent with its purposes and duties as expressed in such resolution or resolutions, have all of the authority and powers of the full Board and its Executive Committee (the same as though it were the full Board and/or its Executive Committee in carrying out such purposes and duties) and will function in accordance with Section 3.09 above. No other provisions of these Bylaws which may at any time appear to conflict with any provisions of this Section 7.02, and no defect or irregularity in the formation, empowering or functioning of any such special committee, will serve to impede, impair or bring into question any action taken or purported to be taken by such committee or the validity of any such action. Any ratification of a transaction pursuant to this Section 7.02 will have the same force and effect as if the transaction has been duly authorized originally. Any such ratification, and any election made pursuant to this Section 7.02 with respect to claims, legal proceedings or settlements, will be binding upon the Company and its shareholders and will constitute a bar to any claim or the execution of any judgment in respect of the transaction involved in such ratification or election.

VIII. SEAL

8.01. Form Thereof. The seal of the Company will have inscribed thereon the name of the Company, the state and year of its incorporation and the words "SEAL".

IX. STOCK CERTIFICATES

9.01. Form Thereof. Shares shall be issued in uncertificated form pursuant to the customary arrangements for issuing shares in such form. This requirement shall not apply to shares represented by a certificate until the certificate is surrendered to the Company. Notwithstanding the foregoing, every holder of stock represented by certificates and, upon request any holder of uncertificated shares, shall be entitled to have a certificate in such form as approved by the Board of Directors.

9.02. Ownership. The Company will be entitled to treat the registered owner of any share as the absolute owner thereof and accordingly, will not be bound to recognize any beneficial, equitable or other claim to, or interest in, such share on the part of any other person, whether or not it has notice thereof, except as may expressly be provided by Chapter 8 of Title 47, Arizona Revised Statutes (or its successor), as at the time in effect, or other applicable law.

9.03. Transfers. Transfer of stock will be made on the books of the Company as follows: (i) with respect to certificated shares, only upon surrender of the certificate therefor, duly endorsed by an appropriate person, with such assurance of the genuineness and effectiveness of the endorsement as the Company may require, all as contemplated by Chapter 8 of Title 47, Arizona Revised Statutes (or its successor), as at the time in effect, and/or upon submission of any affidavit, other document or notice which the Company considers necessary; and (ii) with respect to uncertificated shares, upon compliance with the customary procedures for transferring shares in uncertificated form.

9.04. Lost Certificates. In the event of the loss, theft or destruction of any certificate representing capital stock of this Company, the Company may issue (or, in the case of any such stock as to which a transfer agent and/or registrar have been appointed, may direct such transfer agent and/or registrar to countersign, register and issue) a replacement certificate in lieu of that alleged to be lost, stolen or destroyed, and cause the same to be delivered to the owner of the stock represented thereby, provided that the owner shall have submitted such evidence showing the circumstances of the alleged loss, theft or destruction, and his or her ownership of the certificate as the Company considers satisfactory, together with any other factors which the Company considers pertinent, and further provided that an indemnity agreement and/or indemnity bond shall have been provided in form and amount satisfactory to the Company and to its transfer agent and/or registrar, if applicable.

X. EMERGENCY BYLAWS

10.01. Emergency Conditions. The emergency Bylaws provided in this Part X will be as effective in the event of an emergency as prescribed in Arizona Revised Statutes Section 10-207.D. To the extent not inconsistent with the provisions of this Part X, these Bylaws will remain in effect during such emergency and upon its termination, these emergency Bylaws will cease to be operative.

10.02. Board Meetings. During any such emergency, a meeting of the Board of Directors or any of its committees may be called by any officer or director of the Company. Notice of the time and place of the meeting will be given by the person calling the same to those of the directors whom it may be feasible to reach by any available means of communication. Such notice will be given so much in advance of the meeting as circumstances permit in the judgment of the person calling the same. At any Board or committee meeting held during any such emergency, a quorum will consist of a majority of those who could reasonably be expected to attend the meeting if they were willing to do so, but in no event more than a majority of those to whom notice of such meeting is required to have been given as above provided.

10.03. Certain Actions. The Board of Directors, either before or during any such emergency, may provide and from time to time modify lines of succession in the event that during such an emergency any or all officers, appointees, employees or agents of the Company are for any reason rendered incapable of discharging their duties. The Board, either before or during any such emergency, may, effective in the emergency, change the head office or designate several alternative head offices of the Company, or authorize the officers to do so.

10.04. Liability. No director, officer, appointee, employee or agent acting in accordance with these emergency Bylaws will be liable except for willful misconduct.

10.05. Modifications. These emergency Bylaws will be subject to repeal or change by further action of the Board of Directors, but no such repeal or change will modify the provisions of Section 10.04 with respect to action taken prior to the time of such repeal or change. Any amendment of these emergency Bylaws may make any further or different provisions that may be practical and necessary for the circumstances of the emergency.

XI. DIVIDENDS

11.01. Declaration. Subject to such restrictions or requirements as may be imposed by law or the Company's Articles or as may otherwise be binding upon the Company, the Board of Directors may from time to time declare dividends on stock of the Company outstanding on the dates of record fixed by the Board, to be paid in cash, in property or in shares of the Company's stock on or as of such payment or distribution dates as the Board may prescribe.

XII. BUSINESS COMBINATIONS

12.01. Definitions. In these Bylaws, the following definitions shall apply:

1. "Affiliate" means a person that directly or indirectly controls, is controlled by, or is under common control with a specified person.
2. "Announcement date," when used in reference to any business combination, means the date of the first public announcement of the final, definitive proposal for the business combination.
3. "Associate," when used to indicate a relationship with any person, means any of the following:
 - (a) Any corporation or organization of which the person is an officer, director, or partnership or is, directly or indirectly, the beneficial owner of ten percent (10%) or more of any class or series of shares entitled to vote or other equity interest;
 - (b) Any trust or estate in which the person has a substantial beneficial interest or as to which the person serves as trustee or personal representative or in a similar fiduciary capacity; or
 - (c) Any relative or spouse of the person, or any relative of the spouse, residing in the home of the person.

4. "Beneficial owner," when used with respect to shares or other securities, includes any person who, directly or indirectly through any agreement, arrangement, relationship, understanding, or otherwise, whether or not in writing, has or shares the power to vote, or direct the voting of the shares or securities or has or shares the power to dispose of or direct the disposition of the shares or securities, except that:
 - (a) A person is not deemed the beneficial owner of shares or securities tendered pursuant to a tender or exchange offer made by the person or any of the person's affiliates or associates until the tendered shares or securities are accepted for purchase or exchange; and
 - (b) A person is not deemed the beneficial owner of shares or securities with respect to which the person has the power to vote or direct the voting arising solely from a revocable proxy given in response to a proxy solicitation required to be made and made in accordance with the applicable rules and regulations under the Securities Exchange Act of 1934, as amended, and is not then reportable under that act on a Schedule 13D or comparable report.
5. "Beneficial ownership" includes the right to acquire shares or securities through the exercise of options, warrants, or rights, the conversion of convertible securities, or otherwise. The shares or securities subject to the options, warrants, rights, or conversion privileges held by a person are deemed to be outstanding for the purpose of computing the percentage of outstanding shares or securities of the class or series owned by the person but are not deemed to be outstanding for the purpose of computing the percentage of the class or series owned by any other person. A person is deemed the beneficial owner of shares and securities beneficially owned by the spouse of the person or any relative of the spouse residing in the home of the person, any trust or estate in which the person owns ten percent (10%) or more of the total beneficial interest or serves as trustee or personal representative, any corporation or entity in which the person owns ten percent (10%) or more of the equity and any affiliate of the person.
6. "Business combination," when used in reference to the Company and any interested shareholder of the Company, means any of the following:
 - (a) Any merger or consolidation of the Company or any subsidiary of the Company with either:
 - (i) The interested shareholder; or
 - (ii) Any other domestic or foreign corporation, whether or not itself an interested shareholder of the Company, that is, or after the merger would be, an affiliate or associate of the interested shareholder, except that the foregoing does not include the merger of a wholly-owned subsidiary of the Company into the Company or the merger of two or more wholly-owned subsidiaries of the Company.

- (b) Any exchange, pursuant to a plan of exchange under the laws of the State of Arizona or a comparable statute of any other state or jurisdiction, of shares of the Company or any subsidiary of the Company for shares of either:
 - (i) The interested shareholder; or
 - (ii) Any other domestic or foreign corporation, whether or not itself an interested shareholder of the Company, that is, or after the exchange would be, an affiliate or associate of the interested shareholder.
- (c) Any sale, lease, exchange, mortgage, pledge, transfer, or other disposition, in a single transaction or a series of transactions, to or with the interested shareholder or any affiliate or associate of the interested shareholder, of assets of the Company or any subsidiary of the Company to which any of the following applies:
 - (i) Has an aggregate market value equal to ten percent (10%) or more of the aggregate market value of all the assets, determined on a consolidated basis, of the Company.
 - (ii) Has an aggregate market value equal to ten percent (10%) or more of the aggregate market value of all the outstanding shares of the Company.
 - (iii) Represents ten percent (10%) or more of the earning power or net income, determined on a consolidated basis, of the Company.
- (d) The issuance or transfer by the Company or any subsidiary of the Company, in a single transaction or a series of transactions, of any shares of the Company or any subsidiary of the Company that have an aggregate market value equal to five percent (5%) or more of the aggregate market value of all the outstanding shares of the Company to the interested shareholder or any affiliate or associate of the interested shareholder, except pursuant to the exercise of warrants or rights to purchase shares offered or a dividend or distribution paid or made pro rata to all shareholders of the Company.

- (e) The adoption of any plan or proposal for the liquidation or dissolution of the Company, or any reincorporation of the Company in another state or jurisdiction, proposed by, on behalf of, or pursuant to any agreement, arrangement, or understanding, whether or not in writing, with the interested shareholder or any affiliate or associate of the interested shareholder.
 - (f) Any reclassification of securities, including any share dividend or split, reverse share split, or other distribution of shares in respect of shares, recapitalization of the Company, merger or consolidation of the Company with any subsidiary of the Company exchange of shares of the Company with any subsidiary of the Company or other transaction, whether or not with or into or otherwise involving the interested shareholder, proposed by, on behalf of, or pursuant to any agreement, arrangement, or understanding, whether or not in writing, with the interested shareholder or any affiliate or associate of the interested shareholder that has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class or series of shares entitled to vote, or securities that are exchangeable for or convertible into or that carry a right to acquire shares entitled to vote, of the Company or any subsidiary of the Company that is, directly or indirectly, owned by the interested shareholder or any affiliate or associate of the interested shareholder, except as a result of immaterial changes due to fractional share adjustments.
 - (g) Any receipt by the interested shareholder or any affiliate or associate of the interested shareholder of the benefit, directly or indirectly, except proportionately as a shareholder of the Company, of any loans, advances, guarantees, pledges, or other financial assistance or any tax credits or other tax advantages provided by or through the Company or any subsidiary of the Company (other than expense account advances made in the ordinary course of business).
7. "Consummation date," with respect to any business combination, means the date of consummation of the business combination or, in the case of a business combination as to which a shareholder vote is taken, the later of:
- (i) The business day before the vote; or
 - (ii) Twenty (20) days before the date of consummation of the business combination.

8. "Control," "controlling," "controlled by" or "under common control with" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person's beneficial ownership of ten percent (10%) or more of the voting power of the Company's outstanding shares entitled to vote in the election of directors creates a presumption that the person has control of the Company. A person is not considered to have control of the Company if the person holds voting power, in good faith and not for the purpose of avoiding any provision of law as an agent, bank, broker, nominee, custodian, or trustee for one or more beneficial owners who do not individually or as a group have control of the Company.
 9. "Interested shareholder," when used in reference to the Company means any person, other than the Company or any subsidiary of the Company, that is either:
 - (a) The beneficial owner, directly or indirectly, of ten percent (10%) or more of the voting power of the outstanding shares entitled to vote of the Company; or
 - (b) An affiliate or associate of the Company who at any time within the three (3) year period immediately before the date in question was the beneficial owner of ten percent (10%) or more of the voting power of the then outstanding shares entitled to vote of the Company.
 10. "Market value," when used in reference to shares or property of the Company, means the following:
 - (a) In the case of shares, the highest closing sale price during the thirty (30) day period immediately preceding the date in question of a share on the composite tape for New York Stock Exchange listed shares or, if the shares are not quoted on the composite tape or not listed on the New York Stock Exchange, on the principal United States securities exchange registered under the Securities Exchange Act of 1934, as amended, on which the share are listed or, if the shares are not listed on any such exchange, on the National Association of Securities Dealers, Inc. Automated Quotations National Market System or, if the shares are not quoted on the National Association of Securities Dealers, Inc. Automated Quotations National Market System, the highest closing bid quotation during the thirty (30) day period preceding the date in question of a share on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use or, if no such quotation is available, the fair market value on the date in question of a share as determined in good faith by the Board of the Company.
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(b) In the case of property other than cash or shares, the fair market value of the property on the date in question as determined in good faith by the Board of the Company.

11. "Person" means any natural person, partnership, corporation, group, association, venture, firm, or other entity (other than the Company, any subsidiary of the Company, or a trustee or fiduciary holding stock for the benefit of the employees of the Company or its subsidiaries or any one of its subsidiaries, pursuant to one or more employee benefit plans). If two or more persons act as a partnership, limited partnership, syndicate, or other group pursuant to any agreement, arrangement, relationship, understanding, or otherwise, whether or not in writing, for the purposes of acquiring, owning, or voting shares of the Company, all members of the partnership, syndicate, or other group shall be deemed a person. Person does not include a licensed broker, dealer, or underwriter that purchases shares of the Company solely for purposes of resale to the public that is not acting in concert with an interested shareholder.
12. "Share acquisition date," with respect to any person and the Company, means the date that the person first becomes an interested shareholder of the Company.

12.02. Business Combination with Interested Shareholders; Approved by Directors.

1. Except as set forth in these Bylaws, the Company may not engage in any business combination or vote, consent or otherwise act to authorize a subsidiary of the Company to engage in any business combination with respect to, proposed by, or on behalf of, or pursuant to any agreement, arrangement or understanding, whether or not in writing, with any interested shareholder of the Company or any affiliate or associate of the interested shareholder for a period of three (3) years after the interested shareholder's share acquisition date, unless the business combination or the acquisition of shares made by the interested shareholder on the interested shareholder's share acquisition date is approved by a committee of the Board of Directors of the Company before the interested shareholder's share acquisition date. The committee shall be formed in accordance with subsection 4 of this Section 12.02.

2. If a good faith definitive proposal regarding a business combination is made in writing to the Board of Directors of the Company, a committee of the Board formed in accordance with subsection 4 of this Section 12.02 shall consider and take action on the proposal. Unless the committee responds affirmatively in writing within forty-five (45) days after receipt of the proposal by the Company, the committee shall be considered to have disapproved the business combination.
3. If a good faith definitive proposal to acquire shares is made in writing to the Board of Directors of the Company, a committee of the Board of Directors formed in accordance with subsection 4 of this Section 12.02 shall consider and take action on the proposal. Unless the committee responds affirmatively in writing within forty-five (45) days after receipt of the proposal by the Company, the committee shall be considered to have disapproved the share acquisition.
4. When a business combination or acquisition of shares is proposed pursuant to this Section 12.02, the Board of Directors shall promptly form a committee composed of all of the Board's disinterested Directors. The committee shall take action on the proposal by the affirmative vote of a simple majority of the committee members. The committee is not subject to any direction or control by the Board with respect to the committee's consideration of or any action concerning a business combination or acquisition of shares pursuant to this Section 12.02. A committee formed pursuant to this subsection shall be composed of one or more members. Only disinterested Directors may be members of a committee formed pursuant to this subsection. However, if the Board of Directors has no disinterested Directors, the Board shall select three or more disinterested persons to be committee members. For purposes of this subsection, a Director or person is disinterested if the Director or person is not an interested shareholder or an affiliate thereof or a present or former officer or employee of the Company or an affiliate or associate of the Company or of the interested shareholder or of any affiliate or associate of the interested shareholder.

12.03. Requirements after Three Years. Except for the provisions of Sections 12.02 and 12.04, the Company may not engage at any time in any business combination or vote, consent, or otherwise act to authorize a subsidiary of the Company to engage in any business combination with respect to, proposed by, on behalf of, or pursuant to any agreement, arrangement, or understanding, whether or not in writing, with an interested shareholder of the Company or any affiliate or associate of the interested shareholder other than a business combination meeting all the requirements of this Article XII, the Articles, and the requirements specified in any of the following:

1. A business combination with respect to which the consummation date is no less than three years after the share acquisition date, approved by the Board of Directors of the Company before the interested shareholder's share acquisition date, or as to which the acquisition of shares made by the interested shareholder on the interested shareholder's acquisition date had been approved by the Board of Directors before the interested shareholder's share acquisition date.
2. A business combination approved by the affirmative vote of the holders of a majority of the outstanding shares entitled to vote not beneficially owned by the interested shareholder proposing the business combination or any affiliate or associate of the interested shareholder proposing the business combination at a meeting called for that purpose no earlier than three years after the interested shareholder's share acquisition date.
3. A business combination, with respect to which the consummation date is no earlier than three years after the interested shareholder's share acquisition date, that meets all of the following conditions:
 - (a) The aggregate amount of the cash and the market value as of the consummation date of consideration other than cash to be received per share by holders of outstanding common shares of the Company in the business combination is at least equal to the higher of the following:
 - (i) The highest per share price paid by the interested shareholder, at a time when the interested shareholder was the beneficial owner, directly or indirectly, of five percent (5%) or more of the outstanding shares entitled to vote of the Company, for any common shares of the same class or series acquired by it within the three (3) year period immediately before the announcement date with respect to the business combination or within the three (3) year period immediately before, or in, the transaction in which the interested shareholder became an interested shareholder, whichever is higher, plus, in either case, interest compounded annually from the earliest date on which the highest per share acquisition price was paid through the consummation date at the rate for one year United States treasury obligations from time to time in effect less the aggregate amount of any cash dividends paid, and the market value of any dividends paid other than in cash, per common share since the earliest date, up to the amount of the interest.

- (ii) The market value per common share on the announcement date with respect to the business combination or on the interested shareholder's share acquisition date, whichever is higher, plus interest compounded annually from that date through the consummation date at the rate for one year United States treasury obligations from time to time in effect less the aggregate amount of any cash dividends paid and the market value of any dividends paid other than in cash, per common share since that date, up to the amount of the interest.
- (b) The aggregate amount of the cash and the market value as of the consummation date of consideration other than cash to be received per share by holders of outstanding shares of any class or series of shares, other than common shares, of the Company in the business combination is at least equal to the highest of the following, whether or not the interested shareholder has previously acquired any shares of the class or series:
 - (i) The highest per share price paid by the interested shareholder, at a time when the interested shareholder was the beneficial owner, directly or indirectly, of five percent (5%) or more of the outstanding shares entitled to vote of the Company, for any shares of the class or series acquired by it within the three (3) year period immediately before the announcement date with respect to the business combination or within the three (3) year period immediately before, or in, the transaction in which the interested shareholder became an interested shareholder, whichever is higher, plus, in either case, interest compounded annually from the earliest date on which the highest per share acquisition price was paid through the consummation date at the rate for one year United States treasury obligations from time to time in effect less the aggregate amount of any cash dividends paid and the market value of any dividends paid other than in cash, per share of the class or series since such earliest date, up to the amount of the interest.

- (ii) The highest preferential amount per share to which the holders of shares of the class or series are entitled in the event of any voluntary liquidation, dissolution, or winding up of the Company, plus the aggregate amount of any unpaid dividends declared or due as to which the holders are entitled before payment of dividends on some other class or series of shares, unless the aggregate amount of the dividends is included in the preferential amount.
- (iii) The market value per share of the class or series on the announcement date with respect to the business combination or on the interested shareholder's share acquisition date, whichever is higher, plus interest compounded annually from that date through the consummation date at the rate for one year United States treasury obligations from time to time in effect less the aggregate amount of any cash dividends paid and the market value of any dividends paid other than in cash, per share of the class or series since that date, up to the amount of the interest.
- (c) The consideration to be received by holders of a particular class or series of outstanding shares, including common shares, of the Company in the business combination is in cash or in the same form as the interested shareholder has used to acquire the largest number of shares of the class or series of shares previously acquired by it and the consideration is distributed promptly.
- (d) The holders of all outstanding shares of the Company not beneficially owned by the interested shareholder immediately before the consummation date with respect to the business combination are entitled to receive in the business combination cash or other consideration for the shares in compliance with subdivisions (a), (b) and (c).

- (e) After the interested shareholder's share acquisition date and before the consummation date with respect to the business combination, the interested shareholder has not become the beneficial owner of any additional shares entitled to vote of the Company except:
 - (i) As part of the transaction that resulted in the interested shareholder becoming an interested shareholder;
 - (ii) By virtue of proportionate share splits, share dividends, or other distributions of shares in respect of shares not constituting a business combination;
 - (iii) Through a business combination meeting all of the conditions of Section 12.02 and this paragraph; or
 - (iv) Through purchase by the interested shareholder at any price that, if the price had been paid in an otherwise permissible business combination the announcement date and consummation date of which were the date of the purchase, would have satisfied the requirements of subdivisions (a), (b) and (c) of this Section.

12.04. Application. This Article XII does not apply to any business combination of the Company with an interested shareholder of the Company who became an interested shareholder inadvertently, if the interested shareholder both:

1. As soon as practicable, divests itself of a sufficient amount of the shares entitled to vote of the Company so that it no longer is the beneficial owner, directly or indirectly, of ten percent (10%) or more of the outstanding shares entitled to vote of the Company.
2. Would not at any time within the three (3) year period preceding the announcement date with respect to the business combination have been an interested shareholder except for the inadvertent acquisition.

XIII. LIMITATION ON SHARE REPURCHASES

13.01. Limitation on Share Repurchases. The Company shall not, directly or indirectly, purchase or agree to purchase any shares entitled to vote from a person who beneficially owns more than five per cent (5%) of the voting stock of the Company for more than the "average market price" of the shares if the shares have been beneficially owned by the person or persons for less than three (3) years, unless either (i) the purchase or agreement to purchase is approved at a meeting of shareholders by the affirmative vote of the holders of a majority of the voting stock entitled to vote excluding shares beneficially owned by such person, by any of such person's affiliates or associates, or by any officer or director of the Company or (ii) the Company makes an offer, of at least equal value per share, to all holders of shares of such class or series and to all holders of any class or series into which the shares may be converted.

13.02. Definitions. For the purposes of this Article, "average market price" means the average closing sale price during the thirty trading days immediately preceding the purchase of the shares in question, or if the person or persons have commenced a tender offer or have announced an intention to seek control of the Company, during the thirty trading days preceding the earlier of the commencement of the tender offer or the making of the announcement, of a share on the composite tape for New York Stock Exchange listed shares or, if the shares are not quoted on the composite tape or not listed on the New York Stock Exchange, on the principal United States securities exchange registered under the Securities Exchange Act of 1934, as amended, on which the shares are listed or, if the shares are not listed on any such exchange, on the National Association of Securities Dealers, Inc. Automated Quotations National Market System or, if the shares are not quoted on the National Association of Securities Dealers, Inc. Automated Quotations National Market System, the average closing bid quotation, during the thirty trading days preceding the purchase of the shares in questions of a share on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or if the person or persons have commenced a tender offer or have announced an intention to seek control of the issuing public corporation, during the thirty trading days preceding the earlier of the commencement of the tender offer or the making of the announcement, except that if no quotation is available the average market price is the fair market value on the date of purchase of the shares in question of a share as determined in good faith by the Board of Directors of the Company.

XIV. AMENDMENTS

14.01. Amendment of Bylaws. These Bylaws may be altered, amended, supplemented, repealed, or temporarily or permanently suspended, in whole or in part, or replacement Bylaw provisions adopted by: (i) the affirmative vote of a majority of the directors then in office; or (ii) the affirmative vote of a majority of the votes cast on such matter(s) at a meeting of shareholders.

**PERFORMANCE SHARE AGREEMENT
UNDER THE
PINNACLE WEST CAPITAL CORPORATION
2007 LONG-TERM INCENTIVE PLAN**

THIS AWARD AGREEMENT is made and entered into as of _____, 2010 (the "**Date of Grant**"), by and between Pinnacle West Capital Corporation (the "**Company**"), and _____ ("**Employee**").

BACKGROUND

- A. The Board of Directors of the Company has adopted, and the Company's shareholders have approved, the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (the "**Plan**"), pursuant to which Performance Share Awards and Dividend Equivalent Awards may be granted to employees of the Company and its Subsidiaries and certain other individuals.
- B. The Company desires to grant to Employee a Performance Share Award and the related Dividend Equivalent Award under the terms of the Plan.
- C. Pursuant to the Plan, the Company and Employee agree as follows:

AGREEMENT

- 1. **Grant of Award.** Pursuant to action of the Committee, which was taken on the Date of Grant, the Company grants to Employee _____ (_____) Performance Shares and Dividend Equivalents. The Performance Shares granted under this Section 1 are referred to in this Award Agreement as the "**Base Grant**."
 - 2. **Award Subject to Plan.** This Performance Share Award and the related Dividend Equivalent Award are granted under and are expressly subject to all of the terms and provisions of the Plan, which terms are incorporated herein by reference, and this Award Agreement.
 - 3. **Performance Period.** The Performance Period for this Award begins January 1, 2010 and ends December 31, 2012.
 - 4. **Payment.**
 - (a) **Performance Shares Payable In Stock.** As soon as practicable in the fiscal year immediately following the end of the Performance Period, the Company will determine (i) the Company's Total Shareholder Return (as defined herein) as compared to the Total Shareholder Return of the companies in the S&P 1500 Super Composite Electric Utility Index (the "**Growth Index**") over the Performance Period and (ii) the Company's Average Performance with respect to the Performance Metrics (as defined herein). The Company will then deliver to Employee one (1) share of the Company's Stock for each then-outstanding Performance Share under this Award Agreement, subject to adjustment pursuant to **Section 5** below. The Company anticipates that the Stock payout, if any, related to the Company's Total Shareholder Return will be made on or about January 25, 2013. The Company anticipates that the Stock payout, if any, related to the Performance Metrics will be made on or about November 30, 2013. In no event will the Stock payouts described in this **Subsection 5(a)** be made later than December 31, 2013.
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(b) **Retirement.** In the case of Employee's Retirement (as defined herein) during the Performance Period, Employee shall be deemed to have been employed by the Company through the end of the Performance Period and Employee will receive the Stock and Dividend Equivalents, if any, to which Employee is entitled at the time specified in this Section. For purposes of this Award Agreement, "**Retirement**" means a termination of employment which constitutes an "**Early Retirement**" or a "**Normal Retirement**" under the Pinnacle West Capital Corporation Retirement Plan.

(c) **Dividend Equivalents.** In satisfaction of the Dividend Equivalents Award made pursuant to Section 1, at the time of the Company's delivery of Stock to Employee pursuant to Subsection 4(a) above, the Company also will deliver to Employee fully transferrable shares of stock equal in value to the amount of dividends, if any, that Employee would have received if Employee had directly owned the Stock to which the Performance Shares relate from the Date of Grant to the date of the Stock payout, plus interest on such amount at the rate of 5 percent compounded quarterly, as determined pursuant to the Plan. The number of shares of Stock distributed to Employee will be determined by dividing the amount due by the Fair Market Value of one share of Stock as of the date of the Stock payout.

5. **Performance Criteria and Adjustments.** Fifty percent (50%) of the Performance Shares awarded under this Award Agreement will be determined pursuant to Section 5(a) and fifty percent (50%) of the Performance Shares awarded under this Award Agreement will be determined pursuant to Section 5(b). In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Award Agreement greater than 2.0 times the Base Grant.

(a) **Adjustment of Base Grant for Total Shareholder Return.** Fifty percent (50%) of the Base Grant will increase or decrease based upon the Company's "Total Shareholder Return" as compared to the Total Shareholder Return of the companies in the Growth Index during the Performance Period, as follows:

If the Company's Total Shareholder Return Over The Performance Period As Compared to the Total Shareholder Return of the Companies in the Growth Index is:

The Number of Performance Shares will be:

90th Percentile or greater	1.0 X Base Grant
75th Percentile	.75 X Base Grant
50th Percentile	0.5 X Base Grant
25th Percentile	0.25 X Base Grant
Less than 25th Percentile	None

If intermediate percentiles are achieved, the number of Performance Shares awarded will be prorated (partial shares will be rounded down to the nearest whole share when applicable). For example, if the Company's Total Shareholder Return during the Performance Period places the Company's performance in the 60th percentile, then the number of Performance Shares would be increased to 0.60 (0.5 X 60/50) multiplied by the Base Grant. In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Subsection 5(a) greater than 1.0 times the Base Grant.

- (b) **Adjustment of Base Grant for Performance Metrics.** Fifty percent (50%) of the Base Grant will increase or decrease based upon the Company's "Average Performance" with respect to the "Performance Metrics," as follows:

If the Company's Average Performance is:	The Number of Performance Shares will be:
90th Percentile or greater	1.0 X Base Grant
75th Percentile	.75 X Base Grant
50th Percentile	0.5 X Base Grant
25th Percentile	0.25 X Base Grant
Less than 25th Percentile	None

If intermediate percentiles are achieved, the number of Performance Shares awarded pursuant to this Subsection 5(b) will be prorated (partial shares will be rounded down to the nearest whole share when applicable). For example, if the Company's Average Performance during the Performance Period places the Company's performance in the 60th percentile, then the number of Performance Shares would be increased to .60 (0.5 X 60/50) multiplied by the Base Grant. In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Subsection (b) greater than 1.0 times the Base Grant.

6. **Definitions.**

- (a) **Performance Metrics.** The "Performance Metrics" for the Performance Period are (i) the JD Power Residential Survey for investor-owned utilities in the Western Region; (ii) the System Average Interruption Frequency Index (Major Events Excluded) ("SAIFI"); (iii) Arizona Public Service Company's customer to employee improvement ratio; (iv) the OSHA rate (All Incident Injury Rate); (v) nuclear capacity factor; and (vi) coal capacity factor.
- (1) With respect to the Performance Metric described in clause (i) of this Subsection 6(a), the JD Power Residential Survey will provide data on an annual basis reflecting the Company's percentile ranking, relative to other participating companies.
 - (2) With respect to the Performance Metric described in clause (ii) of this Subsection 6(a), the Edison Electric Institute ("EI") will provide on an annual basis the quartile rankings (or percentile rankings, if available) associated with the SAIFI result of the participating companies; the Company will determine its SAIFI result for the year in question and determine its quartile ranking (or percentile ranking, if percentile rankings are available) based on the information provided by EI.
 - (3) With respect to the Performance Metric described in clause (iii) of this Subsection 6(a), SNL, an independent third party data system, will provide data on an annual basis regarding the customer and employee counts; the Company will use its customer and employee counts for the year in question and determine its percentile ranking based on the information provided by SNL. Only those companies whose customers and employees were included in the data provided by SNL in each of the years of the Performance Period will be considered.
 - (4) With respect to the Performance Metric described in clause (iv) of this Subsection 6(a), EI will provide data on an annual basis regarding the OSHA rate of the participating companies; the Company will calculate its OSHA rate for the year in question and determine its percentile ranking based on the information provided by EI.

- (5) With respect to the Performance Metric described in clause (v) of this Subsection 6(a), SNL will provide data on an annual basis regarding the nuclear capacity factors of the participating nuclear plants; the Company will calculate its nuclear capacity factor for the year in question and determine its percentile ranking based on the information provided by SNL. Only those plants that were included in the data provided by SNL in each of the years of the Performance Period will be considered.
- (6) With respect to the Performance Metric described in clause (vi) of this Subsection 6(a), SNL will provide data on an annual basis regarding the coal capacity factors of the participating coal plants; the Company will calculate its coal capacity factor for the year in question and determine its percentile ranking based on the information provided by SNL. Only those plants that were included in the data provided by SNL in each of the years of the Performance Period will be considered.
- (7) The Company's percentile ranking during the Performance Period for each Performance Metric will be the average of the Company's percentile ranking for each Performance Metric during each of the three years of the Performance Period (each, an "Average Performance Metric"); provided, however, that if a Performance Metric for 2012 is not calculable by December 15, 2013, the Performance Metric shall consist of the three most recent years for which such Performance Metric is calculable. The Company's "Average Performance," for purposes of determining any Base Grant adjustments pursuant to Subsection 5(b) above will be the average of the Average Performance Metrics. If only quartile, rather than percentile, rankings are available for a particular Performance Metric, the Average Performance Metric for any such Performance Metric shall be expressed as a percentile. For example, if the Performance Metric was in the top quartile for two Performance Periods and in the lowest quartile in the other Performance Period, the average of these quartiles would be 3 (the average of 4, 4, and 1) and the Average Performance Metric would be the 75th percentile (3 /4). The calculations in this Subsection 6(a)(7) will be verified by the Company's internal auditors.
- (8) If either EEI or SNL discontinues providing the data specified above, the Committee shall select a data source that, in the Committee's judgment, will provide data most comparable to the data provided by EEI or SNL, as the case may be. If the JD Power Residential Survey for investor-owned utilities in the Western Region (or a successor JD Power survey) is not available during each of the years of the Performance Period, the Performance Metric associated with the JD Power Residential Survey (Subsection 6(b)(1)) will be disregarded and not included in the Company's Average Performance for purposes of determining any Base Grant adjustments pursuant to Subsection 5(b).
- (b) **Total Shareholder Return**. "Total Shareholder Return" for the Performance Period is the measure of a company's stock price appreciation plus any dividends paid during the Performance Period. Only those companies that were included in the Growth Index in each of the years of the Performance Period will be considered. Total Shareholder Return for the Company and the companies in the Growth Index will be determined using the Daily Comparative Return as calculated by Bloomberg [or other independent third party data system]. If the Growth Index is discontinued, the Committee shall select the most comparable index then in use for the sector comparison. In addition, if the sector comparison is no longer representative of the Company's industry or business, the Committee shall replace the Growth

Index with the most representative index then in use. Once the Total Shareholder Returns of the Company and all relevant companies in the Growth Index have been determined, the member companies will be ranked from greatest to least. Percentiles will be calculated based on a company's relative ranking. For example, company 1 out of 26 companies is given a percentile of 96.2% (1.0 — 1/26). Percentiles will be carried out to one (1) decimal place. If the Company is not in the Growth Index, then its percentile will be interpolated between the companies listed in the relative ranking. These calculations will be verified by the Company's internal auditors.

7. **Termination of Award.** This Award Agreement will terminate and be of no further force or effect on the date that Employee is no longer actively employed by the Company or any of its Subsidiaries, whether due to voluntary or involuntary termination, death, retirement, disability, or otherwise, except as specifically set forth in Section 4. Employee will, however, be entitled to receive any Stock and Dividend Equivalents payable under Section 4 of this Award Agreement if Employee's employment terminates after the end of the Performance Period but before Employee's receipt of such Stock and Dividend Equivalents.
8. **Section 409A Compliance.**
 - (a) **Purpose of this Provision.** Section 409A of the Code imposes a number of requirements on "non-qualified deferred compensation" plans and arrangements. Based on regulations issued by the Internal Revenue Service, the Company has concluded that this Performance Share Award is subject to Section 409A. As a result, unless the Plan and this Award Agreement are administered to comply with the new rules, Employee will be required to pay an additional 20% tax (in addition to regular income taxes) on the compensation provided by this Award Agreement. In addition, under Section 409A additional interest will be payable.
 - (b) **Compliance with Section 409A.** The Company intends to comply with Section 409A by assuring that all amounts to which Employee becomes entitled hereunder are payable at a specified time or pursuant to a fixed schedule within the meaning of Treas. Reg. § 1.409A-3(a)(4). As a result, any payment or transfer to Employee shall be made at the time specified in Section 4. The provisions of this Subsection 8(b) apply to all amounts due pursuant to this Award Agreement.
 - (c) **Miscellaneous Payment Provisions.** If a payment is not made due to a dispute in payments, payments can be delayed in accordance with Treas. Reg. § 1.409A-3(g).
 - (d) **Ban on Acceleration or Deferral.** Under no circumstances may the time or schedule of any payment made or benefit provided pursuant to this Award Agreement be accelerated or subject to a further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code.
 - (e) **No Elections.** Employee does not have any right to make any election regarding the time or form of any payment due under this Award Agreement.
 - (f) **Compliant Operation and Interpretation.** The Plan and this Award Agreement shall be administered in compliance with Section 409A and each provision of the Award Agreement and the Plan shall be interpreted, to the extent possible, to comply with Section 409A.

9. **Tax Withholding.** Any and all payments made pursuant to this Award Agreement shall be subject to applicable tax withholding requirements and employment taxes. Employee must pay, or make arrangements acceptable to the Company for the payment of any and all required federal, state, and local income and payroll tax withholding. Employee may satisfy any such tax withholding obligation by paying the amount by check. In the alternative, Employee may elect to have the Company withhold shares of Stock having a Fair Market Value on the date of the Stock payout sufficient to cover the withholding obligation. Within _____ days after the Date of Grant, Employee must elect, on the provided election form, to satisfy any tax withholding obligation by paying the amount by check or by having the Company withhold shares of Stock having a Fair Market Value on the date of the Stock payout sufficient to cover the withholding obligation. In the absence of a timely election by Employee, Employee's withholding obligation will be satisfied through the Company's withholding shares of Stock as set forth above.
10. **Continued Employment.** Nothing in the Plan or this Award Agreement shall be interpreted to interfere with or limit in any way the right of the Company to terminate Employee's employment or services at any time. In addition, nothing in the Plan or this Award Agreement shall be interpreted to confer upon Employee the right to continue in the employ or service of the Company.
11. **Voting Rights.** Employee is not entitled to voting rights with respect to shares of Stock by virtue of this Award. Upon issuance of Stock in settlement of Employee's Performance Share Awards, Employee will have voting rights with respect to such shares of Stock.
12. **Non-Transferability.** Neither this Award nor any rights under this Award Agreement may be assigned, transferred, or in any manner encumbered except by will or the laws of descent and distribution, and any attempted assignment, transfer, mortgage, pledge or encumbrance except as herein authorized, will be void and of no effect.
13. **Definitions: Copy of Plan and Plan Prospectus.** To the extent not specifically defined in this Award Agreement, all capitalized terms used in this Award Agreement will have the same meanings ascribed to them in the Plan. Employee will receive a copy of the Plan and the related Plan Prospectus. In the event of any conflict between the terms and conditions of this Award Agreement and the Plan, the provisions of the Plan shall control.
14. **Amendment.** Except as otherwise provided in the Plan, this Award Agreement may be amended only by a written agreement executed by the Company and Employee.
15. **Choice of Law.** This Award Agreement will be governed by the laws of the State of Arizona, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Award Agreement to another jurisdiction.

An authorized representative of the Company has signed this Award Agreement as of the Date of Grant.

PINNACLE WEST CAPITAL CORPORATION

By: _____

Its: _____

Pinnacle West Capital Corporation

**PERFORMANCE SHARE AWARD
ELECTION FORM**

INFORMATION ABOUT YOU

Last

First

Middle Initial

Employee ID#

TAX WITHHOLDING ELECTION

I hereby elect to satisfy any tax withholding obligation associated with my receipt of Stock pursuant to my Performance Share Agreement in the following form (place an "X" in the "Check" column or in the "Stock" column):

Check

(I will write a check for my taxes that are due and deliver it to the Company within one (1) day of the release of the Stock)

Stock

(The Company should withhold shares of my stock to cover my taxes)

To the extent permitted by law, I hereby elect Federal tax withholding of _____ percent (minimum may not be less than 25% and maximum may not exceed 35%)

PARTICIPANT NAME (PLEASE PRINT)

PARTICIPANT SIGNATURE

DATE

IMPORTANT NOTE: Please complete and return this Election Form to Jennifer Pertner at Mail Station 9996 by _____, 2010.

**RESTRICTED STOCK UNIT AGREEMENT
UNDER THE
PINNACLE WEST CAPITAL CORPORATION
2007 LONG-TERM INCENTIVE PLAN**

THIS AWARD AGREEMENT is made and entered into as of _____, 2010 (the "Date of Grant"), by and between Pinnacle West Capital Corporation (the "Company"), and _____ ("Employee").

BACKGROUND

- A. The Board of Directors of the Company (the "Board of Directors") has adopted, and the Company's shareholders have approved, the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (the "Plan"), pursuant to which Restricted Stock Units and Dividend Equivalents may be granted to employees of the Company and its Subsidiaries and certain other individuals.
- B. The Company desires to grant to Employee Restricted Stock Units and Dividend Equivalents under the terms of the Plan.
- C. Pursuant to the Plan, the Company and Employee agree as follows:

AGREEMENT

1. **Grant of Award.** Pursuant to action of the Committee which was taken on the Date of Grant, the Company grants to Employee _____ (x,xxx) Restricted Stock Units and Dividend Equivalents based on the dividends declared on the shares of Stock to which such Restricted Stock Units relate.
2. **Award Subject to Plan.** This Restricted Stock Unit Award and the related Dividend Equivalent Award are granted under and are expressly subject to all of the terms and provisions of the Plan, which terms are incorporated herein by reference, and this Award Agreement.
3. **Vesting of Restricted Stock Units.** The Restricted Stock Units granted hereunder will vest and no longer be subject to the restrictions of and forfeiture under this Award Agreement on four "Vesting Dates" as follows:
 - (a) x,xxx Restricted Stock Units will vest on February 20, 2011;
 - (b) x,xxx Restricted Stock Units will vest on February 20, 2012;
 - (c) x,xxx Restricted Stock Units will vest on February 20, 2013; and
 - (d) The remaining x,xxx Restricted Stock Units will vest on February 20, 2014.

In addition, the Restricted Stock Units will fully vest and no longer be subject to the restrictions of and forfeiture under this Award Agreement upon Employee's Retirement. For purposes of this Award Agreement, "Retirement" means a termination of employment which constitutes an "Early Retirement" or a "Normal Retirement" under the Pinnacle West Capital Corporation Retirement Plan.

For avoidance of doubt, no acceleration of vesting of the Restricted Stock Units will occur on a Change of Control of the Company.

4. **Payment.**

- (a) **Time and Form of Payment.** Subject to the provisions of this Award Agreement and the Plan, when a Restricted Stock Unit vests on one of the Vesting Dates set forth in clauses (a), (b), (c) or (d) of Section 3 above, Employee shall receive in exchange for each Restricted Stock Unit one unrestricted fully transferrable share of Stock. Employee may elect, pursuant to Section 4(b), to receive payment for the Restricted Stock Units payable on any Vesting Date in the form of 50% cash and 50% in unrestricted fully transferrable shares of Stock. If the allocation between cash and Stock results in a fractional share, the Stock will be increased to provide for the issuance of a full share of Stock and the cash will be reduced accordingly. If a Restricted Stock Unit vests prior to the applicable Vesting Date due to Employee's Retirement, the transfer or payment will be deferred until the applicable Vesting Date. Any cash payment will be based on the Fair Market Value of one share of Stock determined as of the Vesting Date on which the Restricted Stock Unit vests. The transfer or payment shall be made within 90 days of the applicable Vesting Date.
- (b) **Election of Form of Payment.** Within _____ days after the Date of Grant, Employee must elect to receive payment for Employee's vested Restricted Stock Units and Dividend Equivalents in fully transferable shares of Stock or 50% in cash and 50% in fully transferrable shares of Stock by completing and returning to the Company the election form attached to this Agreement. In the absence of a timely election by Employee, Employee will receive payment for the vested Restricted Stock Units and Dividend Equivalents in fully transferable shares of Stock.
- (c) **Dividend Equivalents.** In satisfaction of the Dividend Equivalents Award made pursuant to Section 1, at the time of the Company's delivery of payment pursuant to Section 4(a), the Company also will deliver to Employee a payment equal to the amount of dividends, if any, that Employee would have received if Employee had directly owned the Stock to which the Restricted Stock Units relate from the Date of Grant to the applicable Vesting Date, plus interest on such amount at the rate of 5 percent compounded quarterly, as determined pursuant to the Plan. Pursuant to the election filed by the Employee pursuant to Section 4(b), payment for the Dividend Equivalents will be made in fully transferrable shares of Stock, or 50% in cash and 50% in fully transferrable shares of Stock. The number of shares of Stock distributed to Employee will be determined by dividing the amount due by the Fair Market Value of one share of Stock as of the applicable Vesting Date.

5. **Termination of Award.** Except as otherwise provided in Section 3 with respect to Employee's Retirement, in the event of the termination of Employee's active employment with the Company or any of its Subsidiaries, whether due to voluntary or involuntary termination, death, disability or otherwise, Employee's right to receive and/or vest in any additional Restricted Stock Units under the Plan, if any, will terminate. Any unvested Restricted Stock Units and the related Dividend Equivalents will be forfeited effective as of the date that Employee terminates active employment with the Company or any of its Subsidiaries.

6. **Section 409A Compliance.**

- (a) **Purpose of this Provision.** Section 409A of the Code imposes a number of requirements on "non-qualified deferred compensation" plans and arrangements. Based on regulations issued by the Internal Revenue Service, the Company has concluded that this Award of Restricted Stock Units is subject to Section 409A. As a result, unless the Plan and this Award Agreement are administered to comply with the new rules, Employee will be required to pay an additional 20% tax (in addition to regular income taxes) on the compensation provided by this Award Agreement. In addition, under Section 409A additional interest will be payable.

- (b) **Compliance with Section 409A.** The Company intends to comply with Section 409A by assuring that all amounts to which Employee becomes entitled hereunder are payable at a specified time or pursuant to a fixed schedule within the meaning of Treas. Reg. § 1-409A-3(a)(4). As a result, no payment or transfer shall be made to Employee prior to the applicable Vesting Date. The provisions of this Section 6(b) apply to all amounts due pursuant to this Award Agreement.
 - (c) **Miscellaneous Payment Provisions.** If the Company fails to make a payment (including a transfer of Stock), either intentionally or unintentionally, within the period required by Section 4, but the payment is made within the same calendar year, it will be treated as made within the period required by Section 4 pursuant to Treas. Reg. § 1.409A-3(d). In addition, if a payment is not made due to a dispute in payments, payments can be delayed in accordance with Treas. Reg. § 1.409A-3(g).
 - (d) **Ban on Acceleration or Deferral.** Under no circumstances may the time or schedule of any payment made or benefit provided pursuant to this Award Agreement be accelerated or subject to a further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code.
 - (e) **No Elections.** Employee does not have any right to make any election regarding the time or form of any payment due under this Award Agreement other than the election described in Section 4(b).
 - (f) **Compliant Operation and Interpretation.** The Plan and this Award Agreement shall be administered in compliance with Section 409A and each provision of the Award Agreement and the Plan shall be interpreted, to the extent possible, to comply with Section 409A.
7. **Tax Withholding.** Any and all payments made pursuant to this Award Agreement shall be subject to applicable tax withholding requirements and employment taxes. Employee must pay, or make arrangements acceptable to the Company for the payment of any and all required federal, state, and local income and payroll tax withholding. Employee may satisfy any such tax withholding obligation by paying the amount by check. In the alternative, Employee may elect to have the Company withhold shares of Stock having a Fair Market Value on the applicable Vesting Date sufficient to cover the withholding obligation. Within _____ days after the Date of Grant, Employee must elect, on the election form described in Section 4(b), to satisfy any tax withholding obligation by paying the amount by check or by having the Company withhold shares of Stock having a Fair Market Value on the applicable vesting date sufficient to cover the withholding obligation. In the absence of a timely election by Employee, Employee's withholding obligation will be satisfied through the Company's withholding shares of Stock as set forth above.
8. **Continued Employment.** Nothing in the Plan or this Award Agreement shall be interpreted to interfere with or limit in any way the right of the Company to terminate Employee's employment or services at any time. In addition, nothing in the Plan or this Award Agreement shall be interpreted to confer upon Employee the right to continue in the employ or service of the Company.
9. **Voting Rights.** Employee is not entitled to voting rights with respect to shares of Stock by virtue of this Award. If the Committee, in its discretion, issues Stock in settlement of Employee's Restricted Stock Units, Employee will have voting rights with respect to such shares of Stock.

10. **Non-Transferability.** Neither this Award nor any rights under this Award Agreement may be assigned, transferred, or in any manner encumbered except by will or the laws of descent and distribution, and any attempted assignment, transfer, mortgage, pledge or encumbrance except as herein authorized, will be void and of no effect.
11. **Definitions: Copy of Plan and Plan Prospectus.** To the extent not specifically defined in this Award Agreement, all capitalized terms used in this Award Agreement will have the same meanings ascribed to them in the Plan. Employee will receive a copy of the Plan and the related Plan Prospectus. In the event of any conflict between the terms and conditions of this Award Agreement and the Plan, the provisions of the Plan shall control.
12. **Amendment.** Except as otherwise provided in the Plan, this Award Agreement may be amended only by a written agreement executed by the Company and Employee.
13. **Choice of Law.** This Award Agreement will be governed by the laws of the State of Arizona, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Award Agreement to another jurisdiction.

An authorized representative of the Company has signed this Award Agreement as of the Date of Grant.

PINNACLE WEST CAPITAL CORPORATION

By: _____

Its: _____

Pinnacle West Capital Corporation

**RESTRICTED STOCK UNIT AWARD
ELECTION FORM**

INFORMATION ABOUT YOU

Last

First

Middle Initial

Employee ID#

1. PAYMENT ELECTION

In accordance with the terms of the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan and pursuant to Section 4(b) of the Award Agreement, I hereby elect to receive payment for the Restricted Stock Units and Dividend Equivalents that vest on the dates set forth below in the following form (place an "X" in the "Stock" column or in the "50% Cash/50% Stock" column for each of the years and types of Awards set forth below):

Vesting Date	Restricted Stock Units and Dividend Equivalents	
	Stock	50% Cash/ 50% Stock
02/20/2011	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2012	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2013	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2014	<input type="checkbox"/>	<input type="checkbox"/>

2. TAX WITHHOLDING ELECTION

I hereby elect to satisfy any tax withholding obligation associated with my receipt of stock in exchange for my Restricted Stock Units and Dividend Equivalents in the following form (place an "X" in the "Check" column or in the "Stock" column):

Check

(I will write a check on the vesting date for my taxes that are due and deliver it to the Company within one (1) day of the release date of the Stock)

Stock

(The Company should withhold shares of my stock to cover my taxes)

To the extent permitted by law, I hereby elect Federal tax withholding of _____ percent (minimum may not be less than 25% and maximum may not exceed 35%)

PARTICIPANT NAME (PLEASE PRINT)

PARTICIPANT SIGNATURE

DATE

IMPORTANT NOTE: Please complete and return this Election Form to Jennifer Pertner at Mail Station 9996 by _____, 2010.

Exhibit 12.1

PINNACLE WEST CAPITAL CORPORATION
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)

	Six Months Ended	Twelve Months Ended December 31,				
	June 30,	2009	2008	2007	2006	2005
	2010					
Earnings:						
Income from continuing operations attributable to common shareholders	\$ 96,661	\$ 233,349	\$ 260,840	\$ 283,370	\$ 265,320	\$ 189,315
Income taxes	44,657	136,506	95,544	142,330	123,915	109,270
Fixed charges	123,355	241,568	224,453	213,531	203,899	201,276
Total earnings	\$ 264,673	\$ 611,423	\$ 580,837	\$ 639,231	\$ 593,134	\$ 499,861
Fixed Charges:						
Interest expense	\$ 121,446	\$ 237,527	\$ 219,916	\$ 209,354	\$ 200,411	\$ 198,367
Estimated interest portion of annual rents	1,909	4,041	4,537	4,177	3,488	2,909
Total fixed charges	\$ 123,355	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899	\$ 201,276
Ratio of Earnings to Fixed Charges (rounded down)	2.14	2.53	2.58	2.99	2.90	2.48

Exhibit 12.2

ARIZONA PUBLIC SERVICE COMPANY
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)

	Six Months Ended June 30,	Twelve Months Ended December 31,				
	2010	2009	2008	2007	2006	2005
Earnings:						
Income from continuing operations attributable to common shareholder	\$ 101,204	\$ 251,225	\$ 262,344	\$ 283,940	\$ 269,730	\$ 170,479
Income taxes	47,751	152,574	107,261	151,157	138,927	98,010
Fixed charges	115,846	227,274	206,896	195,144	184,059	171,126
Total earnings	\$ 264,801	\$ 631,073	\$ 576,501	\$ 630,241	\$ 592,716	\$ 439,615
Fixed Charges:						
Interest charges	\$ 111,693	\$ 218,969	\$ 197,964	\$ 186,702	\$ 176,459	\$ 164,626
Amortization of debt discount	2,255	4,675	4,702	4,639	4,363	4,085
Estimated interest portion of annual rents	1,898	3,630	4,230	3,803	3,237	2,415
Total fixed charges	\$ 115,846	\$ 227,274	\$ 206,896	\$ 195,144	\$ 184,059	\$ 171,126
Ratio of Earnings to Fixed Charges (rounded down)						
	2.28	2.77	2.78	3.22	3.22	2.56

Exhibit 12.3

**PINNACLE WEST CAPITAL CORPORATION
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)**

	Six Months Ended June 30,	Twelve Months Ended December 31,				
	2010	2009	2008	2007	2006	2005
Earnings:						
Income from continuing operations attributable to common shareholders	\$ 96,661	\$ 233,349	\$ 260,840	\$ 283,370	\$ 265,320	\$ 189,315
Income taxes	44,657	136,506	95,544	142,330	123,915	109,270
Fixed charges	123,355	241,568	224,453	213,531	203,899	201,276
Total earnings	\$ 264,673	\$ 611,423	\$ 580,837	\$ 639,231	\$ 593,134	\$ 499,861
Fixed Charges:						
Interest expense	\$ 121,446	\$ 237,527	\$ 219,916	\$ 209,354	\$ 200,411	\$ 198,367
Estimated interest portion of annual rents	1,909	4,041	4,537	4,177	3,488	2,909
Total fixed charges	\$ 123,355	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899	\$ 201,276
Preferred Stock Dividend Requirements:						
Income before income taxes attributable to common shareholders	\$ 141,318	\$ 369,855	\$ 356,384	\$ 425,700	\$ 389,235	\$ 298,585
Net income from continuing operations attributable to common shareholders	96,661	233,349	260,840	283,370	265,320	189,315
Ratio of income before income taxes to net income	1.46	1.58	1.37	1.50	1.47	1.58
Preferred stock dividends	—	—	—	—	—	—
Preferred stock dividend requirements — ratio (above) times preferred stock dividends	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Fixed Charges and Preferred Stock Dividend Requirements:						
Fixed charges	\$ 123,355	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899	\$ 201,276
Preferred stock dividend requirements	—	—	—	—	—	—
Total	\$ 123,355	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899	\$ 201,276
Ratio of Earnings to Fixed Charges (rounded down)	2.14	2.53	2.58	2.99	2.90	2.48

CERTIFICATION

I, Donald E. Brandt, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2010.

/s/ Donald E. Brandt

Donald E. Brandt

Chairman, President and Chief Executive Officer

CERTIFICATION

I, James R. Hatfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2010.

/s/ James R. Hatfield

James R. Hatfield

Senior Vice President & Chief Financial Officer

CERTIFICATION

I, Donald E. Brandt, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arizona Public Service Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2010.

/s/ Donald E. Brandt

Donald E. Brandt

Chairman and Chief Executive Officer

CERTIFICATION

I, James R. Hatfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arizona Public Service Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2010.

/s/ James R. Hatfield

James R. Hatfield

Senior Vice President & Chief Financial Officer

**CERTIFICATION
OF
CHIEF EXECUTIVE OFFICER
AND
CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald E. Brandt, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation for the fiscal quarter ended June 30, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Pinnacle West Capital Corporation.

Date: August 3, 2010.

/s/ Donald E. Brandt

Donald E. Brandt
Chairman, President and Chief Executive Officer

I, James R. Hatfield, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation for the fiscal quarter ended June 30, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Pinnacle West Capital Corporation.

Date: August 3, 2010.

/s/ James R. Hatfield

James R. Hatfield
Senior Vice President and Chief Financial Officer

**CERTIFICATION
OF
CHIEF EXECUTIVE OFFICER
AND
CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald E. Brandt, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Arizona Public Service Company for the fiscal quarter ended June 30, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Arizona Public Service Company.

Date: August 3, 2010.

/s/ Donald E. Brandt

Donald E. Brandt
Chairman and Chief Executive Officer

I, James R. Hatfield, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Arizona Public Service Company for the fiscal quarter ended June 30, 2010 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Arizona Public Service Company.

Date: August 3, 2010.

/s/ James R. Hatfield

James R. Hatfield
Senior Vice President and Chief Financial Officer