ARIZONA PUBLIC SERVICE CO
Form 10-Q
August 04, 2009

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FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from _____ to _____

Commission File Number	Exact Name of Each Registrant as specified in its charter; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-8962	**PINNACLE WEST CAPITAL CORPORATION** (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 þ No o
ARIZONA PUBLIC SERVICE COMPANY Yes þ No o

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

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

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

PINNACLE WEST CAPITAL CORPORATION
Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

ARIZONA PUBLIC SERVICE COMPANY

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

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

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

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

PINNACLE WEST CAPITAL CORPORATION	Number of shares of common stock, no par value, outstanding as of July 29, 2009: 101,200,552
ARIZONA PUBLIC SERVICE COMPANY	Number of shares of common stock, $2.50 par value, outstanding as of July 29, 2009: 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.

This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation and Arizona Public Service Company. 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.

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GLOSSARY

ACC Arizona Corporation Commission
ADEQ Arizona Department of Environmental Quality
ALJ Administrative Law Judge
APS Arizona Public Service Company, a subsidiary of the Company
APSES APS Energy Services Company, Inc., a subsidiary of the Company
Base Fuel Rate the portion of APS retail base rates attributable to fuel and purchased power costs
Clean Air Act Clean Air Act, as amended
Company Pinnacle West Capital Corporation
DOE United States Department of Energy
EITF FASB s Emerging Issues Task Force
El Dorado El Dorado Investment Company, a subsidiary of the Company
EPA United States Environmental Protection Agency
FASB Financial Accounting Standards Board
FERC United States Federal Energy Regulatory Commission
FIN FASB Interpretation Number
FIP Federal Implementation Plan
Fitch Fitch, Inc.
Four Corners Four Corners Power Plant
FSP FASB Staff Position
GAAP accounting principles generally accepted in the United States of America
IRS United States Internal Revenue Service
kWh kilowatt-hour, one thousand watts per hour
MMBTU one million British thermal units
Moody s Moody s Investors Service, Inc.
Native Load retail and wholesale sales supplied under traditional cost-based rate regulation
Note a Note to Pinnacle West s Condensed Consolidated Financial Statements in Item 1 of this report
NRC United States Nuclear Regulatory Commission
OCI other comprehensive income
Off-System Sales sales of electricity from generation owned or contracted by the Company that is over and above the amount required to serve APS retail customers and traditional wholesale contracts
Palo Verde Palo Verde Nuclear Generating Station
Pinnacle West Pinnacle West Capital Corporation, the Company

Pinnacle West Marketing & Trading Pinnacle West Marketing & Trading Co., LLC, a subsidiary of the Company
Price Anderson Act Price Anderson Nuclear Industries Indemnity Act
PRP potentially responsible parties under Superfund
PSA power supply adjustor approved by the ACC to provide for recovery or refund of variations in actual fuel and purchased power costs compared with the Base Fuel Rate
Salt River Project Salt River Project Agricultural Improvement and Power District
SEC United States Securities and Exchange Commission
Settlement Agreement Settlement Agreement dated June 12, 2009 between APS and other parties to its general retail rate case
SFAS Statement of Financial Accounting Standards
Standard & Poor s Standard & Poor s Ratings Services
SunCor SunCor Development Company, a subsidiary of the Company
SunCor Secured Revolver SunCor s principal loan facility
Superfund Comprehensive Environmental Response, Compensation and Liability Act
2008 Form 10-K Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2008
VIE variable-interest entity

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Part I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

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

	Three Months Ended June 30,	
	2009	2008
OPERATING REVENUES		
Regulated electricity segment	$ 812,510	$ 829,478
Real estate segment	16,763	23,365
Marketing and trading		22,508
Other revenues	10,782	9,162
Total	840,055	884,513
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	291,699	327,561
Real estate segment operations	23,693	30,594
Real estate impairment charge (Note 21)	632	
Marketing and trading fuel and purchased power		18,687
Operations and maintenance	226,245	193,700
Depreciation and amortization	100,063	97,770
Taxes other than income taxes	32,887	33,251
Other expenses	7,733	6,822
Total	682,952	708,385
OPERATING INCOME	157,103	176,128
OTHER		
Allowance for equity funds used during construction	4,730	5,414
Other income (Note 14)	6,587	3,928
Other expense (Note 14)	(4,187)	(10,055)
Total	7,130	(713)
INTEREST EXPENSE		
Interest charges	58,951	51,521
Capitalized interest	(3,311)	(4,938)
Total	55,640	46,583
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	108,593	128,832
INCOME TAXES	37,600	16,025

INCOME FROM CONTINUING OPERATIONS		70,993		112,807
INCOME (LOSS) FROM DISCONTINUED OPERATIONS				
Net of income tax expense (benefit) of $(1,811) and $13,660 (Note 17)		(2,798)		21,055
NET INCOME		68,195		133,862
Less: Net loss attributable to noncontrolling interests		(152)		
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$	68,347	$	133,862
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC		101,109		100,653
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED		101,193		100,917
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING				
Income from continuing operations attributable to common shareholders basic	$	0.70	$	1.12
Net income attributable to common shareholders basic		0.68		1.33
Income from continuing operations attributable to common shareholders diluted		0.70		1.12
Net income attributable to common shareholders diluted		0.68		1.33
DIVIDENDS DECLARED PER SHARE	$	0.525	$	0.525
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:				
Income from continuing operations, net of tax	$	71,145	$	112,807
Discontinued operations, net of tax		(2,798)		21,055
Net income attributable to common shareholders	$	68,347	$	133,862

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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

	Six Months Ended June 30,	
	2009	2008
OPERATING REVENUES		
Regulated electricity segment	$ 1,415,088	$ 1,452,279
Real estate segment	35,129	49,631
Marketing and trading		52,960
Other revenues	19,231	17,899
Total	1,469,448	1,572,769
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	539,087	596,939
Real estate segment operations	53,974	61,551
Real estate impairment charge (Note 21)	211,938	
Marketing and trading fuel and purchased power		42,673
Operations and maintenance	433,776	386,723
Depreciation and amortization	199,984	193,364
Taxes other than income taxes	67,015	66,403
Other expenses	14,200	12,760
Total	1,519,974	1,360,413
OPERATING INCOME (LOSS)	(50,526)	212,356
OTHER		
Allowance for equity funds used during construction	9,722	11,538
Other income (Note 14)	3,568	7,767
Other expense (Note 14)	(10,529)	(14,951)
Total	2,761	4,354
INTEREST EXPENSE		
Interest charges	114,757	106,223
Capitalized interest	(7,145)	(10,617)
Total	107,612	95,606
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(155,377)	121,104
INCOME TAXES	(58,574)	14,484
INCOME (LOSS) FROM CONTINUING OPERATIONS	(96,803)	106,620
INCOME (LOSS) FROM DISCONTINUED OPERATIONS		
Net of income tax expense (benefit) of $(3,703) and $14,763 (Note 17)	(5,722)	22,769

NET INCOME (LOSS)		(102,525)		129,389
Less: Net loss attributable to noncontrolling interests		(14,362)		
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	$	(88,163)	$	129,389
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING BASIC		101,048		100,587
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING DILUTED		101,048		100,856
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING				
Income (loss) from continuing operations attributable to common shareholders basic	$	(0.82)	$	1.06
Net income (loss) attributable to common shareholders basic		(0.87)		1.29
Income (loss) from continuing operations attributable to common shareholders diluted		(0.82)		1.06
Net income (loss) attributable to common shareholders diluted		(0.87)		1.28
DIVIDENDS DECLARED PER SHARE	$	1.05	$	1.05
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:				
Income (loss) from continuing operations, net of tax	$	(82,441)	$	106,620
Discontinued operations, net of tax		(5,722)		22,769
Net income (loss) attributable to common shareholders	$	(88,163)	$	129,389

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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

	June 30, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 17,595	$ 105,245
Trust fund for bond redemption (Note 4)	163,975	
Customer and other receivables	261,630	292,682
Accrued utility revenues	144,398	100,089
Allowance for doubtful accounts	(2,860)	(3,383)
Materials and supplies (at average cost)	184,043	173,252
Fossil fuel (at average cost)	40,589	29,752
Deferred income taxes	101,356	79,729
Income tax receivable (Note 8)	165,353	
Home inventory (Note 21)	12,910	50,688
Assets held for sale (Note 17)	28,863	
Assets from risk management and trading activities (Note 10)	43,652	32,581
Other current assets	23,318	21,847
Total current assets	1,184,822	882,482
INVESTMENTS AND OTHER ASSETS		
Real estate investments net (Note 21)	199,470	415,296
Assets from long-term risk management and trading activities (Note 10)	24,720	33,675
Nuclear decommissioning trust (Note 18)	363,221	343,052
Other assets	99,544	117,935
Total investments and other assets	686,955	909,958
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	12,557,986	12,264,805
Less accumulated depreciation and amortization	4,234,290	4,141,546
Net	8,323,696	8,123,259
Construction work in progress	481,759	572,354
Intangible assets, net of accumulated amortization	140,411	131,722
Nuclear fuel, net of accumulated amortization	138,163	89,323
Total property, plant and equipment	9,084,029	8,916,658
DEFERRED DEBITS		

Deferred fuel and purchased power regulatory asset (Note 5)		7,984
Other regulatory assets	790,609	787,506
Other deferred debits	116,421	115,505
Total deferred debits	907,030	910,995
TOTAL ASSETS	$ 11,862,836	$ 11,620,093

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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

	June 30, 2009	December 31, 2008
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 202,011	$ 261,029
Accrued taxes	105,397	109,798
Accrued interest	54,730	40,741
Short-term borrowings	390,498	670,469
Current maturities of long-term debt (Note 4)	331,128	177,646
Customer deposits	76,785	78,745
Liabilities from risk management and trading activities (Note 10)	53,038	69,585
Other current liabilities	82,430	97,915
Total current liabilities	1,296,017	1,505,928
LONG-TERM DEBT LESS CURRENT MATURITIES (NOTE 4)	3,528,987	3,031,603
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,475,278	1,403,318
Deferred fuel and purchased power regulatory liability (Note 5)	71,323	
Other regulatory liabilities	622,411	587,586
Liability for asset retirements	285,247	275,970
Liabilities for pension and other postretirement benefits (Note 6)	713,445	675,788
Liabilities from risk management and trading activities (Note 10)	109,711	126,532
Other	524,444	520,000
Total deferred credits and other	3,801,859	3,589,194
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 11)		
Common stock, no par value	2,147,022	2,151,323
Treasury stock	(4,400)	(2,854)
Total common stock	2,142,622	2,148,469
Retained earnings	1,248,086	1,444,208
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(48,530)	(47,547)

Derivative instruments	(135,373)	(99,151)
Total accumulated other comprehensive loss	(183,903)	(146,698)
Total Pinnacle West shareholders equity	3,206,805	3,445,979
Noncontrolling real estate interests	29,168	47,389
Total equity	3,235,973	3,493,368
TOTAL LIABILITIES AND EQUITY	$ 11,862,836	$ 11,620,093

See Notes to Pinnacle West s Condensed Consolidated Financial Statements.

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

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (102,525)	$ 129,389
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	218,939	209,355
Deferred fuel and purchased power	13,144	(25,867)
Deferred fuel and purchased power amortization	66,163	114,265
Allowance for equity funds used during construction	(9,722)	(11,538)
Real estate impairment charge	222,055	
Deferred income taxes	77,588	154,249
Change in mark-to-market valuations	(401)	(29,369)
Changes in current assets and liabilities:		
Customer and other receivables	37,447	23,165
Accrued utility revenues	(44,309)	(60,492)
Materials, supplies and fossil fuel	(21,628)	(3,988)
Other current assets	(1,432)	22,531
Accounts payable	(49,711)	(399)
Accrued taxes	(169,754)	(23,337)
Other current liabilities	(7,977)	(1,036)
Expenditures for real estate investments	(1,560)	(15,614)
Other changes in real estate assets	7,135	6,357
Change in margin and collateral accounts assets	(2,457)	251,299
Change in margin and collateral accounts liabilities	(91,856)	6,275
Change in unrecognized tax benefits	14,386	(115,337)
Change in other long-term assets	(8,025)	9,088
Change in other long-term liabilities	46,898	39,840
Net cash flow provided by operating activities	192,398	678,836
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(393,682)	(477,269)
Contributions in aid of construction	33,371	22,970
Capitalized interest	(7,145)	(10,617)
Proceeds from nuclear decommissioning trust sales	244,858	188,311
Investment in nuclear decommissioning trust	(255,754)	(198,682)
Proceeds from sale of commercial real estate investments		94,171
Trust fund for bond redemption	(163,975)	
Other	990	1,977
Net cash flow used for investing activities	(541,337)	(379,139)

CASH FLOWS FROM FINANCING ACTIVITIES				
Issuance of long-term debt		840,630		63,127
Repayment and reacquisition of long-term debt		(195,767)		(147,467)
Short-term borrowings and payments net		(279,971)		(74,210)
Dividends paid on common stock		(102,439)		(105,592)
Common stock equity issuance		1,707		5,562
Other		(2,871)		(890)
Net cash flow provided by (used for) financing activities		261,289		(259,470)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(87,650)		40,227
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		105,245		56,321
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	17,595	$	96,548
Supplemental disclosure of cash flow information				
Cash paid during the period for:				
Income taxes, net of refunds	$	17,602	$	10,809
Interest, net of amounts capitalized	$	90,847	$	93,734

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, APSES, El Dorado and Pinnacle West Marketing & Trading. By the end of 2008, substantially all of Pinnacle West Marketing & Trading s contracts were transferred to APS or expired. Intercompany accounts and transactions between the consolidated companies have been eliminated. Our accounting records are maintained in accordance with 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. In preparing the accompanying unaudited condensed consolidated financial statements, we have evaluated subsequent events that have occurred after June 30, 2009 through the date the financial statements were issued on August 4, 2009.

2. Condensed Consolidated Financial Statements

Our unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments except as otherwise disclosed in the notes) that we believe are necessary for the fair presentation of our financial position, results of operations and cash flows for the periods presented. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and related notes included in our 2008 Form 10-K. These condensed consolidated financial statements and notes have been prepared consistently with the 2008 Form 10-K with the exception of the reclassification of certain prior-year amounts on our Condensed Consolidated Statement of Income and Condensed Consolidated Balance Sheets in accordance with SFAS No. 160 (see Note 19) and SFAS No. 144 (see Note 17).

We have presented certain line items in more detail in the Condensed Consolidated Statement of Cash Flows than was presented in the prior year. The prior year amounts were reclassified to conform to the current year presentation. Customer and other receivables and accrued utility revenues are presented as separate line items instead of the previously reported single line item of customer and other receivables. Accrued taxes and other current liabilities are presented as separate line items instead of the previously reported single line item of other current liabilities. The change in collateral and margin account liabilities and the change in other long-term liabilities are presented separately instead of the previously reported single line item of other long-term liabilities. These reclassifications had no impact on total net cash flow provided by operating activities.

3. Quarterly Fluctuations

Weather conditions cause significant seasonal fluctuations in our revenues. In addition, real estate activities, such as the real estate impairment charges recorded in the first half of 2009 (see Note 21), can have significant impacts on our results for interim periods. For these reasons, results for interim periods do not necessarily represent results expected for the year.

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Liquidity Matters

The following table shows principal payments due on Pinnacle West s and APS total long-term debt and capitalized lease requirements as of June 30, 2009 (dollars in millions):

Year	Consolidated Pinnacle West	APS
2009	$ 211	$ 164
2010	316	197
2011	578	401
2012	446	446
2013	34	32
Thereafter	2,283	2,283
Total	$ 3,868	$ 3,523

The credit and liquidity markets experienced significant stress beginning the week of September 15, 2008. While Pinnacle West s and APS ability to issue commercial paper has been negatively impacted by market conditions, they have both been able to access existing credit facilities, ensuring adequate liquidity.

Pinnacle West (parent company) has a $283 million revolving credit facility that terminates in December 2010. The revolver is available to support the issuance of up to $250 million in commercial paper or to be used as bank borrowings, including issuances of letters of credit of up to $94 million. At June 30, 2009, the parent company had outstanding $177 million of borrowings under its revolving credit facility and no letters of credit. It also had no commercial paper outstanding at June 30, 2009. At June 30, 2009, the parent company had remaining capacity available under its revolver of approximately $106 million.

On February 26, 2009, APS issued $500 million of 8.75% unsecured senior notes that mature on March 1, 2019. Net proceeds from the sale of the notes were used to repay short-term borrowings under two committed revolving lines of credit incurred to fund capital expenditures and for general corporate purposes.

During the second quarter of 2009, APS refinanced approximately $343 million of its $539 million variable rate pollution control bonds. As a result of these refinancings, which are described in the following three paragraphs, APS no longer has any outstanding debt securities in auction rate mode.

On May 28, 2009, the Navajo County, Arizona Pollution Control Corporation issued approximately $166 million of Navajo County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A-E, due 2034. The bonds were issued to redeem all of approximately $166 million of the Navajo County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds 2004 Series A-E, due 2034. The 2009 Series A-E bonds are payable solely from revenues obtained from APS pursuant to a loan agreement between APS and the Navajo County, Arizona Pollution Control Corporation. We will be required to purchase the bonds at the applicable interest reset date and have the opportunity to remarket the bonds at that time. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets.

Also on May 28, 2009, the Coconino County, Arizona Pollution Control Corporation issued approximately $13 million of 5.50% Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A, due 2034. The bonds were issued to redeem all of approximately $13 million of the Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds 2004 Series A, due 2034. The 2009 Series A bonds are payable solely from revenues obtained from APS pursuant to a loan agreement between APS and the Coconino County, Arizona Pollution Control Corporation. We will be required to purchase the bonds at the interest reset date and have the opportunity to remarket the bonds at that time. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets.

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On June 26, 2009, the Maricopa County, Arizona Pollution Control Corporation issued approximately $164 million of Maricopa County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A-E, due 2029. The bonds were issued to redeem all of approximately $164 million of the Maricopa County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds 2005 Series A-E, due 2029. The 2009 Series A-E bonds are payable solely from revenues obtained from APS pursuant to a loan agreement between APS and Maricopa County, Arizona Pollution Control Corporation. We will be required to purchase the bonds at the applicable interest reset date and have the opportunity to remarket the bonds at that time. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets.

Approximately $164 million of the Maricopa 2005 Series A-E bonds, which were redeemed in July 2009, are classified as current maturities of long-term debt on our Condensed Consolidated Balance Sheets. Approximately $164 million was also held in a restricted trust until redemption and is classified as Trust fund for bond redemption on the Condensed Consolidated Balance Sheets.

The following table provides details related to the pollution control bonds described above:

Issuer	Navajo County, AZ Pollution Control Corporation	Coconino County, AZ Pollution Control Corporation	Maricopa County, AZ Pollution Control Corporation
Issuance Date	May 28, 2009	May 28, 2009	June 26, 2009
Bond series details (series, interest rate, amount, reset date)	Series A 5.00% $38 million June 1, 2012	Series A 5.5% $13 million, June 1, 2014	Series A 6.00% $36 million May 1, 2014
	Series B 5.50% $32 million June 1, 2014		Series B 5.50% $32 million May 1, 2012
	Series C 5.50% $32 million, June 1, 2014		Series C 5.75% $32 million May 1, 2013
	Series D 5.75% $32 million, June 1, 2016		Series D 6.00% $32 million May 1, 2014
	Series E 5.75%, $32 million, June 1, 2016		Series E 6.00% $32 million May 1, 2014

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APS has two committed revolving credit facilities totaling $866 million, of which $377 million terminates in December 2010 and $489 million terminates in September 2011. The revolvers are available either to support the issuance of up to $250 million in commercial paper (see discussion above) or to be used for bank borrowings, including issuances of letters of credit up to $583 million. At June 30, 2009, APS had borrowings of approximately $209 million and no letters of credit under its revolving lines of credit. At June 30, 2009, APS had remaining capacity available under its revolvers of $657 million.

An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is common equity divided by the sum of common equity and long-term debt, including current maturities of long-term debt. At June 30, 2009, APS common equity ratio, as defined, was 48%. Its total common equity was approximately $3.3 billion, and total capitalization was approximately $6.8 billion. APS would be prohibited from paying dividends if the payment would reduce its common equity below approximately $2.7 billion, assuming APS total capitalization remains the same. This restriction does not materially affect Pinnacle West s ability to meet its ongoing capital requirements.

The SunCor Secured Revolver matures in January 2010 and requires SunCor to reduce its outstanding borrowings by specified amounts over the term of the facility. As of June 30, 2009, approximately $108 million of borrowings were outstanding under the SunCor Secured Revolver and approximately $67 million of debt was outstanding under other SunCor credit facilities. SunCor intends to apply the proceeds of planned asset sales (see Note 21) to the repayment of the SunCor Secured Revolver and SunCor s other outstanding debt. The impairment charges discussed in Note 21 and the maturity and non-payment of approximately $7 million of project loans resulted in violations of certain covenants contained in the SunCor Secured Revolver and SunCor s other credit facilities. SunCor has obtained a forbearance agreement from the SunCor Secured Revolver lenders under which those lenders have agreed not to enforce any of their remedies under the SunCor Secured Revolver until August 15, 2009. SunCor remains in discussions with these lenders to modify the SunCor Secured Revolver to resolve the covenant defaults and extend the principal repayment provisions in a manner that more closely corresponds to SunCor s planned asset sales. SunCor also is seeking extensions, waivers or similar relief from its other lenders and, while doing so, continues to make current interest payments to its lenders. If SunCor is unable to obtain additional extensions, waivers or similar relief from its lenders, SunCor could be required to immediately repay its outstanding indebtedness under the SunCor Secured Revolver and its other credit facilities. Such debt acceleration would have a material adverse impact on SunCor s business and its financial position. 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. As a result, Pinnacle West does not believe that SunCor s inability to obtain waivers or similar relief from SunCor s lenders would have a material adverse impact on Pinnacle West s cash flows or liquidity.

As of June 30, 2009, SunCor could not transfer any cash dividends to Pinnacle West as a result of the covenants mentioned above. The restriction does not materially affect Pinnacle West s ability to meet its ongoing capital requirements.

PINNACLE WEST CAPITAL CORPORATION
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5. Regulatory Matters

2008 General Retail Rate Case

Summary of APS Request and Interim Rate Surcharge On June 2, 2008, APS filed with the ACC updated financial statements, testimony and other data in the general rate case originally filed on March 24, 2008. In its filing, APS requested a net retail rate increase of $278.2 million effective no later than October 1, 2009, which represents a base rate increase of $448.2 million less the reclassification of $170 million of fuel and purchased power revenues from the existing PSA to base rates.

On December 18, 2008, the ACC approved an emergency interim base rate surcharge for APS. This surcharge became effective for retail customer bills issued after December 31, 2008 and will continue in effect until a decision in the general rate case becomes effective. This surcharge increased annual pretax retail revenues by approximately $65.2 million, and is subject to refund with interest pending the final outcome of APS general retail rate case.

Proposed Settlement Agreement APS and other parties to the rate case began settlement discussions on January 30, 2009 and, on June 12, 2009, they entered into an agreement (the Settlement Agreement) detailing the terms upon which the parties have agreed to settle the rate case. The Settlement Agreement is conditioned upon approval of the ACC. Testimony filings were made by APS and other parties to the case in July and additional testimony will be filed in early August. The ACC has scheduled an evidentiary hearing on the matter commencing on August 19, 2009.

The Settlement Agreement includes a net retail rate increase of $207.5 million, which represents a base rate increase of $344.7 million less the reclassification of $137.2 million of fuel and purchased power revenues from the existing PSA to base rates.

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. In addition, the parties will 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.

Other key provisions of the Settlement Agreement include the following:

- A non-fuel base rate increase in annual pretax revenues of $196.3 million, which would replace the $65.2 million interim base rate surcharge described above;
- A net increase in annual pretax revenues of $11.2 million for fuel and purchased power costs reflected in base rates that would not otherwise have been recoverable under the PSA;
- A Base Fuel Rate of $0.0376 per kWh (compared to the current Base Fuel Rate of $0.0325 per kWh);

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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), resulting in present estimates of increased revenues of $23 million, $25 million and $49 million, respectively;

An authorized return on common equity of 11.0%;

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 (an increase of $10 million above the $20 million required reductions for 2009 ordered by the ACC in its interim rate decision in this matter);

Equity infusions into APS of at least $700 million during the period beginning June 1, 2009 through December 31, 2014; and

Various modifications to the existing energy efficiency, demand-side management and renewable energy programs that would 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.

If the Settlement Agreement is approved by the ACC, APS expects that its provisions, including the new rates, would become effective on or about January 1, 2010.

Energy Efficiency, Demand-Side Management and Renewable Energy Programs

In 2006, the ACC approved the Arizona Renewable Energy Standard and Tariff (the RES). Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include an RES surcharge on customer bills to recover the approved amounts for use on renewable energy projects. On July 1, 2009, APS filed its annual RES implementation plan with the ACC, which covers the 2010-2014 timeframe and requests approval for RES funding of $85.5 million for 2010, or an increase of $7.1 million above 2009 levels. We expect to receive a determination from the ACC on this matter by the end of 2009.

On July 15, 2009, APS filed its initial Energy Efficiency Implementation Plan in compliance with certain provisions of the Settlement Agreement. APS is requesting approval by the ACC of programs and program elements for which APS has budgeted $49.9 million for 2010. The Plan is also contingent upon ACC approval of the Settlement Agreement. In order to recover the budgeted amounts for use on certain demand-side management programs, a surcharge would be added to customer bills similar to that described above under the RES. The surcharge will offset energy efficiency expenses and allow for the recovery of any earned incentives. We expect to receive a determination from the ACC on this matter simultaneously with its decision on the Settlement Agreement.

PINNACLE WEST CAPITAL CORPORATION
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PSA Balance

The following table shows the changes in the deferred fuel and purchased power regulatory asset (liability) for the six-month period ended June 30, 2009 and 2008 (dollars in millions):

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Beginning balance	$ 8	$ 111
Deferred fuel and purchased power costs-current period	(13)	25
Interest on deferred fuel and purchased power		1
Amounts recovered through revenues	(66)	(114)
Ending balance	$ (71)	$ 23

The PSA annual adjustor rate is reset for a PSA Year effective for a twelve-month period beginning February 1 each year. The PSA rate for the PSA Year that began February 1, 2008 was set at $0.004 per kWh. The PSA rate for the PSA year that began February 1, 2009 was set at $0.0053 per kWh. The PSA rate may not be increased more than $0.004 per kWh in a year without permission of the ACC. The $71 million regulatory liability at June 30, 2009 reflects the seasonal nature of fuel and purchased power costs and lower average prices. Any uncollected (overcollected) deferrals during the 2009 PSA Year resulting from this limit will be included in the historical component of the PSA rate for the PSA Year beginning February 1, 2010.

Formula Transmission Tariff

In July 2008, the 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 the costs that APS incurs in providing transmission services. 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, and projected capital expenditures. 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.

In 2009, APS was authorized to implement increases in its annual transmission revenues based on calculations filed with the FERC using data for its 2008 fiscal year. Increases in APS annual transmission revenues of $22.8 million became effective June 1, 2009. Of this amount, $21 million represents an increase in Retail Transmission Charges which was approved by the ACC on July 29, 2009 and allows APS to reflect the related increased Retail Transmission Charges in its retail rates through the TCA effective August 1, 2009.

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Equity Infusion Approval

On May 2, 2008, Pinnacle West filed a notice with the ACC that would allow Pinnacle West to infuse up to $400 million of equity into APS in the event Pinnacle West deems it appropriate to do so to strengthen or maintain APS financial integrity. Under Arizona law and implementing regulatory decisions, Pinnacle West is required to give such notice at least 120 days prior to an equity infusion into APS that exceeds $150 million in a single calendar year. On August 6, 2008, the ACC issued an order permitting the infusion to occur on or before December 31, 2009. Pursuant to the terms of the Settlement Agreement, APS would have authorization to obtain equity infusions of up to $700 million during the period beginning June 1, 2009 through December 31, 2014, and such authorization would replace the $400 million authorization described above.

6. 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.

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

	Pension Benefits				Other Benefits			
	Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008	2009	2008	2009	2008
Service cost benefits earned during the period	$ 13	$ 13	$ 27	$ 26	$ 4	$ 4	$ 9	$ 9
Interest cost on benefit obligation	30	28	59	55	9	9	19	19
Expected return on plan assets	(29)	(30)	(58)	(59)	(8)	(11)	(17)	(22)
Amortization of:								
Transition obligation					1	1	2	2
Prior service cost			1	1				
Net actuarial loss	4	2	7	6	2		5	1
Net periodic benefit cost	$ 18	$ 13	$ 36	$ 29	$ 8	$ 3	$ 18	$ 9
Portion of cost charged to expense	$ 9	$ 5	$ 17	$ 12	$ 4	$ 1	$ 9	$ 4
APS share of cost charged to expense	$ 8	$ 5	$ 16	$ 12	$ 4	$ 1	$ 8	$ 4

Contributions

In the first quarter of 2009, IRS regulations were modified to allow alternative measurement dates to determine the interest rate used to value the year-end 2008 pension liability for funding purposes. As a result of this change, we estimate our 2009 minimum pension contribution to be zero. The expected contribution to our other postretirement benefit plans in 2009 is estimated to be approximately $15 million. APS and other subsidiaries fund their share of the contributions. APS share is approximately 97% of both plans.

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PINNACLE WEST CAPITAL CORPORATION
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7. 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 electricity service to 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.

Financial data for the three and six months ended June 30, 2009 and 2008 and at June 30, 2009 and December 31, 2008 is provided as follows (dollars in millions):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Operating revenues:				
Regulated electricity segment	$ 812	$ 829	$ 1,415	$ 1,452
Real estate segment	17	23	35	50
All other (a)	11	33	19	71
Total	$ 840	$ 885	$ 1,469	$ 1,573
Net income (loss) attributable to common shareholders:				
Regulated electricity segment	$ 78	$ 121	$ 58	$ 114
Real estate segment	(9)	15	(140)	14
All other (a)	(1)	(2)	(6)	1
Total	$ 68	$ 134	$ (88)	$ 129

	As of June 30, 2009	As of December 31, 2008
Assets:		
Regulated electricity segment	$ 11,369	$ 10,951
Real estate segment	361	523
All other (a)	133	146
Total	$ 11,863	$ 11,620

(a) Includes activities related to marketing and trading, APSES and El Dorado. None of these segments is a

reportable
segment.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. Income Taxes

As of June 30, 2009, the tax year ended December 31, 2005 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. We do not anticipate that there will be any significant increases or decreases in our unrecognized tax benefits within the next 12 months.

Pinnacle West expects to recognize approximately $100 million of cash tax benefits related to SunCor s strategic asset sales (see Note 21) which will not be realized until the asset sale transactions are completed. Approximately $80 million of these benefits were recorded in the first quarter of 2009 as reductions to income tax expense related to the current impairment charges. The additional $20 million of tax benefits were recorded as reductions to income tax expense related to the SunCor impairment charge recorded in the fourth quarter of 2008.

The $165 million income tax receivable on the Condensed Consolidated Balance Sheets represents the expected tax benefits related to the SunCor strategic asset sales and other anticipated cash refunds related to current income taxes.

9. Variable-Interest Entities

In 1986, APS entered into agreements with three separate VIE lessors in order to sell and lease back interests in Palo Verde Unit 2. The leases are accounted for as operating leases in accordance with GAAP. We are not the primary beneficiary of the Palo Verde VIEs and, accordingly, do not consolidate them.

APS is exposed to losses under the Palo Verde sale leaseback agreements upon the occurrence of certain events that APS does not consider to be reasonably likely to occur. Under certain circumstances (for example, the NRC issuing specified violation orders with respect to Palo Verde or the occurrence of specified nuclear events), APS would be required to assume the debt associated with the transactions, make specified payments to the equity participants, and take title to the leased Unit 2 interests, which, if appropriate, may be required to be written down in value. If such an event had occurred as of June 30, 2009, APS would have been required to assume approximately $167 million of debt and pay the equity participants approximately $161 million. See Note 15 for a discussion of letters of credit that support certain lessors in the Palo Verde sale leaseback transactions.

SunCor has certain land development arrangements that are required to be consolidated under FIN 46R, Consolidation of Variable Interest Entities. The assets and non-controlling interests reflected in our Condensed Consolidated Balance Sheets related to these arrangements were approximately $29 million at June 30, 2009 and December 31, 2008.

In addition, see Note 19 for a discussion of SFAS No. 167, Amendments to FASB Interpretation No. 46(R).

10. Derivative and Energy Trading Accounting

Our derivative instruments are accounted for at fair value in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted. See Note 20 for a discussion of fair value measurements. We adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, on January 1, 2009. This new standard requires enhanced disclosures about derivative instruments and hedging activities. The adoption of SFAS No. 161 did not have a material impact on our financial statements.

PINNACLE WEST CAPITAL CORPORATION
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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. As of June 30, 2009, we hedged the majority of certain exposures to the price variability of commodities for a maximum of 39 months. The changes in market value of such contracts have a high correlation to price changes in the hedged transactions.

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 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.

Accounting hedges must meet specific hedging requirements for designation. Accounting hedges, which do not meet the normal purchase and sales scope exception (as discussed below), are recognized at fair value as either assets or liabilities on the balance sheet.

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 other comprehensive income 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.

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 may also invest in derivative instruments for trading purposes; however, for the six months ended June 30, 2009, there was no material trading activity.

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.

For its regulated operations, APS defers for future rate treatment approximately 90% of gains and losses on certain derivatives that would otherwise be recognized in income pursuant to the PSA mechanism. Unless otherwise noted, gains and losses from derivatives in the following tables represent the amounts reflected as income after the effect of PSA deferrals.

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As of June 30, 2009 we had the following outstanding gross notional amount of derivatives, which represent both purchases and sales (does not reflect net position):

Commodity	**Quantity**
Power	15,042,878 MWh
Gas	197,259,000 MMBTU

Derivative Instruments in Designated Accounting Hedging Relationships

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

Commodity Contracts	Financial Statement Location	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Amount of Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion)	Accumulated other comprehensive loss-derivative instruments	$ 5,554	$ (132,994)
Amount of Loss Reclassified from OCI into Income (Effective Portion Realized)	Regulated electricity segment fuel and purchased power	47,964	73,330
Amount of Loss Recognized in Income from Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing) (a) (b)	Regulated electricity segment fuel and purchased power	141	42

(a) Excludes net losses of $1,269 for the three months ended June 30, 2009 and $377 for the six months ended June 30, 2009 which were deferred under the PSA (see Note 5).

(b) During the six months ended June 30, 2009 we had no amounts reclassified from OCI to earnings related to discontinued cash flow hedges.

During the next twelve months, we estimate that a net loss of $134 million before income taxes will be reclassified from accumulated other comprehensive income as an offset to the effect of market price changes for the related hedged transactions. In accordance with the PSA, at least 90% of these amounts will be recorded as either a regulatory asset or liability and have no effect on earnings (see Note 5).

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Derivative Instruments Not Designated as Accounting Hedges

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

Commodity Contracts	Financial Statement Location	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Amount of Gain (Loss) Recognized in Income from Derivative Instruments	Regulated electricity segment revenue	$ (97)	$ 11
Amount of Gain Recognized in Income from Derivative Instruments	Regulated electricity segment fuel and purchased power expense	4,462	431
Total (a)		$ 4,365	$ 442

(a) Amounts exclude net gains of $42,185 for the three months ended June 30, 2009 and $811 for the six months ended June 30, 2009 which were deferred under the PSA (see Note 5).

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fair Values of Derivative Instruments in the Condensed Consolidated Balance Sheets

The following table provides information about the fair value of our derivative instruments. These amounts are located in the asset or liability from risk management and trading activities lines of our Condensed Consolidated Balance Sheets. Amounts are as of June 30, 2009 (dollars in thousands):

Commodity Contracts	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Derivatives designated as accounting hedging instruments:					
Assets	$	$ 379	$ 8,839	$ 736	$ 9,954
Liabilities	(2,877)	(318)	(131,237)	(93,949)	(228,381)
Total hedging instruments	(2,877)	61	(122,398)	(93,213)	(218,427)
Derivatives not designated as accounting hedging instruments:					
Assets	31,140	31,248	49,811	38,909	151,108
Liabilities	(890)	(6,589)	(181,463)	(84,944)	(273,886)
Total non-hedging instruments	30,250	24,659	(131,652)	(46,035)	(122,778)
Total derivatives	27,373	24,720	(254,050)	(139,248)	(341,205)
Margins and options at cost	16,279		64,022	1,906	82,207
Collateral provided to counterparties			137,240	27,631	164,871
Collateral provided from counterparties			(250)		(250)
Balance Sheet Total	$ 43,652	$ 24,720	$ (53,038)	$ (109,711)	$ (94,377)

Derivative instrument assets and liabilities in the table are reported on a gross basis and exclude cash collateral and margin accounts. Transactions with counterparties that have master netting arrangements are reported net on the balance sheet, including cash collateral and margin in accordance with FSP FIN 39-1.

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 and trading contracts with many counterparties, including one counterparty for which our exposure represents approximately 42% of Pinnacle West s $68 million of risk management and trading assets as of June 30, 2009. This exposure relates to a long-term traditional wholesale contract with a counterparty that has very high credit quality. Our risk management process assesses and monitors the financial exposure of all counterparties. Despite the fact that the great majority of 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 June 30, 2009 was $417 million for which we had posted collateral of $165 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 were to fall below investment grade (below BBB- for S&P or Fitch, or Baa3 for Moody s), which would be a violation of the credit rating provisions. If the investment grade contingent features underlying these agreements had been triggered on June 30, 2009, after off-setting asset positions under master netting arrangements we would have been required to post approximately an additional $140 million of collateral to our counterparties; this amount includes those contracts which qualify for scope exceptions, which are excluded from the derivative details in the above footnote. We also have energy related non-derivative instrument contracts with investment grade credit-related contingent features which could also require us to post additional collateral of approximately $200 million if our debt were to fall below investment grade.

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11. Changes in Equity

The following tables shows the Company s changes in common stock equity and changes in equity of noncontrolling interests for the three and six months ended June 30, 2009 and 2008 (dollars in thousands):

	Three Months Ended June 30, 2009			Three Months Ended June 30, 2008		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, March 31	$ 3,162,902	$ 34,366	$ 3,197,268	$ 3,544,201	$ 54,247	$ 3,598,448
Net income (loss)	68,347	(152)	68,195	133,862		133,862
Other comprehensive income (loss):						
Net unrealized gains on derivative instruments (a)	5,554		5,554	240,986		240,986
Net reclassification of realized (gains) losses to income (b)	47,964		47,964	(36,705)		(36,705)
Reclassification of pension and other postretirement benefits to income	1,253		1,253	1,304		1,304
Net unrealized losses related to pension and other postretirement benefits	(4,204)		(4,204)	(10,595)		(10,595)
Income tax expense related to items of other comprehensive income	(19,844)		(19,844)	(76,344)		(76,344)
Total other comprehensive income	30,723		30,723	118,646		118,646
Total comprehensive income (loss)	99,070	(152)	98,918	252,508		252,508
Issuance of capital stock	2,717		2,717	2,747		2,747
Purchase of treasury stock, net of reissuances	5		5			
Other (primarily stock compensation)	(4,820)	(41)	(4,861)	1,188	(382)	806
Common stock dividends	(53,069)		(53,069)	(52,831)		(52,831)
Net capital activities by noncontrolling interests		(5,005)	(5,005)			

Ending balance, June 30	$ 3,206,805	$ 29,168	$ 3,235,973	$ 3,747,813	$ 53,865	$ 3,801,678

PINNACLE WEST CAPITAL CORPORATION
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	Six Months Ended June 30, 2009			Six Months Ended June 30, 2008		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, January 1	$ 3,445,979	$ 47,389	$ 3,493,368	$ 3,531,611	$ 54,569	$ 3,586,180
Net income (loss)	(88,163)	(14,362)	(102,525)	129,389		129,389
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	(132,994)		(132,994)	360,792		360,792
Net reclassification of realized (gains) losses to income (b)	73,330		73,330	(38,771)		(38,771)
Reclassification of pension and other postretirement benefits to income	2,506		2,506	2,347		2,347
Net unrealized losses related to pension and other postretirement benefits	(4,204)		(4,204)	(10,595)		(10,595)
Income tax (expense) benefit related to items of other comprehensive income	24,157		24,157	(122,825)		(122,825)
Total other comprehensive income (loss)	(37,205)		(37,205)	190,948		190,948
Total comprehensive income (loss)	(125,368)	(14,362)	(139,730)	320,337		320,337
Issuance of capital stock	5,346		5,346	5,562		5,562
Purchase of treasury stock, net of reissuances	(1,546)		(1,546)	(1,344)		(1,344)
Other (primarily stock compensation)	(11,527)	(170)	(11,697)	(2,763)	(704)	(3,467)
Common stock dividends	(106,079)		(106,079)	(105,590)		(105,590)
Net capital activities by noncontrolling interests		(3,689)	(3,689)			

Ending balance, June 30	$ 3,206,805	$ 29,168	$ 3,235,973	$ 3,747,813	$ 53,865	$ 3,801,678

(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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12. 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 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 has announced that the repository cannot be completed before at least 2017. 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 is currently pursuing that damages claim. In August 2008, the United States Court of Appeals for the Federal Circuit issued decisions in three damages actions brought by other nuclear utilities that could result in a decrease in the amount of our recoverable damages; however, additional appeals in those actions are possible and APS continues to monitor the status of those actions. The trial in the APS matter began on January 28, 2009, and closing arguments were heard in late May. The court has not indicated when it will reach its decision in the matter.

APS currently estimates it will incur $132 million (in 2009 dollars) over the current life of Palo Verde for its share of the costs related to the on-site interim storage of spent nuclear fuel. At June 30, 2009, APS had a regulatory liability of $28 million that represents amounts recovered in retail rates in excess of amounts spent for on-site interim spent fuel storage.

Purchased Power and Fuel Commitments

APS is party to various purchased power and fuel contracts that include required purchase provisions. APS estimates the contract requirements to be approximately $569 million in 2009; $406 million in 2010; $333 million in 2011; $347 million in 2012; $483 million in 2013; and $10.9 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 2008 Form 10-K primarily due to purchased power and fuel commitments, predominately a contingent renewable purchased power agreement with Starwood Solar I for a 290MW solar project scheduled for completion in 2013.

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California Energy Market Issues and Refunds in the Pacific Northwest

FERC

In July 2001, the FERC ordered an expedited fact-finding hearing to calculate refunds for spot market transactions in California during a specified time frame. APS was a seller and a purchaser in the California markets at issue and, to the extent that refunds are ordered, APS should be a recipient as well as a payor of such amounts. In addition, on March 19, 2002, the State of California filed a complaint with the FERC alleging that wholesale sellers of power and energy, including APS, failed to properly file rate information at the FERC in connection with sales to California from 2000 to March 2002 under market-based rates. Since 2004, the Ninth Circuit and the FERC have issued various decisions and orders involving the aforementioned issues, including decisions related to: entities subject to FERC jurisdiction and, therefore, potentially owing refunds; applicable refund methodologies; the temporal scope and types of transactions that are properly subject to the refund orders; and the appropriate standard of review at the FERC on wholesale power contracts in the refund proceedings. A settlement, resolving APS issues with certain California parties for the current refund period, 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 our financial position, results of operations or cash flows. We currently believe the refund claims at the FERC related to the parties not involved in this settlement will have no material adverse impact on our financial position, results of operations or cash flows.

On July 25, 2001, the FERC also ordered an evidentiary proceeding to discuss and evaluate possible refunds for wholesale sales in the Pacific Northwest. The FERC affirmed the ALJ 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. Petitions for rehearing of this opinion were filed. 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

Superfund establishes liability for the cleanup of hazardous substances found contaminating the soil, water or air. Those who generated, transported or disposed of hazardous substances at a contaminated site are among those who are PRPs. PRPs may be strictly, and often are jointly and severally, liable for clean-up. On September 3, 2003, the EPA advised APS that the EPA considers APS to be a PRP in the Motorola 52nd Street Superfund Site, Operable Unit 3 (OU3) in Phoenix, Arizona. APS has facilities that are within this Superfund site. APS and Pinnacle West have agreed with the EPA to perform certain investigative activities of the APS facilities within OU3. Because the investigation has not yet been completed and ultimate remediation requirements are not yet finalized, at the present time neither APS nor Pinnacle West can accurately estimate the expenditures that may be required.

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Salt River Project

Salt River Project previously notified APS that Salt River Project allegedly failed to bill APS for (a) energy losses under certain service schedules of a power contract between the parties and (b) certain other charges under the contract. Salt River Project asserted that certain of these failures to bill APS for such losses and charges may have extended back to 1996 and, as a result, claimed that APS owed it approximately $29 million, which APS disputed. The parties entered into a settlement agreement on April 9, 2009, resolving these matters. The resolution had no material adverse impact on our financial position, results of operations or cash flows.

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. We currently have several assets on our books related to our landlord, the most significant of which is an asset related to rent payments for the building of approximately $64 million. This amount will continue to increase to approximately $94 million as a result of the lease terms until 2015 when this amount will begin to decrease over the remaining life of the lease. We are monitoring this matter and, while there can be no assurances as to the ultimate outcome of the matter due to the complexity of the bankruptcy proceedings, we currently do not expect that it will have a material adverse effect on our financial position, results of operations, or cash flows.

Litigation

We are party to various other claims, legal actions and complaints arising in the ordinary course of business, including but not limited to environmental matters related to the Clean Air Act, Navajo Nation issues and EPA and ADEQ issues. In our opinion, the ultimate resolution of these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

13. Nuclear Insurance

The Palo Verde participants are insured against public liability for a nuclear incident up to $12.5 billion per occurrence. As required by the Price Anderson Act, Palo Verde maintains the maximum available nuclear liability insurance in the amount of $300 million, which is provided by commercial insurance carriers. The remaining balance of $12.2 billion is provided through a mandatory industry wide retrospective assessment program. If losses at any nuclear power plant covered by the program exceed the accumulated funds, APS could be assessed retrospective premium adjustments. The maximum assessment per reactor under the program for each nuclear incident is approximately $118 million, subject to an annual limit of $18 million per incident, to be periodically adjusted for inflation. Based on APS interest in the three Palo Verde units, APS maximum potential assessment per incident for all three units is approximately $103 million, with an annual payment limitation of approximately $15 million.

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The Palo Verde participants maintain all risk (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.75 billion, a substantial portion of which must first be applied to stabilization and decontamination. APS has also secured insurance against portions of any increased cost of generation or purchased power and business interruption resulting from a sudden and unforeseen accidental outage of any of the three units. The property damage, decontamination, and replacement power coverages are provided by Nuclear Electric Insurance Limited (NEIL). APS is subject to retrospective assessments under all NEIL policies if NEIL s losses in any policy year exceed accumulated funds. The maximum amount APS could incur under the current NEIL policies totals approximately $21 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 $56 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.

14. Other Income and Other Expense

The following table provides detail of other income and other expense for the three and six months ended June 30, 2009 and 2008 (dollars in thousands):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Other income:				
Interest income	$ 398	$ 3,233	$ 659	$ 5,476
Investment gains net	3,398			
SunCor other income (a)	323	42	258	1,629
Miscellaneous	2,468	653	2,651	662
Total other income	$ 6,587	$ 3,928	$ 3,568	$ 7,767
Other expense:				
Non-operating costs	$ (3,248)	$ (3,594)	$ (4,855)	$ (5,524)
Investment losses net		(5,534)	(3,832)	(8,200)
Miscellaneous	(939)	(927)	(1,842)	(1,227)
Total other expense	$ (4,187)	$ (10,055)	$ (10,529)	$ (14,951)

(a) Includes equity earnings from a real estate joint venture that is a pass-through entity for tax purposes.

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15. Guarantees

We have issued parental guarantees and obtained letters of credit and surety bonds on behalf of some of our subsidiaries.

Our parental guarantees for APS relate to commodity energy products. As required by Arizona law, Pinnacle West has also obtained a $10 million bond on behalf of APS in connection with the interim base rate surcharge approved by the ACC in December 2008. In addition, Pinnacle West has obtained approximately $8 million of surety bonds related to APS operations, which primarily relate to self-insured workers compensation. Our credit support instruments enable APSES to offer energy-related products and services. Non-performance or non-payment under the original contract by our subsidiaries would require us to perform 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 on behalf of our subsidiaries. At June 30, 2009 we had no guarantees that were in default. Our guarantees have no recourse or collateral provisions to allow us to recover from our subsidiaries amounts paid under the guarantees. The amounts and approximate terms of our guarantees and surety bonds for each subsidiary at June 30, 2009 are as follows (dollars in millions):

	Guarantees		Surety Bonds	
	Amount	Term (in years)	Amount	Term (in years)
APS	$ 1	1	$ 18	1
APSES	14	1	13	1
Total	$ 15		$ 31	

APS has entered into various agreements that require letters of credit for financial assurance purposes. At June 30, 2009, approximately $200 million of letters of credit were outstanding to support existing pollution control bonds of approximately $200 million. The letters of credit are available to fund the payment of principal and interest of such debt obligations and expire in 2010. APS has also entered into approximately $70 million of letters of credit to support certain equity lessors in the Palo Verde sale leaseback transactions (see Note 9 for further details on the Palo Verde sale leaseback transactions). These letters of credit expire in 2010. APS intends to provide from either existing or new facilities for the extension, renewal or substitution of the letters of credit to the extent required.

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

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16. Earnings Per Share

The following table presents earnings per weighted average common share outstanding for the three and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Basic earnings per share:				
Income (loss) from continuing operations attributable to common shareholders	$ 0.70	$ 1.12	$ (0.82)	$ 1.06
Income (loss) from discontinued operations	(0.02)	0.21	(0.05)	0.23
Earnings per share basic	$ 0.68	$ 1.33	$ (0.87)	$ 1.29
Diluted earnings per share:				
Income (loss) from continuing operations attributable to common shareholders	$ 0.70	$ 1.12	$ (0.82)	$ 1.06
Income (loss) from discontinued operations	(0.02)	0.21	(0.05)	0.22
Earnings per share diluted	$ 0.68	$ 1.33	$ (0.87)	$ 1.28

Dilutive stock options and performance shares (which are contingently issuable) increased average common shares outstanding by approximately 84,000 shares and 264,000 shares for the three months ended June 30, 2009 and 2008 respectively, and by approximately 269,000 shares for the six months ended June 30, 2008. For the six months ended June 30, 2009 the weighted average common shares outstanding were the same for both basic and diluted shares. Options to purchase 599,324 shares of common stock for the three-month period ended June 30, 2009, and 713,291 shares for the three-month period ended June 30, 2008 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 612,424 shares and 688,167 shares of common stock for the six-month periods ended June 30, 2009 and June 30, 2008, respectively, were outstanding but were excluded from the computation of diluted earnings per share because the impact of including those options would be antidilutive.

17. Discontinued Operations

SunCor (real estate segment) In 2009 and 2008, SunCor sold or expects to sell properties that are required to be reported as discontinued operations on Pinnacle West s Condensed Consolidated Statements of Income in accordance with SFAS No. 144. SFAS No. 144 requires reclassification of certain prior-year amounts from operations to discontinued operations. Assets held for sale relate to properties in the amount of $29 million at June 30, 2009. These properties were classified as home inventory and real estate investments at December 31, 2008. In addition, see Note 21 Real Estate Impairment Charge.

APSES (other) Includes activities related to discontinued commodity-related energy services in 2008, and the associated revenues and costs that were reclassified to discontinued operations in 2008.

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The following table provides revenue, income (loss) before income taxes and income (loss) after taxes classified as discontinued operations in Pinnacle West s Condensed Consolidated Statements of Income for the three and six months ended June 30, 2009 and 2008 (dollars in millions):

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenue:				
SunCor	$	$ 12	$ 1	$ 35
APSES		28		56
Total revenue	$	$ 40	$ 1	$ 91
Income (loss) before taxes:				
SunCor	$ (5)	$ 34	$ (9)	$ 39
APSES		1		(1)
Total income before taxes	$ (5)	$ 35	$ (9)	$ 38
Income (loss) after taxes:				
SunCor (a)	$ (3)	$ 21	$ (5)	$ 23

(a) Includes a tax benefit recognized by the parent company in accordance with an intercompany tax sharing agreement of $2 million for the three months ended June 30, 2009 and $4 million for the six months ended June 30, 2009.

18. 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. APS invests the trust funds in fixed income securities and domestic equity securities. APS applies the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, in accounting for investments in decommissioning trust funds, and classifies these investments as available for sale. As a result, we record the decommissioning trust funds at their fair value on our Condensed Consolidated Balance Sheets. Because of the ability of APS to recover decommissioning costs in rates and in accordance with the regulatory treatment for decommissioning trust funds, we have recorded the offsetting amount of gains or losses on investment securities in other regulatory liabilities or assets. The following table summarizes the fair value of APS nuclear decommissioning trust fund assets at June 30, 2009 and December 31, 2008 (dollars in millions):

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
June 30, 2009			
Equity securities	$ 126	$ 19	$ (17)
Fixed income securities	237	9	(2)
Total	$ 363	$ 28	$ (19)

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	Total Unrealized	Total Unrealized