ARIZONA PUBLIC SERVICE CO
Form 10-K
February 18, 2011

Table of Contents

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

OR

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

For the transition period from _____ to _____

Commission File Number	Registrants; State of Incorporation; Addresses; 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

Securities registered pursuant to Section 12(b) of the Act:

	Title Of Each Class	Name Of Each Exchange On Which Registered
PINNACLE WEST CAPITAL CORPORATION	Common Stock, No Par Value	New York Stock Exchange
ARIZONA PUBLIC SERVICE COMPANY	None	None

Securities registered pursuant to Section 12(g) of the Act:

ARIZONA PUBLIC SERVICE COMPANY Common Stock, Par Value $2.50 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

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

Indicate by check mark whether the 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 þ	No o
ARIZONA PUBLIC SERVICE COMPANY	Yes þ	No o

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or in any amendment to this Form 10-K. þ

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. (Check one):

PINNACLE WEST CAPITAL CORPORATION

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

ARIZONA PUBLIC SERVICE COMPANY

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether each registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

State the aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of each registrant s most recently completed second fiscal quarter:

PINNACLE WEST CAPITAL CORPORATION	$3,935,855,234 as of June 30, 2010
ARIZONA PUBLIC SERVICE COMPANY	$0 as of June 30, 2010

The number of shares outstanding of each registrant s common stock as of February 15, 2011

PINNACLE WEST CAPITAL CORPORATION	108,780,623 shares
ARIZONA PUBLIC SERVICE COMPANY	Common Stock, $2.50 par value, 71,264,947 shares. Pinnacle West Capital Corporation is the sole holder of Arizona Public Service Company s Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Pinnacle West Capital Corporation s definitive Proxy Statement relating to its Annual Meeting of Shareholders to be held on May 18, 2011 are incorporated by reference into Part III hereof.

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

TABLE OF CONTENTS

	Page
GLOSSARY OF NAMES AND TECHNICAL TERMS	1
FORWARD-LOOKING STATEMENTS	2
PART I	3
Item 1. Business	3
Item 1A. Risk Factors	27
Item 1B. Unresolved Staff Comments	38
Item 2. Properties	39
Item 3. Legal Proceedings	41
Executive Officers of Pinnacle West	42
PART II	44
Item 5. Market for Registrants Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	44
Item 6. Selected Financial Data	46
Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations	48
Item 7A. Quantitative and Qualitative Disclosures about Market Risk.	78
Item 8. Financial Statements and Supplementary Data	79
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	173
Item 9A. Controls and Procedures	173
Item 9B. Other Information	174
PART III	174
Item 10. Directors, Executive Officers and Corporate Governance of Pinnacle West	174
Item 11. Executive Compensation	174
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	174

Item 13. Certain Relationships and Related Transactions, and Director Independence 176

Item 14. Principal Accountant Fees and Services 176

PART IV 177

Item 15. Exhibits and Financial Statement Schedules 177

SIGNATURES 219

Exhibit 10.6.5
Exhibit 10.9.1C
Exhibit 10.11.4
Exhibit 12.1
Exhibit 12.2
Exhibit 12.3
Exhibit 21.1
Exhibit 23.1
Exhibit 23.2
Exhibit 31.1
Exhibit 31.2
Exhibit 31.3
Exhibit 31.4
Exhibit 32.1
Exhibit 32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

This combined Form 10-K is separately filed by Pinnacle West and APS. Each registrant is filing on its own behalf all of the information contained in this Form 10-K that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is filing 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 8 of this report includes Consolidated Financial Statements of Pinnacle West and Consolidated Financial Statements of APS. Item 8 also includes Notes to Pinnacle West s Consolidated Financial Statements, the majority of which also relates to APS, and Supplemental Notes, which only relate to APS s Consolidated Financial Statements.

Table of Contents

GLOSSARY OF NAMES AND TECHNICAL TERMS

ACC	Arizona Corporation Commission
ADEQ	Arizona Department of Environmental Quality
AFUDC	Allowance for Funds Used During Construction
ANPP	Arizona Nuclear Power Project, also known as Palo Verde
APS	Arizona Public Service Company, a subsidiary of the Company
APSES	APS Energy Services Company, Inc., a subsidiary of the Company
Base Fuel Rate	The portion of APS s retail base rates attributable to fuel and purchased power costs
Cholla	Cholla Power Plant
DOE	United States Department of Energy
El Dorado	El Dorado Investment Company, a subsidiary of the Company
EPA	United States Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	United States Federal Energy Regulatory Commission
Four Corners	Four Corners Power Plant
GWh	Gigawatt-hour, one billion watts per hour
IFRS	International Financial Reporting Standards
kV	Kilovolt, one thousand volts
kWh	Kilowatt-hour, one thousand watts per hour
MMBtu	One million British Thermal Units
MW	Megawatt, one million watts
Native Load	Retail and wholesale sales supplied under traditional cost-based rate regulation
Navajo Plant	Navajo Generating Station
NRC	United States Nuclear Regulatory Commission
OCI	Other comprehensive income
Palo Verde	Palo Verde Nuclear Generating Station
Pinnacle West	Pinnacle West Capital Corporation (any use of the words Company, we, and our refer to Pinnacle West)
Pinnacle West Marketing & Trading	Pinnacle West Marketing & Trading Co., LLC, a subsidiary of the Company
PRP	Potentially responsible party under Superfund
PSA	Power supply adjustor approved by the ACC to provide for recovery or refund of variations in actual fuel and purchased power costs compared with the Base Fuel Rate
RES	Arizona Renewable Energy Standard and Tariff
Salt River Project or SRP	Salt River Project Agricultural Improvement and Power District
SunCor	SunCor Development Company, a subsidiary of the Company
TCA	Transmission cost adjustor
VIE	Variable-interest entity
West Phoenix	West Phoenix Power Plant

Table of Contents

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations. These forward-looking statements are often identified by words such as estimate, predict, may, believe, plan, expect, require, intend, ass 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 and in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, these factors include, but are not limited to:

- our ability to achieve timely and adequate rate recovery of our costs, including returns on debt and equity capital;
- our ability to manage 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 and distributed generation;
- power plant performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- regulatory and judicial decisions, developments and proceedings;
- new legislation or regulation, including those relating to greenhouse gas emissions, renewable energy mandates and energy efficiency standards;
- our ability to meet renewable energy requirements and recover related costs;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- competition in retail and wholesale power markets;
- the duration and severity of the economic decline in Arizona and current real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- changes to our credit ratings;
- the investment performance of the assets of our nuclear decommissioning trust, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;
- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- generation, transmission and distribution facility and system conditions and operating costs;
- the ability to meet the anticipated future need for additional baseload generation and associated transmission facilities in our region;
- the willingness or ability of our counterparties, power plant participants and power plant land owners to meet contractual or other obligations or extend the rights for continued power plant operations;
- technological developments affecting the electric industry; and
- restrictions on dividends or other burdensome provisions in our credit agreements and ACC orders.

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

Table of Contents

PART I
ITEM 1. BUSINESS

Pinnacle West

Pinnacle West is a holding company that conducts business through its subsidiaries. We derive substantially all of our revenues and earnings from our wholly-owned subsidiary, APS. APS is a vertically-integrated electric utility that provides either retail or 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.

	Year Ended December 31,		
Operating Revenues (in thousands):	2010	2009	2008
APS	$ 3,180,807	$ 3,149,500	$ 3,133,496
Percentage of Pinnacle West Consolidated	97%	99%	97%

Pinnacle West s other first-tier subsidiaries are SunCor, APSES and El Dorado. Additional information related to these businesses is provided later in this report.

Our reportable business segment is our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily electric service to Native Load customers) and related activities, and includes electricity generation, transmission and distribution. In 2009 our real-estate subsidiary, SunCor, began disposing of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce its outstanding debt (see Note 23). All of SunCor s operations are reflected as discontinued operations. As a result, the real estate segment is no longer a reportable segment. See Note 17 for financial information of our business segments.

BUSINESS OF ARIZONA PUBLIC SERVICE COMPANY

APS currently provides electric service to approximately 1.1 million customers. We own or lease more than 6,290 MW of regulated generation capacity and we hold a mix of both long-term and short-term purchased power agreements for additional capacity, including a variety of agreements for the purchase of renewable energy. During 2010, no single purchaser or user of energy accounted for more than 1.2% of our electric revenues.

Table of Contents

The following map shows APS s retail service territory, including the locations of its generating facilities and principal transmission lines.

Table of Contents

Energy Sources and Resource Planning

To serve its customers, APS obtains power through its various generation stations and through purchased power agreements. Resource planning is an important function necessary to meet Arizona s future energy needs. APS s sources of energy by fuel type during 2010 were as follows:

Generation Facilities

APS has ownership interests in or leases the coal, nuclear, gas, oil and solar generating facilities described below. For additional information regarding these facilities, see Item 2.

Coal Fueled Generating Facilities

Four Corners Four Corners is a 5-unit coal-fired power plant located in the northwestern corner of New Mexico. APS operates the plant and owns 100% of Four Corners Units 1, 2 and 3 and 15% of Units 4 and 5. APS has a total entitlement from Four Corners of 791 MW. The Four Corners plant site is leased from the Navajo Nation and is also subject to an easement from the federal government. APS purchases all of Four Corners coal requirements from a supplier with a long-term lease of coal reserves with the Navajo Nation. The Four Corners coal contract runs through 2016.

On November 8, 2010, APS and Southern California Edison (SCE) entered into an asset purchase agreement providing for the purchase by APS of SCE s 48% interest in each of Units 4 and 5 of Four Corners. If consummated, APS would acquire 739 MW from SCE unless any of the other owners of interests in Units 4 and 5 exercise their rights of first refusal prior to March 8, 2011, in which case APS would not be able to purchase SCE s entire share of the Units. Completion of the purchase by APS, which is expected to occur in the second half of 2012, is conditioned upon the receipt of regulatory approvals from the ACC, the California Public Utilities Commission and the FERC, the execution of a new coal supply contract for a lease renewal period described below, expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act and other typical closing conditions.

Table of Contents

APS, on behalf of the Four Corners participants, has negotiated amendments to an existing facility lease with the Navajo Nation which would extend the Four Corners leasehold interest to 2041. Execution by the Navajo Nation of the lease amendments is a condition to closing of the purchase by APS of SCE s interests in Four Corners. The execution of these amendments by the Navajo Nation requires the approval of the Navajo Nation Council, which occurred on February 15, 2011 and is awaiting final signature by the Nation s President. The effectiveness of the amendments also requires the approval of the U.S. Department of the Interior (DOI), as does a related Federal rights-of-way grant which the Four Corners participants will pursue. A Federal environmental review will be conducted as part of the DOI review process.

APS has announced that, if APS s purchase of SCE s interests in Units 4 and 5 at Four Corners is consummated, it will close Units 1, 2 and 3 at the plant. These events will change the plant s overall generating capacity from 2,100 MW to 1,540 MW and APS s entitlement from the plant from 791 MW to 970 MW.

Cholla Cholla is a 4-unit coal-fired power plant located in northeastern Arizona. APS operates the plant and owns 100% of Cholla Units 1, 2 and 3. PacifiCorp owns Cholla Unit 4, and APS operates that Unit for PacifiCorp. APS has a total entitlement from Cholla of 647 MW. APS purchases all of Cholla s coal requirements from a coal supplier that mines all of the coal under long-term leases of coal reserves with the federal government and private landholders. The Cholla coal contract runs through 2024. APS has the ability under the contract to reduce its annual coal commitment and purchase a portion of Cholla s coal requirements on the spot market to take advantage of competitive pricing options and to purchase coal required for increased operating capacity. APS believes that the current fuel contracts and competitive fuel supply options ensure the continued operation of Cholla for its useful life. In addition, APS has a long-term coal transportation contract.

Navajo Generating Station The Navajo Plant is a 3-unit coal-fired power plant located in northern Arizona. Salt River Project operates the plant and APS owns a 14% interest in Navajo Units 1, 2 and 3. APS has a total entitlement from the Navajo Plant of 315 MW. The Navajo Plant s coal requirements are purchased from a supplier with long-term leases from the Navajo Nation and the Hopi Tribe. The Navajo Plant is under contract with its coal supplier through 2011, with options to extend through 2019. The Navajo Plant site is leased from the Navajo Nation and is also subject to an easement from the federal government.

These coal plants face uncertainties related to existing and potential legislation and regulation that could significantly impact their economics and operations. See Environmental Matters below and Management s Discussion and Analysis of Financial Condition and Results of Operations Overview and Capital Expenditures in Item 7 for environmental and climate change developments and lease renewal negotiations with the Navajo Nation impacting these coal facilities. See Note 11 for information regarding APS s coal mine reclamation obligations.

Nuclear

Palo Verde Nuclear Generating Station Palo Verde is a nuclear power plant located about 50 miles west of Phoenix, Arizona. APS operates the plant and owns 29.1% of Palo Verde Units 1 and 3 and about 17% of Unit 2. In addition, APS leases about 12.1% of Unit 2, resulting in a 29.1% combined interest in that Unit. APS has a total entitlement from Palo Verde of 1,146 MW.

Table of Contents

Palo Verde Leases In 1986, APS entered into agreements with three separate lessor trust entities in order to sell and lease back about 42% of its share of Palo Verde Unit 2 and certain common facilities. Prior to 2010, APS accounted for these arrangements as operating leases. Due to amended VIE accounting guidance, in 2010 APS began consolidating the lessor trust entities, and eliminated lease accounting for these transactions. The agreements have terms of 29.5 years and contain options to renew the leases or to purchase the property for fair market value at the end of the lease terms. APS must give notice to the respective lessor trusts between December 31, 2010 and December 31, 2012 if it wishes to exercise, or not exercise, either of these options. We are analyzing these options. See Note 20 for additional information regarding the Palo Verde Unit 2 sale leaseback transactions.

Palo Verde Operating Licenses Operation of each of the three Palo Verde Units requires an operating license from the NRC. The NRC issued full power operating licenses for Unit 1 in June 1985, Unit 2 in April 1986 and Unit 3 in November 1987. The full power operating licenses, each valid for a period of 40 years, authorize APS, as operating agent for Palo Verde, to operate the three Palo Verde Units. On December 15, 2008, APS applied for renewed operating licenses for the Palo Verde Units for a period of 20 years beyond the expirations of the current licenses. The current NRC schedule for the applications estimates that a final NRC decision will be issued in April 2011. APS is making preparations to secure resources necessary to operate the plant for the period of extended operation, including the execution in April 2010 of a Municipal Effluent Purchase and Sale Agreement that provides effluent water rights necessary for cooling purposes at Palo Verde through 2050.

Palo Verde Fuel Cycle The fuel cycle for Palo Verde is comprised of the following stages:

- mining and milling of uranium ore to produce uranium concentrates;
- conversion of uranium concentrates to uranium hexafluoride;
- enrichment of uranium hexafluoride;
- fabrication of fuel assemblies;
- utilization of fuel assemblies in reactors; and
- storage and disposal of spent nuclear fuel.

The Palo Verde participants are continually identifying their future nuclear fuel resource needs and negotiating arrangements to fill those needs. The Palo Verde participants have contracted for all of Palo Verde s requirements for uranium concentrates through 2011 and 95% of its requirements through 2017. A new contract is currently being negotiated that will cover Palo Verde s remaining requirements for uranium concentrates through 2017. The participants have also contracted for all of Palo Verde s conversion services through 2018, all of Palo Verde s enrichment services through 2020 and all of Palo Verde s fuel assembly fabrication services through 2016.

Spent Nuclear Fuel and Waste Disposal The Nuclear Waste Policy Act of 1982 (NWPA) required the DOE to accept, transport, and dispose of spent nuclear fuel and high level waste generated by the nation s nuclear power plants by 1998. The DOE s obligations are reflected in a Contract for Disposal of Spent Nuclear Fuel and/or High-Level Radioactive Waste (Standard Contract) with each nuclear power plant. The DOE failed to begin accepting Palo Verde s spent nuclear fuel by 1998, and APS (on behalf of itself and the other Palo Verde participants) filed a lawsuit for DOE s breach of the Palo Verde Standard Contract in the U.S. Court of Federal Claims. The Court of Federal Claims ruled in favor of APS and in October 2010 awarded $30.2 million in damages to the Palo Verde participants for costs incurred through December 2006.

Table of Contents

The DOE had planned to meet its NWPA and Standard Contract disposal obligations by designing, licensing, constructing, and operating a permanent geologic repository at Yucca Mountain, Nevada. In June 2008, DOE submitted its application to the NRC to authorize construction of the Yucca Mountain repository. In March 2010, the DOE filed a motion to dismiss with prejudice its Yucca Mountain construction authorization application that was pending before the NRC. Several interested parties have intervened in the NRC proceeding, and the proceeding has not been conclusively decided by the NRC or the courts. Additionally, a number of interested parties have filed a variety of lawsuits in different jurisdictions around the country challenging the DOE s authority to withdraw the Yucca Mountain construction authorization application. None of these lawsuits have been conclusively decided by the courts.
Palo Verde has sufficient capacity at its on-site independent spent fuel storage installation (ISFSI) to store all of the nuclear fuel that will be irradiated during the initial operating license period, which ends in December 2027. Additionally, Palo Verde has sufficient capacity at its on-site ISFSI to store a portion of the fuel that will be irradiated during the period of extended operation, which ends in December 2047 (assuming the NRC approves APS s request for renewed operating licenses, as discussed above). If uncertainties regarding the United States government s obligation to accept and store spent fuel are not favorably resolved, APS will evaluate alternative storage solutions that may obviate the need to expand the ISFSI to accommodate all of the fuel that will be irradiated during the period of extended operation.
In addition to the spent fuel stored at Palo Verde s on-site ISFSI, Palo Verde also generates certain types of low level radioactive waste that are stored on-site. Currently, the Class B and Class C waste (the higher radioactivity of the low level wastes) is stored on-site since industry access to a disposal site was eliminated several years ago. The NRC is considering regulations that would allow the industry to eliminate much of this waste by blending it with lower level Class A waste so that it can be disposed of at a facility such as the one Palo Verde utilizes in Utah.
Nuclear Decommissioning Costs APS currently relies on an external sinking fund mechanism to meet the NRC financial assurance requirements for decommissioning its interests in Palo Verde Units 1, 2 and 3. The decommissioning costs of Palo Verde Units 1, 2 and 3 are currently included in APS s ACC jurisdictional rates. Decommissioning costs are recoverable through a non-bypassable system benefits charge (one paid by all retail customers taking service from the APS system), which allows APS to maintain its external sinking fund mechanism. See Note 12 for additional information about APS s nuclear decommissioning costs.
Palo Verde Liability and Insurance Matters See Palo Verde Nuclear Generating Station Nuclear Insurance in Note 11 for a discussion of the insurance maintained by the Palo Verde participants, including APS, for Palo Verde.

Natural Gas and Oil Fueled Generating Facilities

APS has six natural gas power plants located throughout Arizona, consisting of Redhawk, located near the Palo Verde Nuclear Generating Station; Ocotillo, located in Tempe; Sundance, located in Coolidge; West Phoenix, located in southwest Phoenix; Saguaro, located north of Tucson; and Yucca, located near Yuma. Several of the units at Saguaro and Yucca run on either gas or oil. APS has one oil only power plant, Douglas, located in the town of Douglas, Arizona. APS owns and operates each of these plants with the exception of one combustion turbine unit and one steam unit at Yucca that are operated by APS and owned by the Imperial Irrigation District. APS has a total entitlement from these plants of 3,389 MW. Gas for these plants is acquired through APS s hedging program. APS has long-term gas transportation agreements with three different companies, some of which are effective through 2024. Fuel oil is acquired under short-term purchases delivered primarily to West Phoenix, where it is distributed to APS s other oil power plants by truck.

Table of Contents

Solar Facilities

APS owns and operates more than sixty small solar systems around the state. Together they have the capacity to produce about 5 MW of renewable energy. This fleet of solar systems includes a 3 MW facility located at the Prescott Airport, a 1 MW facility located at APS s Saguaro power plant and less than 1 MW of solar photovoltaic distributed energy systems installed as part of the Community Power Project in Flagstaff, Arizona. The Community Power Project, approved by the ACC on April 1, 2010, is a pilot program through which, upon completion, APS will own, operate and receive energy from approximately 1.5 MW of solar photovoltaic distributed energy systems located within a certain test area in Flagstaff, Arizona.

Purchased Power Contracts

In addition to its own available generating capacity, APS purchases electricity under various arrangements, including long-term contracts and purchases through short-term markets to supplement its owned or leased generation and hedge its energy requirements. A substantial portion of APS s purchased power expense is netted against wholesale sales on the Consolidated Statements of Income. (See Note 18.) APS continually assesses its need for additional capacity resources to assure system reliability. APS does not expect to require new conventional generation sources sooner than 2017, due primarily to planned additions of renewable resources and energy efficiency initiatives.

Purchased Power Capacity APS s purchased power capacity under long-term contracts, including its renewable energy portfolio, is summarized in the tables below. All capacity values are based on net capacity unless otherwise noted.

Type	Dates Available	Capacity (MW)
Purchase Agreement (a)	Year-round through December 2014	104
Purchase Agreement (b)	Year-round through June 14, 2020	60
Exchange Agreement (c)	May 15 to September 15 annually through 2020	480
Tolling Agreement	Year-round through May 2017	500
Tolling Agreement	Summer seasons through October 2019	560
Day-Ahead Call Option Agreement	Summer seasons through September 2015	500
Day-Ahead Call Option Agreement	Summer seasons through summer 2016	150
Demand Response Agreement (d)	Summer seasons through 2024	100
Renewable Energy (e)	Various	223

(a) The capacity under this agreement varies by month, with a maximum capacity of 104 MW.

(b) Up to 60 MW of capacity is available; however, the amount of electricity available to APS under this agreement is based in large part on customer demand and is adjusted annually.

Table of Contents

(c) This is a seasonal capacity exchange agreement under which APS receives electricity during the summer peak season (from May 15 to September 15) and APS returns a like amount of electricity during the winter season (from October 15 to February 15).

(d) The capacity under this agreement increases in phases over the first three years to reach the 100 MW level by the summer of 2012.

(e) Renewable energy purchased power agreements are described in detail below under Current and Future Resources Renewable Energy Standard Renewable Energy Portfolio.

Current and Future Resources

Current Demand and Reserve Margin

Electric power demand is generally seasonal. In Arizona, demand for power peaks during the hot summer months. APS s 2010 peak one-hour demand on its electric system was recorded on July 15, 2010 at 6,936 MW, compared to the 2009 peak of 7,218 MW recorded on July 27, 2009. APS s operable generating capacity, together with firm purchases totaling 2,974 MW, including short-term seasonal purchases and unit contingent purchases, resulted in an actual reserve margin, at the time of the 2010 peak demand, of 21.8%. The power actually available to APS from its resources fluctuates from time to time due in part to planned and unplanned plant and transmission outages.

Future Resources and Resource Plan

Under the ACC s modified resource planning rule, APS will file by April 1 of each even year its resource plans for the next fifteen-year period. The ACC s modified rule also requires APS to file its first resource plan within 120 days after the rule becomes effective. The modified rule became effective in January 2011 and APS will likely file a resource plan in the first quarter of 2011. The modified rule also requires the ACC to issue an order with its acknowledgment of APS s resource plan within approximately ten months following its submittal. The ACC s acknowledgment of APS s resource plan will consider factors such as the total cost of electric energy services, demand management, analysis of supply-side options, system reliability and risk management.

Table of Contents

Renewable Energy Standard

In 2006, the ACC adopted the RES. Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. The renewable energy requirement is 3% of retail electric sales in 2011 and increases annually until it reaches 15% in 2025. In APS s 2009 retail rate case settlement agreement, APS committed to have 1,700 GWh of new renewable resources in service by year-end 2015 in addition to its 2008 renewable resource commitments. Taken together, APS s commitment is estimated to be 3,400 GWh, or approximately 10% of retail sales, by year-end 2015, which is double the existing RES target of 5% for that year. (See Note 3.) A component of the RES is focused on stimulating development of distributed energy systems (generally speaking, small-scale renewable technologies that are located on customers properties). Accordingly, under the RES, an increasing percentage of that requirement must be supplied from distributed energy resources. This distributed energy requirement is 25% of the overall RES requirement of 3% in 2011 and increases to 30% of the applicable RES requirement in 2012 and subsequent years. The following table summarizes these requirement standards and their timing:

	2011	2015	2020	2025
RES as a % of retail electric sales	3%	5%	10%	15%
Percent of RES to be supplied from distributed energy resources	25%	30%	30%	30%

Renewable Energy Portfolio. APS has a diverse portfolio of existing and planned renewable resources totaling 875 MW, including wind, geothermal, solar, biomass and biogas. Of this portfolio, 288 MW are currently in operation and 587 MW are under contract for development or are under construction. Renewable resources in operation include 5 MW of facilities owned by APS, 223 MW of long-term purchased power agreements, and an estimated 60 MW of customer-sited, third-party owned distributed energy resources.

APS continues to actively consider opportunities to enhance its renewable energy portfolio, both to ensure its compliance with the RES and to meet the needs of its customer base. APS s strategy to achieve its RES requirements includes executing purchased power contracts for new facilities, ongoing development of distributed energy resources and procurement of new facilities to be owned by APS. One of the key programs under which APS will own solar resources is the AZ Sun Program. As approved by the ACC, the AZ Sun Program will allow APS to own 100 MW of solar photovoltaic power plants across Arizona by investing up to $500 million through 2014. Under this program to date, APS has executed contracts for the development of 83 MW of new solar generation, representing an investment commitment of approximately $377 million. See Note 3 for additional details about the AZ Sun Program, including the related cost recovery.

The following table summarizes APS s renewable energy sources in operation and under development. Agreements for the development and completion of future resources are subject to various conditions, including successful siting, permitting and interconnection of the projects to the electric grid.

Table of Contents

	Location	Actual/ Target Commercial Operation Date	Term (Years)	Net Capacity In Operation (MW)	Net Capacity Planned/ Under Development (MW)
APS Owned					
Solar:					
AZ Sun Program:					
Paloma	Gila Bend, AZ	2011			17
Cotton Center	Gila Bend, AZ	2011			17
Hyder Phase 1	Hyder, AZ	2011			11
Hyder Phase 2	Hyder, AZ	2012			5
Chino Valley	Chino Valley, AZ	2012			19
Luke AFB	Glendale, AZ	2012/2013(a)			14
Subtotal AZ Sun Program (b)					83
Multiple Facilities	AZ	Various		5	
Total APS Owned				5	83
Purchased Power Agreements					
Solar:					
Solana (c)	Gila Bend, AZ	2013	30		250
RE Ajo	Ajo, AZ	2011	25		5
Sun E AZ 1	Prescott, AZ	2011	30		10
Solar 1 (d)	Tonopah, AZ	2012	30		15
Wind:					
Aragonne Mesa	Santa Rosa, NM	2006	20	90	
High Lonesome	Mountainair, NM	2009	30	100	
Perrin Ranch Wind	Williams, AZ	2011	25		99
Geothermal:					
Salton Sea	Imperial County, CA	2006	23	10	
Biomass:					
Snowflake	Snowflake, AZ	2008	15	10	
Snowflake	Snowflake, AZ	2008	1	10	
Biogas:					
Glendale Landfill	Glendale, AZ	2010	20	3	
Landfill 1 (d)	Surprise, AZ	2012	20		3
Total Purchased Power Agreements				223	382
Distributed Energy					
Solar:					

APS Owned (e)	AZ	various			1
Third-party Owned (f)	AZ	various		60	66
Agreement 1	Bagdad, AZ	2012	25		15
Agreement 2 (g)	AZ	2012-2014	20-25		40
Total Distributed Energy				60	122
Total Renewable Portfolio				288	587

(a) The timing is dependent on site preparation activities.

(b) Under the AZ Sun Program, 17 MW remains to be fulfilled.

(c) Represents contracted capacity.

(d) Details of these agreements have not yet been publicly announced.

(e) Reflects Community Power Project. See Note 3.

(f) Achieved through incentive-based programs. Includes resources with production-based incentives that have terms of 10-20 years.

(g) Agreement ramps up to 40 MW over 3 years.

Table of Contents

Demand Side Management

Arizona regulators are placing an increased focus on energy efficiency and other 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% cumulative annual energy savings by 2020. This standard was adopted and became effective on January 1, 2011. This ambitious standard will likely impact Arizona s future energy resource needs. (See Note 3 for energy efficiency and other demand side management obligations resulting from APS s 2009 retail rate case settlement.)

Economic Stimulus Projects

Through the American Recovery and Reinvestment Act of 2009 (ARRA), the Federal government made a number of programs available for utilities to develop renewable resources, improve reliability and create jobs by using economic stimulus funding. Certain programs are also available through the State of Arizona.

In 2009, the DOE announced an ARRA commitment to fund the majority of a carbon dioxide emission reduction research and development project in the amount of $71 million, which was to be located at our Cholla power plant. Due to the increased resource and funding requirements for a project of that size, APS elected not to move forward with that award and is now in the process of closing out the project. However, APS is moving forward with work under the $3 million award from DOE for a high penetration photovoltaic generation study related to the Community Power Project in Flagstaff, Arizona. The funding under this DOE award will continue to be contingent upon meeting certain project milestones, including DOE-established budget parameters, over the next four years.

APS is also continuing its work as a sub-recipient under an ARRA award received through the State of Arizona s Department of Commerce. This approximately $4 million award is for the implementation of various distributed energy and energy efficiency programs in Arizona. APS will be implementing certain solar water heater and photovoltaic-related community projects under this award.

Competitive Environment and Regulatory Oversight

Retail

The ACC regulates APS s retail electric rates and its issuance of securities. The ACC must also approve any transfer or encumbrance of APS s property used to provide retail electric service and approve or receive prior notification of certain transactions between Pinnacle West, APS and their respective affiliates.

Table of Contents

APS is subject to varying degrees of competition from other investor-owned electric and gas utilities in Arizona (such as Southwest Gas Corporation), as well as cooperatives, municipalities, electrical districts and similar types of governmental or non-profit organizations. In addition, some customers, particularly industrial and large commercial customers, may own and operate generation facilities to meet some or all of their own energy requirements. This practice is becoming more popular with customers installing or having installed products such as roof top solar panels to meet or supplement their energy needs.

In 1999, the ACC approved rules for the introduction of retail electric competition in Arizona. As a result, as of January 1, 2001, all of APS s retail customers were eligible to choose alternate energy suppliers. However, there are currently no active retail competitors offering unbundled energy or other utility services to APS s customers. In 2000, the Arizona Superior Court found that the rules were in part unconstitutional and in other respects unlawful, the latter finding being primarily on procedural grounds, and invalidated all ACC orders authorizing competitive electric services providers to operate in Arizona. In 2004, the Arizona Court of Appeals invalidated some, but not all of the rules and upheld the invalidation of the orders authorizing competitive electric service providers. In 2005, the Arizona Supreme Court declined to review the Court of Appeals decision.

To date, the ACC has taken no further or substantive action on either the rules or the prior orders authorizing competitive electric service providers in response to the final Court of Appeals decision. In 2008, the ACC directed the ACC staff to investigate whether such retail competition was in the public interest and what legal impediments remain to competition in light of the Court of Appeals decision referenced above. The ACC staff s report on the results of its investigation was issued on August 12, 2010. The report stated that additional analysis, discussion and study of all aspects of the issue are required in order to perform a proper evaluation. While the report did not make any specific recommendations other than to conduct more workshops, the report did state that the current retail electric competition rules are incomplete and in need of modification.

On April 14, 2010, the ACC issued a decision holding that solar vendors that install and operate solar facilities for non-profit schools and governments pursuant to a specific type of contract that calculates payments based on the energy produced are not public service corporations under the Arizona Constitution, and are therefore not regulated by the ACC. A second matter is pending with the ACC to determine whether that ruling should extend to solar providers who serve a broader customer base under the same business model. Use of such products by customers within our territory would result in some level of competition. APS cannot predict when, and the extent to which, additional electric service providers will enter or re-enter APS s service territory.

Table of Contents

Wholesale

The FERC regulates rates for wholesale power sales and transmission services. (See Note 3 for information regarding APS s transmission rates.) During 2010, approximately 5.8% of APS s electric operating revenues resulted from such sales and services. APS s wholesale activity primarily consists of managing fuel and purchased power supplies to serve retail customer energy requirements. APS also sells, in the wholesale market, its generation output that is not needed for APS s Native Load and, in doing so, competes with other utilities, power marketers and independent power producers. Additionally, subject to specified parameters, APS markets, hedges and trades in electricity and fuels.

Environmental Matters

Climate Change

Legislative Initiatives. In the past several years, the United States Congress has considered bills that would regulate domestic greenhouse gas emissions. In 2009, the House of Representatives passed a comprehensive energy and climate change bill, but the Senate did not consider it or a similar bill in the 111th Congress. With much focus on the economy, it is unclear when Congress will consider another global warming bill. The actual economic and operational impact of any legislation on APS depends on a variety of factors, none of which can be fully known until such legislation passes and the specifics of the resulting program are established. These factors include the terms of the legislation with regard to allowed emissions; whether any permitted emissions allowances will be allocated to source operators free of cost or auctioned; the cost to reduce emissions or buy allowances in the marketplace; and the availability of offsets and mitigating factors to moderate the costs of compliance. At the present time, we cannot predict what form of legislation, if any, will ultimately pass.

In addition to federal legislative initiatives, state-specific initiatives may also impact our business. While Arizona has not yet enacted any state-specific legislation regarding greenhouse gas emissions, the California legislature enacted AB 32 and SB 1368 in 2006 to address greenhouse gas emissions. In December 2010, the California Air Resources Board approved regulations that will establish a cap-and-trade program for greenhouse gas emissions which is scheduled to be launched in 2012 as part of the state s program implementing AB32. In addition, the New Mexico Environmental Improvement Board recently enacted a greenhouse gas cap-and-trade program and emissions cap, to become effective in 2012 and 2013, respectively.

We are monitoring these and other state legislative developments to understand the extent to which they may affect our business, including our sales into the impacted states or the ability of our out-of-state power plant participants to continue their participation in certain coal-fired power plants. In particular, SCE, a participant in Four Corners, has indicated that SB 1368 may prohibit it from making emission control expenditures at the plant. (See Energy Sources and Resource Planning Generation Facilities Coal Fueled Generating Facilities Four Corners above for details of the pending sale of SCE s interest in Four Corners to APS.)

Table of Contents

Regulatory Initiatives. 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. New Source Review is a pre-construction permitting program under the Clean Air Act that requires analysis of pollution controls prior to building a new stationary source or making major modifications to an existing stationary source. The tailoring rule became effective on August 2, 2010 and it became applicable to power plants on January 2, 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, we 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 s operations.

On December 30, 2010, pursuant to its authority under the Clean Air Act, the EPA finalized a greenhouse gas Federal Implementation Plan (FIP) for Arizona relating to pre-construction permits for construction of new sources or major modifications of existing sources. As a result of this action, effective January 2, 2011, the EPA assumed responsibility for acting on permit applications for only the greenhouse gas portion of such pre-construction permits. State permitting authorities will continue to retain responsibility for the remaining parts of pre-construction permits that are unrelated to emissions of greenhouse gasses. To the extent Arizona seeks and receives from the EPA a delegation of permitting authority for greenhouse gas emissions, the state will assume responsibility for issuing both the greenhouse gas and non-greenhouse gas portions of pre-construction permits. The greenhouse gas FIP will remain in place until such time as the EPA approves a State Implementation Plan that applies pre-construction permit requirements to greenhouse gas-emitting stationary sources in Arizona. APS does not expect the greenhouse gas FIP to have a significant impact on its current operations.

The EPA also recently announced its intent to promulgate New Source Performance Standards (NSPS) for greenhouse gas emissions from certain industrial facilities, under the Clean Air Act. The EPA intends to propose the new standards by July 2011 and to finalize them by May 2012. The EPA has indicated that the rules will apply to coal-fired electric generating units (EGUs) and will establish NSPS for new and modified EGUs and emission guidelines for existing EGUs. The rules are expected to apply to the Four Corners, Cholla and the Navajo Plant. We cannot currently predict the impact of these rules on APS s operations.

If any emission reduction legislation or additional regulations are enacted, we will assess our compliance alternatives, which may include replacement of existing equipment, installation of additional pollution control equipment, purchase of allowances, retirement or suspension of operations at certain coal-fired facilities, or other actions. Although associated capital expenditures or operating costs resulting from greenhouse gas emission regulations or legislation could be material, we believe that we would be able to recover the costs of these environmental compliance initiatives through our rates.

Table of Contents

Regional Initiative. In 2007, six western states (Arizona, California, New Mexico, Oregon, Utah and Washington) and two Canadian provinces (British Columbia and Manitoba) entered into an accord, the Western Climate Initiative (WCI), to reduce greenhouse gas emissions from automobiles and certain industries, including utilities. Montana, Quebec and Ontario have also joined WCI. WCI participants set a goal of reducing greenhouse gas emissions 15% below 2005 levels by 2020. After soliciting public comment, in September 2008 WCI issued the design of a cap-and-trade program for greenhouse gas emissions. Due in part to the recent activity at the federal level discussed above, the initiative s momentum and the movement toward detailed proposed rules has slowed. On February 2, 2010, Arizona s Governor issued an executive order stating that Arizona will continue to be a member of WCI to monitor its advancements in this area, but it will not implement the WCI regional cap-and-trade program. As a result, while we continue to monitor the progress of WCI, at the present time we do not believe it will have a material impact on our operations.

Company Response to Climate Change Initiatives. We have undertaken a number of initiatives to address emission concerns, including renewable energy procurement and development, promotion of programs and rates that promote energy conservation, renewable energy use and energy efficiency. (See Energy Sources and Resource Planning Current and Future Resources above for details of these plans and initiatives.) APS currently has a diverse portfolio of renewable resources, including wind, geothermal, solar and biomass and we are focused on increasing the percentage of our energy that is produced by renewable resources.

In January 2008, APS joined the Climate Registry as a Founding Reporter. Founding Reporters are companies that voluntarily joined the non-profit organization before May 2008 to measure and report greenhouse gas emissions in a common, accurate and transparent manner consistent across industry sectors and borders. Beginning in 2010, APS stopped participating in the Climate Registry because APS began reporting substantially the same information under the mandatory greenhouse gas reporting rule issued by the EPA on September 22, 2009. Pinnacle West prepares an annual Corporate Responsibility Report, which is available on our website (*www.pinnaclewest.com*). The report provides information related to the Company and its approach to sustainability and its workplace and environmental performance. The information on Pinnacle West s website, including the Corporate Responsibility Report, is not incorporated by reference into this report.

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 Ninth Circuit Court of Appeals in November 2009, and Pinnacle West filed its reply on June 30, 2010. The court has not yet scheduled oral arguments on the plaintiffs appeal. We believe the action is without merit and intend to continue to defend against the claims.

A similar nuisance lawsuit, *American Electric Power Co., Inc. v. Connecticut,* is currently pending in the United States Supreme Court. Another such lawsuit was dismissed by the Fifth Circuit on procedural grounds. Both cases, as well as the Kivalina case, raise political and legal considerations, including whether the courts can or should be making climate change policy decisions. The outcome of the *American Electric Power* case is particularly significant because the issues being considered by the Supreme Court closely overlap with the main issues presented in the *Kivalina* appeal. We are not a party to either of these two lawsuits, but are monitoring these developments and their potential industry impacts.

Table of Contents

EPA Environmental Regulation

Regional Haze Rules. Over a decade ago, the EPA announced regional haze rules to reduce visibility impairment in national parks and wilderness areas. The rules require states (or, for sources located on tribal land, the EPA) to determine what pollution control technologies constitute the best available retrofit technology (BART) for certain older major stationary sources. The EPA subsequently issued the Clean Air Visibility Rule, which provides guidelines on how to perform a BART analysis.

Cholla. In 2007, ADEQ required APS to perform a BART analysis for Cholla pursuant to the Clean Air Visibility Rule. APS completed the BART analysis for Cholla and submitted its BART recommendations to ADEQ on February 4, 2008. The recommendations include the installation of certain pollution control equipment that APS believes constitutes BART. ADEQ has reviewed APS s recommendations and is expected to submit to EPA Region 9 its proposed BART State Implementation Plan (SIP) for Cholla and other sources within the state in the near future. On January 19, 2011, a group of environmental organizations notified EPA of its intent to sue the agency as a result of EPA s alleged failure to promulgate a Federal Implementation Plan for states that have not yet submitted all or part of the required BART SIPs, including Arizona.

Once APS receives a final determination as to what constitutes BART for Cholla, we will have five years to complete the installation of the equipment and to achieve the emission limits established by ADEQ. However, in order to coordinate with the plant s other scheduled activities, APS is currently implementing portions of its recommended plan for Cholla on a voluntary basis. Costs related to the implementation of these portions of our recommended plan are included in our environmental expenditure estimates (see Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Expenditures in Item 7).

Four Corners and the Navajo Plant. EPA Region 9 previously requested that APS, as the operating agent for Four Corners, and SRP, as the operating agent for the Navajo Plant, perform a BART analysis for Four Corners and the Navajo Plant, respectively. APS and SRP each submitted an analysis to the EPA concluding that certain combustion control equipment constitutes BART for these plants. Based on the analyses and comments received through EPA s rulemaking process, the EPA will determine what it believes constitutes BART for each plant.

On October 6, 2010, the EPA issued its proposed BART determination for Four Corners. The proposed rule would require the installation of post-combustion controls on each of Units 1-5 at Four Corners to reduce nitrogen oxides (NOx) emissions. Current estimates indicate that APS s total costs for these controls could be up to approximately $400 million for Four Corners. If APS s purchase of SCE s interest in Units 4 and 5 is consummated and Units 1-3 are closed, APS s total costs for these controls would be approximately $300 million. (See Energy Sources and Resource Planning Generation Facilities Coal Fueled Generating Facilities Four Corners for details of this proposed transaction.) The EPA also indicated in the proposal that it may require the installation of electrostatic precipitators or baghouses on Units 1, 2 and 3 to reduce particulate matter emissions. APS estimates that its total costs for such particulate removal equipment is approximately $220 million, which may also be required under the anticipated mercury rules. (See Environmental Matters Mercury and Other Hazardous Air Pollutants below for additional information on these anticipated rules.) The EPA proposed a 10% stack opacity limitation for all five units and a 20% opacity limitation on certain fugitive dust emissions, although the proposed fugitive dust provision is unrelated to BART.

Table of Contents

On November 24, 2010, APS submitted a letter to the EPA proposing an alternative to the EPA s October BART proposal. Specifically, APS proposed to close Four Corners Units 1, 2 and 3 by 2014 and to install post-combustion pollution controls for NOx on Units 4 and 5 by the end of 2018, provided that the EPA agrees to a contemporaneous resolution of Four Corners obligations or liability, if any, under the regional haze and reasonably attributable visibility impairment programs, the New Source Review program, and NSPS programs of the Clean Air Act.

On February 10, 2011, the EPA signed a Supplemental Notice Requesting Comment, related to the BART rulemaking for Four Corners. In the Supplemental Notice, the EPA proposed to find that a different alternative emission control strategy, based upon APS s November 2010 proposal, would achieve more progress than the EPA s October 2010 BART proposal. The Supplemental Notice proposes that Units 1, 2 and 3 would close by 2014, post-combustion pollution controls for NOx would be installed on Units 4 and 5 by July 31, 2018, and the NOx emission limitation for Units 4 and 5 would be 0.098 lbs/MMBtu, rather than the 0.11 lbs/MMBtu proposed by the EPA in October 2010. The EPA extended the comment deadline for both the October 2010 proposal and the Supplemental Notice to May 2, 2011. We are currently evaluating both proposals and will be providing comments to the EPA on both.

The EPA has not yet issued a proposed rule for the Navajo Plant. SRP s recommended plan for the Navajo Plant includes the installation of combustion control equipment, with an estimated cost to APS of approximately $6 million based on APS s Navajo Plant ownership interest. If the EPA determines that post-combustion controls are required, APS s total costs could be up to approximately $93 million for the Navajo Plant. The Four Corners and the Navajo Plant participants will have five years after the EPA issues its final determinations to achieve compliance with their respective BART requirements.

In addition, on February 16, 2010, a group of environmental organizations filed a petition with the Departments of Interior and Agriculture requesting those agencies to certify to the EPA that visibility impairment in sixteen national park and wilderness areas is reasonably attributable to emissions from Four Corners, the Navajo Plant and other non-APS plants. If the agencies certify impairment, the EPA is required to evaluate and, if necessary, determine BART for Four Corners and the Navajo Plant under a different haze program known as Reasonably Attributable Visibility Impairment. On January 19, 2011, a similar group of environmental organizations filed a lawsuit against the Departments of Interior and Agriculture, alleging among other things that the agencies failed to act on the February 2010 petition without unreasonable delay and requesting the court to order the agencies to act on the petition within 30 days. We are currently evaluating the potential impact of this lawsuit on APS.

The Four Corners and Navajo Plant participants obligations to comply with the EPA s final BART determinations, coupled with the financial impact of future climate change legislation, other environmental regulations, the result of the lawsuit mentioned above and other business considerations, could jeopardize the economic viability of these plants or the ability of individual participants to continue their participation in these plants.

In order to coordinate with each plant s other scheduled activities, the plants are currently implementing portions of their recommended plans described above on a voluntary basis. APS s share of the costs related to the implementation of these portions of the recommended plans are included in our environmental expenditure estimates (see Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Expenditures in Item 7).

Table of Contents

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. APS estimates that the cost for equipment necessary to meet these anticipated standards is approximately $220 million for Four Corners Units 1-3 and $89 million for Cholla Units 1-3. The estimated costs for Four Corners Units 1-3 are not included in our current environmental expenditure estimates since our estimates assume the consummation of APS s purchase of SCE s interest in Four Corners Units 4 and 5 and the subsequent shut down of Units 1-3. Cholla s estimated costs for the next three years are included in our environmental expenditure estimates. (See Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Expenditures in Item 7 for details of our capital expenditure estimates).

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 requested comments 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 filed comments on the proposed rule during the public comment period, which ended on November 19, 2010. 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.

Ozone National Ambient Air Quality Standards. In March 2008, the EPA adopted new, more stringent eight-hour ozone standards, known as national ambient air quality standards or NAAQS. In January 2010, the EPA proposed to adopt even more stringent eight-hour ozone NAAQS. As ozone standards become more stringent, our fossil generation units may come under increasing pressure to reduce emissions of nitrogen oxides and volatile organic compounds and/or to generate emission offsets for new projects or facility expansions. At this time, APS is unable to predict what impact the adoption of these standards may have on its operations.

Table of Contents

New Source Review. On April 6, 2009, APS received a request from the EPA under Section 114 of the Clean Air Act seeking detailed information regarding projects at and operations of Four Corners. This request is part of an enforcement initiative that the EPA has undertaken under the Clean Air Act. The EPA has taken the position that many utilities have made certain physical or operational changes at their plants that should have triggered additional regulatory requirements under the New Source Review provisions of the Clean Air Act. Other electric utilities have received and responded to similar Section 114 requests, and several of them have been the subject of notices of violation and lawsuits by the EPA. APS responded to the EPA s request in August 2009 and is currently unable to predict the timing or content of the EPA s response, if any, or any resulting actions.

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 NSPS 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 2010, and the EPA did not take any action. At this time, we cannot predict whether or when Earthjustice might file a lawsuit.

Endangered Species Act. On January 30, 2011, the Center for Biological Diversity, Dine Citizens Against Running Our Environment, and San Juan Citizens Alliance field a lawsuit against the Office of Surface Mining Reclamation and Enforcement (OSM) and the Department of the Interior, alleging that OSM failed to engage in mandatory Endangered Species Act (ESA) consultation with the Fish and Wildlife Service prior to authorizing the renewal of an operating permit for the mine that serves Four Corners. The lawsuit alleges that activities at the mine, including mining and the disposal of coal combustion residue, will adversely affect several endangered species and their critical habitats. The lawsuit requests the court to vacate and remand the mining permit and enjoin all activities carried out under the permit until OSM has complied with the ESA. Although we are not a party to the lawsuit, we are evaluating the lawsuit to determine its potential impact on plant operations.

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 PRPs. PRPs may be strictly, and often are jointly and severally, liable for clean-up. On September 3, 2003, the 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. APS estimates that its costs related to this investigation and study will be approximately $1 million, which is reserved as a liability on its 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.

By letter dated April 25, 2008, the EPA informed APS that it may be a PRP in the Gila River Indian Reservation Superfund Site in Maricopa County, Arizona. APS, along with three other electric utility companies, owns a parcel of property on which a transmission pole and a portion of a transmission line are located. The property abuts the Gila River Indian Community boundary and, at one time, may have been part of an airfield where crop dusting took place. Currently, the EPA is only seeking payment from APS and four other PRPs for past cleanup-related costs involving contamination from the crop dusting. Based upon the total amount of cleanup costs reported by the EPA in its letter to APS, we do not expect that the resolution of this matter will have a material adverse impact on APS s financial position, results of operations, or cash flows.

Manufactured Gas Plant Sites. Certain properties which APS now owns or which were previously owned by it or its corporate predecessors were at one time sites of, or sites associated with, manufactured gas plants. APS is taking action to voluntarily remediate these sites. APS does not expect these matters to have a material adverse effect on its financial position, results of operations, cash flows or liquidity.

Table of Contents

Navajo Nation Environmental Issues

Four Corners and the Navajo Plant are located on the Navajo Reservation and are held under easements granted by the federal government as well as leases from the Navajo Nation. See Energy Sources and Resource Planning Generation Facilities Coal Fueled Generating Facilities above for additional information regarding these plants.

In July 1995, the Navajo Nation enacted the Navajo Nation Air Pollution Prevention and Control Act, the Navajo Nation Safe Drinking Water Act and the Navajo Nation Pesticide Act (collectively, the Navajo Acts). The Navajo Acts purport to give the Navajo Nation Environmental Protection Agency authority to promulgate regulations covering air quality, drinking water and pesticide activities, including those activities that occur at Four Corners and the Navajo Plant. On October 17, 1995, the Four Corners participants and the Navajo Plant participants each filed a lawsuit in the District Court of the Navajo Nation, Window Rock District, challenging the applicability of the Navajo Acts as to Four Corners and the Navajo Plant. The Court has stayed these proceedings pursuant to a request by the parties, and the parties are seeking to negotiate a settlement.

In April 2000, the Navajo Nation Council approved operating permit regulations under the Navajo Nation Air Pollution Prevention and Control Act. APS believes the Navajo Nation exceeded its authority when it adopted the operating permit regulations. On July 12, 2000, the Four Corners participants and the Navajo Plant participants each filed a petition with the Navajo Supreme Court for review of these regulations. Those proceedings have been stayed, pending the settlement negotiations mentioned above. APS cannot currently predict the outcome of this matter.

On May 18, 2005, APS, Salt River Project, as the operating agent for the Navajo Plant, and the Navajo Nation executed a Voluntary Compliance Agreement to resolve their disputes regarding the Navajo Nation Air Pollution Prevention and Control Act. As a result of this agreement, APS sought, and the courts granted, dismissal of the pending litigation in the Navajo Nation Supreme Court and the Navajo Nation District Court, to the extent the claims relate to the Clean Air Act. The agreement does not address or resolve any dispute relating to other Navajo Acts. APS cannot currently predict the outcome of this matter.

Water Supply

Assured supplies of water are important for APS s generating plants. At the present time, APS has adequate water to meet its needs. However, the Four Corners region, in which Four Corners is located, has been experiencing drought conditions that may affect the water supply for the plants if adequate moisture is not received in the watershed that supplies the area. APS is continuing to work with area stakeholders to implement agreements to minimize the effect, if any, on future operations of the plant. The effect of the drought cannot be fully assessed at this time, and APS cannot predict the ultimate outcome, if any, of the drought or whether the drought will adversely affect the amount of power available, or the price thereof, from Four Corners.

Conflicting claims to limited amounts of water in the southwestern United States have resulted in numerous court actions, which, in addition to future supply conditions, have the potential to impact APS operations.

Table of Contents

San Juan River Adjudication. Both groundwater and surface water in areas important to APS s operations have been the subject of inquiries, claims and legal proceedings, which will require a number of years to resolve. APS is one of a number of parties in a proceeding, filed March 13, 1975, before the Eleventh Judicial District Court in New Mexico to adjudicate rights to a stream system from which water for Four Corners is derived. An agreement reached with the Navajo Nation in 1985, however, provides that if Four Corners loses a portion of its rights in the adjudication, the Navajo Nation will provide, for an agreed upon cost, sufficient water from its allocation to offset the loss.

Gila River Adjudication. A summons served on APS in early 1986 required all water claimants in the Lower Gila River Watershed in Arizona to assert any claims to water on or before January 20, 1987, in an action pending in Maricopa County, Arizona, Superior Court. Palo Verde is located within the geographic area subject to the summons. APS s rights and the rights of the other Palo Verde participants to the use of groundwater and effluent at Palo Verde are potentially at issue in this action. As operating agent of Palo Verde, APS filed claims that dispute the court s jurisdiction over the Palo Verde participants groundwater rights and their contractual rights to effluent relating to Palo Verde. Alternatively, APS seeks confirmation of such rights. Five of APS s other power plants are also located within the geographic area subject to the summons. APS s claims dispute the court s jurisdiction over its groundwater rights with respect to these plants. Alternatively, APS seeks confirmation of such rights. In November 1999, the Arizona Supreme Court issued a decision confirming that certain groundwater rights may be available to the federal government and Indian tribes. In addition, in September 2000, the Arizona Supreme Court issued a decision affirming the lower court s criteria for resolving groundwater claims. Litigation on both of these issues has continued in the trial court. In December 2005, APS and other parties filed a petition with the Arizona Supreme Court requesting interlocutory review of a September 2005 trial court order regarding procedures for determining whether groundwater pumping is affecting surface water rights. The Court denied the petition in May 2007, and the trial court is now proceeding with implementation of its 2005 order. No trial date concerning APS s water rights claims has been set in this matter.

Little Colorado River Adjudication. APS has also filed claims to water in the Little Colorado River Watershed in Arizona in an action pending in the Apache County, Arizona, Superior Court, which was originally filed on September 5, 1985. APS s groundwater resource utilized at Cholla is within the geographic area subject to the adjudication and, therefore, is potentially at issue in the case. APS s claims dispute the court s jurisdiction over its groundwater rights. Alternatively, APS seeks confirmation of such rights. A number of parties are in the process of settlement negotiations with respect to certain claims in this matter. Other claims have been identified as ready for litigation in motions filed with the court. No trial date concerning APS s water rights claims has been set in this matter. Although the above matters remain subject to further evaluation, APS does not expect that the described litigation will have a material adverse impact on its financial position, results of operations, cash flows or liquidity.

BUSINESS OF OTHER SUBSIDIARIES

The operations of our other first-tier subsidiaries (described below) are not expected to contribute in any material way to our future financial performance nor will they require any material amounts of capital over the next three years.

Table of Contents

APSES

APSES provides energy-related products and services (such as energy master planning, energy use consultation and facility audits, cogeneration analysis and installation, and project management) with a focus on energy efficiency and renewable energy to commercial and industrial retail customers in the western United States. On June 22, 2010, APSES sold its district cooling business consisting of operations in downtown Phoenix, Tucson, and on certain Arizona State University campuses. This sale resulted in an after-tax gain of approximately $25 million.

Financial Summary.

	2010	2009	2008
	(dollars in millions)		
Net income (loss)	$ 30	$ (2)	$ (1)
Total assets at December 31	$ 43	$ 74	$ 70

SunCor

SunCor was a developer of residential, commercial and industrial real estate projects in Arizona, Idaho, New Mexico and Utah. Due to the continuing distressed conditions in the real estate markets, in 2009 SunCor undertook a program to dispose of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to eliminate its outstanding debt.

Financial Summary.

	2010	2009	2008
	(dollars in millions)		
Revenues (a)	$ 102	$ 158	$ 242
Net loss attributable to common shareholders (b)	$ (9)	$ (279)	$ (26)
Total assets at December 31 (c)	$ 16	$ 166	$ 547

(a) All reported as discontinued operations on Pinnacle West s Consolidated Statements of Income. (See Note 22).

(b) These amounts include $266 million (pre-tax) and $53 million (pre-tax) real estate impairment charges for 2009 and 2008, respectively.

(c) The reduction in assets in 2010 is primarily due to asset sales. The $16 million of assets at December 31, 2010 consists primarily of $8 million of intercompany receivables, $3 million of assets held for sale and $5 million of other assets.

In 2010 and 2009, income tax benefits related to SunCor operations were recorded by Pinnacle West in accordance with an intercompany tax sharing agreement. See Liquidity and Capital Resources Other Subsidiaries SunCor in Item 7 for a discussion of SunCor s long-term debt, liquidity and capital requirements, and the SunCor-related risk factor in Item 1A for a discussion of risks facing SunCor.

Table of Contents

El Dorado

El Dorado owns minority interests in several energy-related investments and Arizona community-based ventures. El Dorado s short-term goal is to prudently realize the value of its existing investments. On a long-term basis, Pinnacle West may use El Dorado, when appropriate, for investments that are strategic to the business of generating, distributing and marketing electricity.

Financial Summary.

	2010	2009	2008
	(dollars in millions)		
Net income (loss)	$ 2	$ (7)	$ (10)
Total assets at December 31	$ 19	$ 19	$ 28

Income taxes related to El Dorado are recorded by Pinnacle West.

OTHER INFORMATION

Pinnacle West, APS and Pinnacle West s other first-tier subsidiaries are all incorporated in the State of Arizona. Additional information for each of these companies is provided below:

	Principal Executive Office Address	Year of Incorporation	Approximate Number of Employees at December 31, 2010
Pinnacle West	400 North Fifth Street Phoenix, AZ 85004	1985	80
APS	400 North Fifth Street P.O. Box 53999 Phoenix, AZ 85072-3999	1920	6,600
APSES	60 E. Rio Salado Parkway Suite 1001 Tempe, AZ 85281	1998	50
SunCor	80 East Rio Salado Parkway Suite 410 Tempe, AZ 85281	1965	10
El Dorado	400 North Fifth Street Phoenix, AZ 85004	1983	
Total			6,740

The APS number includes employees at jointly-owned generating facilities (approximately 3,100 employees) for which APS serves as the generating facility manager. Approximately 1,940 APS employees are union employees. The collective bargaining agreement with union employees in the fossil generation, energy delivery and customer service business areas expires in April 2011, and the parties began negotiating a successor agreement in February 2011. The

agreement with union employees serving as Palo Verde security officers expires in 2013.

Table of Contents

WHERE TO FIND MORE INFORMATION

We use our website *www.pinnaclewest.com* as a channel of distribution for material Company information. The following filings are available free of charge on our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC: Annual Reports on Form 10-K, definitive proxy statements for our annual shareholder meetings, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports. Our board and committee charters, Code of Ethics for Financial Executives, Ethics Policy and Standards of Business Practices and other corporate governance information is also available on the Pinnacle West website. Pinnacle West will post any amendments to the Code of Ethics for Financial Executives and Ethics Policy and Standards of Business Practices, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, on its website. The information on Pinnacle West s website is not incorporated by reference into this report.

You can request a copy of these documents, excluding exhibits, by contacting Pinnacle West at the following address: Pinnacle West Capital Corporation, Office of the Secretary, Station 9068, P.O. Box 53999, Phoenix, Arizona 85072-3999 (telephone 602-250-3252).

Table of Contents

ITEM 1A. RISK FACTORS

In addition to the factors affecting specific business operations identified in the description of these operations contained elsewhere in this report, set forth below are risks and uncertainties that could affect our financial results. Unless otherwise indicated or the context otherwise requires, the following risks and uncertainties apply to Pinnacle West and its subsidiaries, including APS.

REGULATORY RISKS

Our financial condition depends upon APS s ability to recover costs in a timely manner from customers through regulated rates and otherwise execute its business strategy.

APS is subject to comprehensive regulation by several federal, state and local regulatory agencies that significantly influence its business, liquidity, results of operations and its ability to fully recover costs from utility customers in a timely manner. The ACC regulates APS s retail electric rates and the FERC regulates rates for wholesale power sales and transmission services. The profitability of APS is affected by the rates it may charge. Consequently, our financial condition and results of operations are dependent upon the satisfactory resolution of any APS retail rate proceedings and ancillary matters which may come before the ACC and the FERC. Arizona, like certain other states, has a statute that allows the ACC to reopen prior decisions and modify final orders under certain circumstances. The ACC must also approve APS s issuance of securities and any transfer of APS property used to provide retail electric service, and must approve or receive prior notification of certain transactions between us, APS and our respective affiliates. Decisions made by the ACC and the FERC could have a material adverse impact on our financial condition, results of operations or cash flows.

APS s ability to conduct its business operations and avoid fines and penalties depends upon compliance with federal, state or local statutes and regulations, and obtaining and maintaining certain regulatory permits, approvals and certificates.

APS must comply in good faith with all applicable statutes, regulations, rules, tariffs, and orders of agencies that regulate APS s business, including the FERC, the NRC, the EPA and state and local governmental agencies. These agencies regulate many aspects of APS s utility operations, including safety and performance, emissions, siting and construction of facilities, customer service and the rates that APS can charge retail and wholesale customers. Failure to comply can subject APS to, among other things, fines and penalties. For example, under the Energy Policy Act of 2005, the FERC can impose penalties (up to one million dollars per day per violation) for failure to comply with mandatory electric reliability standards. In addition, APS is required to have numerous permits, approvals and certificates from these agencies. APS believes the necessary permits, approvals and certificates have been obtained for its existing operations and that APS s business is conducted in accordance with applicable laws in all material respects. However, changes in regulations or the imposition of new or revised laws or regulations could have an adverse impact on our results of operations. We are also unable to predict the impact on our business and operating results from pending or future regulatory activities of any of these agencies.

The operation of APS s nuclear power plant exposes it to substantial regulatory oversight and potentially significant liabilities and capital expenditures.

The NRC has broad authority under federal law to impose licensing and safety-related requirements for the operation of nuclear generation facilities. In the event of noncompliance, the NRC has the authority to impose monetary civil penalties or a progressively increased inspection regime that could ultimately result in the shut down of a unit, or both, depending upon the NRC s assessment of the severity of the situation, until compliance is achieved. The increased costs resulting from penalties, a heightened level of scrutiny and implementation of plans to achieve compliance with NRC requirements may adversely affect APS s financial condition, results of operations and cash flows.

APS is subject to numerous environmental laws and regulations, and changes in, or liabilities under, existing or new laws or regulations may increase APS s cost of operations or impact its business plans.

APS is subject to numerous environmental laws and regulations affecting many aspects of its present and future operations, including air emissions, water quality, wastewater discharges, solid waste, hazardous waste, and coal combustion products, which consist of bottom ash, fly ash and air pollution control wastes. These laws and regulations can result in increased capital, operating, and other costs, particularly with regard to enforcement efforts focused on power plant emissions obligations. These laws and regulations generally require APS to obtain and comply with a

wide variety of environmental licenses, permits, and other approvals. If there is a delay or failure to obtain any required environmental regulatory approval, or if APS fails to obtain, maintain or comply with any such approval, operations at affected facilities could be suspended or subject to additional expenses. In addition, failure to comply with applicable environmental laws and regulations could result in civil liability or criminal penalties. Both public officials and private individuals may seek to enforce applicable environmental laws and regulations. APS cannot predict the outcome (financial or operational) of any related litigation that may arise.

Table of Contents

Environmental Clean Up. APS has been named as a PRP for a Superfund site in Phoenix, Arizona and it could be named a PRP in the future for other environmental clean up at sites identified by a regulatory body. APS cannot predict with certainty the amount and timing of all future expenditures related to environmental matters because of the difficulty of estimating clean up costs. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability on all potentially responsible parties.

Regional Haze. APS is currently awaiting a final rulemaking from the EPA that could impose new requirements on Four Corners and the Navajo Plant. APS is also awaiting a final rulemaking from ADEQ that could impose new requirements on Cholla. The EPA and ADEQ will require these plants to install pollution control equipment that constitutes the best available retrofit technology to lessen the impacts of emissions on visibility surrounding the plants. Depending upon the agencies final determinations of what constitutes BART for these plants, the financial impact of installing the required pollution control equipment could jeopardize the economic viability of the plants or the ability of individual participants to continue their participation in these plants.

Coal Ash. The EPA released proposed regulations governing the disposal of CCRs, which are generated as a result of burning coal and consist of, among other things, fly ash and bottom ash. The EPA proposed regulating CCRs as either non-hazardous or hazardous waste. APS currently disposes of CCRs in ash ponds and dry storage areas at Four Corners and Cholla, and also sells a portion of its fly ash for beneficial reuse as a constituent in concrete products. If the EPA regulates CCRs as a hazardous solid waste or phases out APS s ability to dispose of CCRs through the use of ash ponds, APS could incur significant costs for CCR disposal and may be unable to continue its sale of fly ash for beneficial reuse.

New Source Review. The EPA has taken the position that many projects electric utilities have performed are major modifications that trigger New Source Review requirements under the Clean Air Act. The utilities generally have taken the position that these projects are routine maintenance and did not result in emissions increases, and thus are not subject to New Source Review. In 2009, APS received and responded to a request from the EPA regarding projects and operations of Four Corners. A civilian organization notified the Four Corners participants that it intends to file a citizen suit against the participants for alleged violations of New Source Review and the NSPS program of the Clean Air Act. If the EPA seeks to impose New Source Review requirements at Four Corners or any other APS plant, or if the citizen suit is filed and the citizens group prevails, significant capital investments could be required to install new pollution control technologies. The EPA could also seek civil penalties.

Mercury and other Hazardous Air Pollutants. The EPA is required to adopt maximum achievable control technology emissions standards for mercury and other hazardous air pollutants by November 2011. Compliance with the new standards will be required three years after the EPA issues its final rule. Depending on the compliance requirements contained in the final rule, APS may need to make significant capital investments to install additional pollution control equipment to meet these new standards.

APS cannot assure that existing environmental regulations will not be revised or that new regulations seeking to protect the environment will not be adopted or become applicable to it. Revised or additional regulations that result in increased compliance costs or additional operating restrictions, particularly if those costs incurred by APS are not fully recoverable from APS s customers, could have a material adverse effect on its financial condition, results of operations or cash flows.

Table of Contents

APS faces physical and operational risks related to climate change, and potential financial risks resulting from climate change litigation and legislative and regulatory efforts to limit greenhouse gas emissions.

Concern over climate change, deemed by many to be induced by rising levels of greenhouse gases in the atmosphere, has led to significant legislative and regulatory efforts to limit CO_2, which is a major byproduct of the combustion of fossil fuel, and other greenhouse gas emissions. In addition, lawsuits have been filed against companies that emit greenhouse gases, including a lawsuit filed by the Native Village of Kivalina and the City of Kivalina, Alaska against us and several other utilities seeking damages related to climate change, which was dismissed but has been appealed.

Financial Risks Potential Legislation and Regulation. In the past several years, the United States Congress has considered bills that would regulate domestic greenhouse gas emissions. It is possible that some form of legislation may occur in the future at the federal level with respect to greenhouse gas emissions.

If the United States Congress, or individual states or groups of states in which APS operates, ultimately pass legislation regulating the emissions of greenhouse gases, any resulting limitations on CO_2 and other greenhouse gas emissions could result in the creation of substantial additional capital expenditures and operating costs in the form of taxes, emissions allowances or required equipment upgrades and could have a material adverse impact on all fossil fuel fired generation facilities (particularly coal-fired facilities, which constitute approximately 28% of APS s generation capacity).

At the state level, the California legislature enacted legislation to address greenhouse gas emissions and the California Air Resources Board approved regulations that will establish a cap-and-trade program for greenhouse gas. This legislation, regulation and other state-specific initiatives may affect APS s business, including sales into the impacted states or the ability of its out-of-state power plant participants to continue their participation in certain coal-fired power plants, including Four Corners following expiration of the current lease term in 2016.

In addition, the EPA has 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. Several groups have filed lawsuits challenging the EPA s endangerment finding. APS cannot predict what rules or regulations may ultimately result from the EPA s endangerment finding, whether the parties challenging the endangerment finding will be successful, or what impact other potential rules or regulations will have on APS s operations. Excessive costs to comply with future legislation or regulations could force APS and other similarly-situated electric power generators to retire or suspend operations at certain coal-fired facilities.

Physical and Operational Risks. Assuming that the primary physical and operational risks to APS from climate change are increased potential for drought or water shortage, and a mild to moderate increase in ambient temperatures, APS believes it is taking the appropriate steps to respond to these risks. Weather extremes such as drought and high temperature variations are common occurrences in the Southwest s desert area, and these are risks that APS considers in the normal course of business in the engineering and construction of its electric system. Large increases in ambient temperatures could require evaluation of certain materials used within its system and represent a greater challenge.

Table of Contents

If APS cannot meet or maintain the level of renewable energy required under Arizona s increasing Renewable Energy Standards, APS may be subject to penalties or fines for non-compliance.

The RES requires APS to supply an increasing percentage of renewable energy each year, so that the amount of retail electricity sales from eligible renewable resources is at least 3% of total retail sales by 2011. This amount increases annually to 15% by 2025. In its 2009 retail rate case settlement agreement, APS agreed to exceed these standards and committed to an interim renewable energy target of 1,700 GWh of renewable resources to be in service by year end 2015 in addition to its 2008 renewable resource commitments. Taken together, APS s commitment is estimated to be 3,400 GWh, or approximately 10% of retail sales, by year end 2015. A portion of this total renewable energy requirement must be met with an increasing percentage of distributed energy resources (generally, small scale renewable technologies located on customers properties). The distributed energy requirement is 25% of the overall RES requirement of 3% in 2011 and increases to 30% of the applicable RES requirement in 2012 and subsequent years. If APS fails to implement any of its annual ACC-approved renewable implementation plans, it may be subject to penalties imposed by the ACC, including APS s inability to recover certain costs. Compliance with the distributed resource requirement is contingent upon customer participation. The development of any renewable generation facilities resulting from the RES is subject to many other risks, including risks relating to financing, permitting, technology, fuel supply, and the construction of sufficient transmission capacity to support these facilities.

Deregulation or restructuring of the electric industry may result in increased competition, which could have a significant adverse impact on APS s business and its results of operations.

In 1999, the ACC approved rules for the introduction of retail electric competition in Arizona. Retail competition could have a significant adverse financial impact on APS due to an impairment of assets, a loss of retail customers, lower profit margins or increased costs of capital. Although some very limited retail competition existed in APS s service area in 1999 and 2000, there are currently no active retail competitors offering unbundled energy or other utility services to APS s customers. As a result, APS cannot predict if, when, and the extent to which, additional competitors may re-enter APS s service territory.

In 2010, the ACC issued a decision holding that solar vendors that install and operate solar facilities for non-profit schools and governments pursuant to a specific type of contract that calculates payments based on the energy produced are not public service corporations under the Arizona Constitution, and are therefore not regulated by the ACC. A second matter is pending with the ACC to determine whether that ruling should extend to solar providers who serve a broader customer base under the same business model. The use of such products by customers within our territory would result in some level of competition. APS cannot predict whether the ACC will deem these vendors public service corporations subject to ACC regulation and when, and the extent to which, additional service providers will enter APS s service territory, increasing the level of competition in the market.

Table of Contents

OPERATIONAL RISKS

APS s results of operations can be adversely affected by various factors impacting demand for electricity.

Weather Conditions. Weather conditions directly influence the demand for electricity and affect the price of energy commodities. Electric power demand is generally a seasonal business. In Arizona, demand for power peaks during the hot summer months, with market prices also peaking at that time. As a result, APS s overall operating results fluctuate substantially on a seasonal basis. In addition, APS has historically sold less power, and consequently earned less income, when weather conditions are milder. As a result, unusually mild weather could diminish APS s results of operations.

Higher temperatures may decrease the snowpack, which might result in lowered soil moisture and an increased threat of forest fires. Forest fires could threaten APS s communities and electric transmission lines. Any damage caused as a result of forest fires could negatively impact APS s results of operations.

Effects of Energy Conservation Measures and Distributed Energy. The ACC has enacted rules regarding energy efficiency that mandate a 22% annual energy savings requirement by 2020. This will likely increase participation by APS customers in energy efficiency and conservation programs and other demand-side management efforts, which in turn will impact the demand for electricity. The rules also include a requirement for the ACC to review and address financial disincentives, recovery of fixed costs and the recovery of net lost income/revenue that would result from lower sales due to increased energy efficiency requirements. To that end, the ACC passed a policy statement on per customer revenue decoupling in December of 2010. The policy statement will have no effect on APS s rates unless implemented in a rate case. The 2009 retail rate case settlement agreement also establishes energy efficiency goals for APS that begin in 2010 that extend through 2012, subjecting APS to energy efficiency requirements slightly greater for those years than required under the rules described above.

APS must also meet certain distributed energy requirements. A portion of APS s total renewable energy requirement must be met with an increasing percentage of distributed energy resources (generally, small scale renewable technologies located on customers properties). The distributed energy requirement is 25% of the overall RES requirement of 3% in 2011 and increases to 30% of the applicable RES requirement in 2012 and subsequent years. Customer participation in distributed energy programs would result in lower demand, since customers would be meeting some or all of their own energy needs.

Reduced demand due to these energy efficiency and distributed energy requirements, unless offset through ratemaking mechanisms, could have a material adverse impact on APS s financial condition, results of operations and cash flows.

The operation of power generation facilities involves risks that could result in unscheduled power outages or reduced output, which could materially affect APS s results of operations.

The operation of power generation facilities involves certain risks, including the risk of breakdown or failure of equipment, fuel interruption, and performance below expected levels of output or efficiency. Unscheduled outages, including extensions of scheduled outages due to mechanical failures or other complications, occur from time to time and are an inherent risk of APS s business. If APS s facilities operate below expectations, especially during its peak seasons, it may lose revenue or incur additional expenses, including increased purchased power expenses.

Table of Contents

The lack of access to sufficient supplies of water could have a material adverse impact on APS s business and results of operations.

Assured supplies of water are important for APS s generating plants. Water in the southwestern United States is limited and various parties have made conflicting claims regarding the right to access and use such limited supply of water. Both groundwater and surface water in areas important to APS s generating plants have been and are the subject of inquiries, claims and legal proceedings. In addition, the Four Corners region, in which Four Corners is located, has been experiencing drought conditions that may affect the water supply for the plants if adequate moisture is not received in the watershed that supplies the area. APS s inability to access sufficient supplies of water could have a material adverse impact on our business and results of operations.

The ownership and operation of power generation and transmission facilities on Indian lands could result in uncertainty related to continued leases, easements and rights-of-way, which could have a significant impact on our business.

Certain APS power plants, including Four Corners, and portions of the transmission lines that carry power from these plants are located on Indian lands pursuant to leases, easements or other rights-of-way that are effective for specified periods. APS is currently unable to predict the final outcome of discussions with the appropriate Indian tribes and approval by their respective governing bodies with respect to renewals of these leases, easements and rights-of-way.

There are inherent risks in the ownership and operation of nuclear facilities, such as environmental, health, fuel supply, spent fuel disposal, regulatory and financial risks and the risk of terrorist attack.

APS has an ownership interest in and operates, on behalf of a group of participants, Palo Verde, which is the largest nuclear electric generating facility in the United States. Palo Verde is subject to environmental, health and financial risks such as the ability to obtain adequate supplies of nuclear fuel; the ability to dispose of spent nuclear fuel; the ability to maintain adequate reserves for decommissioning; potential liabilities arising out of the operation of these facilities; the costs of securing the facilities against possible terrorist attacks; and unscheduled outages due to equipment and other problems. APS maintains nuclear decommissioning trust funds and external insurance coverage to minimize its financial exposure to some of these risks; however, it is possible that damages could exceed the amount of insurance coverage. In addition, APS may be required under federal law to pay up to $118 million (but not more than $18 million per year) of liabilities arising out of a nuclear incident occurring not only at Palo Verde, but at any other nuclear power plant in the United States. Although we have no reason to anticipate a serious nuclear incident at Palo Verde, if an incident did occur, it could materially and adversely affect our results of operations and financial condition. A major incident at a nuclear facility anywhere in the world could cause the NRC to limit or prohibit the operation or licensing of any domestic nuclear unit.

The operation of Palo Verde requires licenses that need to be periodically renewed and/or extended. In December 2008, APS applied for renewed operating licenses for all three Palo Verde units for 20 years beyond the expirations of the current licenses. APS does not anticipate any problems renewing these licenses. However, as a result of potential terrorist threats and increased public scrutiny of utilities, the licensing process could result in increased licensing or compliance costs that are difficult to predict.

Table of Contents

The use of derivative contracts in the normal course of our business could result in financial losses that negatively impact our results of operations.

APS s operations include managing market risks related to commodity prices. APS is exposed to the impact of market fluctuations in the price and transportation costs of electricity, natural gas and coal to the extent that unhedged positions exist. We have established procedures to manage risks associated with these market fluctuations by utilizing various commodity derivatives, including exchange-traded futures and options and over-the-counter forwards, options, and swaps. As part of our overall risk management program, we enter into derivative transactions 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 commodity. To the extent that commodity markets are illiquid, we may not be able to execute our risk management strategies, which could result in greater unhedged positions than we would prefer at a given time and financial losses that negatively impact our results of operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which was signed into law in July 2010, contains measures aimed at increasing the transparency and stability of the over-the counter, or OTC, derivative markets and preventing excessive speculation. The Dodd-Frank Act could restrict, among other things, trading positions in the energy futures markets, require different collateral or settlement positions, or increase regulatory reporting over derivative positions. Based on the provisions included in the Dodd-Frank Act and the implementation of regulations yet to be developed, these changes could, among other things, impact our ability to hedge commodity price and interest rate risk or increase the costs associated with our hedging programs.

We are exposed to losses in the event of nonperformance or nonpayment by counterparties. We use a risk management process to assess and monitor the financial exposure of all counterparties. Despite the fact that the majority of APS s trading counterparties are rated as investment grade by the rating agencies, there is still a possibility that one or more of these companies could default, which could result in a material adverse impact on our earnings for a given period.

Changes in technology could create challenges for APS s existing business.

Research and development activities are ongoing to assess alternative technologies that produce power or reduce power consumption, including clean coal and coal gasification, renewable technologies including photovoltaic (solar) cells, customer-sited generation (solar) and efficiency technologies, and improvements in traditional technologies and equipment, such as more efficient gas turbines. Advances in these, or other technologies could reduce the cost of power production, making APS s existing generating facilities less economical. In addition, advances in technology could reduce the demand for power supply, which could adversely affect APS s business.

APS is pursuing and implementing smart grid technologies, including advanced transmission and distribution system technologies, digital meters enabling two-way communications between the utility and its customers, and electric usage monitoring devices for customers homes and businesses. Many of the products and processes resulting from these and other alternative technologies have not yet been widely used or tested, and their use on large-scale systems is not as advanced and established as APS s existing technologies and equipment. Uncertainties and unknowns related to these and other advancements in technology and equipment could adversely affect APS s business if national standards develop that do not embrace the current technologies or if the technologies and equipment fail to perform as expected. In addition, widespread installation and acceptance of these devices could enable the entry of new market participants, such as technology companies, into the interface between APS and its customers.

Table of Contents

We are subject to employee workforce factors that could adversely affect our business and financial condition.

Like most companies in the electric utility industry, our workforce is aging and a number of our employees will become eligible to retire within the next few years. Although we have undertaken efforts to recruit and train new employees, we may not be successful. We are subject to other employee workforce factors, such as the availability of qualified personnel, the need to negotiate collective bargaining agreements with union employees and potential work stoppages. Exposure to these or other employee workforce factors could negatively impact our business, financial condition or results of operations.

We are subject to information security risks.

In the regular course of our business we handle a range of sensitive security and customer information. We are subject to laws and rules issued by different agencies concerning safeguarding and maintaining the confidentiality of this information. A security breach of our information systems such as theft or the inappropriate release of certain types of information, including confidential customer information or system operating information could have a material adverse impact on our business and financial condition.

FINANCIAL RISKS

Financial market disruptions may increase our financing costs or limit our access to the credit and capital markets, which may adversely affect our liquidity and our ability to implement our financial strategy.

We rely on access to short-term money markets, longer-term capital markets and the bank market as a significant source of liquidity and for capital requirements not satisfied by the cash flow from our operations. We believe that we will maintain sufficient access to these financial markets. However, certain market disruptions may increase our cost of borrowing or adversely affect our ability to access one or more financial markets. Such disruptions could include:

- continuation of the current economic downturn;
- terrorist attacks or threatened attacks;
- mergers among financial institutions and the overall health of the banking industry; or
- the overall health of the utility industry.

In addition, the credit commitments of our lenders under our bank facilities may not be satisfied for a variety of reasons, including unexpected periods of financial distress affecting our lenders, which could materially adversely affect the adequacy of our liquidity sources.

Table of Contents

Changes in economic conditions could result in higher interest rates, which would increase our interest expense on our debt and reduce funds available to us for our current plans. Additionally, an increase in our leverage could adversely affect us by:

- reducing our credit ratings;
- increasing the cost of future debt financing and refinancing;
- increasing our vulnerability to adverse economic and industry conditions; and
- requiring us to dedicate an increased portion of our cash flow from operations to payments on our debt, which would reduce funds available to us for operations, future business opportunities or other purposes.

A reduction in our credit ratings could materially and adversely affect our business, financial condition and results of operations.

Our current ratings are set forth in Liquidity and Capital Resources Credit Ratings in Item 7. We cannot be sure that any of our current ratings will remain in effect for any given period of time or that a rating will not be lowered or withdrawn entirely by a rating agency if, in its judgment, circumstances in the future so warrant. Any downgrade or withdrawal could adversely affect the market price of Pinnacle West s and APS s securities, limit our access to capital and increase our borrowing costs, which would diminish our financial results. We would be required to pay a higher interest rate in future financings, and our potential pool of investors and funding sources could decrease. In addition, borrowing costs under certain of our existing credit facilities depend on our credit ratings. A downgrade would also require us to provide substantial additional support in the form of letters of credit or cash or other collateral to various counterparties. If our short-term ratings were to be lowered, it could completely eliminate any possible future access to the commercial paper market. We note that the ratings from rating agencies are not recommendations to buy, sell or hold our securities and that each rating should be evaluated independently of any other rating.

Market performance, changing interest rates and other economic factors could decrease the value of our benefit plan assets and nuclear decommissioning trust funds and increase our related obligations, resulting in significant additional funding that could negatively impact our business.

Disruptions in the capital markets and/or decline in market value may adversely affect the values of fixed income and equity investments held in our employee benefit plan trusts and nuclear decommissioning trusts. We have significant obligations in these areas and hold substantial assets in these trusts. A decline in the market value of the investments in these trusts may increase our funding requirements. Additionally, the pension plan and other postretirement benefit liabilities are impacted by the discount rate, which is the interest rate used to discount future pension and other postretirement benefit obligations. Declining interest rates impact the discount rate, and may result in increases in pension and other postretirement benefit costs, cash contributions, regulatory assets, and charges to other comprehensive income. Changes in demographics, including increased numbers of retirements or changes in life expectancy assumptions, may also increase the funding requirements of the obligations related to the pension and other postretirement benefit plans. A significant portion of the pension costs and other postretirement benefit costs and all of the nuclear decommissioning costs are recovered in regulated electricity prices. Our inability to fully recover these costs in a timely manner or any increased funding obligations could negatively impact our financial condition, results of operations or cash flows.

Table of Contents

We may be required to adopt IFRS. The ultimate adoption of such standards could negatively impact our business, financial condition or results of operations.

IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board (IASB) that is being considered by the SEC to replace accounting principles generally accepted in the United States of America (GAAP) for use in preparation of financial statements. If the SEC requires mandatory adoption of IFRS, we may lose our ability to use regulatory accounting treatment, and would follow IFRS rather than GAAP for the preparation of our financial statements beginning in 2014. In the meantime, the FASB and the IASB are working on several accounting standards jointly to converge certain accounting differences before 2014. The implementation and adoption of these new standards and the inability to use regulatory accounting could negatively impact our business, financial condition or results of operations.

Our cash flow largely depends on the performance of APS.

We conduct our operations primarily through our subsidiary, APS. Substantially all of our consolidated assets are held by APS. Accordingly, our cash flow is dependent upon the earnings and cash flows of APS and its distributions to us. APS is a separate and distinct legal entity and has no obligation to make distributions to us.

APS s debt agreements may restrict its ability to pay dividends, make distributions or otherwise transfer funds to us. In addition, an ACC financing order requires APS to maintain a common equity ratio of at least 40% and does not allow APS to pay common dividends if the payment would reduce its common equity below that threshold. The common equity ratio, as defined in the ACC order, is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt.

Pinnacle West s ability to meet its debt service obligations could be adversely affected because its debt securities are structurally subordinated to the debt securities and other obligations of its subsidiaries.

Because Pinnacle West is structured as a holding company, all existing and future debt and other liabilities of our subsidiaries will be effectively senior in right of payment to our debt securities. The assets and cash flows of our subsidiaries will be available, in the first instance, to service their own debt and other obligations. Our ability to have the benefit of their assets and cash flows, particularly in the case of any insolvency or financial distress affecting our subsidiaries, would arise only through our equity ownership interests in our subsidiaries and only after their creditors have been satisfied.

The market price of our common stock may be volatile.

The market price of our common stock could be subject to significant fluctuations in response to factors such as the following, some of which are beyond our control:

- variations in our quarterly operating results;
- operating results that vary from the expectations of management, securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;

Table of Contents

developments generally affecting industries in which we operate, particularly the energy distribution and energy generation industries;
announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
announcements by third parties of significant claims or proceedings against us;
favorable or adverse regulatory or legislative developments;
our dividend policy;
future sales by the Company of equity or equity-linked securities; and
general domestic and international economic conditions.

In addition, the stock market in general has experienced volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations may adversely affect the market price of our common stock.

Certain provisions of our articles of incorporation and bylaws and of Arizona law make it difficult for shareholders to change the composition of our board and may discourage takeover attempts.

These provisions, which could preclude our shareholders from receiving a change of control premium, include the following:

restrictions on our ability to engage in a wide range of business combination transactions with an interested shareholder (generally, any person who owns 10% or more of our outstanding voting power or any of our affiliates or associates) or any affiliate or associate of an interested shareholder, unless specific conditions are met;
anti-greenmail provisions of Arizona law and our bylaws that prohibit us from purchasing shares of our voting stock from beneficial owners of more than 5% of our outstanding shares unless specified conditions are satisfied;
the ability of the Board of Directors to increase the size of the Board and fill vacancies on the Board, whether resulting from such increase, or from death, resignation, disqualification or otherwise; and
the ability of our Board of Directors to issue additional shares of common stock and shares of preferred stock and to determine the price and, with respect to preferred stock, the other terms, including preferences and voting rights, of those shares without shareholder approval.

While these provisions have the effect of encouraging persons seeking to acquire control of us to negotiate with our Board of Directors, they could enable the Board to hinder or frustrate a transaction that some, or a majority, of our shareholders might believe to be in their best interests and, in that case, may prevent or discourage attempts to remove and replace incumbent directors.

SunCor s continuing wind-down of its real estate business may give rise to various claims.

Since 2009, SunCor has been engaged in 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. As of December 31, 2010, SunCor had no existing bank debt and had total assets remaining on its books of $16 million, consisting of $8 million of intercompany receivables, $3 million of assets held for sale and $5 million of other assets. SunCor is focusing on concluding an orderly wind-down of its business. This effort includes addressing contingent liabilities, such as warranty and construction claims that may be brought by property owners and potential funding obligations to local taxing districts that financed infrastructure at certain of its real estate developments.

Pinnacle West has not guaranteed any of SunCor s obligations. SunCor s remaining business operations, and its ability to generate cash from operations, are minimal. As a result, SunCor may seek judicial protection to effectuate a resolution of any claims that cannot be successfully addressed by other means. In such event, Pinnacle West could be exposed to the uncertainties and complexities inherent for parent companies in such proceedings.

Table of Contents

ITEM 1B. UNRESOLVED STAFF COMMENTS

Neither Pinnacle West nor APS has received written comments regarding its periodic or current reports from the SEC staff that were issued 180 days or more preceding the end of its 2010 fiscal year and that remain unresolved.

Table of Contents

ITEM 2. PROPERTIES

Generation Facilities

APS s portfolio of owned and leased generating facilities is provided in the table below:

Name	No. of Units	% Owned (a)	Principal Fuels Used	Primary Dispatch Type	Owned Capacity (MW)
Nuclear:					
Palo Verde (b)	3	29.1%	Uranium	Base Load	1,146
Total Nuclear					1,146
Steam:					
Four Corners 1, 2, 3	3		Coal	Base Load	560
Four Corners 4, 5 (c)	2	15%	Coal	Base Load	231
Cholla	3		Coal	Base Load	647
Navajo (d)	3	14%	Coal	Base Load	315
Ocotillo	2		Gas	Peaking	220
Saguaro	2		Gas/Oil	Peaking	210
Total Steam					2,183
Combined Cycle:					
Redhawk	2		Gas	Load Following	984
West Phoenix	5		Gas	Load Following	887
Total Combined Cycle					1,871
Combustion Turbine:					
Ocotillo	2		Gas	Peaking	110
Saguaro 1, 2	2		Gas/Oil	Peaking	110
Saguaro 3	1		Gas	Peaking	79
Douglas	1		Oil	Peaking	16
Sundance	10		Gas	Peaking	420
West Phoenix	2		Gas	Peaking	110
Yucca 1, 2, 3	3		Gas/Oil	Peaking	93
Yucca 4	1		Oil	Peaking	54
Yucca 5, 6	2		Gas	Peaking	96
Total Combustion Turbine					1,088
Solar:					
Multiple facilities			Solar	As Available	5
Total Solar					5

Total Capacity	6,293

(a) 100% unless otherwise noted.

(b) See Business of Arizona Public Service Company Energy Sources and Resource Planning Generation Facilities Nuclear in Item 1 for details regarding leased interests in Palo Verde. The other participants are Salt River Project (17.49%), SCE (15.8%), El Paso Electric Company (15.8%), Public Service Company of New Mexico (10.2%), Southern California Public Power Authority (5.91%), and Los Angeles Department of Water & Power (5.7%). The plant is operated by APS.

Table of Contents

(c) The other participants are Salt River Project (10%), Public Service Company of New Mexico (13%), SCE (48%), Tucson Electric Power Company (7%) and El Paso Electric Company (7%). The plant is operated by APS. As discussed under Business of Arizona Public Service Company Energy Sources and Resource Planning Generation Facilities Coal Fueled Generating Facilities Four Corners in Item 1, APS and SCE have entered into an agreement by which APS would acquire SCE s interest in Units 4 and 5, after which APS would close Units 1, 2 and 3.

(d) The other participants are Salt River Project (21.7%), Nevada Power Company (11.3%), the United States Government (24.3%), Tucson Electric Power Company (7.5%) and Los Angeles Department of Water & Power (21.2%). The plant is operated by Salt River Project.

See Business of Arizona Public Service Company Environmental Matters in Item 1 with respect to matters having a possible impact on the operation of certain of APS s generating facilities.

See Business of Arizona Public Service Company in Item 1 for a map detailing the location of APS s major power plants and principal transmission lines.

Transmission and Distribution Facilities

Current Facilities. APS s transmission facilities consist of approximately 5,992 pole miles of overhead lines and approximately 49 miles of underground lines, 5,769 miles of which are located in Arizona. APS s distribution facilities consist of approximately 11,098 miles of overhead lines and approximately 17,417 miles of underground primary cable, all of which are located in Arizona. APS shares ownership of some of its transmission facilities with other companies. The following table shows APS s jointly-owned interests in those transmission facilities recorded on the Consolidated Balance Sheets at December 31, 2010:

	Percent Owned (Weighted Average)
North Valley System	71.2%
Palo Verde Estrella 500KV System	50.0%
Round Valley System	50.0%
ANPP 500KV System	34.0%
Navajo Southern System	26.1%
Four Corners Switchyards	47.5%
Palo Verde Yuma 500KV System	43.5%
Phoenix Mead System	17.5%

Expansion. Each year APS prepares and files with the ACC a ten-year transmission plan. In APS s 2011 plan, APS projects it will invest approximately $450 million in new transmission over the next ten years, which includes 258 miles of new lines. This investment will increase the import capability into metropolitan Phoenix by approximately 6% and will increase the import capability into the Yuma area by approximately 39%. One significant project presently nearing completion is the Morgan Pinnacle Peak project, which consists of 26 miles of 500kV and 230kV lines.

APS continues to work with regulators to identify transmission projects necessary to support renewable energy facilities. Two such projects, which are included in APS s 2011 transmission plan, are the Delany to Palo Verde line and the North Gila to Palo Verde line, both of which are intended to support the transmission of renewable energy to Phoenix and California.

Table of Contents

Plant and Transmission Line Leases and Easements on Indian Lands

The Navajo Plant and Four Corners are located on land held under leases from the Navajo Nation and also under easements from the federal government. The easement and lease for the Navajo Plant expire in 2019 and the easement and lease for Four Corners expire in 2016. Each of the leases contains an option to extend for an additional 25-year period from the end of the existing lease term, for a rental amount tied to the original rent payment adjusted based on an index. The easements do not contain an express renewal option and it is unclear what conditions to renewal or extension of the easements may be imposed. APS is currently working with the Navajo Nation to extend the Four Corners leases and the transmission rights-of-way discussed below for an additional twenty-five years. (See Business of Arizona Public Service Company Energy Sources and Resource Planning Generation Facilities Coal Fueled Generating Facilities in Item 1 for details of this extension and the related required approvals.) The ultimate cost of renewal of the Navajo Plant and Four Corners leases and easements is uncertain. The coal contracted for use in these plants is also located on Indian reservations.

Certain portions of the transmission lines that carry power from several of our power plants are located on Indian lands pursuant to easements or other rights-of-way that are effective for specified periods. Some of these rights-of-way have expired and our renewal applications have not yet been acted upon by the appropriate Indian tribes. Other rights expire at various times in the future and renewal action by the applicable tribe will be required at that time. The majority of our transmission lines residing on Indian lands are on the Navajo Nation. The Four Corners and Navajo Plant leases provide Navajo Nation consent to certain of the rights-of-way for transmission lines related to those plants at a specified rental rate for the original term of the rights-of-way and for a like payment in any renewal period. In addition, a 1985 amendment to the leases provides a formula for calculating payments for certain new and renewal rights-of-way. However, some of our rights-of-way are not covered by the leases, or are granted by other Indian tribes. In recent negotiations with other utilities or companies for renewal of similar rights-of-way, certain of the affected Indian tribes have required payments substantially in excess of amounts that we have paid in the past for such rights-of-way or that are typical for similar permits across non-Indian lands; however, we are unaware of the underlying agreements and/or specific circumstances surrounding these renewals. The ultimate cost of renewal of the rights-of-way for our transmission lines is uncertain. We are monitoring these rights-of-way and easement issues and have had extensive discussions with the Navajo Nation regarding them. We are currently unable to predict the outcome of this matter.

ITEM 3. LEGAL PROCEEDINGS

See Business of Arizona Public Service Company Environmental Matters in Item 1 with regard to pending or threatened litigation and other disputes.

See Note 3 for ACC and FERC-related matters.

See Note 11 for information relating to the FERC proceedings on Pacific Northwest energy market issues, liability associated with the Motorola 52nd Street Superfund Site and for information regarding the bankruptcy proceeding involving the landlord for our corporate headquarters building.

Table of Contents

EXECUTIVE OFFICERS OF PINNACLE WEST

Pinnacle West s executive officers are elected no less often than annually and may be removed by the Board of Directors at any time. The executive officers, their ages at February 18, 2011, current positions and principal occupations for the past five years are as follows:

Name	Age	Position	Period
Donald E. Brandt	56	Chairman of the Board and Chief Executive Officer of Pinnacle West; Chairman of the Board of APS	2009-Present
		President of Pinnacle West	2008-Present
		Chief Executive Officer of APS	2008-Present
		Chief Operating Officer of Pinnacle West	2008-2009
		President of APS	2006-2009
		Executive Vice President of Pinnacle West; Chief Financial Officer of APS	2003-2008
		Chief Financial Officer of Pinnacle West	2002-2008
		Executive Vice President of APS	2003-2006
Donald G. Robinson	57	President and Chief Operating Officer of APS	2009-Present
		Senior Vice President, Planning and Administration of APS	2007-2009
		Vice President, Planning of APS	2003-2007
Denise R. Danner	55	Vice President, Controller and Chief Accounting Officer of Pinnacle West; Chief Accounting Officer of APS	2010-Present
		Vice President and Controller of APS	2009-Present
		Senior Vice President, Controller and Chief Accounting Officer of Allied Waste Industries, Inc.	2007-2008
		Vice President, Controller and Chief Accounting Officer of Phelps Dodge Corporation	2004-2007
Randall K. Edington	57	Executive Vice President and Chief Nuclear Officer of APS	2007-Present
		Senior Vice President and Chief Nuclear Officer of APS	2007
		Site Vice President and Chief Nuclear Officer of Cooper Generating Station with Entergy Corporation	2003-2007
David P. Falck	57	Executive Vice President, General Counsel and Secretary of Pinnacle West and APS	2009-Present
		Senior Vice President Law of Public Service Enterprise Group Inc.	2007-2009
		Partner Pillsbury Winthrop Shaw Pittman LLP	1987-2007

Table of Contents

Name	Age	Position	Period
James R. Hatfield	53	Senior Vice President and Chief Financial Officer of Pinnacle West and APS	2008-Present
		Treasurer of Pinnacle West and APS	2009-2010
		Senior Vice President and Chief Financial Officer of OGE Energy Corp.	1999-2008
John Hatfield	45	Vice President, Communications of APS	2010-Present
		Director, Corporate Communications of Southern California Edison	2004-2010
Lee R. Nickloy	44	Vice President and Treasurer of Pinnacle West and APS	2010-Present
		Assistant Treasurer and Director Corporate Finance of Ameren Corporation	2000-2010
Mark A. Schiavoni	55	Senior Vice President, Fossil Operations of APS	2009-Present
		Senior Vice President of Exelon Generation and President of Exelon Power	2004-2009
Lori S. Sundberg	47	Senior Vice President, Human Resources and Ethics of APS	2011-Present
		Vice President, Human Resources and Ethics of APS	2010-2011
		Vice President, Human Resources of APS	2007-2010
		Vice President, Employee Relations, Safety, Compliance & Embrace of American Express Company	2007
		Vice President, HR Relationship Leader, Global Corporate Travel Division of American Express Company	2003-2007

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANTS COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Pinnacle West s common stock is publicly held and is traded on the New York Stock Exchange. At the close of business on February 15, 2011, Pinnacle West s common stock was held of record by approximately 26,953 shareholders.

QUARTERLY STOCK PRICES AND DIVIDENDS PAID PER SHARE STOCK SYMBOL: PNW

2010	High	Low	Close	Dividends Per Share
1st Quarter	$ 38.37	$ 34.62	$ 37.73	$ 0.525
2nd Quarter	39.10	32.31	36.36	0.525
3rd Quarter	41.75	35.71	41.27	0.525
4th Quarter	42.68	39.97	41.45	0.525

2009	High	Low	Close	Dividends Per Share
1st Quarter	$ 35.13	$ 22.32	$ 26.56	$ 0.525
2nd Quarter	30.30	25.28	30.15	0.525
3rd Quarter	33.71	28.87	32.82	0.525
4th Quarter	37.96	31.08	36.58	0.525

APS s common stock is wholly-owned by Pinnacle West and is not listed for trading on any stock exchange. As a result, there is no established public trading market for APS s common stock.

The chart below sets forth the dividends paid on APS s common stock for each of the four quarters for 2010 and 2009.

Common Stock Dividends
(Dollars in Thousands)

Quarter	**2010**	**2009**
1st Quarter	$ 42,500	$ 42,500
2nd Quarter	56,900	42,500
3rd Quarter	56,900	42,500
4th Quarter	26,100	42,500

The sole holder of APS s common stock, Pinnacle West, is entitled to dividends when and as declared out of legally available funds. As of December 31, 2010, APS did not have any outstanding preferred stock.

Table of Contents

Issuer Purchases of Equity Securities

The following table contains information about our purchases of our common stock during the fourth quarter of 2010.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 October 31, 2010				
November 1 November 30, 2010				
December 1 December 31, 2010	1,994	$ 41.39		
Total	1,994	$ 41.39		

(1) Represents shares of common stock repurchased for rescission of director stock grant.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA
PINNACLE WEST CAPITAL CORPORATION CONSOLIDATED

	2010	2009	2008	2007	2006
	(dollars in thousands, except per share amounts)				
OPERATING RESULTS					
Operating revenues:					
Regulated electricity segment	$ 3,180,678	$ 3,149,187	$ 3,127,383	$ 2,918,163	$ 2,635,036
Marketing and trading			66,897	138,247	136,748
Other revenues	82,967	26,723	25,407	34,375	24,282
Total operating revenues	$ 3,263,645	$ 3,175,910	$ 3,219,687	$ 3,090,785	$ 2,796,066
Income from continuing operations	$ 350,598	$ 252,558	$ 278,335	$ 299,218	$ 279,586
Discontinued operations net of income taxes (a)	19,611	(179,794)	(18,715)	23,773	61,935
Net income	370,209	72,764	259,620	322,991	341,521
Less: Net income attributable to noncontrolling interests	20,156	4,434	17,495	15,848	14,266
Net income attributable to common shareholders	$ 350,053	$ 68,330	$ 242,125	$ 307,143	$ 327,255
COMMON STOCK DATA					
Book value per share year-end	$ 33.93	$ 32.69	$ 34.16	$ 35.15	$ 34.48
Earnings per weighted-average common share outstanding:					
Continuing operations attributable to common shareholders basic	$ 3.10	$ 2.31	$ 2.59	$ 2.83	$ 2.67
Net income attributable to common shareholders basic	$ 3.28	$ 0.68	$ 2.40	$ 3.06	$ 3.29
Continuing operations attributable to common shareholders diluted	$ 3.08	$ 2.30	$ 2.58	$ 2.81	$ 2.65
Net income attributable to common shareholders diluted	$ 3.27	$ 0.67	$ 2.40	$ 3.05	$ 3.27
Dividends declared per share	$ 2.10	$ 2.10	$ 2.10	$ 2.10	$ 2.025
Weighted-average common shares outstanding basic	106,573,348	101,160,659	100,690,838	100,255,807	99,417,008
	107,137,785	101,263,795	100,964,920	100,834,871	100,010,108

Weighted-average common shares outstanding diluted					
BALANCE SHEET DATA					
Total assets	$ 12,362,703	$ 11,986,324	$ 11,805,967	$ 11,355,788	$ 11,019,185
Liabilities and equity:					
Current liabilities	$ 1,310,736	$ 1,108,943	$ 1,527,683	$ 1,365,192	$ 943,497
Long-term debt less current maturities	3,045,794	3,496,524	3,183,386	3,300,663	3,426,914
Deferred credits and other	4,230,947	3,952,853	3,523,929	3,029,866	3,131,901
Total liabilities	8,587,477	8,558,320	8,234,998	7,695,721	7,502,312
Total equity	3,775,226	3,428,004	3,570,969	3,660,067	3,516,873
Total liabilities and equity	$ 12,362,703	$ 11,986,324	$ 11,805,967	$ 11,355,788	$ 11,019,185

(a) Amounts primarily related to SunCor s real estate impairment charges (see Note 23) and APSES discontinued operations (see Note 22).

Table of Contents

SELECTED FINANCIAL DATA
ARIZONA PUBLIC SERVICE COMPANY CONSOLIDATED

	2010	2009	2008	2007	2006
			(dollars in thousands)		
OPERATING RESULTS					
Electric operating revenues	$ 3,180,807	$ 3,149,500	$ 3,133,496	$ 2,936,277	$ 2,658,513
Fuel and purchased power costs	1,046,815	1,178,620	1,289,883	1,151,392	969,767
Other operating expenses	1,584,955	1,501,081	1,376,257	1,326,934	1,258,848
Operating income	549,037	469,799	467,356	457,951	429,898
Other income (deductions)	20,138	13,893	836	20,870	27,584
Interest deductions net of AFUDC	213,349	213,258	188,353	179,033	173,486
Net income	355,826	270,434	279,839	299,788	283,996
Less: Net income attributable to noncontrolling interests	20,163	19,209	17,495	15,848	14,266
Net income attributable to common shareholder	$ 335,663	$ 251,225	$ 262,344	$ 283,940	$ 269,730
BALANCE SHEET DATA					
Total assets	$ 12,241,582	$ 11,681,571	$ 11,149,451	$ 10,514,981	$ 10,150,051
Liabilities and equity:					
Total equity	$ 3,916,037	$ 3,527,679	$ 3,416,751	$ 3,425,328	$ 3,278,230
Long-term debt less current maturities	2,948,991	3,180,406	2,850,242	2,876,881	2,877,502
Palo Verde sale leaseback lessor notes less current maturities	96,803	126,000	151,783	173,538	194,281
Total capitalization	6,961,831	6,834,085	6,418,776	6,475,747	6,350,013
Current liabilities	1,095,897	900,625	1,289,523	1,076,449	826,715
Deferred credits and other	4,183,854	3,946,861	3,441,152	2,962,785	2,973,323
Total liabilities and equity	$ 12,241,582	$ 11,681,571	$ 11,149,451	$ 10,514,981	$ 10,150,051

Table of Contents

ITEM 7. 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 Consolidated Financial Statements and APS s Consolidated Financial Statements and the related Notes that appear in Item 8 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.

OVERVIEW

Pinnacle West owns all of the outstanding common stock of APS. APS is a vertically-integrated electric utility that provides either retail or 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

Operational Performance, Reliability and Recent Developments.

Nuclear. In 2010, Palo Verde achieved its best generation year ever, producing over 31 million megawatt-hours, with an overall station capacity factor of 90.5%. The generation from each Palo Verde operating unit directly reflects the station s currently effective 18-month refueling cycle. In 2010, Palo Verde successfully refueled both Unit 1 and Unit 3. As part of the 2010 refueling outages, Palo Verde installed new reactor vessel closure heads and simplified head assembly modifications. These projects are designed to provide safety benefits, eliminate costly inspections and reduce the duration of future outages.

Coal and Related Environmental Matters. APS-operated coal plants, Four Corners and Cholla, achieved net capacity factors of 82% and 79%, respectively, in 2010. 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 our 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 any 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, on October 6, 2010, the EPA issued its proposed determination for Best Available Retrofit Technology (BART) requirements for Four Corners that, as proposed, would require installation of additional pollution control equipment on all five of the plant s units. Based on APS s current ownership share of Four Corners, APS currently estimates that its total costs for the proposed controls could be up to approximately $400 million for nitrogen oxide controls and about $220 million for particulate removal equipment. It is currently evaluating the impacts of the proposed determination and intends to submit comments during the EPA s comment period. See Business of Arizona Public Service Company Environmental Matters in Item 1 and environmental and climate change-related risks described in Item 1A for additional environmental and climate change developments and risks facing APS.

Table of Contents

In addition, SCE, a participant in Four Corners, has indicated that certain California legislation may prohibit it from making emission control expenditures at the plant. On November 8, 2010, APS and SCE entered into an asset purchase agreement, providing for the purchase by APS of SCE s 48% interest in each of Units 4 and 5 of Four Corners. The purchase price is $294 million, subject to certain adjustments. Completion of the purchase by APS, which is expected to occur in the second half of 2012, is subject to the receipt of approvals by the ACC, the California Public Utilities Commission and the FERC. APS and SCE filed applications with their respective commissions seeking requisite authority or approvals to complete the transaction. Closing is also conditioned on the execution of a new coal supply contract for the lease renewal period described below, expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act and other typical closing conditions.

APS, on behalf of the Four Corners participants, has negotiated amendments to an existing facility lease with the Navajo Nation which would extend the Four Corners leasehold interest to 2041. Execution by the Navajo Nation of the lease amendments is a condition to closing of the purchase by APS of SCE s interests in Four Corners. The execution of these amendments by the Navajo Nation requires the approval of the Navajo Nation Council, which occurred on February 15, 2011 and is awaiting final signature by the Nation s President. The effectiveness of the amendments also requires the approval of the DOI, as does a related Federal rights-of-way grant which the Four Corners participants will pursue. A Federal environmental review will be conducted as part of the DOI review process.

Pursuant to a Co-Tenancy Agreement among the Four Corners participants, the other participants have a right of first refusal to purchase shares of SCE s interests proportional to their current ownership percentages. The exercise of this purchase right by any of the other participants must be exercised by March 8, 2011. If any of the purchase rights are exercised, the amount available for purchase by APS would be reduced. At this time APS does not know whether any of the other participants will exercise the right of first refusal.

APS has announced that, if APS s purchase of SCE s interests in Units 4 and 5 at Four Corners is consummated, it will close Units 1, 2 and 3 at the plant. These events will change the plant s overall generating capacity from 2,100 MW to 1,540 MW and APS s entitlement from the plant from 791 MW to 970 MW. When applying for approval to purchase Units 4 and 5, APS also requested from the ACC recovery of any unrecovered costs associated with the closure of Units 1, 2 and 3.

Transmission and Delivery. In the area of transmission and delivery to its customers, APS ranked favorably during 2010, with top quartile performance for average customer outage time and its best reliability year to date. During 2010, APS undertook several significant transmission projects, including the Morgan to Pinnacle Peak transmission line scheduled for completion in 2011. APS s 2011 transmission plan projects that it will invest approximately $450 million in new transmission over the next ten years, which includes 258 miles of new lines. The first three years of these additions are included in the capital expenditures table presented in the Liquidity section below along with other transmission costs for upgrades and replacements. 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 long-term benefits both to APS and its customers. APS is piloting and deploying a variety of technologies that are intended 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.

Table of Contents

Renewable Energy. The ACC approved the RES in 2006, recognizing the importance of renewable energy to our state. The renewable energy requirement is 3% of retail electric sales in 2011 and increases annually until it reaches 15% in 2025. In the 2009 retail rate case settlement agreement, APS agreed to exceed the RES standards, committing to 1,700 GWh of new renewable resources to be in service by year-end 2015 in addition to its 2008 renewable resource commitments. Taken together, APS s commitment is estimated to be 3,400 GWh or approximately 10% of APS s retail energy sales by year-end 2015, which is double the existing RES target of 5% for that year. See Note 3. A component of the RES is focused on stimulating development of distributed energy systems (generally speaking, small-scale renewable technologies that are located on customers properties).

APS has a diverse portfolio of existing and planned renewable resources totaling 875 MW, including solar, wind, geothermal, biomass and biogas. Of this portfolio, 288 MW are currently in operation and 587 MW are under contract for development or are under construction. Renewable resources in operation include 5 MW of utility-scale facilities owned by APS, 223 MW of long-term purchased power agreements, and an estimated 60 MW of customer-sited, third-party owned distributed energy resources.

To achieve our RES requirements, as mentioned above, to date APS has entered into contracts for 587 MW of renewable resources that are planned, in development or under construction. APS s strategy to procure these resources includes new facilities to be owned by APS, purchased power contracts for new facilities and ongoing development of distributed energy resources. Through the AZ Sun Program, approved by the ACC on March 3, 2010, APS plans to own 100 MW of solar photovoltaic power plants across Arizona by investing up to $500 million through 2014. Under this program, APS has executed contracts for the development of 83 MW of new solar generation, representing an investment commitment of approximately $377 million. See Note 3 for additional details of the AZ Sun Program, including the related cost recovery. APS has also entered into long-term purchased power agreements for 382 MW from solar, wind and biogas facilities currently planned, in development or under construction, and 122 MW from distributed energy resources. Agreements for the development and completion of future resources are subject to various conditions, including successful siting, permitting and interconnection of the project to the electric grid.

APS continues to actively consider opportunities to enhance its renewable energy portfolio, both to ensure its compliance with the Renewable Energy Standard and to meet the needs of its customer base.

Demand Side Management. Arizona regulators are placing an increased focus on energy efficiency and other 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% cumulative 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 adopted by the ACC, approved by the Arizona Attorney General and became effective on January 1, 2011. This ambitious standard will likely impact Arizona s future energy resource needs.

Table of Contents

Rate Matters. APS needs timely recovery through rates of its capital and operating expenditures to maintain adequate financial health. APS s 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 s general retail rate case, with modifications that did not materially affect the overall economic terms of the agreement. The rate case settlement authorizes and requires equity infusions into APS of at least $700 million prior to the end of 2014. The settlement demonstrated cooperation among APS, the ACC staff, the Residential Utility Consumer Office (RUCO) 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 detailed discussion of the settlement agreement terms and information on APS s 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 demand-side management and renewable energy efforts and customer programs. These mechanisms are described more fully in Note 3.

On October 18, 2010, the Chairman of the ACC issued a draft decoupling policy statement for consideration by the commission. On December 15, 2010 the ACC unanimously approved a slightly modified decoupling policy statement supportive of using a revenue-per-customer methodology, which is the mechanism APS and a number of other parties support. Decoupling refers to a ratemaking design which reduces or removes the linkage between sales and utility revenues and/or profits, reducing utility disincentives to the adoption of programs that benefit customers by saving energy. Mechanically, decoupling compares actual versus authorized revenues or revenue per customer over a period and either credits or collects any differences from customers in a subsequent period. The policy permits regulated utilities to file a decoupling proposal in their next general rate case. APS intends to include a decoupling model consistent with the policy statement for consideration in its upcoming general rate case, currently expected to be filed in June 2011.

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, ensuring adequate liquidity for each company. In early February 2010, APS entered into a $500 million revolving credit facility, replacing its $377 million revolving credit 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 market, 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.

In early February 2011, APS entered into a $500 million revolving credit facility, replacing its $489 million revolving credit facility that would have otherwise terminated in September 2011.

SunCor Real Estate Operations. As a result of the continuing 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. At December 31, 2010, SunCor had total remaining assets of about $16 million, which includes approximately $3 million of assets held for sale. See Liquidity and Capital Resources Other Subsidiaries SunCor below for information regarding 2010 asset sales and liquidity matters.

Table of Contents

District Cooling Business Sale. On June 22, 2010, 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. APSES is now focused on its core business of energy conservation and renewable energy contracting services.

Subsidiaries. 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.

Electric Operating Revenues. For the years 2008 through 2010, retail electric revenues comprised approximately 93% of our total electric operating revenues. Our electric operating revenues are affected by customer growth or decline, 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 s 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 s service territory for the year ended December 31, 2010 was 0.6% compared with the prior year. For the three years 2008 through 2010, APS s customer growth averaged 0.9% per year. We currently expect customer growth to average about 1.7% per year for 2011 through 2013 due to anticipated improving economic conditions both nationally and in Arizona. Retail sales in kilowatt-hours, adjusted to exclude the effects of weather variations, for 2010 declined 1.0% compared to the prior year, reflecting the poor economic conditions in 2010 and the effects of our energy efficiency programs. For the three years 2008 through 2010, APS s actual retail electricity sales in kilowatt-hours, adjusted to exclude the effects of weather variations, declined at an average annual rate of 0.9%. We currently estimate that total retail electricity sales in kilowatt-hours will remain flat on average per year during 2011 through 2013, including the effects of APS s 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.

Table of Contents

Fuel and Purchased Power Costs. Fuel and purchased power costs included on our 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 2009 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. See Capital Expenditures below for 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 8.0% of the assessed value in 2010, 7.5% of the assessed value in 2009 and 7.8% of the assessed value in 2008. We expect property taxes to increase as we add new utility plants (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 AFUDC. 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 6.) The primary factors affecting borrowing levels are expected to be our capital expenditures, long-term debt maturities, equity issuances 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 AFUDC on a project when it is placed in commercial operation.

Table of Contents

RESULTS OF OPERATIONS

Pinnacle West s reportable business segment is our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily electricity service to Native Load customers) and related activities and includes electricity generation, transmission and distribution.

Our reportable business segments reflect a change from previously reported information. As of December 31, 2010, our real estate activities are no longer considered a segment requiring separate reporting or disclosure. In 2009 our real estate subsidiary, SunCor, began disposing of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce its outstanding debt (see Note 23). At December 31, 2010, SunCor had total remaining assets of about $16 million, which includes approximately $3 million of assets held for sale. Additionally, all of SunCor s operations are reflected in discontinued operations.

Operating Results 2010 compared with 2009

Our consolidated net income attributable to common shareholders for 2010 was $350 million, compared with $68 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.

Table of Contents

In addition, regulated electricity segment net income increased approximately $82 million from the prior-year period due to increased revenues related to APS s retail rate increases and other factors. Our consolidated results for 2010 also include a gain of $25 million after income taxes related to the sale of APSES district cooling business. The following table presents net income (loss) attributable to common shareholders by business segment compared with the prior-year period:

	Year Ended December 31,		
	2010	2009	Net Change
	(dollars in millions)		
Regulated Electricity Segment:			
Operating revenues less fuel and purchased power expenses	$ 2,134	$ 1,970	$ 164
Operations and maintenance	(870)	(822)	(48)
Depreciation and amortization	(415)	(407)	(8)
Taxes other than income taxes	(135)	(123)	(12)
Other income (expenses), net	(4)	(2)	(2)
Interest charges, net of allowance for funds used during construction	(204)	(212)	8
Income taxes	(161)	(142)	(19)
Noncontrolling interests (Note 20)	(20)	(19)	(1)
Regulated electricity segment net income	325	243	82
All other (a)	5	(10)	15
Income from Continuing Operations Attributable to Common Shareholders	**330**	**233**	**97**
Discontinued real estate activities, primarily impairment charges at SunCor (Note 23)	(6)	(167)	161
All other discontinued operations (b)	26	2	24
Income (Loss) from Discontinued Operations Attributable to Common Shareholders	**20**	**(165)**	**185**
Net Income Attributable to Common Shareholders	**$ 350**	**$ 68**	**$ 282**

(a) Includes activities related to APSES and El Dorado. None of the activities of either of these companies constitutes a reportable segment.

(b) Income from discontinued operations for 2010 includes a gain of $25 million after income taxes related to the sale of APSES district cooling business.

Table of Contents

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 $164 million higher for the year ended 2010 compared with the prior year. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating revenues	Fuel and purchased power expenses	Net change
	(dollars in millions)		
Retail regulatory settlement effective January 1, 2010:			
Retail base rate increases, net of deferrals	$ 269	$ 128	$ 141
Line extension revenues (Note 3)	19		19
Transmission rate increases	6		6
Higher demand-side management and renewable energy surcharges (substantially offset in operations and maintenance expense)	33	2	31
Higher fuel and purchased power costs offset by the effects of higher off-system sales, net of related PSA deferrals	28	26	2
Lower retail revenues related to recovery of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(270)	(276)	6
Lower retail sales primarily due to lower usage per customer, including the effects of the Company s energy efficiency programs, but excluding the effects of weather	(28)	(9)	(19)
Effects of weather on retail sales, primarily due to milder weather in the second quarter 2010	(20)	(6)	(14)
Miscellaneous items, net	(5)	3	(8)
Total	$ 32	$ (132)	$ 164

Operations and maintenance Operations and maintenance expenses increased $48 million for the year ended 2010 compared with the prior year primarily because of:

- An increase of $25 million related to demand-side management and renewable energy programs, which are primarily offset in operating revenues;
- An increase of $18 million related to employee benefits costs; and
- An increase of $5 million related to other miscellaneous factors.

Table of Contents

Depreciation and Amortization Depreciation and amortization expenses were $8 million higher for the year ended 2010 compared with the prior year primarily because of increased plant in service partially offset by lower depreciation rates.

Taxes other than income taxes Taxes other than income taxes increased $12 million for the year ended 2010 compared with the prior year primarily because of higher property tax rates in the current year.

Interest charges, net of allowance for funds used during construction Interest charges, net of allowance for funds used during construction, decreased $8 million for the year ended 2010 compared with the prior year primarily because of higher rates in the current year for the allowance for equity and borrowed funds used during construction, partially offset by higher interest charges due to higher debt balances. Interest charges, net of allowance for funds used during construction are comprised of the regulated electricity segment portions of the line items interest expense and allowance for equity and borrowed funds used during construction from the Consolidated Statements of Income.

Income taxes Income taxes were $19 million higher for the year ended 2010 compared with the prior year primarily because of higher pretax income in the current-year period, partially offset by $17 million of income tax benefits related to prior years that were resolved in the current year. See Note 4.

All other

All other revenues increased $56 million partially offset by increased other expenses of $41 million resulting primarily from improved margins from APSES products and services business. In addition, other income was higher due to investment losses at El Dorado in 2009.

Discontinued Operations

Real estate activities 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 $161 million after income taxes in 2009. As of December 31, 2010, all of SunCor s operations have been reclassified to discontinued operations (see Note 22). The after-tax impacts of the $6 million loss from real estate activities for the year ended 2010 includes real estate impairment charges of approximately $10 million (see Note 23) and other costs of $6 million, partially offset by a gain from debt restructuring of approximately $10 million (see Note 6).

All other All other earnings from discontinued operations were $24 million higher for the year ended 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 2009 Compared with 2008

Our consolidated net income attributable to common shareholders for 2009 was $68 million, compared with $242 million for the prior year period. The decrease in net income was primarily due to 2009 real estate impairment charges recorded by SunCor, the Company s real estate subsidiary.

Table of Contents

In addition, regulated electricity segment net income decreased approximately $13 million from the prior year primarily due to lower retail sales resulting from lower usage per customer; higher interest charges, net of capitalized financing costs; higher depreciation and amortization expenses; and the absence of income tax benefits related to prior years recorded in 2008. These negative factors were partially offset by increased revenues due to an interim rate increase effective January 1, 2009 and transmission rate increases.

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

	Year Ended December 31,		
	2009	2008	Net Change
	(dollars in millions)		
Regulated Electricity Segment:			
Operating revenues less fuel and purchased power expenses	$ 1,970	$ 1,843	$ 127
Operations and maintenance	(822)	(756)	(66)
Depreciation and amortization	(407)	(391)	(16)
Taxes other than income taxes	(123)	(125)	2
Other income (expenses), net	(2)	(21)	19
Interest charges, net of allowance for funds used during construction	(212)	(185)	(27)
Income taxes	(142)	(92)	(50)
Noncontrolling interests (Note 20)	(19)	(17)	(2)
Regulated electricity segment net income	243	256	(13)
All other (a)	(10)	5	(15)
Income from Continuing Operations Attributable to Common Shareholders	**233**	**261**	**(28)**
Discontinued real estate activities, primarily impairment charges at SunCor (Note 23)	(167)	(26)	(141)
All other discontinued operations (a)	2	7	(5)
Loss from Discontinued Operations Attributable to Common Shareholders	**(165)**	**(19)**	**(146)**
Net Income Attributable to Common Shareholders	**$ 68**	**$ 242**	**$ (174)**

(a) Includes activities related to marketing and trading, APSES and El Dorado. Income for 2008 includes income from discontinued operations of $8 million related to the resolution of certain tax issues associated with the sale of Silverhawk Power Station (Silverhawk) in 2005. None of these segments is a reportable segment.

Regulated electricity segment

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

58

Table of Contents

Operating revenues less fuel and purchased power expenses Regulated electricity segment operating revenues less fuel and purchased power expenses were $127 million higher for the year ended 2009 compared with the prior year. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating revenues	Fuel and purchased power expenses	Net change
	(dollars in millions)		
Higher renewable energy and demand-side management surcharges (substantially offset in operations and maintenance expense)	$ 63	$	$ 63
Interim retail rate increases effective January 1, 2009	61		61
Transmission rate increases	21		21
Increased mark-to-market valuations of fuel and purchased power contracts related to favorable changes in market prices, net of related PSA deferrals		(18)	18
Effects of weather on retail sales, primarily due to hotter weather in the third quarter of 2009	12	3	9
Lower retail sales primarily due to lower usage per customer, including the effects of the Company s energy efficiency programs, but excluding the effects of weather	(58)	(26)	(32)
Higher fuel and purchased power costs including the effects of lower off-system sales, net of related PSA deferrals	(30)	(19)	(11)
Lower retail revenues related to recovery of PSA deferrals, offset by lower amortization of the same amount recorded as fuel and purchased power expense (see Note 3)	(36)	(36)	
Miscellaneous items, net	(11)	(9)	(2)
Total	$ 22	$ (105)	$ 127

Operations and maintenance Operations and maintenance expenses increased $66 million for the year ended 2009 compared with the prior year primarily because of:

An increase of $62 million related to renewable energy and demand-side management programs, which are offset in operating revenues;

An increase of $29 million in generation costs, including more planned maintenance, partially offset by lower costs at Palo Verde due to cost efficiency measures; and

A decrease of $25 million associated with cost saving measures and other factors, including the absence of employee severance costs in 2009.

Table of Contents

Depreciation and amortization Depreciation and amortization expenses increased $16 million for the year ended 2009 compared with the prior year primarily because of increases in utility plant in service. The increases in utility plant in service are the result of various improvements to APS s existing fossil and nuclear generating plants and distribution and transmission infrastructure additions and upgrades.

Interest charges, net of allowance for funds used during construction Interest charges, net of allowance for funds used during construction increased $27 million for the year ended 2009 compared with the prior year primarily because of higher debt balances, partially offset by the effects of lower interest rates (see discussion related to APS s debt issuances in Pinnacle West Consolidated Liquidity and Capital Resources below). Interest charges, net of allowance for funds used during construction are comprised of the regulated electricity segment portions of the line items interest expense and allowance for equity and borrowed funds used during construction from the Consolidated Statements of Income.

Other income (expenses), net Other income (expenses), net improved $19 million for the year ended 2009 compared with the prior year primarily because of improved investment gains. Other income (expenses), net is comprised of the regulated electricity segment portions of the line items other income and other expense from the Consolidated Statements of Income.

Income taxes Income taxes were $50 million higher for the year ended 2009 compared with the prior year primarily because of $30 million of income tax benefits related to prior years recorded in 2008 and higher pretax income. See Note 4.

All other

All other earnings from continuing operations were $15 million lower for the year ended 2009 compared with the prior year primarily because of planned reductions of marketing and trading activities.

Discontinued operations

Real estate activities During the first quarter of 2009, we decided to sell substantially all of SunCor s assets to reduce its outstanding debt. The loss from real estate activities attributable to common shareholders was $141 million higher for the year ended 2009 compared with the prior year primarily because of an increase in real estate impairment charges of $213 million before income taxes (see Note 23 for details of the impairment charges).

All other All other earnings from discontinued operations were $5 million lower for the year ended 2009 compared with the prior year primarily because of the absence of the 2008 resolution of certain tax issues associated with the sale of Silverhawk in 2005.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows Pinnacle West Consolidated

The following table presents net cash provided by (used for) operating, investing and financing activities for the years ended December 31, 2010, 2009 and 2008 (dollars in millions):

	2010	2009	2008
Net cash flow provided by operating activities	$ 750	$ 1,067	$ 848
Net cash flow used for investing activities	(576)	(705)	(815)
Net cash flow provided by (used for) financing activities	(209)	(322)	16
Net increase (decrease) in cash and cash equivalents	$ (35)	$ 40	$ 49

2010 Compared with 2009

The decrease of approximately $317 million in net cash provided by operating activities is primarily due to voluntary pension contributions in 2010 of approximately $200 million, changes in collateral and margin cash provided as a result of changes in commodity prices and other changes in working capital.

The decrease of approximately $129 million in net cash used for investing activities is primarily due to approximately $100 million of proceeds from the sale of the district cooling business in June 2010 and the increase in proceeds from the sale of commercial real estate investments of approximately $29 million.

The decrease of approximately $113 million in net cash used for financing activities is primarily due to lower repayments of short-term borrowings in 2010 due to lower short-term debt balances partially offset by lower net sources of equity and long-term debt financing, including the proceeds of approximately $253 million from the issuance of equity in April 2010 and APS s issuance of $500 million of unsecured senior notes in 2009.

2009 Compared with 2008

The increase of approximately $219 million in net cash provided by operating activities is primarily due to a reduction of collateral and margin cash required as a result of changes in commodity prices and a 2009 income tax refund (see Note 4).

The decrease of approximately $110 million in net cash used for investing activities is primarily due to lower levels of capital expenditures net of contributions (see table and discussion below), partially offset by lower real estate sales primarily due to a commercial property sale in 2008.

The increase of approximately $338 million in net cash used for financing activities is primarily due to repayments of short-term borrowings, partially offset by APS s issuance of $500 million of unsecured senior notes.

Table of Contents

Cash Flows Arizona Public Service Company

The following table presents APS s net cash provided by (used for) operating, investing and financing activities for the years ended December 31, 2010, 2009 and 2008 (dollars in millions):

	2010	2009	2008
Net cash flow provided by operating activities	$ 695	$ 995	$ 820
Net cash flow used for investing activities	(747)	(738)	(879)
Net cash flow provided by (used for) financing activities	31	(208)	79
Net increase (decrease) in cash and cash equivalents	$ (21)	$ 49	$ 20

2010 Compared with 2009

The decrease of approximately $300 million in net cash provided by operating activities is primarily due to voluntary pension contributions in 2010 of approximately $200 million, increased collateral and margin cash provided as a result of changes in commodity prices, and the payment of income taxes in 2010. These were partially offset by other changes in working capital.

The increase of approximately $9 million in net cash used for investing activities is primarily due to lower contributions in aid of construction and other cash flows.

The decrease of approximately $239 million in net cash used for financing activities is primarily due to the repayment of short-term borrowings in 2009, partially offset by lower net sources of equity and long-term debt financing including the proceeds of approximately $253 million from the infusion of equity from Pinnacle West in 2010 and by APS s issuance of $500 million of unsecured senior notes in 2009.

2009 Compared with 2008

The increase of approximately $175 million in net cash provided by operating activities is primarily due to a reduction of collateral and margin cash required as a result of changes in commodity prices.

The decrease of approximately $141 million in net cash used for investing activities is primarily due to lower levels of capital expenditures net of contributions.

The increase of approximately $287 million in net cash used for financing activities is primarily due to repayments of short-term borrowings, partially offset by APS s issuance of $500 million of unsecured senior notes (see Note 6).

Table of Contents

Liquidity

Capital Expenditure Requirements

The following table summarizes the actual capital expenditures for 2008, 2009 and 2010 and estimated capital expenditures for the next three years:

CAPITAL EXPENDITURES

(dollars in millions)

	Actual			Estimated		
	2008	2009	2010	2011	2012	2013
APS						
Generation:						
Nuclear Fuel	$ 47	$ 64	$ 63	$ 65	$ 68	$ 69
Renewables			6	236	179	90
Environmental	96	33	11	11	22	122
Four Corners Units 4 and 5					294	
Other Generation	167	144	172	144	152	107
Distribution	340	246	232	284	350	285
Transmission	163	193	120	143	220	248
Other (a)	43	52	62	78	49	41
Total APS	856	732	666	961	1,334	962
Other	48	13	4			
Total	$ 904	$ 745	$ 670	$ 961	$ 1,334	$ 962

(a) Primarily information systems and facilities projects.

Generation capital expenditures are comprised of various improvements to APS s 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. Included under Renewables is the AZ Sun Program, which is a significant component of the increase in capital expenditures from 2010 to 2011. For purposes of this table, we have assumed the consummation of APS s purchase of SCE s interest in Four Corners Units 4 and 5 and the subsequent shut down of Units 1-3, as discussed in the Overview section above. As a result, we included the $294 million purchase price under Generation and have not included environmental expenditures for Units 1-3.

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, Mercury and Other Hazardous Air Pollutants and Coal Combustion Waste in Item 1.)

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.

Table of Contents

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 January 19, 2011, the Pinnacle West Board of Directors declared a quarterly dividend of $0.525 per share of common stock, payable on March 1, 2011, to shareholders of record on February 1, 2011.

Our primary sources of cash are dividends from APS, external debt and equity financings. For the years 2008 through 2010, total distributions from APS were $522 million and there were no distributions from SunCor. For 2010, cash distributions from APS were $182 million.

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 total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At December 31, 2010, APS s common equity ratio, as defined, was 53%. Its total shareholder equity was approximately $3.8 billion, and total capitalization was approximately $7.2 billion. APS would be prohibited from paying dividends if the payment would reduce its total shareholder equity below approximately $2.9 billion, assuming APS s total capitalization remains the same. Based on the discussion above, this restriction does not materially affect Pinnacle West s ability to meet its ongoing capital requirements.

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for the 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 program 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 December 31, 2010, the $200 million credit facility was available to support the issuance of up to $183 million in commercial paper or for bank borrowings, including issuances of letters of credit up to $183 million. At December 31, 2010, Pinnacle West had no outstanding borrowings under this credit facility, $17 million of commercial paper borrowings and no outstanding letters of credit.

Table of Contents

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, at 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 23), a majority of which have been realized as of December 31, 2010. Approximately $7 million of these benefits were recorded in 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 $68 million income tax receivables on the Consolidated Balance Sheets represent the anticipated refunds related to an APS tax accounting method change approved by the IRS in the third quarter of 2009 and the current year tax benefits related to the SunCor strategic asset sales that closed in 2010.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 includes provisions making qualified property placed into service after September 8, 2010 and before January 1, 2012 eligible for 100% bonus depreciation for federal income tax purposes. In addition, qualified property placed into service in 2012 is eligible for 50% bonus depreciation for federal income tax purposes. These provisions of the recent tax legislation are expected to generate approximately $450-500 million of cash tax benefits for APS through accelerated depreciation. It is anticipated that these cash benefits will be fully realized by APS by the end of 2013, with a majority of the benefit realized in 2012 and 2013. The cash generated is an acceleration of tax benefits that APS would have otherwise received over 20 years.

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, real estate, and short-term investments. Future year contribution amounts are dependent on plan asset performance and plan actuarial assumptions. During 2010, we made voluntary contributions of $200 million to our pension plan. The required minimum contribution to our pension plan is zero in 2011 and approximately $85 million in 2012. The contribution to our other postretirement benefit plans in 2010 was approximately $17 million. The contributions to our other postretirement benefit plans for 2011 and 2012 are expected to be approximately $20 million each year. APS and other subsidiaries fund their share of the contributions. APS s share is approximately 98% of both plans.

Table of Contents

APS

APS s 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, external debt financing and equity infusions from Pinnacle West. 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 may 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 program support and for the issuance of letters of credit. Interest rates are based on APS s senior unsecured debt credit ratings.

On February 14, 2011, APS refinanced its $489 million credit facility that would have matured in September 2011, and increased the size of the facility to $500 million. The new credit facility terminates in February 2015. APS may 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 program support and for the issuance of letters of credit. Interest rates are based on APS s senior unsecured debt credit ratings.

At December 31, 2010, APS had two credit facilities totaling $989 million, consisting of the $500 million and $489 million credit facilities described above. These facilities were 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 $989 million. At December 31, 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 s $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 August 10, 2010, APS changed the letter of credit supporting the approximately $17 million of Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Bonds (Arizona Public Service Company Project) Series 1998, due 2033. The bonds were in a daily rate mode supported by a prior letter of credit and remain in a daily rate mode, supported by a new three-year letter of credit expiring in August 2013.

Table of Contents

On October 12, 2010, APS changed the interest rate mode for the approximately $147 million of City of Farmington, New Mexico Pollution Control Revenue Refunding Bonds (Arizona Public Service Company Four Corners Project) 1994 Series A and 1994 Series B, due 2024 and City of Farmington, New Mexico Pollution Control Revenue Bonds (Arizona Public Service Company Four Corners Project) 1994 Series C, due 2024. The rate period for the 1994 Series A bonds and the 1994 Series B bonds changed from a daily rate mode, supported by letters of credit, to a term rate mode to maturity, subject to optional redemption after year ten, that will bear interest at a rate of 4.70% per annum until maturity in 2024 unless the optional redemption is exercised by APS. The rate period for the 1994 Series C 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 2.875% per annum until October 2013. The letters of credit supporting each of these three series of bonds were terminated in connection with these changes, and there is no bank or other third-party credit support for any of these bonds.

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 20) and, as a result of consolidation of these VIEs, APS has reported the Lessor Trusts long-term debt on its Consolidated Balance Sheets. Interest rates on these debt instruments are 8% and are fixed for the remaining life of the debt. As of December 31, 2010 approximately $29 million was classified as current maturities of long-term debt and $97 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 20 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 s 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 requirements of equity infusions into APS of at least $700 million by December 31, 2014.

See Note 18 for information related to the change in our margin accounts.

Other Subsidiaries

SunCor In 2010, SunCor sold land parcels, commercial assets and master planned home-building communities for approximately $72 million, which approximated the carrying value of these assets, resulting in a net gain of zero. In connection with these sales, SunCor negotiated a restructuring of certain of its credit facilities. The debt restructuring resulted in an after-tax gain of approximately $10 million. At December 31, 2010, SunCor had total remaining assets of about $16 million, which includes approximately $3 million of assets held for sale. At December 31, 2010, SunCor had no debt outstanding.

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 s debt covenants related to their respective bank financing arrangements include maximum debt to capitalization ratios. Pinnacle West and APS comply with this covenant and each anticipates it will continue to meet this and other significant covenant requirements. For both Pinnacle West and APS, this covenant requires that the ratio of consolidated debt to total consolidated capitalization not exceed 65%. At December 31, 2010, the ratio was approximately 49% for Pinnacle West and 46% for APS. 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.

Table of Contents

Neither Pinnacle West s nor APS s 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 credit agreements contain a pricing grid in which the interest rates we pay for borrowings thereunder 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 s 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 facilities borrowings. See Notes 5 and 6 for further discussions of liquidity matters.

Credit Ratings

The ratings of securities of Pinnacle West and APS as of February 17, 2011 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 s securities and/or result in an increase in the cost of, or limit access to, capital. Such revisions may also result in 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.

	Moody s	Standard & Poor s	Fitch
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.

Table of Contents

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 statements. See Notes 1, 2 and 20 for a discussion of these impacts.

Guarantees and Surety Bonds

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 Consolidated Balance Sheets related to such instruments. At December 31, 2010, we had no outstanding claims for payment under any of these instruments. Our guarantees and surety bonds have no recourse or collateral provisions to allow us to recover amounts paid under these instruments 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 21 for additional information regarding guarantees and letters of credit.

Table of Contents

Contractual Obligations

The following table summarizes Pinnacle West s consolidated contractual requirements as of December 31, 2010 (dollars in millions):

	2011	2012-2013	2014-2015	Thereafter	Total
Long-term debt payments, including interest: (a)					
APS	$ 673	$ 949	$ 1,071	$ 2,587	$ 5,280
Pinnacle West	177				177
Total long-term debt payments, including interest and capital lease obligations	850	949	1,071	2,587	5,457
Short-term debt payments, including interest (b)	17				17
Fuel and purchased power commitments (c)	381	824	1,070	7,084	9,359
Operating lease payments	24	38	27	9	98
Nuclear decommissioning funding requirements	24	49	49	137	259
Renewable energy credits (d)	57	40	40	196	333
Purchase obligations (e)	214	125		117	456
Noncontrolling interests	10	28	55		93
Total contractual commitments	$ 1,577	$ 2,053	$ 2,312	$ 10,130	$ 16,072

(a) The long-term debt matures at various dates through 2038 and bears interest principally at fixed rates. Interest on variable-rate long-term debt is determined by using average rates at December 31, 2010 (see Note 6).

(b) The short-term debt represents commercial paper borrowings at Pinnacle West (see Note 5).

(c) Our fuel and purchased power commitments include purchases of coal, electricity, natural gas, renewable energy and nuclear fuel (see Notes 3 and 11).

(d) Contracts to purchase renewable energy credits in compliance with the Renewable Energy Standard.

(e) These contractual obligations include commitments for capital expenditures and other obligations. These amounts do not include the purchase of SCE s interest in Four Corners Units 4 and 5 due to additional approvals required. See discussion in Overview.

This table excludes $133 million in unrecognized tax benefits because the timing of the future cash outflows is uncertain. This table also excludes $85 million in estimated minimum pension contributions in 2012 (see Note 8).

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. We consider the following accounting policies to be our

most critical because of the uncertainties, judgments and complexities of the underlying accounting standards and operations involved.

Table of Contents

Regulatory Accounting

Regulatory accounting allows for the actions of regulators, such as the ACC and the FERC, to be reflected in our financial statements. Their actions may cause us to capitalize costs that would otherwise be included as an expense in the current period by unregulated companies. Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates. Regulatory liabilities generally represent expected future costs that have already been collected from customers. Management continually assesses whether our regulatory assets are probable of future recovery by considering factors such as applicable regulatory environment changes and recent rate orders to other regulated entities in the same jurisdiction. This determination reflects the current political and regulatory climate in the state and is subject to change in the future. If future recovery of costs ceases to be probable, the assets would be written off as a charge in current period earnings. We had $1.0 billion of regulatory assets and $753 million of regulatory liabilities on the Consolidated Balance Sheets at December 31, 2010. Included in the balance of regulatory assets at December 31, 2010 is a regulatory asset of $669 million for pension and other postretirement benefits. This regulatory asset represents the future recovery of these costs through retail rates as these amounts are charged to earnings. If these costs are disallowed by the ACC, this regulatory asset would be charged to OCI and result in lower future earnings.

See Notes 1 and 3 for more information.

Pensions and Other Postretirement Benefit Accounting

Changes in our actuarial assumptions used in calculating our pension and other postretirement benefit liability and expense can have a significant impact on our earnings and financial position. The most relevant actuarial assumptions are the discount rate used to measure our liability and net periodic cost, the expected long-term rate of return on plan assets used to estimate earnings on invested funds over the long-term, and the assumed healthcare cost trend rates. We review these assumptions on an annual basis and adjust them as necessary.

Table of Contents

The following chart reflects the sensitivities that a change in certain actuarial assumptions would have had on the December 31, 2010 reported pension liability on the Consolidated Balance Sheets and our 2010 reported pension expense, after consideration of amounts capitalized or billed to electric plant participants, on Pinnacle West s Consolidated Statements of Income (dollars in millions):

	Increase (Decrease)	
Actuarial Assumption (a)	Impact on Pension Liability	Impact on Pension Expense
Discount rate:		
Increase 1%	$ (261)	$ (8)
Decrease 1%	294	10
Expected long-term rate of return on plan assets:		
Increase 1%		(7)
Decrease 1%		7

(a) Each fluctuation assumes that the other assumptions of the calculation are held constant while the rates are changed by one percentage point.

The following chart reflects the sensitivities that a change in certain actuarial assumptions would have had on the December 31, 2010 reported other postretirement benefit obligation on the Consolidated Balance Sheets and our 2010 reported other postretirement benefit expense, after consideration of amounts capitalized or billed to electric plant participants, on Pinnacle West s Consolidated Statements of Income (dollars in millions):

	Increase (Decrease)	
Actuarial Assumption (a)	Impact on Other Postretirement Benefit Obligation	Impact on Other Postretirement Benefit Expense
Discount rate:		
Increase 1%	$ (118)	$ (5)
Decrease 1%	138	6
Health care cost trend rate (b):		
Increase 1%	134	9
Decrease 1%	(107)	(7)
Expected long-term rate of return on plan assets pretax:		
Increase 1%		(2)
Decrease 1%		2

(a) Each fluctuation assumes that the other assumptions of the calculation are held constant while the rates are changed by one percentage point.

(b) This assumes a 1% change in the initial and ultimate health care cost trend rate.

See Note 8 for further details about our pension and other postretirement benefit plans.

Table of Contents

Derivative Accounting

Derivative accounting requires evaluation of rules that are complex and subject to varying interpretations. Our evaluation of these rules, as they apply to our contracts, determines whether we use accrual accounting (for contracts designated as normal) or fair value (mark-to-market) accounting. Mark-to-market accounting requires that changes in the fair value are recognized periodically in income unless certain hedge criteria are met. For cash flow hedges, the effective portion of changes in the fair value of the derivative is recognized in common stock equity (as a component of other comprehensive income (loss)) and the ineffective portion is recognized in current earnings.

See Market Risks Commodity Price Risk below for quantitative analysis. See Fair Value Measurements below for additional information on valuation. See Note 1 for discussion on accounting policies and Note 18 for a further discussion on derivative accounting.

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. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We use inputs, or assumptions that market participants would use, to determine fair market value. The significance of a particular input determines how the instrument is classified in the fair value hierarchy. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The determination of fair value sometimes requires subjective and complex judgment. Our assessment of the inputs and the significance of a particular input to fair value measurement may affect the valuation of the instruments and their placement within the fair value hierarchy. Actual results could differ from our estimates of fair value. See Note 14 for further fair value measurement discussion, Note 1 for discussion on accounting policies and Note 18 for a further discussion on derivative accounting.

Our nuclear decommissioning trusts invest in fixed income securities and equity securities. The fair values of these securities are based on observable inputs for identical or similar assets. See Note 14 for further discussion of our nuclear decommissioning trusts.

Real Estate Investment Impairments

While we do not have any real estate investments or home inventory at December 31, 2010, we did have real estate investments of $120 million and $3 million of home inventory on our Consolidated Balance Sheets at December 31, 2009. For purposes of evaluating impairment, in accordance with guidance on the impairment and disposal of long-lived assets, we classified our real estate assets, such as land under development, land held for future development, and commercial property, as held and used. When events or changes in circumstances indicated that the carrying value of real estate assets considered held and used were not recoverable, we compared the undiscounted cash flows that we estimated would be generated by each asset to its carrying amount. If the carrying amount exceeded the undiscounted cash flows, we adjusted the asset to fair value and recognized an impairment charge. The adjusted value became the new book value (carrying amount) for held and used assets. We may have had real estate assets classified as held and used with fair values that were lower than their carrying amounts, but were not deemed to be impaired because the undiscounted cash flows exceeded the carrying amounts.

Table of Contents

Real estate home inventory was considered to be held for sale for the purposes of evaluating impairment. Home inventories were reported at the lower of carrying amount or fair value less cost to sell. Fair value less cost to sell was evaluated each period to determine if it had changed. Losses (and gains not to exceed any cumulative loss previously recognized) were reported as adjustments to the carrying amount.

We determined fair value for our real estate assets primarily based on the future cash flows that we estimated would be generated by each asset discounted for market risk. Our impairment assessments and fair value determinations required significant judgment regarding key assumptions such as future sales prices, future construction and land development costs, future sales timing, and discount rates. The assumptions were specific to each project and may have varied among projects. The discount rates we used to determine fair values at December 31, 2009 ranged from 11% to 29%. Due to the judgment and assumptions applied in the estimation process, with regard to impairments, it is possible that actual results could have differed from those estimates.

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 statements. See Notes 1, 2 and 20 for a discussion of these impacts.

The FASB is currently working on several significant projects with the desire to converge GAAP with IFRS. These projects include accounting for leases, revenue recognition, and financial instruments, among other items. Concurrently, the SEC is considering mandating IFRS for U.S. companies. See Note 2 for a discussion of these potential changes.

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 14). 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.

Table of Contents

The tables below present contractual balances of our consolidated long-term and short-term debt at the expected maturity dates as well as the fair value of those instruments on December 31, 2010 and 2009. The interest rates presented in the tables below represent the weighted-average interest rates as of December 31, 2010 and 2009 (dollars in thousands):

Pinnacle West Consolidated

	Short-Term Debt		Variable-Rate Long-Term Debt		Fixed-Rate Long-Term Debt	
2010	Interest Rates	Amount	Interest Rates	Amount	Interest Rates	Amount
2011	0.84%	$ 16,600	0.32%	$ 26,710	6.32%	$ 605,169
2012					6.41%	477,435
2013			0.32%	16,870	4.94%	122,828
2014					5.91%	502,274
2015					4.79%	313,420
Years thereafter					6.69%	1,619,150
Total		$ 16,600		$ 43,580		$ 3,640,276
Fair value		$ 16,600		$ 43,580		$ 3,869,681

Pinnacle West Consolidated

	Short-Term Debt		Variable-Rate Long-Term Debt		Fixed-Rate Long-Term Debt	
2009	Interest Rates	Amount	Interest Rates	Amount	Interest Rates	Amount
2010	1.09%	$ 153,715	1.66%	$ 276,636	7.90%	$ 26,840
2011			2.00%	39,967	6.32%	605,425
2012			5.25%	38	6.41%	477,674
2013			5.25%	1,774	6.77%	58,912
2014					5.91%	502,499
Years thereafter					6.46%	1,817,420
Total		$ 153,715		$ 318,415		$ 3,488,770
Fair value		$ 153,715		$ 318,415		$ 3,631,585

Table of Contents

The tables below present contractual balances of APS s long-term debt at the expected maturity dates as well as the fair value of those instruments on December 31, 2010 and 2009. The interest rates presented in the tables below represent the weighted-average interest rates as of December 31, 2010 and 2009 (dollars in thousands):

APS Consolidated

	Variable-Rate Long-Term Debt		Fixed-Rate Long-Term Debt	
2010	Interest Rates	Amount	Interest Rates	Amount
2011	0.32%	$ 26,710	6.48%	$ 430,169
2012			6.41%	477,435
2013	0.32%	16,870	4.94%	122,828
2014			5.91%	502,274
2015			4.79%	313,420
Years thereafter			6.69%	1,619,150
Total		$ 43,580		$ 3,465,276
Fair value		$ 43,580		$ 3,693,276

APS Consolidated

	Variable-Rate Long-Term Debt		Fixed-Rate Long-Term Debt	
2009	Interest Rates	Amount	Interest Rates	Amount
2010	0.25%	$ 196,170	7.91%	$ 26,789
2011	0.26%	26,710	6.48%	430,398
2012			6.41%	477,654
2013			6.77%	58,910
2014			5.91%	502,499
Years thereafter			6.46%	1,817,420
Total		$ 222,880		$ 3,313,670
Fair value		$ 222,880		$ 3,451,255

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.

76

Table of Contents

The following table shows the net pretax changes in mark-to-market of our derivative positions in 2010 and 2009 (dollars in millions):

	2010	2009
Mark-to-market of net positions at beginning of year	$ (169)	$ (282)
Recognized in earnings:		
Change in mark-to-market losses for future period deliveries	(7)	(4)
Mark-to-market losses realized including ineffectiveness during the period	5	11
Decrease (increase) in regulatory asset	(36)	76
Recognized in OCI:		
Change in mark-to-market losses for future period deliveries (a)	(155)	(155)
Mark-to-market losses realized during the period	123	185
Change in valuation techniques		
Mark-to-market of net positions at end of year	$ (239)	$ (169)

(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 December 31, 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, for more discussion of our valuation methods.

Source of Fair Value	2011	2012	2013	2014	2015	Years thereafter	Total fair value
Prices actively quoted	$ (1)	$	$	$	$	$	$ (1)
Prices provided by other external sources	(139)	(47)	(14)				(200)
Prices based on models and other valuation methods	(7)	(4)	(7)	(6)	(6)	(8)	(38)
Total by maturity	$ (147)	$ (51)	$ (21)	$ (6)	$ (6)	$ (8)	$ (239)

Table of Contents

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 Consolidated Balance Sheets at December 31, 2010 and 2009 (dollars in millions):

	December 31, 2010 Gain (Loss)		December 31, 2009 Gain (Loss)	
	Price Up 10%	Price Down 10%	Price Up 10%	Price Down 10%
Mark-to-market changes reported in:				
Earnings				
Electricity	$	$	$ 1	$ (1)
Natural gas	1	(1)	1	(1)
Regulatory asset (liability) or OCI (a)				
Electricity	13	(13)	21	(21)
Natural gas	42	(42)	59	(59)
Total	$ 56	$ (56)	$ 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 18 for a discussion of our credit valuation adjustment policy.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Market and Credit Risks in Item 7 above for a discussion of quantitative and qualitative disclosures about market risk.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS AND
FINANCIAL STATEMENT SCHEDULES

	Page
Management_s Report on Internal Control Over Financial Reporting (Pinnacle West Capital Corporation)	80
Report of Independent Registered Public Accounting Firm	81
Pinnacle West Consolidated Statements of Income for 2010, 2009 and 2008	83
Pinnacle West Consolidated Balance Sheets as of December 31, 2010 and 2009	84
Pinnacle West Consolidated Statements of Cash Flows for 2010, 2009 and 2008	86
Pinnacle West Consolidated Statements of Changes in Equity for 2010, 2009 and 2008	87
Notes to Pinnacle West_s Consolidated Financial Statements	88
Management_s Report on Internal Control Over Financial Reporting (Arizona Public Service Company)	153
Report of Independent Registered Public Accounting Firm	154
APS Consolidated Statements of Income for 2010, 2009 and 2008	156
APS Consolidated Balance Sheets as of December 31, 2010 and 2009	157
APS Consolidated Statements of Cash Flows for 2010, 2009 and 2008	159
APS Consolidated Statements of Changes in Equity for 2010, 2009 and 2008	160
Supplemental Notes to APS_s Consolidated Financial Statements	162
Financial Statement Schedules for 2010, 2009 and 2008	
Pinnacle West Schedule I__Condensed Statements of Income for 2010, 2009 and 2008	168
Pinnacle West Schedule I__Condensed Balance Sheets as of December 31, 2010 and 2009	169
Pinnacle West Schedule I__Condensed Statements of Cash Flows for 2010, 2009 and 2008	170
Pinnacle West Schedule II__Reserve for Uncollectibles for 2010, 2009 and 2008	171
APS Schedule II__Reserve for Uncollectibles for 2010, 2009 and 2008	172

See Note 13 and S-2 for the selected quarterly financial data (unaudited) required to be presented in this Item.

Table of Contents

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING (PINNACLE WEST CAPITAL CORPORATION)

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f), for Pinnacle West Capital Corporation. Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control Integrated Framework,* our management concluded that our internal control over financial reporting was effective as of December 31, 2010. The effectiveness of our internal control over financial reporting as of December 31, 2010 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein and also relates to the Company s consolidated financial statements.

February 18, 2011

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Pinnacle West Capital Corporation
Phoenix, Arizona

We have audited the accompanying consolidated balance sheets of Pinnacle West Capital Corporation and subsidiaries (the Company) as of December 31, 2010 and 2009 and the related consolidated statements of income, changes in equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedules listed in the Index at Item 15. We also have audited the Company s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and financial statement schedules and an opinion on the Company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Table of Contents

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As disclosed in Note 2 to the consolidated financial statements, the Company adopted amended accounting guidance related to the consolidation of variable interest entities on January 1, 2010.

/s/ DELOITTE & TOUCHE LLP

Phoenix, Arizona

February 18, 2011

Table of Contents

PINNACLE WEST CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(dollars and shares in thousands, except per share amounts)

	Year Ended December 31,		
	2010	2009	2008
OPERATING REVENUES			
Regulated electricity segment	$ 3,180,678	$ 3,149,187	$ 3,127,383
Marketing and trading			66,897
Other revenues	82,967	26,723	25,407
Total	3,263,645	3,175,910	3,219,687
OPERATING EXPENSES			
Regulated electricity segment fuel and purchased power	1,046,815	1,178,620	1,284,116
Marketing and trading fuel and purchased power			45,572
Operations and maintenance	877,406	831,863	765,277
Depreciation and amortization	414,555	407,463	391,190
Taxes other than income taxes	135,334	123,277	124,853
Other expenses	65,651	24,534	26,032
Total	2,539,761	2,565,757	2,637,040
OPERATING INCOME	723,884	610,153	582,647
OTHER INCOME (DEDUCTIONS)			
Allowance for equity funds used during construction (Note 1)	22,066	14,999	18,636
Other income (Note 19)	6,368	5,278	9,541
Other expense (Note 19)	(9,764)	(14,269)	(31,576)
Total	18,670	6,008	(3,399)
INTEREST EXPENSE			
Interest charges	244,174	237,527	219,916
Allowance for borrowed funds used during construction (Note 1)	(16,539)	(10,430)	(14,547)
Total	227,635	227,097	205,369
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	514,919	389,064	373,879
INCOME TAXES (Note 4)	164,321	136,506	95,544
INCOME FROM CONTINUING OPERATIONS	350,598	252,558	278,335
INCOME (LOSS) FROM DISCONTINUED OPERATIONS Net of income tax expense (benefit) of $12,808, $(107,596) and $(11,648) (Note 22)	19,611	(179,794)	(18,715)
NET INCOME	370,209	72,764	259,620
Less: Net income attributable to noncontrolling interests (Note 20)	20,156	4,434	17,495

NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ 350,053	$ 68,330	$ 242,125
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC	106,573	101,161	100,691
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED	107,138	101,264	100,965
EARNINGS PER WEIGHTED AVERAGE COMMON SHARE OUTSTANDING			
Income from continuing operations attributable to common shareholders basic	$ 3.10	$ 2.31	$ 2.59
Net income attributable to common shareholders basic	3.28	0.68	2.40
Income from continuing operations attributable to common shareholders diluted	3.08	2.30	2.58
Net income attributable to common shareholders diluted	3.27	0.67	2.40
DIVIDENDS DECLARED PER SHARE	$ 2.10	$ 2.10	$ 2.10
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:			
Income from continuing operations, net of tax	$ 330,435	$ 233,349	$ 260,840
Discontinued operations, net of tax	19,618	(165,019)	(18,715)
Net income attributable to common shareholders	$ 350,053	$ 68,330	$ 242,125

See Notes to Pinnacle West s Consolidated Financial Statements.

Table of Contents

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

	December 31, 2010	2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 110,188	$ 145,378
Customer and other receivables	324,207	301,915
Accrued unbilled revenues	103,292	110,971
Allowance for doubtful accounts	(7,981)	(6,153)
Materials and supplies (at average cost)	181,414	176,020
Fossil fuel (at average cost)	21,575	39,245
Deferred income taxes (Note 4)	94,602	53,990
Income tax receivable (Note 4)	2,483	26,005
Assets from risk management activities (Note 18)	73,788	50,619
Other current assets	28,362	30,747
Total current assets	931,930	928,737
INVESTMENTS AND OTHER ASSETS		
Real estate investments net (Notes 1, 6 and 23)		119,989
Assets from risk management activities (Note 18)	39,032	28,855
Nuclear decommissioning trust (Note 14)	469,886	414,576
Other assets	116,216	110,091
Total investments and other assets	625,134	673,511
PROPERTY, PLANT AND EQUIPMENT (Notes 1, 6, 9 and 10)		
Plant in service and held for future use	13,201,960	12,848,138
Accumulated depreciation and amortization	(4,514,204)	(4,340,645)
Net	8,687,756	8,507,493
Construction work in progress	459,361	467,700
Palo Verde sale leaseback, net of accumulated depreciation of $213,094 and $204,328 (Note 20)	137,956	146,722
Intangible assets, net of accumulated amortization of $330,584 and $294,724	184,952	164,380
Nuclear fuel, net of accumulated amortization of $85,270 and $64,544	108,794	118,243
Total property, plant and equipment	9,578,819	9,404,538
DEFERRED DEBITS		
Regulatory assets (Notes 1, 3 and 4)	1,048,656	813,161
Income tax receivable (Note 4)	65,103	65,103

Other	113,061	101,274
Total deferred debits	1,226,820	979,538
TOTAL ASSETS	$ 12,362,703	$ 11,986,324

See Notes to Pinnacle West s Consolidated Financial Statements.

Table of Contents

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

	December 31, 2010	2009
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 236,354	$ 240,637
Accrued taxes (Note 4)	104,711	104,011
Accrued interest	54,831	54,596
Short-term borrowings (Note 5)	16,600	153,715
Current maturities of long-term debt (Note 6)	631,879	303,476
Customer deposits	68,322	71,026
Liabilities from risk management activities (Note 18)	58,976	55,908
Other current liabilities	139,063	125,574
Total current liabilities	1,310,736	1,108,943
LONG-TERM DEBT LESS CURRENT MATURITIES (Note 6)		
Long-term debt less current maturities	2,948,991	3,370,524
Palo Verde sale leaseback lessor notes less current maturities (Note 20)	96,803	126,000
Total long-term debt less current maturities	3,045,794	3,496,524
DEFERRED CREDITS AND OTHER		
Deferred income taxes (Note 4)	1,833,566	1,496,095
Deferred fuel and purchased power regulatory liability (Note 3)	58,442	87,291
Other regulatory liabilities (Notes 1 and 3)	694,589	679,072
Liability for asset retirements (Note 12)	328,571	301,783
Liabilities for pension and other postretirement benefits (Note 8)	813,121	811,338
Liabilities from risk management activities (Note 18)	65,390	62,443
Customer advances	121,645	136,595
Coal mine reclamation	117,243	92,060
Unrecognized tax benefits (Note 4)	66,349	142,099
Other	132,031	144,077
Total deferred credits and other	4,230,947	3,952,853
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 7)		
Common stock, no par value; authorized 150,000,000 shares; issued 108,820,067 at end of 2010 and 101,527,937 at end of 2009	2,421,372	2,153,295
Treasury stock at cost; 50,410 shares at end of 2010 and 93,239 at end of 2009	(2,239)	(3,812)

Total common stock	2,419,133	2,149,483
Retained earnings	1,423,961	1,298,213
Accumulated other comprehensive loss:		
Pension and other postretirement benefits (Note 8)	(59,420)	(50,892)
Derivative instruments	(100,347)	(80,695)
Total accumulated other comprehensive loss	(159,767)	(131,587)
Total shareholders equity	3,683,327	3,316,109
Noncontrolling interests (Note 20)	91,899	111,895
Total equity	3,775,226	3,428,004
TOTAL LIABILITIES AND EQUITY	$ 12,362,703	$ 11,986,324

See Notes to Pinnacle West s Consolidated Financial Statements.

Table of Contents

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

	Year Ended December 31,		
	2010	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 370,209	$ 72,764	$ 259,620
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sale of district cooling business	(41,973)		
Depreciation and amortization including nuclear fuel	472,807	450,864	431,672
Deferred fuel and purchased power	93,631	(51,742)	(80,183)
Deferred fuel and purchased power amortization	(122,481)	147,018	183,126
Allowance for equity funds used during construction	(22,066)	(14,999)	(18,636)
Real estate impairment charge	16,731	280,188	53,250
Gain on real estate debt restructuring	(16,755)		
Deferred income taxes	260,411	105,492	158,024
Change in mark-to-market valuations	2,688	(6,939)	9,074
Changes in current assets and liabilities:			
Customer and other receivables	(67,943)	12,292	73,446
Accrued unbilled revenues	7,679	(10,882)	7,388
Materials, supplies and fossil fuel	12,276	(12,261)	(25,453)
Other current assets	5,246	24,647	56,775
Accounts payable	9,125	(27,328)	(69,439)
Accrued taxes and income tax receivable net	24,222	(31,792)	(13,149)
Other current liabilities	5,204	29,274	(5,130)
Expenditures for real estate investments	(622)	(2,957)	(21,168)
Other changes in real estate assets	4,068	(4,216)	18,211
Change in margin and collateral accounts assets	(9,937)	(12,806)	17,450
Change in margin and collateral accounts liabilities	(88,315)	35,654	(132,416)
Change in long term income tax receivable		(131,984)	
Change in unrecognized tax benefits	(73,621)	137,898	(94,551)
Change in other regulatory liabilities	54,518	110,642	(12,129)
Change in other long-term assets	(43,189)	(47,899)	6,104
Change in other long-term liabilities	(101,456)	16,377	46,207
Net cash flow provided by operating activities	750,457	1,067,305	848,093
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(748,374)	(764,609)	(935,577)
Contributions in aid of construction	32,754	53,525	60,292
Allowance for borrowed funds used during construction	(16,778)	(10,745)	(18,820)
Proceeds from the sale of district cooling business	100,300		
Proceeds from nuclear decommissioning trust sales	560,469	441,242	317,619
Investment in nuclear decommissioning trust	(584,885)	(463,033)	(338,361)
Proceeds from sale of commercial real estate investments	72,038	43,370	94,171
Other	8,576	(4,667)	5,517