

ARIZONA PUBLIC SERVICE CO

Form 10-Q

October 28, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from _____ to _____

Commission File Number	Exact Name of Each Registrant as specified in its charter; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-8962	PINNACLE WEST CAPITAL CORPORATION (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0512431
1-4473	ARIZONA PUBLIC SERVICE COMPANY (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0011170

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

PINNACLE WEST CAPITAL CORPORATION Yes No

ARIZONA PUBLIC SERVICE COMPANY Yes No

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

PINNACLE WEST CAPITAL CORPORATION Yes No

ARIZONA PUBLIC SERVICE COMPANY Yes No

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

PINNACLE WEST CAPITAL CORPORATION

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

ARIZONA PUBLIC SERVICE COMPANY

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

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

PINNACLE WEST CAPITAL Yes No

CORPORATION

ARIZONA PUBLIC SERVICE COMPANY Yes No

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

PINNACLE WEST CAPITAL

Number of shares of common stock, no par value, outstanding as of October 25, 2010: 108,711,779

CORPORATION

ARIZONA PUBLIC SERVICE COMPANY

Number of shares of common stock, \$2.50 par value, outstanding as of October 25, 2010: 71,264,947

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

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This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation (Pinnacle West) and Arizona Public Service Company (APS). Any use of the words Company, we, and our refer to Pinnacle West. Each registrant is providing on its own behalf all of the information contained in this Form 10-Q that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is providing any information that does not relate to such registrant, and therefore makes no

representation as to any such information. The information required with respect to each company is set forth within the applicable items. Item 1 of this report includes Condensed Consolidated Financial Statements of Pinnacle West and Condensed Consolidated Financial Statements of APS. Item 1 also includes Notes to Pinnacle West's Condensed Consolidated Financial Statements, the majority of which also relate to APS, and Supplemental Notes, which only relate to APS' Condensed Consolidated Financial Statements. Item 2 of this report is divided into two sections - Pinnacle West Consolidated and APS. The Pinnacle West Consolidated section describes Pinnacle West and its subsidiaries on a consolidated basis, including discussions of Pinnacle West's regulated utility and non-utility operations.

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FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations, and neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by applicable law. These forward-looking statements are often identified by words such as estimate, predict, may, believe, plan, expect, require, intend, assume and similar words. Because actual results may differ materially from expectations, we caution readers not to place undue reliance on these statements. A number of factors could cause future results to differ materially from historical results, or from outcomes currently expected or sought by Pinnacle West or APS. In addition to the Risk Factors described in Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (2009 Form 10-K) and in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations herein, these factors include, but are not limited to:

- regulatory and judicial decisions, developments and proceedings;
- our ability to achieve timely and adequate rate recovery of our costs;
- our ability to reduce capital expenditures and other costs while maintaining reliability and customer service levels;
- variations in demand for electricity, including those due to weather, the general economy, customer and sales growth (or decline), and the effects of energy conservation measures;
- power plant performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- new legislation or regulation, 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, including returns on debt and equity capital;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- competition in retail and wholesale power markets;
- the duration and severity of the economic decline in Arizona and current credit, financial and real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- restrictions on dividends or other burdensome provisions in our credit agreements and Arizona Corporation Commission (ACC) orders;
- our ability, or the ability of our subsidiaries, to meet debt service obligations;
- changes to our credit ratings;
- the investment performance of the assets of our nuclear decommissioning trust, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;
- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- 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 and power plant participants to meet contractual or other obligations;
- technological developments affecting the electric industry; and
- economic and other conditions affecting SunCor Development Company's (SunCor) ability to dispose of its remaining assets and satisfy its debt obligations.

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

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(unaudited)

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

	Three Months Ended September 30,	
	2010	2009
OPERATING REVENUES		
Regulated electricity segment	\$ 1,116,211	\$ 1,083,750
Other revenues	22,874	5,286
Total	1,139,085	1,089,036
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	353,904	381,543
Operations and maintenance	221,469	198,030
Depreciation and amortization	104,194	103,008
Taxes other than income taxes	37,528	34,015
Other expenses	18,365	5,033
Total	735,460	721,629
OPERATING INCOME	403,625	367,407
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	5,524	2,197
Other income (Note 11)	4,348	4,386
Other expense (Note 11)	(3,855)	(1,934)
Total	6,017	4,649
INTEREST EXPENSE		
Interest charges	60,491	60,299
Allowance for borrowed funds used during construction	(6,163)	(1,349)
Total	54,328	58,950
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	355,314	313,106
INCOME TAXES	123,486	109,778
INCOME FROM CONTINUING OPERATIONS	231,828	203,328
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of \$4,721 and \$(7,567) (Note 14)	7,211	(12,305)
NET INCOME	239,039	191,023
Less: Net income attributable to noncontrolling interests (Notes 7 and 16)	5,119	4,371

NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	\$ 233,920	\$ 186,652
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC	108,632	101,223
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED	109,094	101,385
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income from continuing operations attributable to common shareholders basic	\$ 2.09	\$ 1.96
Net income attributable to common shareholders basic	2.15	1.84
Income from continuing operations attributable to common shareholders diluted	2.08	1.96
Net income attributable to common shareholders diluted	2.14	1.84
DIVIDENDS DECLARED PER SHARE	\$	\$ 0.525
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income from continuing operations, net of tax	\$ 226,700	\$ 198,375
Discontinued operations, net of tax	7,220	(11,723)
Net income attributable to common shareholders	\$ 233,920	\$ 186,652

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

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PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

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

	Nine Months Ended September 30,	
	2010	2009
OPERATING REVENUES		
Regulated electricity segment	\$ 2,527,052	\$ 2,498,838
Other revenues	52,982	16,164
Total	2,580,034	2,515,002
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	821,244	920,630
Operations and maintenance	644,415	610,401
Depreciation and amortization	307,864	304,066
Taxes other than income taxes	100,936	100,788
Other expenses	41,009	15,862
Total	1,915,468	1,951,747
OPERATING INCOME		
	664,566	563,255
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	16,417	11,919
Other income (Note 11)	3,828	4,102
Other expense (Note 11)	(8,650)	(8,887)
Total	11,595	7,134
INTEREST EXPENSE		
Interest charges	181,937	177,447
Allowance for borrowed funds used during construction	(12,314)	(8,318)
Total	169,623	169,129
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		
	506,538	401,260
INCOME TAXES		
	168,143	137,594
INCOME FROM CONTINUING OPERATIONS		
	338,395	263,666
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of \$12,611 and \$(97,662) (Note 14)	19,313	(165,867)
NET INCOME		
	357,708	97,799
Less: Net income (loss) attributable to noncontrolling interests (Notes 7 and 16)	15,005	(690)
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS		
	\$ 342,703	\$ 98,489

WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	BASIC	105,846	101,107
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	DILUTED	106,318	101,184
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING			
Income from continuing operations attributable to common shareholders	basic	\$ 3.06	\$ 2.47
Net income attributable to common shareholders	basic	3.24	0.97
Income from continuing operations attributable to common shareholders	diluted	3.04	2.46
Net income attributable to common shareholders	diluted	3.22	0.97
DIVIDENDS DECLARED PER SHARE		\$ 1.575	\$ 1.575
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:			
Income from continuing operations, net of tax		\$ 323,361	\$ 249,412
Discontinued operations, net of tax		19,342	(150,923)
Net income attributable to common shareholders		\$ 342,703	\$ 98,489

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

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PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(dollars in thousands)

	September 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 195,915	\$ 145,378
Customer and other receivables	387,435	301,915
Accrued unbilled revenues	180,006	110,971
Allowance for doubtful accounts	(7,901)	(6,153)
Materials and supplies (at average cost)	174,428	176,020
Fossil fuel (at average cost)	21,826	39,245
Deferred income taxes	134,012	53,990
Income tax receivable (Note 6)	22,840	26,005
Assets from risk management activities (Note 8)	68,476	50,619
Assets held for sale (Notes 14 and 16)	22,312	
Other current assets	43,983	30,747
Total current assets	1,243,332	928,737
INVESTMENTS AND OTHER ASSETS		
Real estate investments net (Note 16)		119,989
Assets from risk management activities (Note 8)	54,968	28,855
Nuclear decommissioning trust (Note 15)	453,963	414,576
Other assets	112,797	110,091
Total investments and other assets	621,728	673,511
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	12,987,278	12,848,138
Accumulated depreciation and amortization	(4,459,579)	(4,340,645)
Net	8,527,699	8,507,493
Construction work in progress	555,137	467,700
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	140,145	146,722
Intangible assets, net of accumulated amortization	178,666	164,380
Nuclear fuel, net of accumulated amortization	124,101	118,243
Total property, plant and equipment	9,525,748	9,404,538
DEFERRED DEBITS		
Regulatory assets	879,056	813,161

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Income tax receivable (Note 6)	65,103	65,103
Other	100,520	101,274
Total deferred debits	1,044,679	979,538
TOTAL ASSETS	\$ 12,435,487	\$ 11,986,324

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

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PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(dollars in thousands)

	September 30, 2010	December 31, 2009
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 253,565	\$ 240,637
Accrued taxes	157,697	104,011
Accrued interest	52,384	54,596
Short-term borrowings		153,715
Current maturities of long-term debt (Note 2)	238,513	303,476
Customer deposits	68,254	71,026
Liabilities from risk management activities (Note 8)	55,847	55,908
Other current liabilities	141,547	125,574
Total current liabilities	967,807	1,108,943
LONG-TERM DEBT LESS CURRENT MATURITIES		
Long-term debt less current maturities (Note 2)	3,349,927	3,370,524
Palo Verde sale leaseback lessor notes (Notes 2 and 7)	113,379	126,000
Total long-term debt less current maturities	3,463,306	3,496,524
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,868,860	1,496,095
Deferred fuel and purchased power regulatory liability (Note 3)	41,385	87,291
Other regulatory liabilities	685,908	679,072
Liability for asset retirements	323,134	301,783
Liabilities for pension and other postretirement benefits (Note 4)	737,644	811,338
Liabilities from risk management activities (Note 8)	80,656	62,443
Customer advances	127,449	136,595
Coal mine reclamation	117,029	92,060
Unrecognized tax benefits (Note 6)	66,837	142,099
Other	127,243	144,077
Total deferred credits and other	4,176,145	3,952,853
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 9)		
Common stock, no par value	2,418,660	2,153,295
Treasury stock	(2,157)	(3,812)

Total common stock	2,416,503	2,149,483
Retained earnings	1,473,683	1,298,213
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(52,626)	(50,892)
Derivative instruments	(120,634)	(80,695)
Total accumulated other comprehensive loss	(173,260)	(131,587)
Total shareholders' equity	3,716,926	3,316,109
Noncontrolling interests (Note 7)	111,303	111,895
Total equity	3,828,229	3,428,004
TOTAL LIABILITIES AND EQUITY	\$ 12,435,487	\$ 11,986,324

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

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PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)
(dollars in thousands)

	Nine Months Ended September 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 357,708	\$ 97,799
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	350,762	338,311
Deferred fuel and purchased power	50,020	(46,743)
Deferred fuel and purchased power amortization	(95,926)	115,214
Allowance for equity funds used during construction	(16,417)	(11,919)
Real estate impairment charges	16,731	260,450
Gain on real estate debt restructuring	(14,403)	
Deferred income taxes	281,486	154,517
Change in mark-to-market valuations	3,716	(5,970)
Changes in current assets and liabilities:		
Customer and other receivables	(103,973)	(79,297)
Accrued unbilled revenues	(69,035)	(56,420)
Materials, supplies and fossil fuel	19,011	(16,781)
Other current assets	(13,236)	26,308
Accounts payable	36,687	(35,923)
Accrued taxes and income tax receivable-net	56,851	(120,878)
Other current liabilities	10,989	8,789
Expenditures for real estate investments	(514)	(2,410)
Gains and other changes in real estate assets	1,811	(10,527)
Change in margin and collateral accounts assets	(4,336)	1,652
Change in margin and collateral accounts liabilities	(143,725)	3,564
Change in unrecognized tax benefits	(72,649)	92,720
Change in other regulatory liabilities	40,121	92,598
Change in other long-term assets	(51,659)	(49,577)
Change in other long-term liabilities	(28,547)	15,491
Net cash flow provided by operating activities	569,500	770,968
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(552,707)	(558,495)
Contributions in aid of construction	25,258	17,393
Allowance for borrowed funds used during construction	(12,553)	(8,568)
Proceeds from sale of district cooling business	100,300	
Proceeds from nuclear decommissioning trust sales	424,255	370,399
Investment in nuclear decommissioning trust	(442,567)	(386,743)
Proceeds from sale of commercial real estate investments	71,174	30,847
Other	9,621	(1,404)

Net cash flow used for investing activities	(377,219)	(536,571)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt		867,582
Repayment of long-term debt	(84,529)	(421,079)
Short-term borrowings and payments net	(153,715)	(528,217)
Dividends paid on common stock	(161,722)	(153,740)
Common stock equity issuance	255,156	2,623
Noncontrolling interests	(3,286)	(3,393)
Other	6,352	(2,594)
Net cash flow used for financing activities	(141,744)	(238,818)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	50,537	(4,421)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	145,378	105,245
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 195,915	\$ 100,824
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes, net of (refunds)	\$ (22,165)	\$ (34,700)
Interest, net of amounts capitalized	\$ 167,576	\$ 163,438
See Notes to Pinnacle West's Condensed Consolidated Financial Statements.		

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**PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

1. Consolidation and Nature of Operations

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

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

In preparing the condensed consolidated financial statements, we have evaluated the events that have occurred after December 31, 2009 through the date the financial statements were issued. Our condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments except as otherwise disclosed in the notes) that we believe are necessary for the fair presentation of our financial position, results of operations and cash flows for the periods presented. The December 31, 2009 condensed consolidated balance sheet data was derived from audited financial statements, but does not include disclosures required by GAAP for audited annual statements. This quarterly report should be reviewed in conjunction with the audited financial statements included in the 2009 Form 10-K. These condensed consolidated financial statements and notes have been prepared consistently with the 2009 Form 10-K with the exception of certain line items that are presented in more detail on the Condensed Consolidated Statements of Cash Flows than were presented in the prior year. The prior year amounts were reclassified to conform to the current year presentation. Change in margin and collateral accounts assets is presented as a separate line item instead of as a single line item of change in other long-term assets as previously reported. Change in margin and collateral accounts liabilities is presented as a separate line item instead of as a single line item of change in other long-term liabilities as previously reported. There has also been a reclassification of certain prior-year amounts on our Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows in accordance with accounting requirements for reporting discontinued operations (see Note 14) and amended accounting guidance on consolidation of VIEs (see Note 7). The following tables show the impacts of the reclassifications to prior year (previously reported) amounts (dollars in thousands):

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	As	Reclassifications as a result of the adoption of	Reclassifications for	Amount reported after adoption of amended VIE accounting guidance and discontinued operations
Statement of Income for the Three Months Ended September 30, 2009	previously reported	new VIE accounting guidance	discontinued operations	discontinued operations
Operating Revenues				
Real estate segment	\$ 47,602	\$	\$ (47,602)	\$
Other revenues	10,853		(5,567)	5,286
Operating Expenses				
Real estate segment operations	25,074		(25,074)	
Real estate impairment charge	37,051		(37,051)	
Operations and maintenance	208,769	(9,916)	(823)	198,030
Depreciation and amortization	102,246	1,927	(1,165)	103,008
Taxes other than income taxes	34,111		(96)	34,015
Other expenses	8,014		(2,981)	5,033
Other				
Other income	4,650		(264)	4,386
Interest Expense				
Interest charges	60,161	3,036	(2,898)	60,299
Allowance for borrowed funds used during construction	(1,423)		74	(1,349)
Income Taxes	103,507		6,271	109,778
Income From Continuing Operations	188,065	4,953	10,310	203,328
Loss From Discontinued Operations	(1,995)		(10,310)	(12,305)
Net Income	186,070	4,953		191,023
Net Income (Loss) Attributable To Noncontrolling Interests	(582)	4,953		4,371
Statement of Income for the Nine Months Ended September 30, 2009				
Operating Revenues				
Real estate segment	\$ 75,122	\$	\$ (75,122)	\$
Other revenues	30,084		(13,920)	16,164
Operating Expenses				
Real estate segment operations	71,413		(71,413)	
Real estate impairment charge	241,469		(241,469)	
Operations and maintenance	642,545	(29,745)	(2,399)	610,401
Depreciation and amortization	302,166	5,778	(3,878)	304,066
Taxes other than income taxes	101,126		(338)	100,788

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Other expenses	22,214		(6,352)	15,862
Other				
Other income	4,820		(718)	4,102
Interest Expense				
Interest charges	174,720	9,713	(6,986)	177,447
Allowance for borrowed funds used during construction	(8,568)		250	(8,318)
Income Taxes	48,082		89,512	137,594
Income From Continuing Operations	96,099	14,254	153,313	263,666
Loss From Discontinued Operations	(12,554)		(153,313)	(165,867)
Net Income	83,545	14,254		97,799
Net Loss Attributable To Noncontrolling Interests	(14,944)	14,254		(690)

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	As previously reported	Reclassifications as a result of the adoption of the new VIE accounting guidance	Amounts reported after adoption of amended VIE accounting guidance
Balance Sheets December 31, 2009			
Property, Plant and Equipment Palo Verde sale leaseback, net of accumulated depreciation	\$	\$ 146,722	\$ 146,722
Deferred Debits Regulatory assets	781,714	31,447	813,161
Current Liabilities Current maturities of long-term debt	277,693	25,783	303,476
Long-Term Debt Less Current Maturities Palo Verde sale leaseback lessor notes		126,000	126,000
Deferred Credits and Other Other	200,015	(55,938)	144,077
Equity Noncontrolling Interests	29,571	82,324	111,895
		Reclassifications as a result of the adoption of the new VIE accounting guidance and to conform	Amounts reported after adoption of amended VIE accounting guidance and to conform to
	As previously reported	to current year presentation	current year presentation
Statement of Cash Flows for the Nine Months Ended September 30, 2009			
Cash Flows from Operating Activities			
Net income	\$ 83,545	\$ 14,254	\$ 97,799
Depreciation and amortization including nuclear fuel	332,532	5,779	338,311
Other current liabilities	25,808	(17,019)	8,789
Change in margin and collateral accounts-assets		1,652	1,652
Change in margin and collateral accounts-liabilities		3,564	3,564
Other long-term assets	(47,925)	(1,652)	(49,577)
Other long-term liabilities	12,071	3,420	15,491
Cash Flows from Financing Activities			
Repayment and acquisition of long-term debt	(414,474)	(6,605)	(421,079)
Noncontrolling interests		(3,393)	(3,393)
Supplemental Disclosure of Cash Flow Information			
Cash paid for Interest, Net of Amounts Capitalized	153,725	9,713	163,438

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2. Long-term Debt and Liquidity Matters

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

Year	Consolidated Pinnacle West	Consolidated APS
2010	\$ 23	\$ 17
2011	632	457
2012	478	478
2013	140	140
2014	503	503
Thereafter	1,932	1,932
Total	\$ 3,708	\$ 3,527

Credit Facilities, Debt and Equity Issuances

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

Pinnacle West

On February 12, 2010, Pinnacle West refinanced its \$283 million revolving credit facility that would have matured in December 2010, and decreased the size of the facility to \$200 million. The new facility matures in February 2013. Pinnacle West has the option to increase the amount of the facility up to a maximum of \$300 million upon the satisfaction of certain conditions and with the consent of the lenders. Pinnacle West will use the facility for general corporate purposes, commercial paper support and for the issuance of letters of credit. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings. As a result of the downsized credit facility, the Company also reduced the size of its commercial paper program to \$200 million from \$250 million.

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

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

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

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APS

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

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

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

On 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 letter of credit and remain in a daily rate mode, supported by a new three-year letter of credit expiring in August 2013.

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 with an 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 7) and, as a result of consolidation of these VIEs, APS has reported the Lessor Trusts' long-term debt on its Condensed Consolidated Balance Sheets. Interest rates on these debt instruments are 8% and are fixed for the remaining life of the debt. As of September 30, 2010, approximately \$30 million was classified as current maturities of long-term debt and \$113 million was classified as long-term debt relating to these VIEs. These debt instruments mature on December 30, 2015 and have sinking fund features that are serviced by the lease payments. See Note 7 for additional discussion of the VIEs.

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SunCor

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

At September 30, 2010, SunCor had approximately \$22 million of assets on its balance sheet classified as assets held for sale. These assets consisted of \$18 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet.

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

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

Debt Provisions

An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At September 30, 2010, APS' 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' total capitalization remains the same. This restriction does not materially affect Pinnacle West's ability to meet its ongoing capital requirements.

3. Regulatory Matters

2008 General Retail Rate Case Impacts

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

Revenue accounting treatment for line extension payments received for new or upgraded service from January 1, 2010 through year end 2012 (or until new rates are established in APS' next general rate case, if that is before the end of 2012), which resulted in projected estimates of increased revenues of \$23 million, \$25 million and \$49 million, respectively (as of September 30, 2010, estimates for the 2010 year are expected to be \$17 - \$21 million);

An authorized return on common equity of 11%;

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A capital structure comprised of 46.2% debt and 53.8% common equity;

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

Authorization and requirements of equity infusions into APS of at least \$700 million during the period beginning June 1, 2009 through December 31, 2014 (\$253 million of which was infused into APS from proceeds of a Pinnacle West equity issuance in the second quarter of 2010 (see Note 2)); and

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

The parties also agreed to a rate case filing plan in which APS is prohibited from filing its next two general rate cases until on or after June 1, 2011 and June 1, 2013, respectively, unless certain extraordinary events occur. Subject to the foregoing, APS may not request its next general retail rate increase to be effective prior to July 1, 2012. APS currently expects it will file its next rate case in June 2011. The parties agreed to use good faith efforts to process these subsequent rate cases within twelve months of sufficiency findings from the ACC staff, which generally occur within 30 days after the filing of a rate case.

Cost Recovery Mechanisms

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

Renewable Energy Standard. In 2006, the ACC approved the Arizona Renewable Energy Standard and Tariff (RES). Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include a RES surcharge on customer bills to recover the approved amounts for use on renewable energy projects. Each year APS is required to file a five-year implementation plan with the ACC and seek approval for the upcoming year's RES funding amount. During 2009, APS filed its annual RES implementation plan, covering the 2010-2014 timeframe and requesting 2010 RES funding approval. The plan provided for the acquisition of renewable generation in compliance with requirements through 2014, and requested RES funding of \$86.7 million for 2010, which was later approved by the ACC. APS also sought various other determinations in its plan, including approval of the AZ Sun Program and the Community Power Project in Flagstaff, Arizona described below.

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On March 3, 2010, the ACC approved the AZ Sun Program, which contemplates the addition of 100 megawatts (MW) of APS-owned solar resources through 2014. Through this program, APS plans to invest up to \$500 million in solar photovoltaic projects across Arizona, which APS will acquire through competitive procurement processes. The costs associated with the first 50 MW under this program will be recovered initially through the RES until such time as the costs are recovered in base rates. The costs of the second 50 MW will be recovered through a mechanism to be determined in APS next retail rate case. As of September 30, 2010, APS had signed two contracts to develop 33 MW of photovoltaic power for approximately \$150 million under the AZ Sun Program.

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

On July 1, 2010, APS filed its annual RES implementation plan, covering the 2011-2015 timeframe and requesting 2011 RES funding of \$96.4 million. The 2011 Plan addressed enhancements to the residential distributed energy incentive program based on high customer participation and additional programs offered in response to ACC workshops on feed in tariffs, which provide opportunities for streamlined development of certain renewable projects. On October 13, 2010, APS filed an adjusted RES implementation plan to reflect the following items, among others: 1) increased clarity relating to customer project in-service dates and related budget revisions; 2) AZ Sun Program updates; and 3) addition of 10 MW of biomass capacity. In addition, APS lowered its 2011 RES funding request to \$92.5 million primarily as a result of an improved understanding of the timing of incentives payable for commercial projects. APS expects the ACC to vote on the 2011 Plan in the fourth quarter of 2010.

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

The ACC approved recovery of all 2009 program costs plus incentives. The change from program cost recovery on a historical basis to recovery on a concurrent basis, as authorized in the Settlement Agreement, resulted in this one-time need to address two years (2009 and 2010) of cost recovery. As requested by APS, 2009 program cost recovery is to be spread over a three-year period.

On June 1, 2010, APS filed its 2011 Energy Efficiency Implementation Plan. In order to meet the energy efficiency goal for 2011 established by the Settlement Agreement of annual energy savings of 1.25%, expressed as a percent of total energy resources to meet retail load, APS proposed a total budget for 2011 of \$79.2 million. If this plan is approved by the ACC as proposed, and when added to the amortization of 2009 costs discussed above less the \$10 million already being recovered in general rates, the DSMAC would recover approximately \$74.8 million over a twelve month period beginning March 1, 2011. These amounts do not include \$1.3 million for an electric vehicle charging station program submitted to the ACC for approval on September 30, 2010.

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

	Nine Months Ended September 30,	
	2010	2009
Beginning balance	\$ (87)	\$ 8
Deferred fuel and purchased power costs-current period	(50)	47
Amounts refunded (recovered)	96	(115)
Ending balance	\$ (41)	\$ (60)

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

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

Transmission Rates and Transmission Cost Adjustor. In July 2008, the United States Federal Energy Regulatory Commission (FERC) approved an Open Access Transmission Tariff for APS to move from fixed rates to a formula rate-setting methodology in order to more accurately reflect and recover the costs that APS incurs in providing transmission services. A large portion of the rate represents charges for transmission services to serve APS' retail customers (Retail Transmission Charges). In order to recover the Retail Transmission Charges, APS must file an application with, and obtain approval from, the ACC under the transmission cost adjustor (TCA) mechanism, by which changes in Retail Transmission Charges can be reflected in APS' retail rates.

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

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

Decoupling. On October 18, 2010, the Chairman of the ACC issued a draft decoupling policy statement. 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 draft policy is supportive of decoupling using a revenue-per-customer methodology, which is the mechanism APS and a number of other parties support because it recognizes increased costs associated with additional customers. The draft policy would allow a utility to file a decoupling plan in its next general rate case. Subsequent steps by the ACC prior to approving any policy statement will likely depend on the nature and extent of the comments received from various stakeholders.

4. Retirement Plans and Other Benefits

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

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

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

	Pension Benefits				Other Benefits			
	Three Months Ended September 30, 2010		Nine Months Ended September 30, 2010		Three Months Ended September 30, 2010		Nine Months Ended September 30, 2010	
Service cost – benefits earned during the period	\$ 14	\$ 13	\$ 42	\$ 40	\$ 4	\$ 4	\$ 14	\$ 14
Interest cost on benefit obligation	31	29	92	88	11	10	32	29
Expected return on plan assets	(31)	(29)	(93)	(87)	(9)	(9)	(29)	(26)
Amortization of:								
Transition obligation						1		2
Prior service cost		1	1	2				
Net actuarial loss	5	4	15	11	2	3	7	8
Net periodic benefit cost	\$ 19	\$ 18	\$ 57	\$ 54	\$ 8	\$ 9	\$ 24	\$ 27
Portion of cost charged to expense	\$ 10	\$ 9	\$ 29	\$ 26	\$ 4	\$ 4	\$ 12	\$ 13
APS' share of cost charged to expense	\$ 9	\$ 8	\$ 28	\$ 25	\$ 4	\$ 4	\$ 12	\$ 12

Contributions

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

5. Business Segments

Pinnacle West's two reportable business segments are:

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Operating revenues:				
Regulated electricity segment	\$ 1,116	\$ 1,084	\$ 2,527	\$ 2,499
All other (a)	23	5	53	16
Total	\$ 1,139	\$ 1,089	\$ 2,580	\$ 2,515
Net income (loss) attributable to common shareholders:				
Regulated electricity segment	\$ 225	\$ 200	\$ 320	\$ 257
Real estate segment	8	(12)	(6)	(153)
All other (a)	1	(1)	29	(6)
Total	\$ 234	\$ 187	\$ 343	\$ 98

	As of September 30, 2010	As of December 31, 2009
Assets:		
Regulated electricity segment	\$ 12,324	\$ 11,691
Real estate segment	41	161
All other (a)	70	134
Total	\$ 12,435	\$ 11,986

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

district cooling
business, which
resulted in an
after-tax gain of
\$25 million for
the nine months
ended
September 30,
2010. See Note
14
Discontinued
Operations.

6. Income Taxes

Pinnacle West expects to receive approximately \$132 million of cash tax benefits related to SunCor's strategic asset sales (see Note 16), which will not be fully realized until all of the asset sales are completed. Approximately \$7 million of these benefits were recorded in the nine months ended September 30, 2010 as reductions to income tax expense related to the current impairment charges. The additional \$125 million of tax benefits were recorded as reductions to income tax expense related to SunCor impairment charges recorded on or before December 31, 2009. The \$88 million income tax receivables on the Condensed Consolidated Balance Sheets represent the anticipated refunds related to an APS tax accounting method change approved by the Internal Revenue Service (IRS) in the third quarter of 2009 and the current year tax benefits related to the SunCor strategic asset sales that closed in 2010.

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

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

7. Variable Interest Entities

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

APS VIEs

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

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

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Consolidation of these VIEs eliminates the lease accounting we previously reported and results in changes in our consolidated assets, debt, equity, and net income. Assets of the VIEs are restricted and may only be used to settle the VIEs' debt obligations and for payment to the noncontrolling interest holders. The creditors of the VIEs have no recourse to the assets of APS or Pinnacle West. As a result of consolidation we have eliminated rent expense, and have recognized depreciation and interest expense, resulting in an increase in net income for the three and nine months ended September 30, 2010 of \$5 million and of \$15 million, respectively, entirely attributable to the noncontrolling interests. Income attributable to Pinnacle West shareholders remains the same. Consolidation of these VIEs also results in changes to our Condensed Consolidated Statements of Cash Flows, but does not impact net cash flows. Our Condensed Consolidated Balance Sheets at September 30, 2010 include the following amounts relating to the VIEs (in millions):

	September 30, 2010
Property plant and equipment, net of accumulated depreciation	\$ 140
Long-term debt including current maturities	143
Equity- Noncontrolling interests	94

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

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

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

SunCor VIEs

SunCor is the primary beneficiary of certain land development trust arrangements and, accordingly, consolidates these VIEs. We have determined that SunCor is the primary beneficiary of these VIEs because SunCor controls the activities related to the development of the land held in the trusts. Our adoption of amended VIE accounting guidance has not changed our accounting treatment of the SunCor VIEs. Our Condensed Consolidated Balance Sheets reflect \$18 million of assets and \$18 million of noncontrolling equity interests relating to these arrangements at September 30, 2010. Our Condensed Consolidated Balance Sheets reflect \$29 million of assets and \$29 million of noncontrolling equity interests related to these arrangements at December 31, 2009. The assets relating to these VIEs consist strictly of land, all of which is restricted and may only be used for payment to the noncontrolling interests. We have not provided, and are not required to provide, financing or other financial support to these entities.

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8. Derivative and Energy Trading Accounting

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

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

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

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

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

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

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

Commodity	Quantity	
Power	14,149,591	megawatt hours
Gas	149,026,687	MMBTU (a)

(a) MMBTU is one million British thermal units.

Derivative Instruments in Designated Accounting Hedging Relationships

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

Commodity Contracts	Financial Statement Location	Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2010	2009	2010	2009
Amount of Gain (Loss) Recognized in AOCI on Derivative Instruments (Effective Portion)	Accumulated other comprehensive loss-derivative instruments	\$ (67,856)	\$ 4,959	\$ (168,110)	\$ (128,035)
Amount of Loss Reclassified from AOCI into Income (Effective Portion Realized)	Regulated electricity segment fuel and purchased power	(59,801)	(81,660)	(102,130)	(154,990)
Amount of Gain (Loss) Recognized in Income from Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing) (a)	Regulated electricity segment fuel and purchased power	(68)	(9,085)	1,364	(12,993)

(a) During the three and nine months ended September 30, 2010 and 2009, we had no amounts

reclassified
from AOCI to
earnings related
to discontinued
cash flow
hedges.

During the next twelve months, we estimate that a net loss of \$119 million before income taxes will be reclassified from AOCI as an offset to the effect of market price changes for the related hedged transactions. Approximately 90% of the amounts related to derivatives subject to the PSA will be recorded as either a regulatory asset or liability and have no effect on earnings.

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PINNACLE WEST CAPITAL CORPORATION
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Derivative Instruments Not Designated as Accounting Hedges

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

	Financial Statement Location	Three Months Ended		Nine Months Ended	
		September 30, 2010	2009	September 30, 2010	2009
Commodity Contracts					
Amount of Net Gain Recognized in Income from Derivative Instruments	Regulated electricity segment revenue	\$ 1,721	\$ 126	\$ 2,316	\$ 464
Amount of Net Gain (Loss) Recognized in Income from Derivative Instruments	Regulated electricity segment fuel and purchased power expense	(41,044)	23,463	(105,272)	(18,259)
Total		\$ (39,323)	\$ 23,589	\$ (102,956)	\$ (17,795)

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Fair Values of Derivative Instruments in the Condensed Consolidated Balance Sheets

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

	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Commodity Contracts					
Derivatives designated as accounting hedging instruments:					
Assets	\$ 2	\$	\$	\$	\$ 2
Liabilities	(1,311)	(2,159)	(123,351)	(86,043)	(212,864)
Total hedging instruments	(1,309)	(2,159)	(123,351)	(86,043)	(212,862)
Derivatives not designated as accounting hedging instruments:					
Assets	40,078	57,154	45,700	30,659	173,591
Liabilities	(1,257)	(27)	(124,165)	(126,066)	(251,515)
Total non-hedging instruments	38,821	57,127	(78,465)	(95,407)	(77,924)
Total derivatives	37,512	54,968	(201,816)	(181,450)	(290,786)
Margin account	23,822		2,068		25,890
Collateral provided to counterparties	12,701		145,230	100,794	258,725
Collateral provided from counterparties	(6,750)		(1,250)		(8,000)
Prepaid option premiums and other	1,191		(79)		1,112
Balance Sheet Total	\$ 68,476	\$ 54,968	\$ (55,847)	\$ (80,656)	\$ (13,059)

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

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

Credit Risk and Credit-Related Contingent Features

We are exposed to losses in the event of nonperformance or nonpayment by counterparties. We have risk management contracts with many counterparties, including two counterparties for which our exposure represents approximately 51% of Pinnacle West's \$123 million of risk management assets as of September 30, 2010. This exposure relates to long-term traditional wholesale contracts with counterparties that have very high credit quality. Our risk management process assesses and monitors the financial exposure of all counterparties. Despite the fact that the great majority of our trading counterparties' debt is rated as investment grade by the credit rating agencies, there is still a possibility that one or more of these companies could default, resulting in a material impact on consolidated earnings for a given period. Counterparties in the portfolio consist principally of financial institutions, major energy companies, municipalities and local distribution companies. We maintain credit policies that we believe minimize overall credit risk to within acceptable limits. Determination of the credit quality of our counterparties is based upon a number of factors, including credit ratings and our evaluation of their financial condition. To manage credit risk, we employ

collateral requirements and standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. Valuation adjustments are established representing our estimated credit losses on our overall exposure to counterparties.

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Certain of our derivative instrument contracts contain credit-risk-related contingent features including, among other things, investment grade credit rating provisions, credit-related cross default provisions, and adequate assurance provisions. Adequate assurance provisions allow a counterparty with reasonable grounds for uncertainty to demand additional collateral based on subjective events and/or conditions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position on September 30, 2010 was \$430 million, for which we had posted collateral of \$247 million in the normal course of business.

For those derivative instruments in a net liability position, with investment grade credit contingencies, the counterparties could demand additional collateral if our debt credit rating were to fall below investment grade (below BBB- for Standard & Poor's Ratings Services (Standard & Poor's) or Fitch, Inc. (Fitch) or Baa3 for Moody's Investors Service, Inc. (Moody's)), which would be a violation of the credit rating provisions. If the investment grade contingent features underlying these agreements had been fully triggered on September 30, 2010, after off-setting asset positions under master netting arrangements we would have been required to post approximately an additional \$111 million of collateral to our counterparties; this amount includes those contracts that qualify for scope exceptions, which are excluded from the derivative details in the above footnote. We also have energy related non-derivative instrument contracts with investment grade credit-related contingent features which could require us to post additional collateral of approximately \$204 million if our debt credit ratings were to fall below investment grade.

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PINNACLE WEST CAPITAL CORPORATION
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9. Changes in Equity

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

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, July 1	\$ 3,479,548	\$ 113,455	\$ 3,593,003	\$ 3,206,805	\$ 112,677	\$ 3,319,482
Net income	233,920	5,119	239,039	186,652	4,371	191,023
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	(67,856)		(67,856)	4,959		4,959
Net reclassification of realized losses to income (b)	59,801		59,801	81,660		81,660
Reclassification of pension and other postretirement benefits to income	1,314		1,314	1,240		1,240
Net income tax benefit (expense) related to items of other comprehensive income (loss)	2,660		2,660	(34,495)		(34,495)
Total other comprehensive income (loss)	(4,081)		(4,081)	53,364		53,364
Total comprehensive income	229,839	5,119	234,958	240,016	4,371	244,387
Issuance of capital stock	2,506		2,506	2,756		2,756
Purchase of treasury stock, net of reissuances	577		577	589		589
Other (primarily stock compensation)	4,456		4,456	(372)		(372)
Dividends on common stock				(53,132)		(53,132)
Net capital activities by noncontrolling interests		(7,271)	(7,271)		(93)	(93)
Ending balance, September 30	\$ 3,716,926	\$ 111,303	\$ 3,828,229	\$ 3,396,662	\$ 116,955	\$ 3,513,617

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	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, January 1	\$ 3,316,109	\$ 111,895	\$ 3,428,004	\$ 3,445,979	\$ 124,990	\$ 3,570,969
Net income (loss)	342,703	15,005	357,708	98,489	(690)	97,799
Other comprehensive income (loss):						
Net unrealized losses on derivative instruments (a)	(168,110)		(168,110)	(128,035)		(128,035)
Net reclassification of realized losses to income (b)	102,130		102,130	154,990		154,990
Reclassification of pension and other postretirement benefits to income	4,069		4,069	3,745		3,745
Net unrealized losses related to pension and other postretirement benefits	(6,933)		(6,933)	(4,204)		(4,204)
Net income tax benefit (expense) related to items of other comprehensive income (loss)	27,171		27,171	(10,337)		(10,337)
Total other comprehensive income (loss)	(41,673)		(41,673)	16,159		16,159
Total comprehensive income (loss)	301,030	15,005	316,035	114,648	(690)	113,958
Issuance of capital stock	260,665		260,665	8,102		8,102
Purchase of treasury stock, net of reissuances	1,655		1,655	(957)		(957)
Other (primarily stock compensation)	4,598		4,598	(11,899)		(11,899)
Dividends on common stock	(167,131)		(167,131)	(159,211)		(159,211)
Net capital activities by noncontrolling interests		(15,597)	(15,597)		(7,345)	(7,345)
Ending balance, September 30	\$ 3,716,926	\$ 111,303	\$ 3,828,229	\$ 3,396,662	\$ 116,955	\$ 3,513,617

(a) These amounts
primarily

include unrealized gains and losses on contracts used to hedge our forecasted electricity and natural gas requirements to serve Native Load. These changes are primarily due to changes in forward natural gas prices and wholesale electricity prices.

- (b) These amounts primarily include the reclassification of unrealized gains and losses to realized gains and losses for contracted commodities delivered during the period.

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10. Commitments and Contingencies

Palo Verde Nuclear Generating Station

Spent Nuclear Fuel and Waste Disposal

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

Based on this decision and the DOE s delay, a number of utilities, including APS (on behalf of itself and the other Palo Verde owners), filed damages actions against the DOE in the Court of Federal Claims. APS pursued a damages claim for costs incurred through December 2006 in a trial that began on January 28, 2009. On June 18, 2010, the court awarded APS and the other Palo Verde owners approximately \$30 million. APS received its share of this amount in October 2010, which is approximately \$9 million.

APS currently estimates it will incur \$132 million (in 2010 dollars) over the current life of Palo Verde for its share of the costs related to the on-site interim storage of spent nuclear fuel. At September 30, 2010, APS had a regulatory liability of \$46 million that represents amounts recovered in retail rates in excess of amounts spent for on-site interim spent fuel storage.

Fuel and Purchased Power Commitments and Purchase Obligations

APS is party to purchase obligations and various fuel and purchased power contracts with terms expiring between 2010 and 2042 that include required purchase provisions. APS estimates the contract requirements to be approximately \$727 million in 2010; \$527 million in 2011; \$435 million in 2012; \$515 million in 2013; \$550 million in 2014; and \$7.6 billion thereafter. However, these amounts may vary significantly pursuant to certain provisions in such contracts that permit us to decrease required purchases under certain circumstances. These amounts have increased since the 2009 Form 10-K primarily due to increased commitments for fuel and purchased power and contracts associated with meeting our renewable energy requirements.

Coal Mine Reclamation Obligations

APS is obligated to reimburse certain coal providers for amounts incurred for coal mine reclamation. APS coal mine reclamation obligation recorded on the Condensed Consolidated Balance Sheets was estimated to be \$117 million at September 30, 2010 and \$92 million at December 31, 2009.

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FERC Market Issues

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

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

Superfund

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

Landlord Bankruptcy

On April 16, 2009, the landlord for our corporate headquarters building announced that it is seeking relief under Chapter 11 of the United States Bankruptcy Code. At September 30, 2010, we have several assets on our books related to our landlord, the most significant of which is an asset related to levelized rent payments for the building of approximately \$70 million which is included in other deferred debits on the Condensed Consolidated Balance Sheets. This amount will continue to increase to approximately \$93 million as a result of the lease terms until 2015, when this amount will begin to decrease over the remaining life of the lease. We are monitoring this matter and, while there can be no assurances as to the ultimate outcome of the matter due to the complexity of the bankruptcy proceedings, we currently do not expect that it will have a material adverse effect on our financial position, results of operations, or cash flows.

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Nuclear Insurance

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

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

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11. Other Income and Other Expense

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Other income:				
Interest income	\$ 943	\$ 543	\$ 2,597	\$ 1,185
Investment gains net	3,390	3,696	1,051	120
Miscellaneous	15	147	180	2,797
Total other income	\$ 4,348	\$ 4,386	\$ 3,828	\$ 4,102
Other expense:				
Non-operating costs	\$ (2,894)	\$ (1,643)	\$ (5,917)	\$ (6,498)
Miscellaneous	(961)	(291)	(2,733)	(2,389)
Total other expense	\$ (3,855)	\$ (1,934)	\$ (8,650)	\$ (8,887)

12. Guarantees

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

	Guarantees		Surety Bonds	
	Amount	Term (in years)	Amount	Term (in years)
APSES	\$ 5	1	\$ 42	1
APS	3	1	9	1
Total	\$ 8		\$ 51	

APS has entered into various agreements that require letters of credit for financial assurance purposes. At September 30, 2010, approximately \$194 million of letters of credit were outstanding to support existing pollution control bonds of approximately \$190 million. The letters of credit are available to fund the payment of principal and interest of such debt obligations. In connection with the change of interest rate modes and termination of corresponding letters of credit for certain pollution control bonds described in Note 2, the letters of credit outstanding have decreased since September 30, 2010. Currently, there are approximately \$44 million of letters of credit outstanding to support existing pollution control bonds of approximately \$44 million. These letters of credit expire in

2011 and 2013. APS has also entered into approximately \$61 million of letters of credit to support certain equity lessors in the Palo Verde sale leaseback transactions (see Note 7 for further details on the Palo Verde sale leaseback transactions). These letters of credit were amended and extended in April 2010, and will expire in 2013.

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

13. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Basic earnings per share:				
Income from continuing operations attributable to common shareholders	\$ 2.09	\$ 1.96	\$ 3.06	\$ 2.47
Income (loss) from discontinued operations	0.06	(0.12)	0.18	(1.50)
Earnings per share basic	\$ 2.15	\$ 1.84	\$ 3.24	\$ 0.97
Diluted earnings per share:				
Income from continuing operations attributable to common shareholders	\$ 2.08	\$ 1.96	\$ 3.04	\$ 2.46
Income (loss) from discontinued operations	0.06	(0.12)	0.18	(1.49)
Earnings per share diluted	\$ 2.14	\$ 1.84	\$ 3.22	\$ 0.97

Dilutive stock options and performance shares (which are contingently issuable) increased average diluted common shares outstanding by approximately 462,000 shares and 162,000 shares for the three months ended September 30, 2010 and 2009, respectively, and by approximately 472,000 and 77,000 shares for the nine months ended September 30, 2010 and 2009, respectively.

Options to purchase 175,333 shares of common stock for the three-month period ended September 30, 2010, and 561,157 shares for the three-month period ended September 30, 2009 were outstanding but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares. Options to purchase 322,333 shares and 595,335 shares of common stock for the nine-month periods ended September 30, 2010 and September 30, 2009, respectively, were outstanding but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

14. Discontinued Operations

SunCor (real estate segment) In July 2010, SunCor sold land parcels, commercial assets and a master planned home-building community for approximately \$70 million, which approximated the carrying value of these assets, resulting in a net gain of zero. At September 30, 2010, SunCor had approximately \$22 million of assets on its balance sheet classified as assets held for sale. These assets consist of \$18 million of consolidated VIEs (see Note 7), master planned home-building communities and golf courses. Because it is expected that SunCor will dispose of these assets within the next 12 months, they are classified as assets held for sale on the balance sheet. As a result, for the three and nine months ended September 30, 2010, all of SunCor's operations are reflected in discontinued operations. Prior comparative period income statement amounts related to these properties were reclassified from continuing operations to discontinued operations. In addition, see Note 16 Real Estate Impairment Charge.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue:				
SunCor	\$ 4	\$ 49	\$ 25	\$ 85
APSES		5	7	14
Total revenue	\$ 4	\$ 54	\$ 32	\$ 99
Income (loss) before taxes:				
SunCor	\$ 14	\$ (20)	\$ (10)	\$ (252)
APSES	(2)	1	42	3
Total income (loss) before taxes	\$ 12	\$ (19)	32	\$ (249)
Income (loss) after taxes:				
SunCor (a)	\$ 8	\$ (12)	\$ (6)	\$ (153)
APSES	(1)	1	26	2
Total income (loss) after taxes	\$ 7	\$ (11)	\$ 20	\$ (151)

(a) Includes a tax (expense) benefit recognized by the parent company in accordance with an intercompany tax sharing agreement of (\$6) million and \$8 million for the three months ended September 30, 2010, and 2009, respectively; and \$4 million and \$99 million for the nine months ended September 30, 2010 and 2009, respectively.

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**PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

15. Fair Value Measurements

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

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

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

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

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

Recurring Fair Value Measurements

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

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**PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Cash Equivalents

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

Risk Management Activities

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

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

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

Nuclear Decommissioning Trust

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Tables

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

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (a) (Level 3)	Counterparty Netting & Other (b)	Balance at September 30, 2010
Assets					
Cash equivalents	\$ 122	\$	\$	\$	\$ 122
Risk management activities:					
Commodity contracts		98	76	(51)	123
Nuclear decommissioning trust:					
Equity securities:					
U.S. commingled funds		151			151
Fixed income securities:					
U.S. Treasury	67				67
Corporate		63			63
Mortgage-backed		61			61
Municipality		71			71
Other		54		(13)	41
Total	\$ 189	\$ 498	\$ 76	\$ (64)	\$ 699
Liabilities					
Risk management activities:					
Commodity contracts	\$ (2)	\$ (338)	\$ (125)	\$ 328	\$ (137)

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

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Commodity Contracts				
Net derivative balance at beginning of period	\$ (42)	\$ (16)	\$ (10)	\$ (7)
Total net gains (losses) realized/unrealized:				
Included in earnings	1	1	(1)	3
Included in OCI	(11)	(2)	(20)	(3)
Deferred as a regulatory asset or liability	(15)	6	(39)	12
Settlements	12	(4)	15	(1)
Transfers into Level 3 from Level 2	(2)	(2)	6	(23)
Transfers from Level 3 into Level 2	8	4		6
Net derivative balance at end of period	\$ (49)	\$ (13)	\$ (49)	\$ (13)

Net unrealized gains (losses) included in earnings related to instruments still held at end of period \$ 1 \$ 1 \$ \$ 3

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

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

Nonrecurring Fair Value Measurements

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

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

Financial Instruments Not Carried at Fair Value

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	As of September 30, 2010		As of December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	\$ 175	\$ 178	\$ 175	\$ 180
APS	3,521	3,919	3,530	3,667
SunCor (a)	6	6	95	95
Total	\$ 3,702	\$ 4,103	\$ 3,800	\$ 3,942

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

Nuclear Decommissioning Trust

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

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
September 30, 2010			
Equity securities	\$ 151	\$ 31	\$ (4)
Fixed income securities	316	20	
Net payables (a)	(13)		
Total	\$ 454	\$ 51	\$ (4)

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Realized gains	\$ 1	\$ 3	\$ 15	\$ 8
Realized losses		(1)	(3)	(6)
Proceeds from the sale of securities (a)	94	126	424	370

(a) Proceeds are reinvested in the trust.

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

	Fair Value
Less than one year	\$ 26
1 year - 5 years	74
5 years - 10 years	93
Greater than 10 years	123
Total	\$ 316

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

16. Real Estate Impairment Charge

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Discontinued Operations:				
Homebuilding and master-planned communities	\$	\$	10	\$ 160
Land parcels and commercial assets			27	11 81
Golf courses			1	1 19
Other				4
Subtotal			38	17 260
Less noncontrolling interests				(14)
Total	\$	\$	38	\$ 17 246

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

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ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars in thousands)

	Three Months Ended September 30,	
	2010	2009
ELECTRIC OPERATING REVENUES	\$ 1,116,220	\$ 1,083,825
OPERATING EXPENSES		
Fuel and purchased power	353,904	381,543
Operations and maintenance	217,044	193,530
Depreciation and amortization	104,152	102,954
Income taxes	126,841	118,923
Taxes other than income taxes	37,270	33,782
Total	839,211	830,732
OPERATING INCOME	277,009	253,093
OTHER INCOME (DEDUCTIONS)		
Income taxes	1,272	1,070
Allowance for equity funds used during construction	5,524	2,197
Other income (Note S-2)	2,962	3,530
Other expense (Note S-2)	(4,074)	(2,790)
Total	5,684	4,007
INTEREST EXPENSE		
Interest on long-term debt	53,946	54,252
Interest on short-term borrowings	2,013	1,058
Debt discount, premium and expense	1,121	1,115
Allowance for borrowed funds used during construction	(6,163)	(1,343)
Total	50,917	55,082
NET INCOME	231,776	202,018
Less: Net income attributable to noncontrolling interests (Note 7)	5,128	4,953
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDER	\$ 226,648	\$ 197,065

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

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ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)
(dollars in thousands)

	Nine Months Ended September 30,	
	2010	2009
ELECTRIC OPERATING REVENUES	\$ 2,527,163	\$ 2,499,072
OPERATING EXPENSES		
Fuel and purchased power	821,244	920,630
Operations and maintenance	632,235	595,929
Depreciation and amortization	307,731	303,814
Income taxes	177,089	158,041
Taxes other than income taxes	100,171	100,077
Total	2,038,470	2,078,491
OPERATING INCOME	488,693	420,581
OTHER INCOME (DEDUCTIONS)		
Income taxes	3,769	3,684
Allowance for equity funds used during construction	16,417	11,919
Other income (Note S-2)	3,872	7,580
Other expense (Note S-2)	(11,091)	(10,798)
Total	12,967	12,385
INTEREST EXPENSE		
Interest on long-term debt	161,918	157,980
Interest on short-term borrowings	5,734	5,326
Debt discount, premium and expense	3,376	3,560
Allowance for borrowed funds used during construction	(12,254)	(8,284)
Total	158,774	158,582
NET INCOME	342,886	274,384
Less: Net income attributable to noncontrolling interests (Note 7)	15,034	14,254
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDER	\$ 327,852	\$ 260,130

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

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ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(dollars in thousands)

	September 30, 2010	December 31, 2009
ASSETS		
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	\$ 12,982,572	\$ 12,781,256
Accumulated depreciation and amortization	(4,456,017)	(4,326,908)
Net	8,526,555	8,454,348
Construction work in progress	555,137	460,748
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	140,145	146,722
Intangible assets, net of accumulated amortization	178,479	164,183
Nuclear fuel, net of accumulated amortization	124,101	118,243
Total property, plant and equipment	9,524,417	9,344,244
INVESTMENTS AND OTHER ASSETS		
Nuclear decommissioning trust (Note 15)	453,963	414,576
Assets from risk management activities (Note 8)	54,968	28,855
Other assets	70,383	68,839
Total investments and other assets	579,314	512,270
CURRENT ASSETS		
Cash and cash equivalents	162,272	120,798
Customer and other receivables	359,053	280,226
Accrued unbilled revenues	180,006	110,971
Allowance for doubtful accounts	(7,660)	(6,063)
Materials and supplies (at average cost)	174,428	176,020
Fossil fuel (at average cost)	21,826	39,245
Assets from risk management activities (Note 8)	68,476	50,619
Deferred income taxes	81,719	53,990
Other current assets	42,901	25,724
Total current assets	1,083,021	851,530
DEFERRED DEBITS		
Regulatory assets	879,056	813,161
Income tax receivable (Note 6)	65,498	65,498
Unamortized debt issue costs	19,719	20,959

Other	77,448	73,909
Total deferred debits	1,041,721	973,527
TOTAL ASSETS	\$ 12,228,473	\$ 11,681,571

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

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ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(dollars in thousands)

	September 30, 2010	December 31, 2009
LIABILITIES AND EQUITY		
CAPITALIZATION		
Common stock	\$ 178,162	\$ 178,162
Additional paid-in capital	2,379,696	2,126,863
Retained earnings	1,421,679	1,250,126
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(31,149)	(29,114)
Derivative instruments	(120,614)	(80,682)
Total shareholder equity	3,827,774	3,445,355
Noncontrolling interests (Note 7)	94,073	82,324
Total equity	3,921,847	3,527,679
Long-term debt less current maturities (Note 2)	3,349,924	3,180,406
Palo Verde sale leaseback lessor notes (Notes 2 and 7)	113,379	126,000
Total capitalization	7,385,150	6,834,085
CURRENT LIABILITIES		
Current maturities of long-term debt (Note 2)	57,275	222,959
Accounts payable	227,224	213,833
Accrued taxes	174,192	158,051
Accrued interest	52,112	54,099
Customer deposits	68,206	70,780
Liabilities from risk management activities (Note 8)	55,847	55,908
Other current liabilities	135,931	124,995
Total current liabilities	770,787	900,625
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,840,300	1,582,945
Deferred fuel and purchased power regulatory liability (Note 3)	41,385	87,291
Other regulatory liabilities	685,908	679,072
Liability for asset retirements	323,134	301,783
Liabilities for pension and other postretirement benefits (Note 4)	697,686	766,378
Liabilities from risk management activities (Note 8)	80,656	62,443
Customer advances	127,449	136,595
Coal mine reclamation	117,029	92,060
Unrecognized tax benefits (Note 6)	65,863	140,638

Other	93,126	97,656
Total deferred credits and other	4,072,536	3,946,861

COMMITMENTS AND CONTINGENCIES (SEE NOTES)

TOTAL LIABILITIES AND EQUITY	\$ 12,228,473	\$ 11,681,571
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See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

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ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)
(dollars in thousands)

	Nine Months Ended September 30,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 342,886	\$ 274,384
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	349,267	334,092
Deferred fuel and purchased power	50,020	(46,743)
Deferred fuel and purchased power amortization	(95,926)	115,214
Allowance for equity funds used during construction	(16,417)	(11,919)
Deferred income taxes	218,575	252,282
Change in mark-to-market valuations	3,716	(5,970)
Changes in current assets and liabilities:		
Customer and other receivables	(93,394)	(92,535)
Accrued unbilled revenues	(69,035)	(56,420)
Materials, supplies and fossil fuel	19,011	(16,781)
Other current assets	(17,177)	(2,473)
Accounts payable	37,150	(28,018)
Accrued taxes	16,141	(149,990)
Other current liabilities	6,375	(740)
Change in margin and collateral accounts assets	(4,336)	1,251
Change in margin and collateral accounts liabilities	(143,725)	3,564
Change in regulatory liabilities	40,121	92,598
Change in unrecognized tax benefits	(72,217)	92,973
Change in other long-term assets	(53,566)	(54,781)
Change in other long-term liabilities	(11,686)	13,473
 Net cash flow provided by operating activities	 505,783	 713,461
 CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(552,331)	(551,042)
Contributions in aid of construction	25,258	17,393
Allowance for borrowed funds used during construction	(12,254)	(8,284)
Proceeds from nuclear decommissioning trust sales	424,255	370,399
Investment in nuclear decommissioning trust	(442,567)	(386,743)
Other	9,621	(1,404)
 Net cash flow used for investing activities	 (548,018)	 (559,681)
 CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt		863,903
Repayment of long-term debt	(9,538)	(350,312)

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Short-term borrowings and payments-net		(521,684)
Equity infusion	252,833	
Dividends paid on common stock	(156,300)	(127,500)
Noncontrolling interests	(3,286)	(3,393)
Net cash flow provided by (used for) financing activities	83,709	(138,986)
NET INCREASE IN CASH AND CASH EQUIVALENTS	41,474	14,794
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	120,798	71,544
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 162,272	\$ 86,338

Supplemental disclosure of cash flow information

Cash paid during the period for:

Income taxes, net of (refunds)	\$ 76,364	\$ 13,555
Interest, net of amounts capitalized	\$ 157,385	\$ 146,062

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

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

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

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ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

S-1. Changes in Equity

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

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Shareholder Equity	Noncontrolling Interests	Total	Shareholder Equity	Noncontrolling Interests	Total
Beginning balance, July 1	\$ 3,605,292	\$ 88,944	\$ 3,694,236	\$ 3,284,568	\$ 83,509	\$ 3,368,077