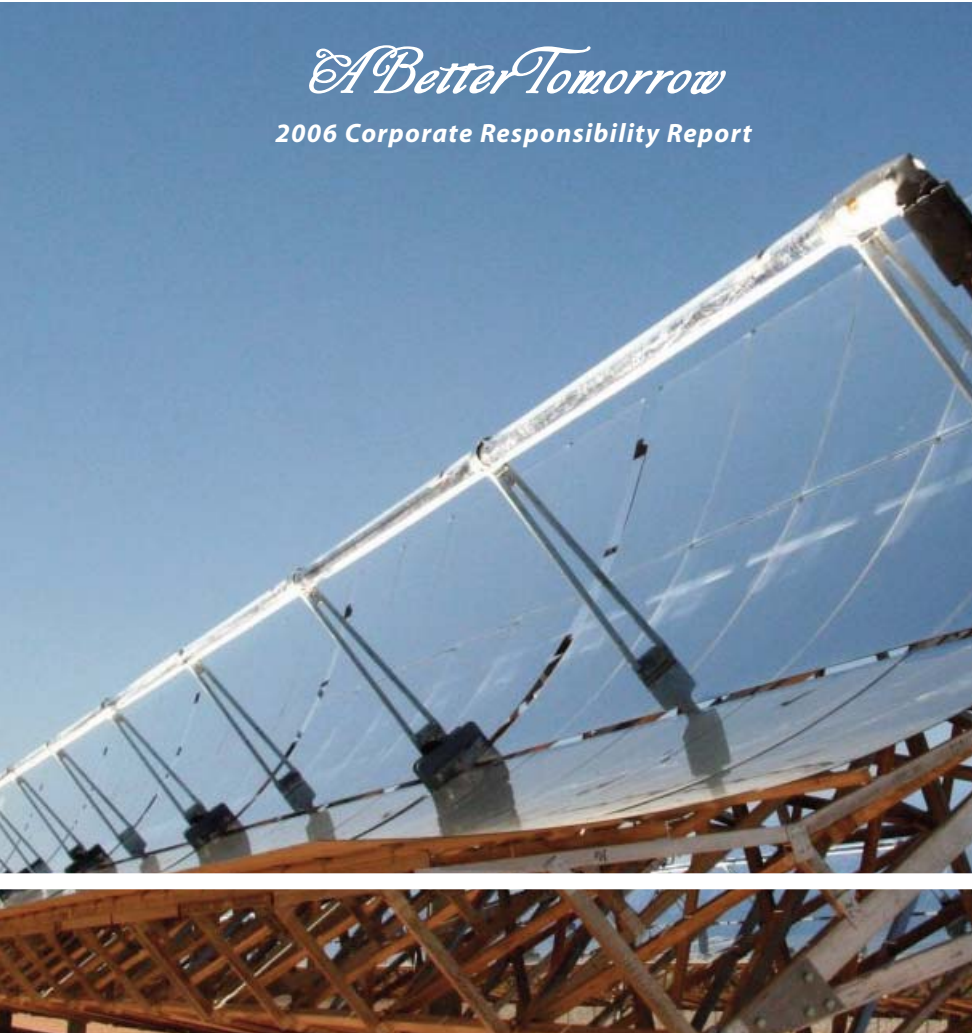




PINNACLE WEST  
CAPITAL CORPORATION

*A Better Tomorrow*

2006 Corporate Responsibility Report



*sustainability  
is not just a word  
it is a mindset  
a culture  
a call to action*



*Pinnacle West Capital Corporation*



**PINNACLE WEST**  
CAPITAL CORPORATION

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## introduction



Welcome to the 2006 Pinnacle West Capital Corporation Corporate Responsibility Report.

This report aims to transparently communicate our corporation's environmental, health, safety and sustainability goals and performance. We have issued an environmental, health and safety annual report every year since 1994, which we expanded to a Corporate Responsibility Report in 2004.

In developing this report, we have used international reporting guidelines from CERES and the Global Reporting Initiative. Additionally, in some instances we have gone beyond these guidelines to provide information our external stakeholders, such as socially responsible investment research groups, have asked us to include.

We continue to use a Web-based format for this report, which allows readers to quickly navigate to areas of interest, and also offers links to additional information. Many of these links are to other resources outside of the Corporate Responsibility Report, such as our PNW and subsidiary websites. This allows the reader to research additional information on these topics, if desired, while keeping the report format more readable.

This Web-based format also allows us to reduce our report's environmental impact by reducing the amount of paper, ink, electricity and other resources needed to create a full-color, printed report.

We believe that continuous improvement is important in a sustainability program, and we value our stakeholders input into our efforts. We have included a feedback mechanism in this year's report so readers can post suggestions and comments via a feedback link on the left-hand navigational menu. We appreciate any feedback we can use to make our report better, and as our way of saying thanks, we will send all respondents an Energy Star® approved energy-efficient compact fluorescent lightbulb (CFL).

The promotion of CFLs is one of our demand-side management programs and something we feel will help consumers save money while significantly reducing electricity use and the number of light bulbs going to landfills.

Since the inception of APS' CFL program in late 2005, almost two million CFLs have been sold at reduced pricing throughout the state. Those sales also mean estimated energy savings of more than 500 million kilowatt-hours – enough energy to power over 40,000 homes for one year and save consumers about \$50 million in energy costs over the life of the bulbs.

This report provides information on Pinnacle West Capital Corporation and our major subsidiaries, Arizona Public Service Company (APS) and SunCor Development Company. We also provide information on our retail subsidiary, APS Energy Services.

Since our most significant environmental issues are associated with Pinnacle West's largest subsidiary, APS, the Environmental Performance section of this report focuses on APS' environmental performance. Information on the company's other subsidiaries can be found in our Subsidiaries Section.

On behalf of our more than 6,000 employees and our community partners, thank you for your interest in our 2006 Pinnacle West Capital Corporation Corporate Responsibility Report.

### Executive Message

For Pinnacle West and its family of companies, sustainability is a decision-making process that requires us to address current needs always in the context of how the decision can support long-term economic vitality, environmental health and strong communities. It is not an end-state to be achieved and victory declared; but rather, it is a continuous-improvement practice that chal-

lenges us to be successful today in ways that establish the foundation for a better tomorrow.

The challenge for Pinnacle West and its electric utility subsidiary, APS, is multiplied by the rapid growth in Arizona. With a population growth three times the national average and electricity consumption four times the national average, the challenge of making decisions that meet the reliability and affordability expectation of our community is made increasingly difficult by the potential environmental impacts of those decisions. But we are working to meet that challenge head on and measure our success by the results.

For example:

- Our voluntary emissions-reductions program is designed to reduce both our regulatory risk and achieve environmental benefits. The outcome will be an increase from 72 to 88 percent in the control level for sulfur dioxide emissions and an agreement with regulators and the business certainty that these low cost generators will meet forthcoming standards.
- The voluntary decommissioning of the Childs and Irving Hydroelectric Power Plants, which will restore historic Fossil Creek to a pristine natural condition has clear benefits for biodiversity and the environment.
- The APS Solar Test and Research (STAR) Center which was built more than 30 years ago to facilitate the development of solar power and other renewable technologies. Not only is it a showcase for our work in renewables, but it has provided hands-on experience on how to reliably integrate these technologies into our operations and provided the basis for new intellectual property that create new revenue opportunities for the company.
- Our financial need for a rate increase in 2006 clearly presented potential financial impact on our low-income customers. Accordingly, the plan to implement the increase included a robust outreach program to these customers to help raise awareness and increase participation in our energy assistance (E-3) programs, where low-income customers receive a discount on their electricity bills. These efforts resulted in an increase of approximately 32 percent of customers enrolled in the E-3 program, including a 135-percent increase for customers living on Tribal lands.

Throughout this report there are other examples of the integrated decision making that reflects APS' commitment to sustainability. And, while it's not about accolades, we are proud that our efforts have received the following recognition:

- APS and its partner, GreenFuel Technologies, recently shared the Emissions Energy Project of the Year Award for our work using emissions (including CO<sub>2</sub>) from one of our natural gas combined-cycle power plants to grow algae and converting the algae into biodiesel and ethanol.
- The Environmental Protection Agency and the Department of Energy named APS its 2007 ENERGY STAR Partner of the Year for its promotion of compact fluorescent lights (CFLs).
- In 2006, Pinnacle West was once again named one of the Global 100 Most Sustainable Corporations in the World by Corporate Knights.

- Pinnacle West has received the highest rating (AAA) by Innovest Strategic Value Advisors in a comprehensive analysis on the U.S. Electric Power Sector covering the environmental, social and governance factors of the largest publicly-traded utility companies.
- APS received the 2006 Climate Protection Award given to the company by the U.S. Environmental Protection Agency. This award recognizes exceptional leadership, dedication and technical achievements in protecting the earth's climate.

But awards are not a prediction of future success. Our focus is on new opportunities, and to maintain our forward momentum we have:

Created a new Eco-Efficiency and Technology Innovation Department to integrate and drive sustainability practices throughout the enterprise.

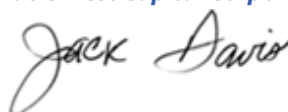
- Established a company goal to generate 15 percent of our energy sales from renewable resources by 2020 - five years sooner than required by the Arizona Corporation Commission's Renewable Energy Standard.
- Formed a consortium, including BHP and Liquid Air, with a Department of Energy grant to commercialize the "hydrogasification" of coal. This is the gasification of coal in the presence of hydrogen to make methane for use in power plants.
- With Intel Corp. founded Arizona Businesses Advancing Sustainability, an association dedicated to improving and promoting sustainable business practices in Arizona. Thirty companies have committed to participate in this first-of-its-kind organization in Arizona.
- Our goal: meeting the reliable affordable energy needs of our customers while building the foundation for a better tomorrow.

A better tomorrow starts today, and we hope that this report gives you a better understanding of our commitment to that future and its new generations.

Thank you for your interest in our company and this report.



**Jack E. Davis**  
**President**  
**Pinnacle West Capital Corporation**



**Edward Z. Fox**  
**Vice President, EHS**  
**Arizona Public Service**





## company profile

Pinnacle West is in Standard and Poor's 500 index and is traded on the New York Stock Exchange under the symbol: PNW. We are headquartered in Phoenix, Arizona - one of the fastest growing regions in the United States. Our assets include approximately 6,400 megawatts of plant generation capacity. We were named one of the Global 100 Most Sustainable Corporations in the World by *Corporate Knights* in 2005 and 2006. Pinnacle West was given an AAA (highest) rating, and ranked in the top two utilities in the United States in every review since 2001 by Innovest Strategic Advisory for environmental and sustainable performance. We are listed in the 2005 and 2006 Dow Jones North America Sustainability Index and in the 2005 and 2006 Dow Jones United States Sustainability Index as a sustainability leader in the electric industry.

Pinnacle West's has two principal business segments. Arizona Public Service Company, our regulated electricity segment (accounting for 77 percent of operating revenue in 2006), which consists of traditional, regulated retail and wholesale electricity businesses (primarily electric service to Native Load customers) and related activities and includes electricity generation, transmission and distribution. Our real estate segment (accounting for 12 percent of operating revenue in 2006), which consists of SunCor's real estate development and investment activities.

In addition, Pinnacle West has a small business segment in competitive energy business, including wholesale marketing and trading and retail commodity-related energy services, which is provided by our APS Energy Services company.

### APS Subsidiaries



#### Arizona Public Service Company

Pinnacle West's largest subsidiary is Arizona Public Service Company (APS). APS, Arizona's largest and longest-serving electricity utility, serves more than one million customers in 11 of the state's 15 counties, with the major exceptions of about one-half of the Phoenix metropolitan area, the Tucson metropolitan area and Mohave County in northwestern Arizona.

Incorporated in 1920 under the laws of the state of Arizona, APS employs more than 6,000 employees, including employees at jointly-owned generating facilities for which APS serves as the generating facility manager. APS owns 29.1 percent of the Palo Verde Nuclear Generating Station located approximately 50 miles west of Phoenix. Operated by APS, Palo Verde has been the nation's top producer of electricity for the past 15 years. The company also owns and operates seven natural-gas and two coal-powered plants, and has an increasing array of renewable energy power generation. Considered by many as the state's largest construction company, APS has built an infrastructure consisting of more than 30,000 miles of transmission and distribution lines and 400 substations.

A leader in renewable technology, APS owns and operates the APS Solar Test and Research Center (STAR), the only facility of its kind in the United States. APS has solar installations across the state. APS owns and operates a variety of photovoltaic solar generation around the state. The company is an active partner in the development and testing of other renewables such as solar trough, biomass, hydrogen and wind technologies.

APS is also a strong community partner. Each year, the company and its employees give back to the community in a variety of ways. Each year, employees volunteered hundreds of thousands of hours to charitable causes and organizations. From its programs for supporting children and education; to its commitment to helping small and minority-owned businesses; to its patronage of the arts and culture; to its encouragement of economic development, APS sees itself as an active participant in Arizona's continued well-being.

Each year the company and its employees donate money and time to many charitable causes such as the United Way.

APS is regulated by the Arizona Corporation Commission (ACC). The ACC regulates APS' retail electric rates and its issuance of securities. The ACC must also approve any transfer of APS' property used to provide retail electric service and approve or receive prior notification of certain transactions between Pinnacle West, APS and their respective affiliates.

APS' principal executive offices are located at: 400 North Fifth Street, P.O. Box 53999, Phoenix, Arizona 85072-3999, 602-250-1000

### **SunCor Development Company**



Now entering its third decade of operations, SunCor Development Company celebrated its 20<sup>th</sup> Anniversary in March 2007. It is one of the most trusted and prolific developers in the Mountain West region, with projects in Arizona, Utah, New Mexico and Idaho.

One of the key factors of its success is its diversity, with divisions in urban infill, retail, industrial, commercial, master-planned community, and golf course development, along with homebuilding. Since it was founded in 1986, SunCor has:

- created 18 master planned communities that 13,000 families now call home;
- built 26 commercial and retail centers where more than 500 entrepreneurs are doing businesses and fueling their local economies;
- provided world class amenities to 300,000 golfers every year; and
- leased or sold more than 25 million square feet of retail space.

*Current projects include:*

- Hayden Ferry Lakeside, a nine-building mixed-use complex in Tempe
- numerous residential, commercial and industrial projects in Palm Valley and Palm Valley 303 in Goodyear
- StoneRidge, a 2,000-acre master-planned community, in Prescott Valley
- Prescott Lakes, a master-planned community in Prescott
- Coral Canyon, a 2,300-acre master-planned community near St. George, Utah
- Rancho Viejo, a 10,000-acre master-planned community in Santa Fe, New Mexico
- Avimor, a 23,000-acre master-planned community near Boise, Idaho
- Rio West, an award-winning, five-building office/industrial project in Tempe

The company also has significant land holdings in Central and Northern Arizona. SunCor has accelerated and enhanced its focus on sustainability this year. Some examples include the creation of a staff position dedicated to research, evaluation and integration of sustainable practices. An increased emphasis on urban infill projects. Support for public policy initiatives, efforts, organizations and forums that promote sustainability (e.g., Proposition 106 – State Trust Land Reform, Valley Forward's Livability Summit, and the Arizona League of Conservation Voters' Earth Day Celebration). Active participation in the Arizona Businesses Advancing Sustainability initiative, and exploration of partnerships with educational institutions seeking to integrate sustainability-focused students and graduates into the development industry.

Equally important, SunCor incorporates and is exploring ways to incorporate sustainable practices into its projects. Some examples include:

- significant water conservation measures in master-planned communities, including community landscaping with native species and xeriscaping; absence of "lawnscapes" option in residential landscape elevations; use of cisterns; significant recharge projects (including an injection well); use of effluent from residences for golf course irrigation; dual irrigation systems; and installation of conservation devices, such as low-flow toilets. In at least one community, StoneRidge, in Prescott Valley, Arizona Department of Water Resource allocation is 3 units per acre foot of water, and actual consumption is 4.5 units per acre foot of water
- in the newest master planned community by SunCor (Avimor, located near Boise, where models will be open next year), and at Rancho Viejo, in Santa Fe, homes will be and are Energy Star certified

- construction of an experimental all-solar home in the SunCor master-planned community of Rancho Viejo, located near Santa Fe
- conservation of significant (40 percent or more) property as open space
- partnership with game management agency to create wildlife management plan that requires “no net loss” of habitat within master-planned community
- exploration of use of formaldehyde-free ceiling tiles and carpet in commercial buildings, and
- exploration of use of no volatile organic compound off-gassing paint

Further information on SunCor’s developments in commercial and residential properties and golf course management can be found at [www.SunCoraz.com](http://www.SunCoraz.com).

### APS Energy Services



APS Energy Services is the full-service energy services provider and competitive electricity subsidiary of Pinnacle West. APS Energy Services was the first Energy Service Provider (ESP) to deliver competitively priced electricity to California customers in 1997. In 1999, APS Energy Services was the first ESP to service direct access customers in the service territory of all three major Arizona utility companies.

Energy conservation is a core focus of APS Energy Services and the company seeks to promote and implement the efficient use of energy and develop comprehensive energy solutions, seeking renewable energy alternatives where applicable and conducting work in a sustainable and environmentally responsible manner. Energy projects are designed to upgrade equipment and provide sustainability to campus settings.

Energy efficiency, renewables, demand response and traditional supply side solutions all will be needed for a sustainable energy future for all and APS Energy Services will help lead the way there.

APS Energy Services is headquartered in Phoenix, Arizona with offices in Tucson, Arizona; California; Nevada; and Texas. The company currently extends services throughout Arizona, California, Nevada, New Mexico, Texas and Utah. For more information about APS Energy Services, please visit [www.APSES.com](http://www.APSES.com)

### APS Energy Services responds to sustainability demands

APS Energy Services, known to many as the company that constructed a combined heat and power plant at Arizona State University and — through its wholly owned subsidiary, Northwind Phoenix — operates a district cooling network that keeps much of downtown Phoenix comfortable, also integrates renewable energy alternatives as part of its energy solutions offerings. “As our name says, we’re an energy services company,” said **Vicki Sandler**, President, APS Energy Services. “Since we were founded in 1998, our mission is to be a world-class developer and the preferred provider of superior energy solutions. We achieve this by helping our customers meet their strategic objectives through a comprehensive energy solution. As energy prices continue to rise, energy efficiency retrofit projects and the deployment of renewable technologies continue to become more viable options than ever for our customers.” Sandler added that, while there are many costs of doing business that institutional, commercial and industrial customers have little control over, energy costs can be reduced, and those savings dropped to the bottom line. To help those customers achieve these savings, APS Energy Services has completed energy efficiency and renewable projects in Arizona, California and Nevada. Among its work with renewables:

#### Biomass

As part of a comprehensive energy program, implemented at the White Pine County School District in Ely, Nev., and the Northern Nevada Corrections Center (NNCC) in Carson City, Nev., biomass systems burning forest waste have been included in the programs to provide low-cost heating and steam output (NNCC only) while helping the environment. The U.S. Forest Service has a long term contract to provide fallen timber as fuel. APS Energy Services expects the construction of these systems to enhance air and water quality in the surrounding areas by providing an environmentally friendly method to dispose woody biomass from forest thinning. Additional benefits include reduced emissions from controlled burning and resulting air pollution, and from the reduced volume of landfill biomass waste.

In addition to the biomass, the NNCC project also includes a photovoltaic solar application of up to 30 kilowatts (kW).

#### Solar

APS Energy Services worked with the Yavapai-Apache Nation to install a solar array producing 30 kW on its parking structures. By designing a split system with separate photovoltaic and uninterrupted power supply subsystems, the nation’s medical facility is able to

receive 30 minutes of standby power. In addition to the solar installation, APS Energy Services also negotiated the procurement of green credits for the sale of green energy into the system, resulting in a substantial rebate to the Yavapai-Apache Nation.

The Hualapai Tribe, located predominantly along the western edge of the Grand Canyon, partnered with APS Energy Services to design and construct a solar hybrid project to provide power to the remote region (75 kW to 100 kW). Because the Hualapai Tribe is located off the grid, the energy generated from this project is the only source of electricity this community has. As a matter of fact, APS Energy Services enlisted the consulting services of APS to complete this project.

APS ES is also working with ASU and the cities of Flagstaff and Rohnert Park, Calif., on included solar as part of their comprehensive energy programs. A solar array producing 30 kW was mounted on ASU's parking structures. The Flagstaff installation is a 15-kW system mounted on a wall and covered entryway. Rohnert Park will install a 30-kW system on its sports center roof, scheduled to be coordinated with a roofing replacement.

### **Digester**

APS Energy Services currently is engineering a unique fixed film digester plant for Classic Farms in Aurora, S.D. The farm received a grant from the USDA to construct a plant that will convert animal waste from a hog farm into biogas to run an electric generator that will serve farm operations, inclusive of water treatment. A rendering component also is part of the grant. APS Energy Services plans to bring the learnings from this project to Arizona to build the most cost-effective dairy farm biogas projects. Arizona has a hot climate and lots of cows, which make this optimal for such a solution.

In addition to these projects, APS Energy Services recently partnered with Sacred Power Corp., an American Indian-owned company based in Albuquerque, to install hybrid solar stations in 100 homes on the Navajo Nation in Arizona this past summer. This was made possible by a \$1.9 million grant the Cameron Navajo Chapter received from the U.S. Department of Agriculture (USDA).

## **PNW's Approach to Sustainability**

Pinnacle West's largest subsidiary, APS, celebrated its 120th anniversary in April, 2006. Back in 1886, APS' first commercial customer was the City of Phoenix. Recently, the City of Phoenix presented APS with an award in recognition of APS' ongoing community service and support to the City. This type of ongoing service and collaboration with the communities we serve, to us, is the very definition of sustainability - working to meet our business needs each day while implementing strategies, business practices and policies that support a vibrant economy and a healthy environment and strong community for future generations.

We plan on building on our 120 years of service and providing exceptional, and sustainable, products and services to our customers far into the future. We don't consider sustainability a "program" or something to do on top of our regular business; rather it is an approach to planning and decision making that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and community developments.

Employing sustainable social, economic and environmental business practices is integral to the way we have done business in the past and how we will do business in the future. For many years, our family of companies have been operated under our corporate philosophy that we term "**Doing the Right Thing**," in a culture that supports and empowers employees to make decisions that make good business sense and which are also "the right thing" for our community, customers and stakeholders, as well as our environment. This simple, common-sense approach enables employees to provide a high level of customer service; to work in an ethical and honest manner and to become active in our communities through volunteerism, charitable donations and community and business leadership. It has also been the foundation that mandates that every employee be treated with dignity and respect.

We recognize, however, that while we have put a number of good, sustainable business practices in place, we need to continue to become more strategic in our sustainability efforts in order to most efficiently address all of our future risks and opportunities. Our new Eco-efficiency and Technology Innovation Department, discussed below, will help us do that.



### **New Eco-efficiency and Technology Innovation Department Formed**

In 2006, Pinnacle West took a major step in improving our strategic approach through the creation of a new area called the Eco-efficiency and Technology Innovation Department. The department's charge is to help integrate sustainability initiatives throughout the enterprise and to better address the evolving expectations and opportunities of stakeholder groups and the general public. This department will help us to improve the strategic direction and planning of our initiatives, while allowing the company to better plan and respond to emerging issues, risks and opportunities. The department is headed by a Senior Manager, who is on direct report to the Vice President, Environmental, Health, Safety and Communication. The department does not have line authority over other PNW departments - it serves a planning, support and coordination role to other PNW Departments.

A cross-departmental team of key managers and leaders will work in tandem with the Eco-Efficiency and Technology Innovation Department to improve coordination among the company's various departments, establishing our sustainability baseline and evaluating new issues and opportunities in sustainable business practices, and helping ingrain those business practices and philosophies among our front-line employees. This team will also help develop and track sustainability performance, including appropriate metrics.

A policy group of company officers and outside experts will provide executive level oversight to this new sustainability effort. The working group will bring recommendations to the officer group for approval for new business strategies and practices in our sustainability program. The officers will interface with our Board of Directors on these sustainability issues. We believe this is an important step in our efforts to continuously improve in our sustainability efforts.

### **Arizona Businesses Advancing Sustainability**

PNW also recognizes that if sustainable business practices are going to be successful, they must be the focus of the larger business community, not just for PNW. Therefore, along with Intel Corp., PNW founded a new association dedicated to improving economic, environmental and social business practices in Arizona.

The association is dedicated to improving economic, environmental and social business practices in Arizona. APS and Intel have invited more than 60 companies across Arizona to join in the association. All of the companies invited to participate either are headquartered in the state or have a major Arizona presence. Twenty companies attended the inaugural meeting in March 2007, and at the time of this report 30 companies have committed to participate in this alliance. This is a first-of-its-kind organization in Arizona.

The goal of ABAS is to discuss sustainable business practices and work collaboratively to improve business aspects in the state. And although the purpose of the association has been established, its targets and goals will be decided by the membership. Among the issues the association expects to discuss is how to work with government policy makers to improve the state's sustainability. The group also will look to build better relationships with the communities the companies serve while addressing environmental concerns.

## **Key Issues**

### **A Sustainable Energy Future**

Providing a reliable energy future that addresses environmental constraints is our key sustainability issue. And in that context, our rapid growth presents the central sustainability challenge and opportunity for our company in the coming decade and beyond.

Arizona is the fastest growing state in the nation and APS has been adding customers at three times the national average for electric utilities, with no signs of slowing. Each year, APS installs 40,000 new electric meters and serves an additional 100,000 customers — the equivalent of adding a medium-sized city to its service territory. The energy used by our customers is growing at about the same rate, as increases in home size, more appliances and other electrical equipment increases the amount of energy customers need, even with increasing efficiency and conservation efforts.

As shown in the chart to the right, we anticipate that both our electric demand and number of customers will about double over the next 20 years. This will require significant new power generation capacity as well as other infrastructure including transmission and distribution lines and substations. This tremendous growth poses quite a challenge as we work to ensure a sustainable energy future for our customers, balancing costs, rates, reliability, risks, environmental impacts and other issues. Many of these challenges, and our response, are discussed in this PNW Corporate Responsibility Report. Additional discussion on this issues is found in our PNW Annual Report and other reports found on our PNW Web page.

### **Pinnacle West believes that a sustainable energy future includes the following components:**

- Providing cost-effective energy to our customers over the long term
- Effective fuel mix, including renewable energy, conventional fuels - used more efficiently (e.g. clean coal - IGCC, hydro gasification and natural gas), and nuclear power.
- Highly-efficient end users who incorporate energy efficiency and sound energy use into their daily lives
- An educated public
- Robust consumer choice
- Optimal use of resources to protect the environment and ensure sustainable fuel sources

While all of the sustainability issues discussed in this report are important to Pinnacle West, some areas have particular importance with respect to our key issue of balancing growth and the creation of a sustainable energy future. These issues are discussed in greater depth in our report, and include:

- Electric System Reliability
- Climate Change
- Renewable Energy
- Demand-Side Management
- Technology Innovation & Future Fuels (e.g. hydrogen, synthetic natural gas, biofuels)
- Customer Satisfaction

## Stakeholder Engagement

Throughout the course of business, Pinnacle West and its affiliated companies interact with a wide variety of stakeholders. The company has numerous programs for engagement or consultation with our communities and other stakeholders, which cover the majority of our operations. These interactions are critical to our business success, and we make great effort to maintain communication and involvement with our stakeholders.

Our primary stakeholders include shareholders, who own our company; our employees, who manage and operate our company; and our customers. A number of other external stakeholders also share critical interactions with our companies.

### A list of our major stakeholders includes:

- Customers
- Employees
- Investors and the investment community
- Municipalities and community organizations in our service territory
- Native American tribes
- Arizona, New Mexico and federal agencies
- The business community and partners
- Industry organizations
- Non-governmental organizations at the local, state and national level

Listed are examples of the numerous ways we interact with our various stakeholders on an on-going basis. Many more examples are provided throughout this report.

### Customers

Pinnacle West interacts with customers in a variety of ways, including our 24-hour call center, customer surveys, focus groups, office visits, our Web sites, and through our active community outreach and volunteer programs. Our goal is to provide an on-going communication and link to our customers to ensure the highest possible customer service. This is discussed in more detail in the Customers section of this report.

From these interactions the company is also able to reward top performing individuals and teams. Company areas experiencing declines often seek additional research information in order to identify causes and develop action plans. Semi-annual customer satisfaction survey research helps Pinnacle West focus on departments that need improvement. Satisfaction results play a partial role in the annual performance assessment for most leaders and managers. Results are also used to determine a portion of APS' annual companywide incentive pay.



Throughout APS, customer input and feedback is sought prior to and following major initiatives and events (such as new bill designs, rate increases and major curtailment efforts) to help direct communications and assess the impact on overall customer satisfaction. Additionally, results from customer satisfaction research are used to identify and prioritize opportunities to improve, to support and assist in decision-making and allocating of customer service and related resources and to assess the success of major initiatives undertaken.

### Employees

Pinnacle West produces a daily employee e-mail newsletter (called *Newsline*) and a monthly written publication (called *On*), to help keep employees informed on issues and news affecting the company and its employees. Other communications tools are also used to keep employees informed of important news and events affecting the company. Processes are also in place for employees to provide feedback to the company, anonymously if desired. These processes are discussed in further detail in other sections of this report, including Workplace Performance and Corporate Governance.

### Our Community

APS works closely with municipalities, government agencies and the public to build consensus and to proactively plan transmission and distribution resources to accommodate the state's rapid customer and business growth. As part of the process, APS conducts environmen-

tal studies and extensive public outreach to identify sensitive areas with respect to the affected communities. This process is described in more detail in the Land Use and Biodiversity section of this report.

APS brings together various stakeholders in special Focus teams to obtain feedback on specific issues or programs, on an ad hoc basis. APS has also formed a stakeholder Demand-Side Management (DSM) Collaborative team which works with APS in the development of DSM portfolio projects.

We also have a formal corporate volunteer program that is an important part of our community outreach efforts. This effort is extensive and partners Pinnacle West with communities across our service territory on an ongoing basis.

Likewise, our small business development program, minority and women owned business development program, state-wide economic development program and other business and community outreach programs all provide formal and ongoing outreach to our communities.

A Community Advisory Panel (CAP) was formed in 1999 by Pinnacle West Energy prior to the construction of the Redhawk Power Plant. CAP members are composed of a broad range of local community interests. Typical members will include local residents, members of civic and homeowners organizations, environmental groups, education institutions, business associations and community leaders. The purpose of the group was to establish two-way communication to review issues of concern and to create a responsive, proactive partnership between the company and the surrounding communities where the plant was to be built.

In the building of Redhawk, the CAP was instrumental in the decision of the formation of the Community Funds (contributions are made annually by the company) and to return the unused portion of the Redhawk plant property to its natural state (previously used for farming).

After the construction of Redhawk (completed in 2002), the CAP continued meeting with Redhawk Power Plant representatives and requested that the Palo Verde Nuclear Generating Station be included in the meetings. Since that time, the group has had periodic meetings with representatives from both plants and covers a wide range of subjects that include:

- Identifying community concerns and issues regarding the power plants
- Providing operational issues at the plants that could affect members of the community
- Assisting APS in distributing information regarding the plants to the community

### **Organizations and other Stakeholders**

The decommissioning of the Childs-Irving Hydroelectric Plants, and restoration of Fossil Creek to its native flow, was the product of a unique cooperative effort between APS, Native American tribes, government agencies, conservation groups and academia. This unprecedented restoration resulted in restoration of a perennial stream in the arid Southwest to a condition similar to that seen a century ago.

APS worked with four environmental interest groups involved in environmental issues in the western United States: Environmental Defense, the Grand Canyon Trust, Western Resource Advocates and the New Mexico Citizens for Clean Air and Water, on the issue of visibility in the western United States, and planned voluntary emission controls at the APS Cholla and Four Corners plants. Throughout this report we provide other examples of how we engage our stakeholders to work in a cooperative and mutually beneficial way.

## **Corporate Governance**

Recent federal legislation, New York Stock Exchange (NYSE) proposals and Securities and Exchange Commission (SEC) pronouncements are changing the way many companies do business. Pinnacle West welcomes these changes, many of which affirm the practices we've had in place for many years. At Pinnacle West, we remain committed to sound corporate governance practices and financial integrity. Key corporate governance information is available to the public on our Web site. These discuss Board responsibilities, independence of board members, compensation, committee responsibilities and other key corporate governance issues at the Company:

### **Independent Directors**

The Board of Directors consists of 11 directors, 9 of which are independent under the applicable criteria. See page 3 of the 2007 Proxy Statement under "Do we have independent directors" and "How did the Board make its independence determinations" for a discussion of the elements for independence and the determinations.

The Chairman of the Board of Directors is William J. Post. His biography appears on page 11 of the 2007 Proxy Statement. The Corporate Governance Committee has considered separating the Chairman and CEO roles but concluded that the Company is best served by a structure in which the CEO also serves as Chairman

## Board Diversity

As of the end of 2006, two women and one minority serve on the company's 11-member Board of Directors

## Director Qualification and Compensation

Director qualifications and compensation are discussed starting on page 5 and 16 of our 2007 Proxy Statement.

## Mechanisms for shareholders and employees to provide recommendations or direction to the Board of Directors

Please see page 5 of the 2007 Proxy Statement, "Shareholder Nominations"; page 8 of the 2007 Proxy Statement, "How can Shareholders communicate with the Board"; and page 49, "How do we submit shareholder proposals or director nominations for the next Annual Meeting?"

## Code of Conduct and Ethics

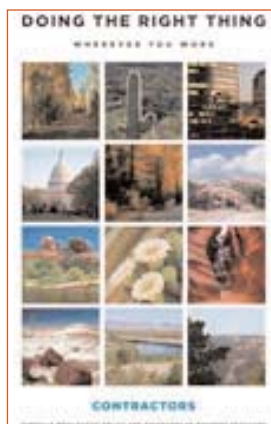
Pinnacle West has specific policies in place to ensure a high level of corporate conduct and ethics. These Pinnacle West Ethics Policies and Standards of Business Practices are summarized in an internal booklet called "Doing the Right Thing."

All Employees receive a copy of "Doing the Right Thing" when they join the company and are provided updates periodically throughout their employment. In addition, Pinnacle West makes the book available for viewing by our external stakeholders on our Web site (click on the link above to view).

All Company officers, Board Members, and employees (including full-time, part-time, supplementals, and interns) are required to take annual training on corporate conduct and ethics, and to pass an on-line test on that training.

Some key sections of the "Doing the Right Thing" booklet include:

- Corporate Ethics Policy (Page 5)
- Supplier/Contractor Relationships (Page 6)
- Giving & Accepting Gifts (Page 6)
- Conflict of Interest (Page 9)
- Reporting Violations of the Ethics Policy (Page 12)
- Employment (Page 14)
- Labor Management Relations/right to organize and collective bargain (Page 16)
- Health and Safety (Page 18)
- Environmental Protection (Page 20)
- Dealings with Public Officials (Page 27)
- Political Participation (Page 28)
- Antitrust (Page 29)
- Sarbanes-Oxley Act of 2002 (Page 31)
- ACC Code of Conduct (Page 34)
- FERC Codes and Standards of Conduct (Page 34)
- Compliance (Page 35)



In 2006, Pinnacle West created a new booklet called *Doing the Right Thing-Contractors*, which provides an abbreviated version of the booklet's content as it applies specifically to contractors. The pamphlet is distributed to key contractors in partnership with the company's contract labor vendors. Again, this is available for viewing by the public on our corporate Web site.

APS employees are encouraged to report any questions or concerns related to our Ethics and Standards of Business Practices to our Business Practices Department or the company's Help Line. The Help Line is administered by an outside third party that is set up to receive employee concerns and allegations, and is available 24 hours a day, seven days a week. Employees can report questions and concerns anonymously if desired. A quote from our internal Employee Concerns procedure to our employees clarifies:

"Concerns/allegations are reported either confidentially or anonymously. Confidentially means that those with a business need-to-know may be informed of the concerned individual's identity or the details of the allegation and investigation. Anonymously means that the concerned individual's identity is unknown because the concerned individual does not identify himself/herself at any time."

## Public Affairs

Electricity is critical to our economy. We believe that the electricity dialogue is a key policy issue, and that shaping an effective public policy is crucial to building a reliable energy future. Every year it becomes more important to inform our community leaders and elected and appointed officials about the importance of electricity to jobs, growth and economic efficiency.

Our ethics policy, described in the *Doing the Right Thing* book above, describes how our employees and our company interact with public officials. PNW has a Government Affairs Department which takes the lead on PNW's interactions with State and Federal officials. In addition, Pinnacle West has a formal Political Action Committee (PAC) for employees of the company who elect to join the PAC. Pinnacle West maintains strict adherence to the laws governing campaign contributions and PACs.

### **Involvement with pesticides, GMOs, fur, alcohol, tobacco, firearms, nuclear weapons, military products, pornography or gambling products**

We do not have any business involvement/revenues in these product areas

### **Military contracts and percentage of total revenue**

Pinnacle West does not have any specific military related contracts. However, as a public service utility, we provide electric services to all customers within our service territory, including military facilities.

## **Affiliations and Memberships**

Pinnacle West recognizes that participation in governmental and non-governmental organizations (NGO), and in industry and professional organizations can provide tremendous business advantages and help enhance our sustainability efforts. Many of our employees participate in professional and business associations related to every function of our business, including accounting, purchasing, environmental, health and safety, human resources, public relations, engineering and electrical trades. Our employees often take leadership roles in these organizations. Here are some of Pinnacle West's key affiliations and memberships:

### **Government and NGO Partnerships and Organizations**

#### ***Coalition of Environmentally Responsible Economies (CERES)***

Ceres is a national network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change

#### ***EPA Coal Combustion Products Partnership (C<sup>2</sup>P<sup>2</sup>)***

The Coal Combustion Products Partnership (C<sup>2</sup>P<sup>2</sup>) program is a cooperative effort between the U.S. Environmental Protection Agency, American Coal Ash Association, Utility Solid Waste Activities Group, U.S. Department of Energy, and U.S. Federal Highway Administration to help promote the beneficial use of Coal Combustion Products (CCPs) and the environmental benefits that result from their use.

#### ***EPA Climate Leaders***

Climate Leaders is an Environmental Protection Agency (EPA) industry-government partnership that works with companies to develop long-term comprehensive climate change strategies. Partners set a corporate-wide greenhouse gas (GHG) reduction goal and inventory their emissions to measure progress. By reporting inventory data to the EPA, partners create a lasting record of their accomplishments. Partners also identify themselves as corporate environmental leaders and strategically position themselves as climate-change policy continues to unfold.

#### ***EPA SF<sub>6</sub> Emission Reduction Partnership***

The SF<sub>6</sub> Emission Reduction Partnership for Electric Power Systems is a collaborative effort between the EPA and the electric power industry to identify and implement cost-effective solutions to reduce sulfur hexafluoride (SF<sub>6</sub>) emissions.

#### ***EPA WasteWise***

WasteWise is a voluntary EPA program through which organizations eliminate costly municipal solid waste and select industrial wastes, beneficially effecting their bottom line and the environment. WasteWise is a flexible program that allows partners to design their own waste-reduction programs tailored to their needs.

#### ***EPA/DOA EnergyStar Program***

ENERGY STAR is a joint program of the U.S. Environmental Protection Agency and the U.S. Department of Energy helping consumers save money and protecting the environment through energy-efficient products and practices.

#### ***PowerTree Carbon Company***

PowerTree Carbon Company LLC is an initiative sponsored by 25 U.S. power companies to plant trees in critical habitats in the Lower Mississippi River Valley in order to manage carbon dioxide levels. The projects will restore bottomland and hardwoods on marginal agricultural lands, create habitats for birds and other wildlife, and provide other environmental benefits including improved water and soil quality.

#### ***The National Wild Turkey Foundation (NWTf) Energy for Wildlife***

The NWTf is a grassroots, non-profit organization with 545,000 members in 50 states, Canada, Mexico and 14 other foreign countries. It supports scientific wildlife management on public, private and corporate lands.

#### ***The Nature Conservancy***

The Nature Conservancy is the leading conservation organization working to protect the most ecologically important lands and waters around the world for nature and people. The mission of The Nature Conservancy is to preserve the plants, animals and natural communities that represent the diversity of life on Earth by protecting the lands and waters they need to survive.

## Industry Groups and Associations

### ***American Council on Renewable Energy (ACORE)***

The ACORE is focused on accelerating the adoption of renewable energy technologies into the mainstream of American society. ACORE promotes all renewable energy options for the production of electricity, hydrogen, fuels and end-use energy including, solar, wind, geothermal, hydro/ocean, waste energy and fuels, biomass and biofuels.

### ***American Wind Energy Association (AWEA)***

The AWEA is a national trade association that represents wind power plant developers, wind turbine manufacturers, utilities, consultants, insurers, financiers, researchers and others involved in the industry. AWEA provides up-to-date, accurate information about the domestic and international wind energy industry.

### ***Arizona Solar Energy Association (ASEA)***

The ASEA's mission is to educate the people of Arizona about solar energy, its applications and the benefits of utilizing solar technologies.

### ***CEA Technologies Inc. (CEATI)***

CEATI brings electrical utility industry professionals together, through focused interest groups and collaborative projects, to identify and address technical issues that are critical to their organizations.

### ***Common Ground Alliance (CGA)***

The Common Ground Alliance (CGA) is a member-driven association dedicated to ensuring public safety, environmental protection, and the integrity of services by promoting effective damage prevention practices.

### ***Edison Electric Institute (EEI)***

EEI is a trade association for U.S. shareholder-owned electric companies. EEI advocates equitable policies in legislative and regulatory arenas and provides advocacy, authoritative analysis and critical industry data to its members, Congress, government agencies, the financial community and other opinion-leader audiences. It provides forums for member company representatives to discuss issues and strategies to advance the industry and to ensure a competitive position in a changing marketplace.

### ***Electric Power Research Institute (EPRI)***

EPRI manages a broad public/private collaborative research program covering generation, environmental protection, power delivery, retail use and power markets on behalf of the electric utility industry, the industry's customers and society at large.

### ***Institute of Nuclear Power Operations (INPO)***

The nuclear electric utility industry created the Institute of Nuclear Power Operations (INPO) in 1979. INPO's mission is to promote the highest levels of safety and reliability - to promote excellence - in the operation of nuclear electric generating plants.

### ***U.S. Green Building Council (USGBC)***

The USGBC is the nation's foremost coalition of leaders from across the building industry working to promote buildings that are environmentally responsible, profitable and healthy places to live and work.

### ***Utility Solid Waste Activities Group (USWAG)***

USWAG is responsible for addressing solid and hazardous waste regulatory issues on behalf of the utility industry and supports a balanced and reasonable approach to waste management that helps ensure cost-effective protection to the environment. Scott Davis, APS EHS Director, is the current Chairman for USWAG.

### ***Utility Water Activities Group (UWAG)***

The UWAG deals with water-related regulatory issues of importance to electric utilities and supports a balanced and reasonable approach to water quality management that helps ensure cost-effective protection of the environment.

### ***WEST Associates***

WEST Associates is a group of 17 public and private electric utility companies that serve 15 million consumers in the rapidly growing 11 Western states and North Dakota. WEST Associates has played a constructive role on energy and environmental issues in the West since 1964. C.V. Mathai, APS Manager for Environmental Policy, was elected President of WEST Associates in 2006.

### ***Western Business Roundtable (WBRT)***

The WBRT is a non-profit business trade association comprised of CEOs and senior executives of organizations doing business in the Western United States. WBRT advocates economic development, environmental protection, regulatory reform, energy policy, public lands use, waste management and air and water quality.

## 2006 Awards and Recognitions

While we do not manage our EHS and sustainability efforts with a goal of winning awards, we do believe that awards and recognition of our efforts by external organizations are another way for our stakeholders to evaluate our performance.

In 2006, the company received the following external awards and recognitions of our corporate responsibility efforts:

- Pinnacle West was named one of the **Global 100 Most Sustainable Corporations** in the World by *Corporate Knights* at the 2006 World Economic Forum in Davos, Switzerland. Pinnacle West was also named to this list in 2005.
- Pinnacle West has the highest rating (AAA) and is **ranked in the top two of utilities** in the United States by Innovest Strategic Value Advisors in a comprehensive analysis on the U.S. Electric Power Sector covering the environmental, social and governance factors of the largest publicly-traded utility companies. PNW has received the AAA rating from Innovest each time since Innovest started evaluating the company in 2001
- Pinnacle West was listed in the 2006 Dow Jones North America Sustainability Index and the 2006 Dow Jones United States Sustainability Index as a **sustainability leader in the electric industry** indexes, for the second year in a row
- The Company earned “best in class” status in 2006 by Storebrand Socially Responsible Investment for its leading environmental and social performance
- The **2006 Climate Protection Award** was given to APS by the U.S. Environmental Protection Agency. This prestigious national award recognizes exceptional leadership, dedication and technical achievements in protecting the earth’s climate
- APS’ Redhawk Power Plants “Emission to Biofuels” project was awarded the **Emissions Energy Project of the Year for 2006** at the eighth annual Platts Global Energy Awards in New York. APS’ Saguaro Solar Power Plant was a finalist in the Global Energy Project of the Year category
- APS’ Saguaro Solar power plant was named **Energy Project of the Year for 2006** by the Association of Energy Engineers (AEE), and was also named one of the top 12 power plants in the world by Power Magazine
- The **2006 Freedom to Compete award** was given to APS by the U.S. Equal Opportunity Commission in recognition of excellence in equal-employment opportunity practices that promote access and inclusion and which can be emulated by other employers or organizations
- APS was identified as a **2006 National Industry Liaison Group “Best Practices Winner”**
- APS was awarded the **Spirit of Caring award** by the United Way in recognition of the company’s culture of giving, volunteerism and philanthropy
- APS was awarded the **first American Corporate Leadership Award** by the National Center for American Indian Enterprise Development for its leadership on behalf of Native American businesses and economic development with Native American communities
- **2006 Economic Engines of Arizona award** from the Arizona Business Magazine for its economic development efforts across the state of Arizona
- APS was awarded the **2006 Community Sustainer Award** by The Volunteer Center and the *Business Journal* in recognition of outstanding corporate citizenship demonstrated by the scope and effect of a company’s employee volunteer program
- Pinnacle West received the **2006 Outstanding Investor Relations Web site** by the Web Marketing Association
- The Education Foundation of Yuma County inducted APS in 2006 to its **Hall of Fame** in recognition of APS’ long history of support to education within Yuma County
- APS was awarded the **2006 Governor’s Heritage Preservation Award** by the Arizona Preservation Foundation and Arizona State Preservation Office for its efforts related to the Childs and Irving hydroelectric plants
- **Tree Line USA Award** for APS by the Arizona Community Tree Council in recognition of APS’ leadership in urban forestry and environmental stewardship
- Bill Post, Pinnacle West Chairman, was awarded **Valley Leadership’s 2006 Man of the Year**, an award which recognizes one man and woman who have demonstrated significant visionary leadership and community service in the Valley of the Sun (Metro Phoenix area)
- Art Othon, Pinnacle West Director of Economic/Community Development was awarded the **2006 Golden Heart award** by the City of Phoenix. The award is presented each year to recognize an individual who has given a lifetime of community investment
- Marty Schultz, Pinnacle West Vice President of Government Affairs, was awarded the **Tree of Life Award** by the Jewish National Fund. This award recognizes an individual for his outstanding service and commitment to his community
- Donna Phipps, APS Community Development, was awarded the **2006 Community Service Award** by the National Association for the Advancement of Colored People (NAACP)

## **economic impacts**

The economic and business success of our family of companies is inextricably tied to the economic success and sustainability of the communities that we serve. That is why Pinnacle West is so active in the community. We have a commitment to bettering the state's economic and social vitality by being active in economic development, through community and business leadership, volunteerism, education, environmental stewardship and charitable giving.

Pinnacle West has a tremendous economic impact on the communities we serve, including:

- Our product, electricity, is essential to economic growth and a functional economy. Our customers rely on us to provide efficient and reliable electrical service so that they can live, work and grow their businesses
- Pinnacle West is a major employer in Arizona, and one of a relatively few S&P 500 companies with headquarters in Arizona
- APS is essentially one of the largest construction companies in Arizona due to the extensive construction of new substations, distribution and transmission lines, power plants and other infrastructure necessary to both maintain our system and to grow our system to meet the rapid growth of our customers
- Affiliate SunCor is a major developer in commercial and residential projects
- Pinnacle West's economic development efforts are a major contributor to economic growth in Arizona. We are somewhat unique in that our economic development efforts extend to all areas of the state, including rural areas, rather than just focusing in on the major metropolitan areas
- Pinnacle West's Supplier Diversity Program has provided a significant benefit to the development of a diverse supplier network in Arizona
- Our extensive network of power plants, transmission and distribution lines, offices and support facilities provides a great deal of property tax dollars to the areas we are located. For example, the Palo Verde Nuclear Generating Station is the largest single commercial taxpayer in Arizona

In this report, we also provide financial details on issues such as spending on minority- and women-owned businesses, and charitable donations, and have a detailed discussion on climate change which may have future economic impacts

### **Financial Performance**

At Pinnacle West, we believe financial success is an integral component in the concept of sustainability. Smart investors and consumers alike are finding that the other two pillars of sustainability — environmental and social performance — can impact a company's bottom line. At the same time, financial success provides us with the ability to financially support leadership efforts in environmental and social performance.

We firmly believe that responsible and sustainable business practices translate into strong financial performance. Whether it is our practice of selling coal ash waste streams rather than disposing of them, having an aggressive investment recovery program, improving efficiencies in our generating units in order to reduce costs and emissions, or improving our community through volunteerism and charitable giving, these actions lead to a sustainable and profitable long-term business.

We provide specific financial details on issues such as spending on minority- and women-owned businesses, and charitable donations in the Community and Suppliers sections of this report. We also provide a detailed discussion on climate change which may have future economic impacts. These are a few of the examples of our efforts to improve our success and increase shareholder value through sustainable business practices.

Detailed information on PNW's 2006 financial performance is found at our website at [www.pinnaclewest.com](http://www.pinnaclewest.com)

## Economic Development

One of the tenants of sustainability is economic development. We realize that in order for our enterprise to be successful, the state's business community must remain robust. That is why our company places such stock in economic development. APS works with partners throughout the state to help bring quality manufacturing and financial services jobs to Arizona.

Our role is to foster healthy economic development in our communities to create vibrant, sustainable communities in our service territory, with a special emphasis on our rural areas. To help Arizona communities retain successful hometown companies and encourage them to create more jobs, APS sponsoring the Building Bridges to Business program, or B3. This Internet-based program provides communities and their economic development organizations with sophisticated survey instruments and customized computer software that help define, analyze and report community-specific company information.

APS' Focused Future economic development programs have helped Arizona communities boost their local economies for the past decade, and in 2002 earned APS a national innovation award from the National Association of Development Organizations. The program has helped dozens of Arizona communities capitalize on the economic development strengths that are unique to each of them. APS benefits directly when these communities thrive and grow.

In 2006, APS' Business Development team worked with our economic development partners to locate eight new companies in our service territory, creating an estimated 2,067 new jobs, new electrical load of 31.2 megawatts (MW), capital investments of \$170 million and 1,360,000 square feet of building space.

**APS' partners include** the Arizona Department of Commerce (ADOC), the Greater Phoenix Economic Council (GPEC), as well as all of the rural Economic Development Departments in our Arizona communities (such as Casa Grande, Yuma, Prescott, Prescott Valley, Payson, Flagstaff, Globe and Parker).

### **These are some of the things APS does to help foster economic development:**

- APS offers its economic development Web site, Explore Arizona, which provides Arizona demographic information and information on available buildings in rural communities and has now created an updated tool called Arizona Prospector [www.arizonaprosector.com](http://www.arizonaprosector.com) to help find land, buildings, and demographics with a GIS integrated system
- APS provides electric rate analysis and infrastructure evaluations for prospective companies
- APS assists its partners with site visits from site selectors and facility managers, and - on occasion for the larger companies - a helicopter tour to help them get a better perspective of transportation routes and other factors
- APS helps GPEC, ADOC and our rural partners with sales missions with site selectors throughout the United States
- The APS Community Initiatives team works with Arizona communities to create business plans that emphasize quality growth with quality of life as well as leadership and other programs, all to help them become vibrant, growing communities

The "Building Bridges to Business" (B3) program for the communities APS serves, using synchronistic technology to work with existing manufacturers/businesses to understand their businesses and ensure their quality growth

## Electric System Reliability

Electricity is an essential component of our economy and our personal lives. That is why electric system reliability is so important to PNW. The company has numerous programs in place to help ensure the efficiency and reliability of our transmission and distribution system.

APS follows the Institute of Electrical and Electronics Engineers (IEEE) Guideline 1366 when measuring its reliability and when it benchmarks with other utilities.

IEEE 1366 defines an interruption as a loss of power for more than five minutes. Anything less than that is considered a momentary interruption. The company uses three popular measures of reliability that are defined in the IEEE Guideline. Within a one-year period, throughout the entire APS system, APS measures the:

- System Average Interruption Frequency Index (SAIFI): the total number of sustained customer interruptions divided by the total number of APS customers
- System Average Interruption Duration Index (SAIDI): the total number of sustained customer interruption minutes divided by the total number of APS customers
- Customer Average Interruption Duration Index (CAIDI): the total number of sustained customer interruption minutes divided by the total number of sustained customer interruptions

**For each of these indices, the lower the number, the better.**

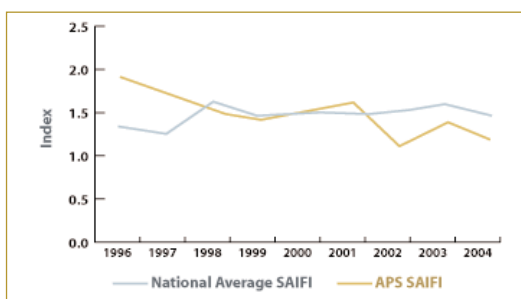
The largest reliability benchmarking effort we know of is performed by the Edison Electric Institute (EEI). In its most recent benchmarking survey, which measures reliability for 2004 and contains data from 75 utilities:

1. For SAIFI, APS was in the middle of the second quartile with a value of 1.17. The U.S. average is 1.47.
2. For SAIDI, APS was in the first quartile at 95 minutes. The U.S. average is 381 minutes.
3. For CAIDI, APS was in the first quartile at 81 minutes. The U.S. average is 187 minutes.

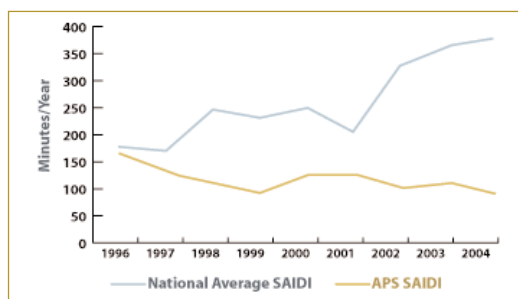
As the below graphs show, between 1996 and 2004 (the latest EEI statistics available at the time of this report), APS' System Average Interruption Frequency Index (SAIFI) or the average number of sustained interruptions seen by the average customer on our system, improved (lower is better) by 38%, while the national average rose (got worse) by 9%.

Similarly, the APS System Average Interruption Duration Index (SAIDI) or the average annual duration of sustained interruptions seen by the average customer on our system improved (lower is better) by 44% while the national average rose (got worse) by 109%.

**SAIFI Comparison**



**SAIDI Comparison**



### **TransWest Express Project**

The TransWest Express Project was announced by the company in October 2005. The goal is to determine the viability of building a new transmission project from Wyoming to Arizona to provide Arizona and other southwestern states increased capability to access electricity generated from wind, coal, and other resources in the Wyoming area. In addition to providing access to energy resources for rapid growth areas in the Southwest, TransWest Express will benefit all western states by providing improved reliability of the western grid. The Phase 1 Feasibility Study is complete. Negotiations for a Participation Agreement to move forward with Phase 2 are under way with interested participants. Phase 2 would include determination of AC or DC technology, route selection, permitting, engineering, regulatory approvals, stakeholder relations and financing. Phase 2 is estimated to take up to five years to complete at a cost of \$115 million which will include options for rights of way.

The parties negotiating in the Participation Agreement are APS, SRP, Southern California Edison, Tucson Electric Power, National Grid and Wyoming Infrastructure Authority. APS and the other groups involved with TransWest are also working with various external stakeholders to address their concerns regarding potential impacts of this transmission line. APS is hopeful the Participation Agreement will be executed in the near future.

### **New Technologies**

New technologies will be a critical factor in meeting increasing electric demands. Examples of some of the new technologies we have incorporated into our Transmission/Distribution system include:

#### **Aluminum Conductor Composite Reinforced Transmission Line**

After extensive evaluation, APS recently used 3M's aluminum conductor composite reinforced (ACCR) conductor to increase a transmission line's capacity without disrupting the surrounding community. The six-mile, 230-kV transmission line, originally built in the 1970s, was forecasted to be maxed out in capacity. This new technology allowed APS to reconductor this transmission line with conductor weighing the same as the previous conductor, but which is able to carry more than twice the electrical power of conventional conductors of the same size, with minimal conductor sag

### Online Monitors

APS is expanding its online monitoring program to all transformers and shunt reactors 230kV and above. Instead of annual manual sampling, the monitors continuously sample the transformer oil for gas levels and issue a report every four hours, using an artificial neural network system called the Transformer Oil Analysis Notification program (TOAN).

This online monitoring program allows APS to detect a problem and repair or replace a transformer before it fails, improving the reliability of the system and significantly reducing costs. The system has been tested at a 92.9 percent accuracy rate for predicting related faults in power transformers, more than double the accuracy of our previous system.

### Smart Meters

New “smart meters” have the ability to send an immediate notification to the utility when the meter experiences a power outage. This significantly decreases the time for the utility to determine the device on the network that is responsible for the outage. This technology allows the utility to dispatch crews sooner to make the needed repairs, ultimately reducing the length of outages.

These “smart meters” also notify the utility once the power at the meter has been restored. Validating that 100 percent of the meters in the affected area have power restored reduces the need to re-dispatch crews to the same area to address an outage on a downstream device such as a transformer that was masked by the larger outage. This metering technology known as Advanced Metering Infrastructure (AMI) also collects much more data about each metering end point on the system. This data helps to facilitate better efficiency in the design of the network. This will reduce outages by identifying areas that need attention and addressing the need prior to overloading the system.

Here are some of the benefits the smart meters offer:

Customers will experience shorter outages

No longer will APS have to rely on calls from customers to initiate repair work since outage notifications would be instant

Smart metering technology also will help APS identify areas more susceptible to service interruptions

In January, APS passed the 20,000-unit mark in its deployment of “smart meter” technology. These intelligent meters will allow customers to dictate in real time when electricity is used, how much is used and how it is used. The initial 20,000-unit installation is part of an agreement with Tempe-based PowerOneData Inc. to provide APS with 160,000 residential meters. Through routine replacements and an existing conversion program, APS projects that its more than one million customers could be part of this smart network within five years.

“We are extremely excited to bring our level of service into the next century,” said APS Vice President of Customer Service Jan Bennett. “These smart meters will allow our customers to gain more control over their energy usage. They also offer APS a diagnostic tool that in turn makes our system more reliable.”



### Distribution Operations Management System (DOMS)

APS prides itself on innovation and service, and the latest developments in smart meters and the company’s Distribution Operations Management System (DOMS) are two cutting edge technologies which will benefit customers and APS.

APS designed the DOMS software system to replace wall maps, track outages information in real time, and manage electrical loads, construction and repair crews. Like many utilities across the country, APS relies on paper wall maps with color-coded pins to understand the big picture of its distribution electrical grid.

When completed, DOMS will allow APS to manage and track information and make updates to this grid via computer. Currently 17 percent of the DOMS project is finished, with overall completion anticipated in 2010.

While APS’ traditional methods of managing electrical loads and its response to outages work well, there is a need for new technology to address the continued rapid growth of APS’ service territory. The company’s goal is to not only address the growth, but to remain ahead of it. The objective of the DOMS project is to improve outage communications and reliability reporting, and further reduce customer power-outage durations. Improved customer satisfaction and enhanced safety practices are just a couple of benefits that would follow.

Before DOMS can be implemented, some preparation must take place. APS is going through a process of field-phasing verification to ensure the information in the DOMS correlates to what is out in the field. In a service territory that adds, on average, 10 new distribution substations each year and more than 125 new customers each day, that’s quite an undertaking.

In the long run, the overall effect of DOMS will be a mass integration of APS services and systems. This will consolidate the systems at five distribution operating centers covering about 35,000-square miles in the Phoenix metro area and four state regions into one as needed, such as after-hour operations. It also means a merging and addition of computer systems. From this, DOMS will have the potential for quickly providing planning analysis, power-flow analysis and suggested switching tools to maintain the electrical grid.

The implementation of DOMS will improve many of the ways APS does business in the future. The DOMS computer stations will be used to provide simulator training to new operators, enabling them to hit the ground running. It will affect the areas of construction, operations, maintenance, data quality and customer care. For APS crews in the field, DOMS will offer crew management and call-out tools to better monitor manpower requirements. The systems fault locator ability will also reduce the time necessary for troubleshooting to isolate faults.

## APS Generation

APS owns and operates a number of power plants located across Arizona and in Farmington, NM.

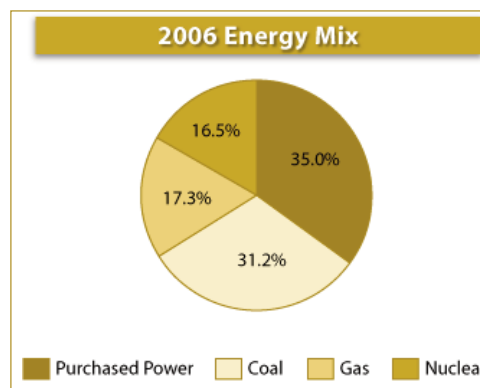
### 2006 Energy Mix

APS' sources of energy during 2006 are shown in the chart to the right.

Since 2003, APS has formally included environmental factors when evaluating power purchase agreements or generation assets for procurement. Environmental factors considered include air emissions of priority pollutants, carbon emissions, water consumption and source, and compliance history.

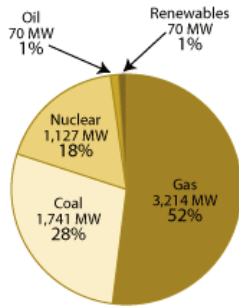
### APS' owned generating facilities 2006 capacities:

Our electric generating facilities use a mix of fuels including coal, natural gas, oil and nuclear, as well as renewable sources. Having a balanced fuel mix has provided APS with a number of financial and environmental benefits. This fuel mix allows us to enter into long-term fuel-purchasing agreements with our suppliers, which reduces our costs and provides stable fuel sources into the future. In addition, it gives us operational flexibility so we can respond to changing markets and current events. Our fuel mix has been a significant factor in our ability to decrease our air emissions intensity while continuing to add generation resources to meet our rapid customer growth. This is discussed in more detail in the Air Emissions section of this report.



Capacity (kW)	
<b>Coal</b>	
Units 1, 2 and 3 at Four Corners	560,000
15% owned Units 4 and 5 at Four Corners	222,000
Units 1, 2 and 3 at Cholla	641,000
14% owned Units 1, 2 and 3 at the Navajo Generating Station	315,000
<b>Subtotal</b>	<b>1,741,000</b>
<b>Gas or Oil</b>	
Two steam units at Ocotillo and two steam units at Saguaro	430,000
Twenty-two combustion turbine units	992,000
Seven combined cycle units	1,862,000
<b>Subtotal</b>	<b>3,284,000</b>
<b>Nuclear</b>	
29.1% owned or leased Units 1, 2, and 3 at Palo Verde	1,126,752
<b>Solar</b>	
	5,816
<b>Total</b>	<b>6,157,568</b>

### 2006 APS Owned Generation Capacity by Fuel Type



This pie chart shows that about 10 MW (1%) of our owned generation is from renewable sources. At the end of 2006, APS had a total of 106.5 MW of renewable energy capacity, most of which comes from purchased sources under contract rather than APS owned generation. This is discussed further in the Clean Energy section of this report.

Nuclear energy is an important part of our generation mix, providing economic and environmental benefits, including significant air emissions avoidance, which is discussed further in the Climate Change section of this report.

We also remain committed to our policy of producing energy from natural resources in the most economic and efficient ways possible. We purchase approximately 97 percent of our coal locally. When feasible,

energy is produced from local and regional fuel sources in an effort to limit the economic and environmental impact of transportation.

More detail on our fuel supply and purchased power may be found in the Investors section of our Pinnacle West Web site.

Our 2006 net generation and fuel use is shown in the table below:

### 2006 Net Generation and Fuel Use - APS Owned Generation

	Net Generation (MWH)	Fuel Use				Total BTUS
		Coal (Tons)	Nat Gas (MCF)	Diesel (BBLS)	Resid (BBLS)	
<b>Four Corners</b>	<b>5,997,506</b>	<b>3,568,120</b>	<b>146,660</b>			<b>63,631,842</b>
<b>Cholla</b>	<b>4,74,187</b>	<b>2,574,420</b>	<b>4,610</b>	<b>4,410</b>		<b>49,984,358</b>
<b>Navajo</b>	<b>2,403,572</b>	<b>1,094,720</b>			<b>2,297</b>	<b>23,357,266</b>
<b>Douglas</b>	<b>59</b>			<b>180</b>		<b>1,040</b>
<b>Yucca</b>	<b>25,942</b>		<b>405,900</b>	<b>5,040</b>		<b>441,523</b>
<b>Ocotillo</b>	<b>139,735</b>		<b>1,629,840</b>	<b>0</b>	<b>0</b>	<b>1,661,258</b>
<b>Saguaro</b>	<b>60,832</b>		<b>673,830</b>	<b>0</b>	<b>0</b>	<b>690,779</b>
<b>West Phoenix</b>	<b>2,057,992</b>		<b>3,071,360</b>	<b>0</b>		<b>3,128,021</b>
<b>Hydro</b>	<b>0</b>					
<b>Solar</b>	<b>10,137</b>					
<b>Palo Verde</b>	<b>6,987,559</b>					
<b>Redhawk</b>	<b>4,915,675</b>		<b>35,731,070</b>			<b>36,516,892</b>
<b>Sundance</b>	<b>102,999</b>		<b>1,001,470</b>			<b>1,025,967</b>
<b>Total</b>	<b>27,476,195</b>	<b>7,237,260</b>	<b>5,932,200</b>	<b>9,630</b>	<b>2,297</b>	<b>142,896,088</b>

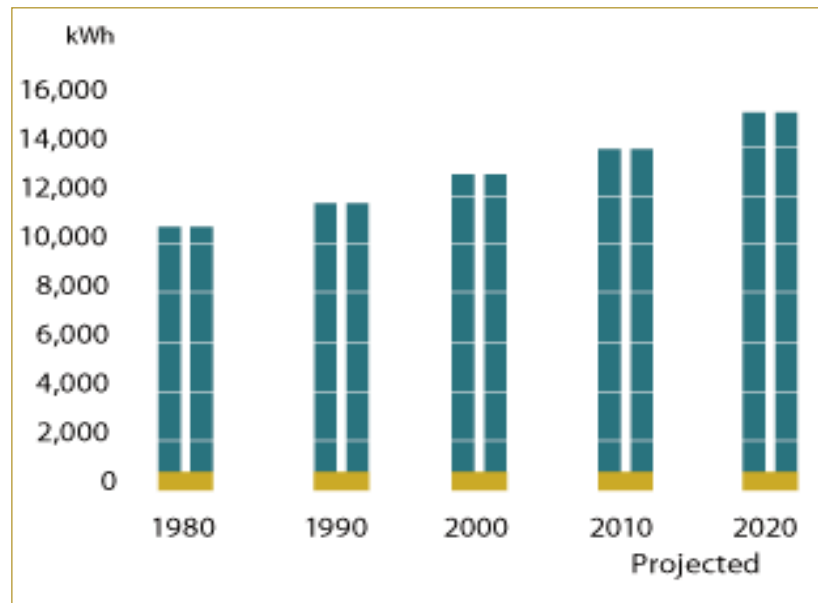


## environmental performance

Pinnacle West has an unwavering commitment to environmental stewardship.

Our primary environmental challenges arise from the need to generate and deliver electricity to a rapidly growing customer base. As noted in our Key Issues section, the APS service territory is one of the fastest-growing in the nation. In addition to the increase in actual numbers of customers, there has been a significant increase in the consumption of electricity by customers as well. For example, in the 1960s, the average Arizona home was about 1,500 square feet and had an eight-foot ceiling, resulting in an average home volume of 12,000 cubic feet. Today, the average Arizona home has grown to about 2,000 square feet, and ceiling heights have increased to make the average home volume go up to about 20,000 cubic feet - more than a 66 percent increase. That is space that needs to be heated in the winter and cooled in the summer, and that space also houses a lot more electricity-consuming appliances and devices than in years past, resulting in each customer using more electricity, despite gains in energy efficiency and energy conservation.

### APS customers are using more electricity each year



All of that increased energy use requires increased electricity generation and increased transmission and distribution infrastructure, which increases our environmental impact. However, with growth and its inherent challenges, come opportunities for innovation and leadership.

We will meet ever-growing environmental responsibilities by continuing to enhance our leadership role in this vital area. We will continue to operate our facilities in compliance with all applicable laws and regulations, and implement the best management practices to ensure we facilitate an energy future that is economical, reliable and increasingly renewable. Throughout this report we highlight various programs we have implemented and are researching in order to meet this demand — in a sustainable manner that best protects and enhances our environment.

These efforts include maintaining fuel-mix diversification, including a significantly expanded role for renewables to help meet increased generation needs, demand-side management programs to help reduce energy growth and a robust technology innovation effort to identify, research and implement new technologies that contribute to a sustainable energy future. We must also employ more "typical" environmental efforts such as reuse of materials such as coal ash and other materials, waste minimization, air emissions controls and wildlife and forest protection.

This section of our Corporate Responsibility Report details our company's environmental philosophies and performance for 2006. We believe it demonstrates our dedication to performing at a high level while maintaining our long-term commitment

## Policy, Organization and Management

APS adopted its first environmental policy in 1973. Over the past 33 years, environmental stewardship has been a core value for the company. During that time, our policies have evolved to keep up with our current thinking and our commitments to the environment. At Pinnacle West, we believe in promoting a healthy environment for our community and our businesses. Taking care of our environment and promoting the health and safety of our employees and community is not just our business, it's our obligation.

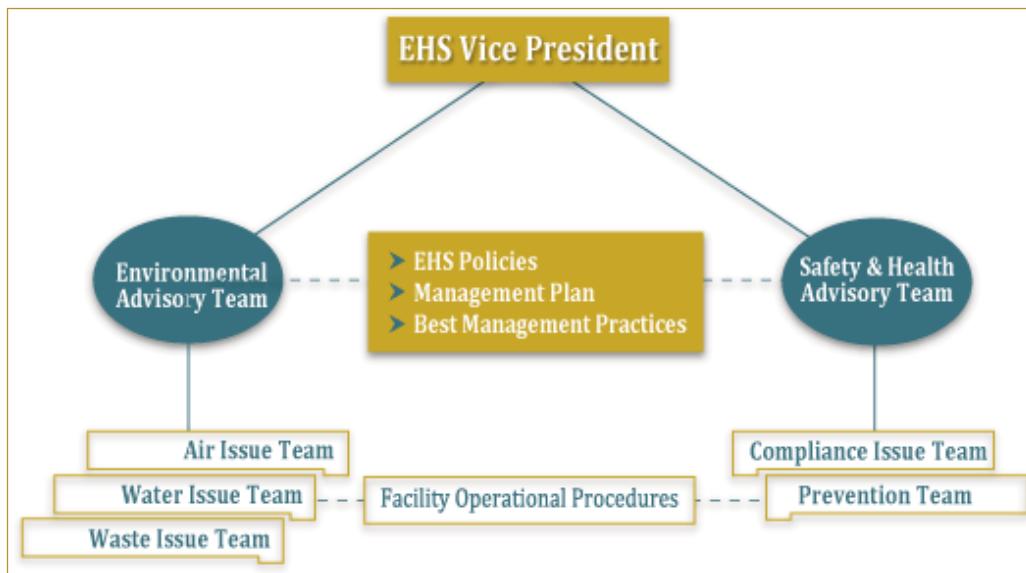
We are committed to responsible environmental practices that meet and surpass regulatory requirements. APS adheres to the environmental principles set forth by Ceres, a coalition of investors and public interest organizations. These commitments are clearly stated in our Environmental, Health and Safety Policy, which is the cornerstone of our EHS Management System. Our EHS Policy is available to view in the online version of this Corporate Responsibility Report.

### Organization

Our Environmental, Health and Safety program is decentralized, with primary responsibility for complying with EHS requirements resting with the leaders and frontline employees at our various facilities. Departments such as Corporate EHS and Corporate Law are available to assist and support the operating areas with technical, strategic, regulatory and legal EHS issues. They also provide strategic direction and leadership on issues such as EHS risk analysis and companywide issues such as Superfund. Throughout the company, each employee shares responsibility for EHS compliance and has an obligation to bring issues and concerns forward for resolution. This obligation is clearly identified in our EHS Policy and in our Corporate Ethics Policy.

APS' EHS strategic direction and leadership on company-wide safety, health and environmental issues is determined by a hierarchy of cross-departmental committees and teams, as shown in the Figure below. The EHS management team consists of two committees: the Environmental Advisory Team and the Safety and Health Advisory Team.

These teams make recommendations to EHS Vice President Edward Z. Fox on matters requiring executive oversight. The teams are also responsible for developing and updating the EHS Policy and EHS Management Plan, and ensuring integrated implementation of these and other critical documents into the company's operations. These teams have various issues teams reporting to them. The issues teams are responsible for more detailed work on important cross-company issues.



Fox provides primary executive oversight for our EHS efforts, and makes periodic reports to the Board of Directors regarding EHS issues and compliance status. Frontline EHS professionals handle issues that arise in the field and at company facilities. These professionals provide daily, on-the-spot attention to EHS issues. They are the backbone of the company's EHS program and work hard to keep things operating smoothly and safely.

### **EHS Management Systems**

Our EHS Management System (EMS) is a systematic framework for managing our EHS practices and ensuring we meet our goals and objectives. Our EMS is modeled upon the general format of the ISO 14000 standard for Environmental Management Systems, though we have not pursued formal certification since all of Pinnacle West's operations are based within the United States. The EMS is based on APS' EHS Policy, which sets the vision and operating foundation for our EHS efforts. In addition to the EHS policy, APS has several policies, standards and plans that underscore the importance of our commitment to excellence and ethical business practices, including protection of our environment.

- The APS EHS Management Plan augments the EHS policy, and outlines our EHS organization and responsibilities for meeting federal, state, county, municipal and tribal environmental, health and safety laws and regulations under which we operate.
- The APS Accident Prevention Manual details the Safety Policy, Responsibilities, and APM rules for employees across the company.
- Our Ethics Policy helps us comply with policies, laws and regulations.
- Our Standards of Business Practices focuses on meeting company standards and legal requirements.
- The APS Code of Conduct outlines the relationship between our traditional energy delivery corporation, APS, and our competitive retail company, APS Energy Services.

In 2005, APS participated in an Environmental Compliance and Management Systems Benchmarking Study of electric utilities sponsored by the Electric Utility Benchmarking Association. In that study, APS was identified as a "Top 5" performer among participating utilities, and components of our EMS were included in the best practices final report from that study. As a participant in the study, APS received a copy of the report for use in reviewing national best practices for further improvement of our EMS.

We believe that the foundation of sound environmental, health and safety management is not only compliance with the regulations that apply to our business, but being an EHS leader. We believe that environmental stewardship and sustainable business practices are a sound business strategy.

In this respect, APS' EHS programs go beyond basic compliance, where activities are consistent with good business practices and goals. The results of these efforts are documented in this report as well as our other EHS annual reports dating back to 1994.

To evaluate and strengthen our compliance management systems we have an EHS Compliance Assurance Program. This program has a four-tier assessment process which includes ongoing facility self-assessments, formal focused self-assessments, an aggressive EHS audit program and periodic extensive compliance reviews. EHS professionals across the company are also active in many professional and industry groups which monitor regulatory changes, evolving EHS and sustainability issues, and other critical EHS matters affecting our industry. APS also has a Public Affairs department that monitors and participates in federal and state legislative processes that may impact the company. All of these efforts are coordinated within the EMS to ensure ongoing compliance and continuous improvement.

### **Organizational Changes**

In 2006, APS created a new department, Eco-efficiency/Technology Innovations, whose charge is to develop sustainability programs through every level of the enterprise.

According to Bill Wiley, senior manager, Eco-efficiency/Technology Innovations (EETI), sustainability is about the long term.

"Sustainability means meeting our business needs today while implementing the strategies, business practices and policies that support a vibrant economy, healthy environment and strong community for future generations," Wiley said. "It is about our actions today supporting a smarter and better tomorrow."

The department's charge is to plan and make decisions that integrate consideration of the long-term economy, environment and community.

At Pinnacle West, sustainability is not a question of how to minimize potential negative impacts of decisions already made, but instead is a set of questions about long-term impacts that must be addressed before business decisions are made.

The new department is comprised of:

- An internal working group
- An advisory committee comprised of individuals from inside and outside the company
- Arizona Businesses Advancing Sustainability (ABAS) – an APS/Intel partnership to encourage and work with other businesses (For more on this partnership, please see our Pinnacle West’s Approach to Sustainability section)
- Technology partnerships
- The EETI organization

## Compliance Assurance Program

Our written Compliance Assurance Program establishes types of assessments and audits, reporting results to management, corrective actions, tracking status of open items, confidentiality of information, record retention, and roles and responsibilities. Results of EHS audit exceptions are reported quarterly to executive management and at least annually to the Board of Directors.

Officers receive quarterly and annual reports on audit activities and trends in audit findings. Additionally, facility managers are provided with quarterly summary reports on EHS audit exceptions for incorporation into their EHS self-assessment activities.

In order to assure every effort is made to maintain compliance in our complex and diverse operations, the following four-tier process is established by our Compliance Assurance Program management practice.

### Tier I — Ongoing Self-Assessments

The Tier I process is relatively informal and involves routine checks of EHS programs to ensure the program elements and standards are being accomplished. Each business unit or facility creates and maintains a plan describing how their Tier I process is implemented. Typical program elements include:

- Reviews of mandatory training progress reports
- Reviews of monthly trend reports
- Field observations and walk-downs
- EHS data review
- Review of company/industry event reports/lesson learned, critiques and the use of the department’s performance indicators

### Tier II — Focused Self-Assessments

Company EHS professionals conduct more formal and focused self-assessments annually in each business unit/department. Tier II assessments are structured, comprehensive reviews of program performance across the facility or department and/or the company. The Environmental Advisory Team and the Safety and Health Advisory team develop the Tier II assessment plan at the beginning of each year.

In 2006, APS facilities completed 70 Tier II self-assessments.

### Tier III — Audit Program

Our EHS audit program is managed by a dedicated corporate EHS Audit Group, which reports organizationally to the PNW director of Audit Services, while maintaining a direct report to the vice president of Environmental, Health, Safety and Communications. The director of Audit Services reports directly to the Chairman and CEO of Pinnacle West.

The corporate EHS Audit Group is responsible for creating a schedule of audits at the beginning of each year and to facilitate the process so that each audit is completed. Cross-functional teams are used to conduct detailed annual compliance audits of EHS programs. These teams can include technical and operational experts from departments across the company. Our audits incorporate all applicable environmental, health and safety regulatory requirements and internal EHS policies, procedures and management practices.

The Tier III process also includes an annual review of the Tier I plans and Tier II process to ensure they are being implemented according to the APS EHS Best Management Practice.

The EHS Audit Group conducted 20 formal Tier III audits at APS facilities in 2006.

### Tier IV — Periodic Compliance Reviews

Periodically, a detailed review of the compliance status of EHS programs are conducted. These reviews are used to establish the baseline of compliance within the EHS programs and identify areas for future Tier II assessments. The reviews are completed either by an independent third party, by internal teams of EHS professionals or by a combination of internal and external professionals. Such reviews may also be done at the direction of the Pinnacle West Law Department, utilizing an independent third party or an internal team of EHS professionals.

No Tier IV reviews were conducted in 2006.

## EHS Training

In 2006, our employees completed more than 63,000 EHS related training courses. This included training in 326 different compliance required topics, and 32 non-required topics areas. Compliance required topics include training required by agencies including OSHA, Department of Transportation (DOT), EPA, NRC and the Mine Safety and Health Administration (MSHA). Through a detailed profiling process, employees are assigned required topics based on the type of work they do. This ensures a safe and healthy work environment, while allowing the company to maintain compliance. EHS training is tracked via a dedicated computer tracking system to insure employees are assigned and received the necessary training during the year.

<b>EHS Training Summary</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Total # EHS training completions</b>	<b>63,730</b>	<b>69,207</b>	<b>53,993</b>
<b>Avg. # completions per employee (office &amp; field combined)</b>	<b>11</b>	<b>12</b>	<b>9</b>
<b># Required EHS topics covered</b>	<b>326</b>	<b>323</b>	<b>327</b>
<b># Non-required EHS topics covered</b>	<b>32</b>	<b>58</b>	<b>35</b>
<b>Total # EHS Topics covered</b>	<b>358</b>	<b>381</b>	<b>362</b>

## EHS Excellence Awards

In addition to normal employee merit and incentive recognition, outstanding individual environmental, health and safety performances and initiatives are recognized through the APS Environmental, Health and Safety Excellence Awards program. In 2006, 16 EHS Excellence Awards were given to individual employees and employee teams. The honored employees were also recognized in our internal company communications.

Employees can recognize each other for EHS excellence, based on Pinnacle West's EHS values, which are:

- Ensuring a safe and healthy work environment
- Being an environmental leader

The EHS Excellence Awards Program's goals are to:

- encourage employees to recognize each other, individuals and teams, specifically for embracing our company values through EHS excellence, with increasingly greater participation by employees who do not have primary roles and responsibilities in EHS
- be accessible to areas of the company, easy to use, immediate, flexible and meaningful
- distinguish those who have contributed a significant or extraordinary amount of EHS value with the Quarterly EHS Excellence Award of Distinction
- provide a CEO EHS Excellence Award to those who meet the stringent criteria established for this ultimate level of recognition

## EHS Targets

Our EHS policy and EHS Management Systems (EMS) sets the framework, goals and objectives of our EHS activities. In addition, APS sets more specific targets in certain key EHS areas. These targets are integrated into corporate and departmental level business plans, and are included as part of employee performance reviews and as a component of corporate incentive pay.

In 2005, APS developed a new long-range business plan encompassing the years 2005 to 2010. This Business Plan identifies safety and the environment as two of our six core values. The Business Plan establishes specific short- and long-term corporate targets for environmental, safety and customer satisfaction, including the following targets to be met by 2010:

## Safety

- To achieve the number one ranking among like-sized investor-owned utilities for OSHA recordable injuries (all injury incident rate, lost work incident rate and severity incident rate) (current results discussed in our Employee Safety section of this report)
- To achieve a green rating (no negative findings) for nuclear safety performance in the areas of reactor performance, maintenance rule systems and collective radiation exposure

## Environmental

- To reduce carbon intensity by 10 percent in year 2010 from a year 2000 baseline (current results discussed in the Air Emissions section of this report)
- To implement voluntary emissions-reduction programs at the Cholla and Four Corners Power Plants (current results discussed in the Air Emissions section of this report)
- To meet environmental portfolio standard requirements for renewable energy (current results discussed in the Clean Energy section of this report)

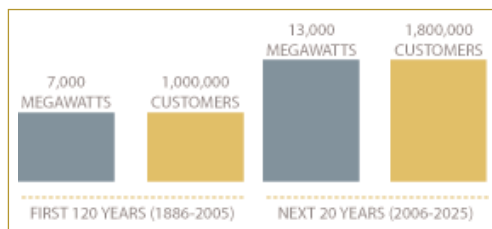
## Customer Satisfaction

- To achieve a 44 percent "very satisfied" and 92 percent "satisfied" rating on customer satisfaction survey (current results discussed in the Customer Satisfaction section of this report)

## Climate Change

Climate change is one of the most significant issues facing our global community. It is a long-term problem requiring long-term vision and steadfast effort. APS has recognized the challenges presented by Climate Change since 1995 when APS signed the Department of Energy Climate Challenge and committed to limiting emissions to 1990 levels by 2000. We met that goal in large measure because of operational excellence at our Palo Verde Nuclear Power plant. Since 2000 however, the rapid growth in Arizona, as discussed below, has created ever greater demands for electricity requiring APS to acquire additional fossil fueled baseload capacity. We have met that demand with natural gas and its lower carbon content enabling APS to establish a trend for reducing the carbon intensity of our electricity supply even while meeting the growing demand. Our ability to achieve this result in 2006, contributed to the United States Environmental Protection Agency recognizing APS' with EPA's prestigious 2006 Climate Protection Award.

### In 2025, APS will be nearly twice the Electric Company we are today



4 times the national average, our peak demand growth has been nine percent year over year for the past three years. Looking forward, Arizona's population is predicted to double by 2025 with a commensurate increase in the demand for electricity. Even as we increase our use of renewable energy and implement more time-

of-use and demand side management programs, our energy outlook continues to require additional new capacity.

Coordinating climate change considerations with our generation forecasting and planning efforts allows APS to evaluate the potential financial and operating impacts of proposed legislation and regulatory programs, including cap and trade programs, and facilitates appropriate early actions for responding to this issue in a competitive manner. Our resource planning and models incorporate various scenarios for a future carbon constrained world and apply a range of potential carbon prices thus allowing us to internalize the potential carbon costs of fossil fuels over the life of generation options. APS has historically recovered costs of environmental controls and programs in its rates approved by the ACC and we anticipate that the costs associated with any regulatory climate program will also be recovered through rate adjustments. The potential impact of these costs on rates is a concern to our customers and us, especially low and fixed income customers. We anticipate that such increased costs, will necessitate expanding our existing programs to assist these members of our community.

Many climate change activities are in process at the international, federal, regional and state levels, including potential legislation. This results in a high degree of uncertainty about the regulatory future and potential financial and operational impacts to specific companies such as Pinnacle West. Our company is actively monitoring and participating in these activities on a number of levels. This includes legislative and regulatory participation through our Public Affairs Department, active participation through our many professional associations (see the Affiliations section of this report), participation in state and regional climate change initiatives such as the Arizona Climate Change Committee formed by Governor Napolitano, and other activities.

### PNW/APS Climate Change Position

APS supports a practical, long-term and sustainable approach to addressing Climate Change. The program must be national in scope and address all major sources of green house gas emissions economy-wide.

Any program to reduce green house gas emissions must realistically address the significant challenges presented by rapid growth in certain areas of the United States, like Arizona, which is the fastest growing state in the Nation with population growth three times the national average and electricity consumption growth four times the national average.

Under these rapid growth conditions short term mandates to roll-back green house gas emissions to past levels are not realistic and will be practical only when low and no carbon technologies are commercially available to achieve the mandates AND meet the affordable energy needs of our customers.

Emission reduction goals must be predicated upon the development and commercial deployment of low and no carbon technologies. Timely and successful deployment of new energy technologies will require significant sustained levels of federal and state financial support.

In the short term, strategies should focus on (i) energy efficiency in all sectors of the economy, including transportation, construction, appliances, electric utilities and consumption patterns, (ii) deployment of cost effective renewable resources, and (iii) utilizing low and no carbon generation technologies that are available to address demand growth and fuel diversity risk.

In the longer term, APS supports a market based approach to addressing Climate Change, such as a cap and trade program. Such a program should be (i) phased-in and include a price cap to avoid the economic disruption that will occur in the event that the technology to achieve emission reductions are not developed or deployed, (ii) updated periodically to recognize and account for rapidly growing areas of the United States, (iii) conditioned to require participation by developing nations, and (iv) designed to create new economic opportunities arising from emerging new technologies and processes.

Any federal regulatory process and structure must avoid conflicts and redundancies with state climate change programs and be (i) crafted to allow regulatory rate-based treatment for associated costs, and (ii) developed to provide incentives for utilities to undertake early investment in low and no carbon technologies.

Finally, any legislation must recognize early action/investments to mitigate green house gas emissions including the recognition of domestic and international green house gas offsets.

### APS Voluntary Climate Change Goal

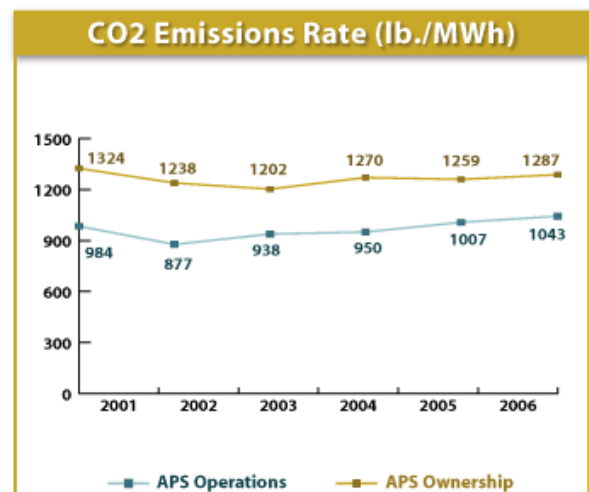
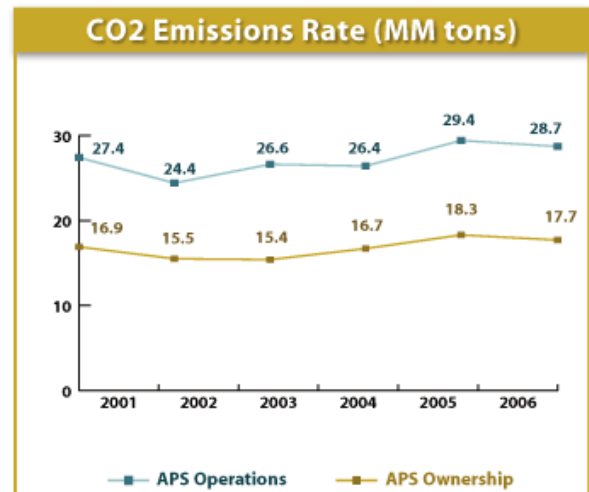
We have established an internal voluntary climate change goal in our 2005-2010 business plan.

The goal: To reduce carbon intensity in power plant emissions by 10 percent in target year 2010 from a baseline year 2000. Carbon intensity has reduced to 1287 lbs/MWh in 2006 from 1324 lb/MWh in baseline year 2000. This is a 3% reduction.

### APS GHG Emissions

Based on an internal evaluation of APS direct emissions of greenhouse gases, we estimate that more than 98 percent of GHG emissions at APS owned facilities is carbon dioxide coming from smokestack emissions at our fossil fuel power plants. About one percent of our overall GHG emissions are from sulfur hexafluoride (SF6) emissions from electrical equipment located across our system (SF6 is discussed further below). The remaining small contribution is from activities such as our fleet transportation (line trucks, bucket trucks and other company vehicles). We have a number of programs in place to address each of these areas, examples of which are discussed in this report.

As shown in the charts below for APS owned and operated generation, over time, the net effect of customer growth and increased electricity demand has been an increase in the overall company CO2 emissions, but with a corresponding reduction in CO2 intensity (lbs/MWh). This means APS has become more efficient at providing electricity to our customers with fewer CO2 emissions per megawatt-hour generated. In 2006, our intensity increased a bit because of the effect of increased outages at our Palo Verde Nuclear Generating Station, which caused APS to utilize correspondingly more fossil fuel generation. We expect that in 2007, our CO2 intensity will once again decline, and for that declining trend to continue through the next 10 years.



### Climate Change Activities at Pinnacle West:

Our efforts in increasing energy production through renewable energy sources, reducing energy demand through our Demand Side Management programs and researching innovative technologies are major components of our overall climate change program, and are discussed elsewhere in this report. In addition to these efforts, here are some of our climate change response actions:

#### APS/DOE Climate Change Accord and Emissions Commitments

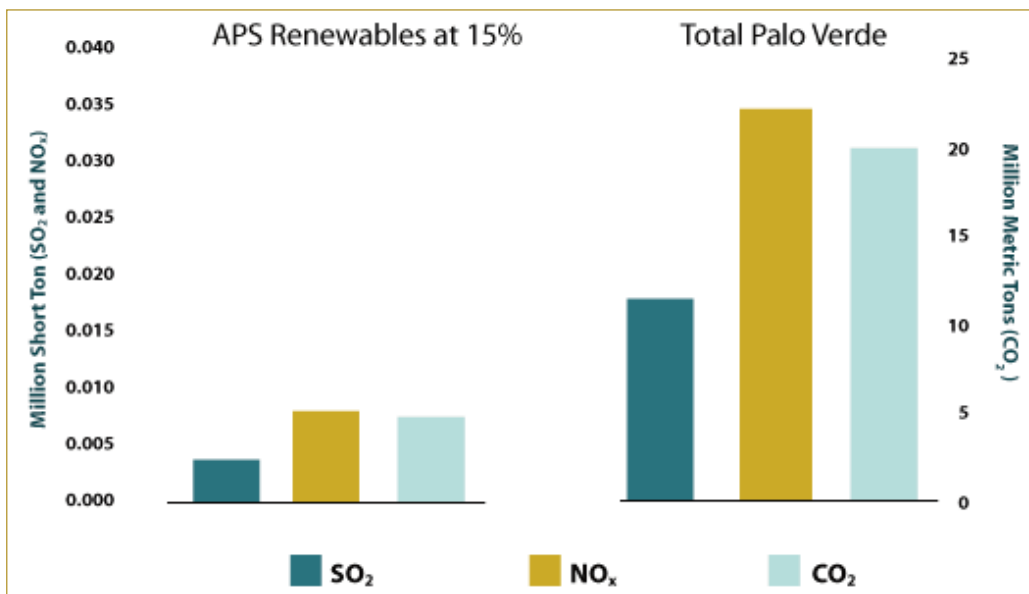
APS was one of the original signatories to the Department of Energy's (DOE) "Climate Challenge Program" in 1995 and was one of the first utilities that committed to maintain system-wide GHG emissions (in tons) to below the 1990 level through 2000. Because of Arizona's rapid growth, APS wanted an "insurance policy" to comply with that commitment. In 1994, APS entered into a first of its kind "inter-pollutant trade agreement" with Niagara Mohawk Power Corporation (NMPC) of Syracuse, New York. The DOE and the Environmental Defense (formerly, Environmental Defense Fund) also were signatories to the agreement. Under the agreement, APS transferred 20,000 SO<sub>2</sub> "allowances" (under the Acid Rain Program) in return for 2.5 million tons of CO<sub>2</sub> reductions, which APS would be able to use, if necessary, to keep its commitment to the DOE. APS upheld its commitment with the DOE, and only a small fraction of the APS/NMPC insurance policy (CO<sub>2</sub> reductions) was utilized in the final year of the agreement, 2000. Furthermore, as part of the agreement, the SO<sub>2</sub> allowances were permanently "retired." As a result, those 20,000 tons of SO<sub>2</sub> emissions will never be emitted into the atmosphere.

#### APS/CFE San Juanico Mini-Grid Project

The APS/NMPC agreement called for joint funding of a renewable energy (solar-wind) project in the small fishing village of San Juanico in Baja California Sur, Mexico. APS designed, engineered and oversaw the construction of the system. The renewable energy plant, supplemented with a battery back-up and diesel generator, provides 24-hour electricity to the village. This project was completed in cooperation with the national electric utility of Mexico, la Comission Federal de Electricidad (CFE), and with additional financial support from DOE and the Mexico City office of the U.S. Agency for International Development (AID). The overall cost for the project exceeded \$1 million. The San Juanico project has been fully operational since 1999 and at the time of its construction was the largest renewable energy project of its kind in North America. It was also selected as a USJI Project (U.S. Initiative on Joint Implementation).

#### Up-Rating at PVNGS and Avoided GHG Emissions

The Palo Verde Nuclear Generating Station is the largest nuclear power plant in the U.S. with a generating capacity of 3,810 MW. It is owned by a consortium of utilities, including APS, which holds the largest share (29.1%) and operates the plant. On average, the plant displaces about 30 million tons of CO<sub>2</sub> annually when compared to the equivalent amount of power produced by coal resources. About 9.5 million tons is APS' annual share of the offset. By 2007, the plant's total generating capacity will be increased by 210 MW, and it is estimated that it will avoid an additional 1.71 million tons of CO<sub>2</sub> annually. APS' share of that offset will be about 0.5 million tons per year. As seen by the figure below, which shows the estimated impact of our renewables program and PVNGS on avoided emissions, PVNGS will continue to provide significant annual emissions reductions far into the future.



2025 Annual Estimated Emissions Avoided in Arizona

### Ash Sales to reduce GHG

U.S. power plants produce millions of tons of coal fly ash annually. APS is using its fly ash to help reduce greenhouse gases while adding to its bottom line. APS sells much of its fly ash to Salt River Materials Group for use in concrete production. This allows them to use the coal ash as a base product in cement production, eliminating their need to produce this material and significantly reducing their energy consumption in cement production. In 2006, APS recycled 658,380 tons of coal ash for cement production or other use, reducing overall greenhouse gas emissions by over 150,000 tons of carbon dioxide.

Ownership of GHG reductions from activities such as ash recycling are current established by APS in contractual language with the other parties involved, in order to prevent "double reporting" of reduction numbers and to establish potential ownership of future emission credits.

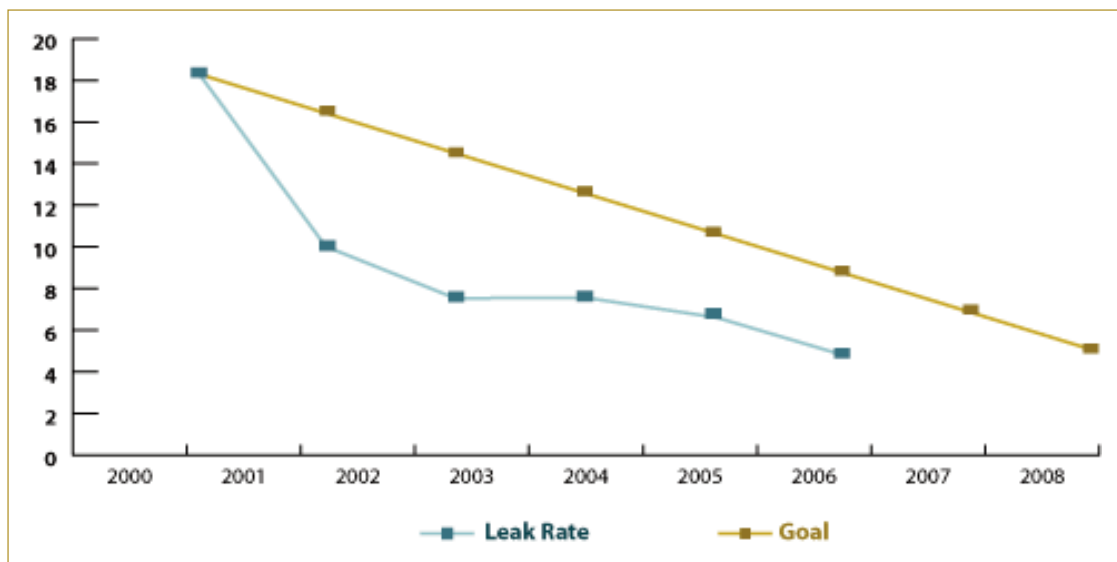
### EPA SF6 Partnership

In 2004, APS joined the EPA's SF6 Emission Reduction Partnership for Electric Power Systems. This is a voluntary, collaborative effort between EPA and the electric power industry to identify and implement cost-effective solutions to reduce sulfur hexafluoride (SF6) emissions. SF6 is a highly potent greenhouse gas used for insulation and current interruption in electric transmission and distribution equipment. As part of this partnership, APS is taking voluntary efforts to significantly reduce SF6 emissions. APS' goal in the SF6 partnership is to reduce equipment leak rate from 18.38 percent in the base year of 2001, down to 5 percent by the end of 2008. APS implemented a number of industry-leading steps to reduce the leak rate, including:

- Utilizing SF6 recycling gas carts to minimize atmospheric releases by reclaiming and purifying the SF6, which was placed back into the equipment after service or repair activities
- Use of a laser-imaging camera to effectively identify SF6 leaks and confirm repairs
- Development of an inventory of our top priority SF6 containing equipment for planning the maintenance, repair and replacement activities of SF6 breakers

By the end of 2006, APS had reduced equipment leak rate from 18.38 percent down to 4.9%, beating our target date by 2 years. We will continue to work on voluntarily reducing our emissions even further. Our results in 2006 resulted in eliminated an estimated 19,624 pounds of SF6 emissions in 2006 compared to our baseline year of 2001. Based on the EPA's greenhouse gas equivalencies, this reduction of SF6 is equivalent to a reduction of 212,741 tons of carbon dioxide.

### SF6 Leak Rate Base on EPA Calculations



### **PowerTree Carbon Company**

To achieve additional CO<sub>2</sub> reductions, APS joined 24 other electric utilities in the PowerTree Carbon Company, which plants trees in ecologically sensitive areas of the lower Mississippi Valley in cooperation with local and national, governmental and conservation organizations. Planting began in 2003 and over two million tons of CO<sub>2</sub> are expected to be sequestered over the 100-year life of the project. In 2006, APS' share of PowerTree Carbon Company sequestration results was the equivalent of a reduction of over 60 short tons of carbon dioxide.

### **Emission Reduction/Sequestration**

APS has an active technology research and development program which is exploring new ways to reduce or sequester carbon dioxide emissions from existing and future electric generation. This includes the development of renewal energy sources, innovate pollution reduction technologies for fossil fuel power plants and other clean energy strategies.

In addition, we are looking at other types of innovative (and sometimes unusual) technologies that can help create a sustainable energy future and reduce greenhouse gases (See Technology Innovation section for details). An example of this effort is our Emissions to Fuel project in which APS is evaluating the possibility of using carbon dioxide in stack emissions to grow algae, which will then be used for bio-fuel. The company and its partner, GreenFuel Technologies, recently shared the Emissions Energy Project of the Year Award at the 8th Annual Platts Global Energy Awards for this project. Another example is our Manure to Renewable Energy project, which explores using methane generated from animal wastes from Concentrated Animal Feeding Operations (CAFOs) to generate electricity and lower methane emissions, a powerful source of greenhouse gases.

### **Trees for the Rim**

APS also partnered with Trees for the Rim, an organization dedicated to replanting trees on Arizona's residential, commercial and community lands damaged by the Rodeo-Chedeki fires of June 2002. APS donated \$25,000 and transported trees, provided volunteers, dug holes for the trees and will continue to be involved as the project unfolds.

### **Changes to Generation Mix**

In addition to our other greenhouse gas-reducing projects, changes to APS' generation mix have helped reduce the intensity of CO<sub>2</sub> emissions measured in pounds per megawatt hour of energy. This reduction is illustrated in the chart above. Key to these reductions is the addition of high-efficiency natural gas capacity, increasing emphasis on renewable energy and the capacity improvements at the Palo Verde Nuclear Generating Station discussed above.

### **Participation in Industry Climate Change Activities**

APS employees build their knowledge of climate change issues through active involvement with industry groups with effective Climate Change programs and activities, including the Edison Electric Institute, the Electric Power Research Institute, the Center for Clean Air Policy and others. The company and its partner, GreenFuel Technologies, recently shared the Emissions Energy Project of the Year Award for work using carbon dioxide (CO<sub>2</sub>) emissions to create reusable biodiesel and ethanol fuel at APS' Redhawk Power Plant. The award came at the 8th Annual Platts Global Energy Awards

### **Green House Gas Emission Reporting**

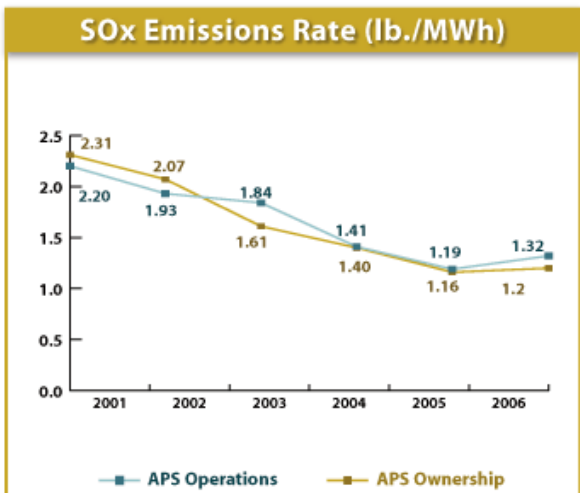
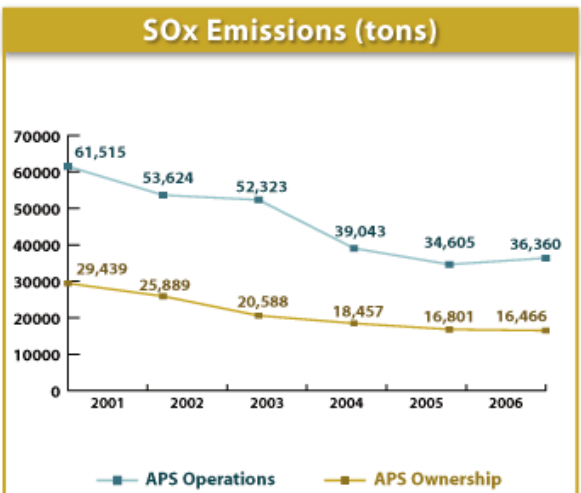
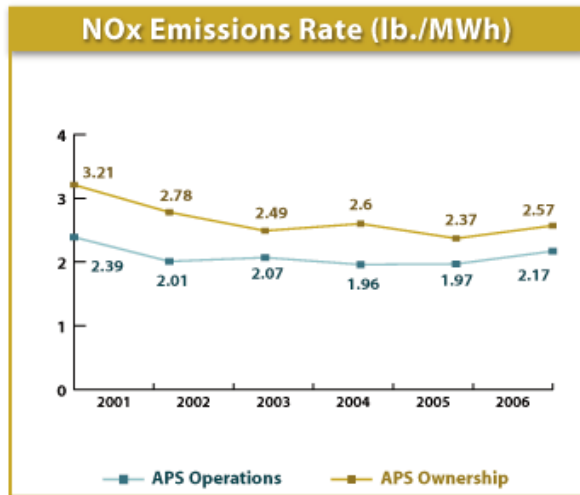
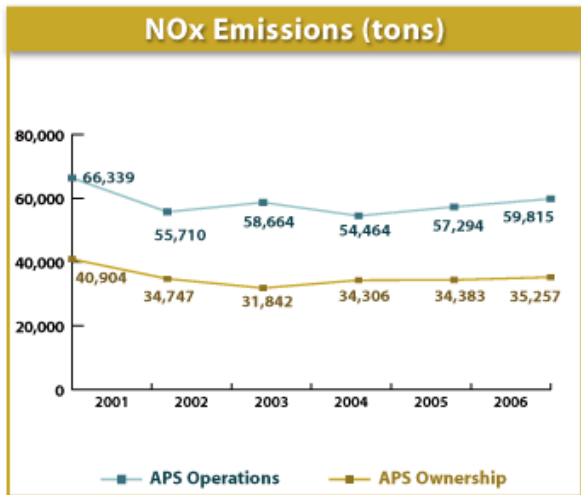
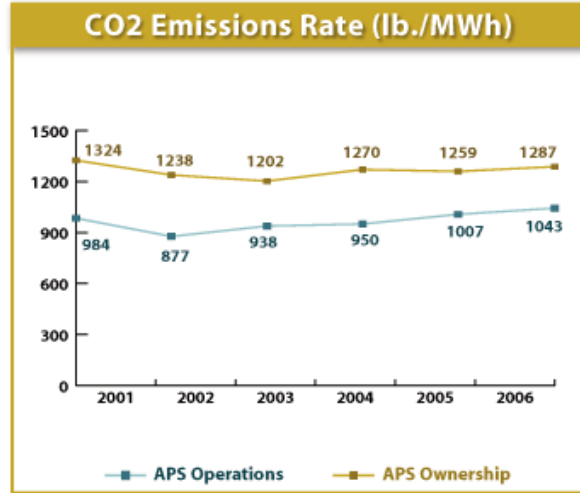
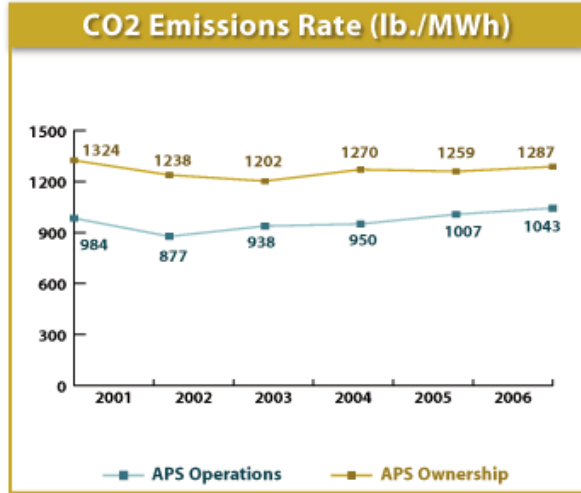
APS voluntarily reports GHG emissions and GHG reduction results to the U.S. Department of Energy (DOE) through its 1605(b) voluntary GHG reporting program. APS also provides an annual report to the EPA (starting in 2005) regarding results in SF<sub>6</sub> emission reduction through the EPA Utility SF<sub>6</sub> Partnership program.

### **Air Emissions**

Our company maintains air emissions per megawatt-hour at or below industry averages. This is achieved through the use of nuclear power in the generation mix, emissions control technology, improved power plant efficiency and a more-diverse fuel mix which includes nuclear, gas/oil, coal and renewables. In addition, we have an aggressive demand-side management program that works to improve energy efficiency and reduce per capita demand.

**Pollutant Emissions from the APS Generation System**

The air emission charts below show our air emissions of primary pollutants from power plant generation over the last five years.



Additional emission charts for: Carbon Monoxide, Lead, Mercury, Particulates, and Volatile Organic Compounds (VOCs) can be viewed in the Air Emissions section of our online report.

APS plants comply with existing Clean Air Act (CAA) regulations. However, as we plan for the future, we recognize the need to significantly reduce emissions over the next several years to comply with new, proposed, and expected laws and regulations.

Sulfur and nitrogen oxides (SO<sub>2</sub> and NO<sub>x</sub>), particulate matter (PM) and mercury (Hg) are by-products of fossil fuel combustion at power plants. The CAA requires the Environmental Protection Agency (EPA) and the Arizona Department of Environmental Quality (ADEQ) to set emission limits for these pollutants to protect public health and the environment. These limits are imposed through regulations and incorporated in the plants' operating permits. The expectation is that by meeting these permit limits, the emissions will not impact the environment or public health negatively. These limits, however, are based upon what is currently known, and as the state of the science on these pollutants improves, the regulatory agencies revise the emission limits. Thus, since the inception of the CAA in 1970, EPA and ADEQ have periodically set new, more stringent emission limits for operating sources. The regulators setting these limits anticipate that industry will respond by installing state-of-the-art pollution control technology as the standard method to minimize pollutant emissions into the environment.

#### ***Voluntary Emission Controls at Four Corners and Cholla Coal-fired Plants***

In the late 1990s, APS initiated a dialog with four environmental-interest groups that are involved in environmental issues in the West (Environmental Defense, the Grand Canyon Trust, Western Resource Advocates, and the New Mexico Citizens for Clean Air and Water – hereafter referred to as the “Environmental Groups”).

The goal of this dialog was to discuss the complexities of environmental laws confronting the electric utility industry and explore common ground for navigating that complexity without the historic confrontation that exists between industry and the Environmental Groups.

The dialogue centered on the issue of visibility in the Western United States. The Clean Air Act designates 156 large national parks and wilderness areas as “Class I areas” and provides for protecting visibility in those areas. EPA's visibility regulations require specific emissions limitations on sources causing, or contributing to, visibility impairment in Class I areas. Those rules focus primarily on SO<sub>2</sub> emissions, and to a lesser extent on NO<sub>x</sub> and particulate matter (PM) emissions, from large stationary sources such as coal-fired power plants. All three of the APS-owned coal-fired power plants are located on the Colorado Plateau, which contains numerous Class I areas.

The dialogue resulted in APS proposing a plan to voluntarily reduce pollutant emissions (especially SO<sub>2</sub>) from its coal-fired plants in a cost-effective manner that would allow APS to meet or exceed the future emissions limits and programs proposed by EPA and ADEQ. This initial plan was then jointly presented to the Navajo EPA, the U.S. EPA and the ADEQ.

#### ***Four Corners Power Plant***

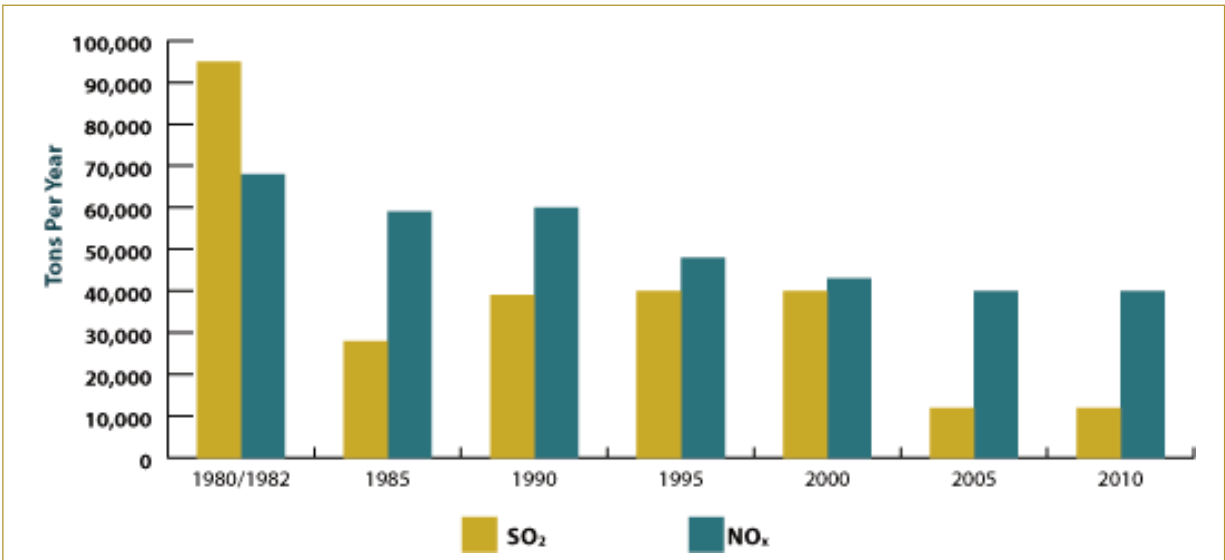
In 2003, APS, the Environmental Groups, Navajo EPA, U.S. EPA and the National Park Service agreed on a proposal to reduce SO<sub>2</sub> emissions at the Four Corners plant utilizing an 18-month-long test program. The test program involved certain phased operational changes and scrubber chemical process changes to increase the SO<sub>2</sub> control level from 72 percent to 85 percent, without triggering operational problems or incurring significant new capital expenditures. APS initiated the test program in early 2004.

The test program was completed during summer 2005. APS prepared a report concluding that the plant not only was able to meet the goal set in the proposal, but it also improved SO<sub>2</sub> controls to the 88 percent level. At that elevated control level, the plant was able to cut its annual SO<sub>2</sub> emissions by more than 55 percent, compared to the pre-test level.

The figure below shows historic and projected future Four Corners emissions, and illustrates a dramatic drop in SO<sub>2</sub> in 2005 from the test program. APS is working with the EPA, NEPA, the NPS and the Environmental Groups to incorporate the higher SO<sub>2</sub> control level as an enforceable emission limit for the plant. In September 2006, the EPA proposed a Federal Implementation Plan that would incorporate the 88 percent SO<sub>2</sub> controls as an enforceable emissions limit for the plant.

The dialog with the Environmental Groups also dealt with NO<sub>x</sub> emissions. As a result of those discussions, an independent consultant was retained to assess the potential for reducing the plant's NO<sub>x</sub> emissions using combustion modifications. The consultant's report concluded that there was little room for improving combustion controls at the three smaller units, although further detailed evaluations were needed to assess potential combustion controls for the two larger units. APS is studying such control options and other post-combustion control options.

## Results of APS Emission Reduction Program



**Four Corners Total Plant Emissions of SO<sub>2</sub> and NO<sub>x</sub>**

### **Cholla Power Plant**

The APS dialog with the Environmental Groups also resulted in an agreement in 2005 to implement several pollution control enhancements at the Cholla plant. The ADEQ and the EPA also were involved in the year-long discussions on selecting the pollution control upgrades and setting the schedule for implementation. Following this activity, APS filed and received a Title V Operating Permit renewal from ADEQ for the Cholla plant, which includes the following pollution control projects:

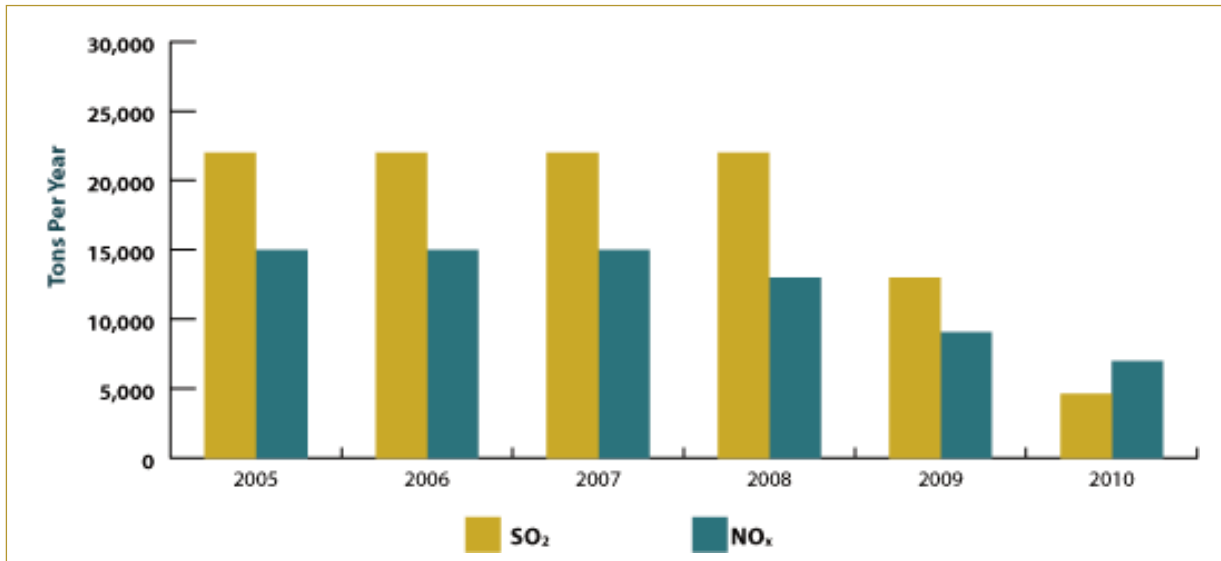
- Install new fabric filter bag-houses, low-NO<sub>x</sub> burners (LNBs), carbon monoxide (CO) continuous emissions monitoring system (CEMS), and upgrade SO<sub>2</sub> scrubber on Unit 1 from 80% to 90% sulfur removal efficiency by 2007.
- Install new LNBs and CO CEMS on Unit 2 by 2008.
- Replace existing hot-side electrostatic precipitators (ESPs) with a new fabric-filter bag-house, install new LNBs, CO CEMS, and a new 95% SO<sub>2</sub> controls on Unit 3 by 2009.
- Upgrade existing SO<sub>2</sub> controls to 92.5 percent, install new LNBs and CO CEMS; replace existing hot-side ESPs with a new fabric-filter bag-house on Unit 4 by 2008.

APS designed the new Cholla pollution control equipment to be flexible enough to meet stringent new rules for 90 percent removal of mercury from flue gas as proposed by ADEQ. APS will also evaluate the need for a new fabric-filter bag-house on Unit 2 by 2010 to meet the proposed mercury removal standards. The total costs for these new pollution control projects are estimated to be about \$393 million.

The control levels and the associated schedule were developed to ensure continued operational viability with a secure coal supply, minimize costs and allow equipment to be installed during scheduled outages.

This collaborative approach for voluntarily achieving more emission reductions sooner – and at lower costs – assures Cholla's economic viability and benefit APS shareholders, customers, regulators, the Environmental Groups, and most importantly, the environment.

## Results of APS Emission Reduction Program



**Cholla Total Plant Emissions of SO<sub>2</sub> and NO<sub>x</sub>**

### **Emissions technology mix**

APS has a total of about 1,100 MW of generation capacity (all coal) which is scrubbed with Venturi scrubbers, flooded disc scrubbers or absorbers. APS has about 1,500 MW of generation capacity with SCR (all natural gas). APS has another 1,300 MW of generation capacity with low NOx burners.

### **Travel Reduction Program**

Employee Travel Reduction is an important part of our EHS programs, particularly in the Phoenix area – a U.S. Environmental Protection Agency (EPA) non-attainment area for particulate matter and eight-hour ozone standard. We encourage employee travel reduction activity and offer subsidies to further persuade our employees to use alternative means of transportation. Our subsidies cover a portion of the costs for vanpooling, bus fares and carpool parking. We accommodate compressed work weeks, telecommuting and videoconferencing. We also offer assistance to employees in finding carpool partners, and in setting up carpools. The Travel Reduction Program also has a reward program for employees participating in travel reduction on High Pollution Advisory days.

APS maintains a fleet of 167 vans that operate daily for employees commuting between Palo Verde Nuclear Generating Station (PVNGS) and the Phoenix area. APS began operating this program in 1994 and almost 62 percent of the permanent APS employees at PVNGS participate. This program has significantly contributed to the site achieving a single occupant vehicle (SOV) rate well below the 60-percent target. The fleet approaches five million commuting miles annually. The commuting miles eliminated with this outstanding program is more than 32.7 million annually, resulting in a pollution savings of approximately 442 tons each year.

Travel reduction incentives for employees include:

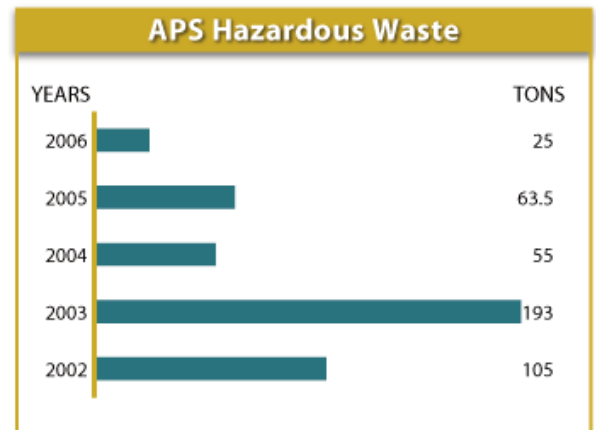
- \$25 monthly subsidy toward vanpool expense for employees who commute in any local Valley Metro vans. The employee monthly costs are payroll deducted
- A 50 percent subsidy of the monthly accrued fares up to \$20 to employees who commute by bus
- Employees carpooling do not pay the monthly \$46 for parking at company headquarters
- Employees carpooling with three or more people do not pay the cost of parking and are given a reserved parking space in the parking garage at headquarters

## Wastes

### Hazardous Wastes

We have had hazardous waste minimization programs in place for a number of years, which has resulted in significant reductions in the amount of hazardous wastes generated at APS facilities.

All our facilities are now normally classified as Small Quantity Generators (SQG) or Conditionally Exempt Small Quantity Generators (CESQG) of hazardous waste, and in 2006 none of our facilities were classified as Large Quantity Generators of Hazardous Waste. In 2006, APS has continued to show good results in hazardous waste reductions, as shown in the chart below. The primary difference between the 2005 and 2006 numbers was that PVNGS had a large episodic generation of mixed wastes (including lead) in 2005.



Waste from Non-Hazardous Wastes (sent to land fill)				
Waste Stream	2003 Volume Generated (tons)	2004 Volume Generated (tons)	2005 Volume Generated (tons)	2006 Volume Generated (tons)
Solid	23,061	14,885	4,862	4,497
Other Electricity Manufacturing Waste	137,341	47,547	25,471	25,471

### Non-hazardous Wastes

Our facilities employ a wide variety of pollution-prevention activities based on the facilities individual and diverse needs. The Deer Valley Service Center is charged with managing the waste and recycling for our service centers. Through a centralized facility, we are able to implement a variety of reuse and recycling activities.

APS is a member of the EPA's WasteWise Partnership and Coal Combustion Products Partnership (C2P2). WasteWise is a voluntary EPA program through which organizations work to minimize solid waste. C2P2 is a cooperative effort between the EPA and the Utility Solid Waste Activity Group (USWAG) to help promote the beneficial use of coal combustion products and the environmental benefits that can result.

### Used Nuclear Materials

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.

The Palo Verde Nuclear Generating Station and other nuclear power plants produce two forms of radioactive waste: high-level waste and low-level waste. High-level waste consists primarily of spent nuclear fuel. This spent fuel is highly radioactive for many years, but can be safely stored in spent fuel storage pools or specially designed and licensed spent fuel storage casks.

We have existing spent fuel storage pools at Palo Verde and have constructed and are using a facility for on-site dry cask storage of spent fuel while we are awaiting the completion of the Nuclear Waste Storage facility at Yucca Mountain in Nevada. With the existing storage pools and the addition of the on-site dry cask storage facility, we believe spent fuel storage methods will be available for use by Palo Verde on-site to allow continued safe operation through the term of the operating license for each of Palo Verde's three units. On average, Palo Verde replaces 200 fuel assemblies annually.

APS Recycled/Reused Materials (2006)	
Material	Tons
Paper/Cardboard	407
Scrap Metals	7,346
Used Oil	1,584
Wood	351
Coal Combustion Products	991,599
Street Lights	27
Electronic Component	70
Miscellaneous	76

Some low-level waste has been stored on-site in a low-level waste facility; however APS is currently shipping low-level waste to off-site disposal facilities which are permitted to accept these types of wastes. Examples of low-level waste include used protective clothing, resins and filters.

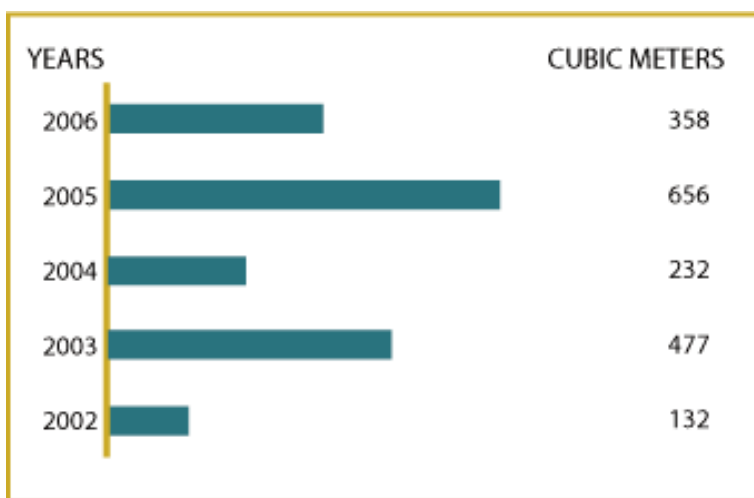
### New Protective Clothing at PVNGS

Palo Verde employees who work in radiological controlled areas of the plant now are using environmentally friendly protective clothing (PC) that will eliminate on- and off-site management of plant laundry.

The new protective clothing, which is sold under the trade name OREX, is designed to be worn once and discarded rather than laundered again and again like standard protective clothing. Terry Gober, section leader, RP Contamination Control, said eliminating offsite laundering means less radioactive material is transported on public highways and there is no need to conduct radiation surveys on the PCs when they come back from laundering. Repairing torn PCs also no longer is required.

According to the product's developer, Eastern Technologies Inc., the clothing's lightweight fabric is made from a substance that can be broken down — with the help of microorganisms — into mostly carbon dioxide and water. The water is then passed through resin beds, making the disposal process less expensive.

### PVNGS Low-Level Solid Radioactive Wastes



Further information on spent nuclear fuel and low-level wastes can be found in the PNW annual report.

### Vendor Audits

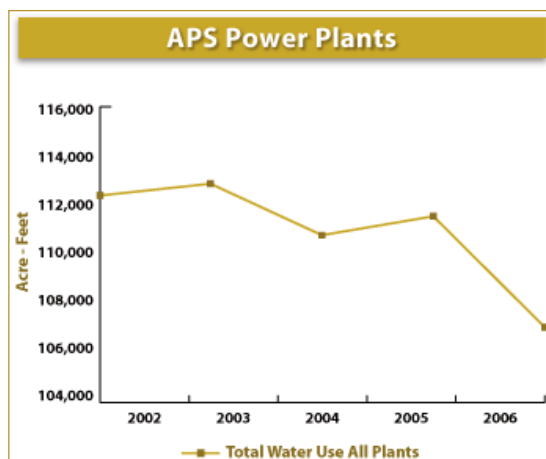
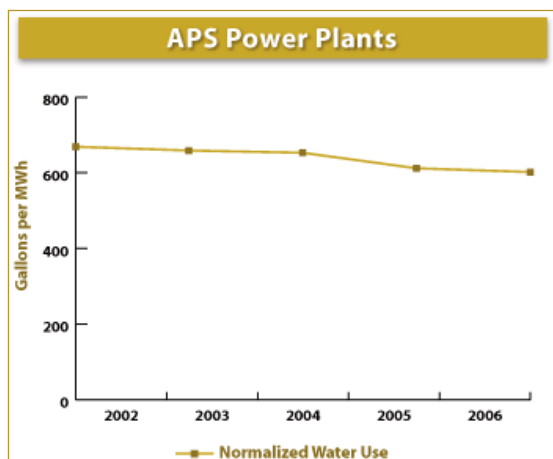
Pinnacle West and APS perform audits of all vendors that provide waste disposal or recycling activities and services to company facilities. This program evaluates our vendor's facility operations, environmental management systems and financial strength in order to minimize short- and long-term liability caused by vendor actions or omissions. The audits also ensure that our waste materials are being properly managed once they leave our facilities. Twenty-three vendor audits were completed in 2006, including 18 audits of waste treatment, storage and disposal facilities, and five audits of recycling firms.

Pinnacle West belongs to the Joint Utility Vendor Audit Consortium (JUVAC), CHWMEG Consortium and the Desert Utility

Vendor Audit Team (DUVAT). The consortiums are made up of various organizations or partnerships that conduct vendor audits and make them available to their members. Participation in these consortiums helps to leverage auditing resources and performance.

### Water

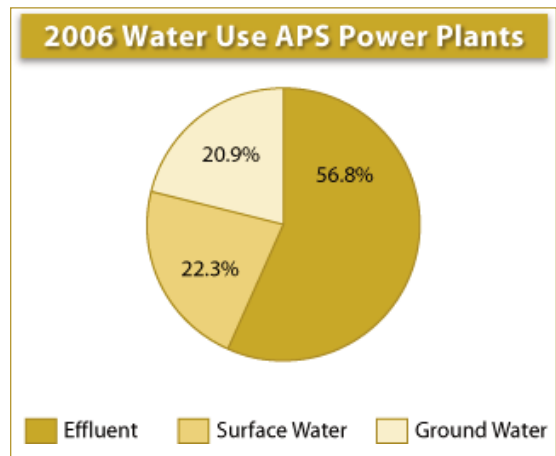
Water is a precious resource in the Southwest, and APS' facilities strive to minimize water usage through a variety of water-conservation activities and through use of treated effluent as a water source. In fact, 56 percent of all water used by APS is treated effluent as discussed in the section below. APS' major use of water is in electricity generation.



### Use of Treated Effluent

APS is one of the largest users of treated effluent in the United States for use in power generation. This significantly reduces the amount of surface and groundwater required in our generation activities. As shown in the chart below, in 2006 over 56 percent of our total power plant water came from treated effluent. At the Palo Verde Nuclear Generating Station and our Redhawk natural gas-powered facility, we use treated effluent purchased from seven cities in the Phoenix metropolitan area for cooling. A 35-mile pipeline carries treated waste water from a City of Phoenix sewage treatment facility to Palo Verde, where we use an advanced waste-water treatment process capable of preparing 90 million gallons of water each day for use at both Palo Verde and Redhawk.

Each year, Palo Verde's water reclamation facility processes about 20 billion gallons of treated effluent for power plant use, preserving enough potable water for about 75,000 homes.



Another way in which APS conserves water is through careful water chemistry and treatment. This allows for a high level of water recycling in our electricity-generation process. We reuse our water supplies as much as possible to avoid wasting water; however, some water must be discharged (this is called "blowdown water") to control the salinity of the water used in the power plant processes.

Water use was also an important consideration in the design of our new power plants, and APS strived to incorporate water conservation measures in these new plants, resulting in power plants that utilize less water per MWh generated.

APS has also been able to reduce water use in power plant generation over the past two years as a result of higher capacity factors (leading to better resource efficiency) at our coal plants, and the addition of several new, more efficient natural-gas generation units.

### Other Water Conservation Efforts

APS also incorporates water conservation and use ideas into facility building and maintenance as part of our participation in the LEED program.

### Material & Chemical Management

At Pinnacle West we realize the importance of properly managing the materials and chemicals used in our daily operations, and we take steps to ensure all materials are tracked, properly disposed of and used in accordance with regulations. Effective procurement management can result in environmental benefits, such as reduced wastes and toxicity, as well as financial benefits. We strive to develop and implement procurement procedures that help maximize these benefits. In addition, we have programs in place that allow us to reuse materials within the company.

We adhere to a specific and focused vision for recycling, resource reduction and conservation of natural resources, including:

- Reduced consumption of virgin materials through product or process redesign
- Water conservation
- Energy conservation
- Habitat conservation
- Risk reduction
- Procurement of goods with recycled content
- Recycling solid waste
- Recycling hazardous waste and toxic materials



Our employees strive to incorporate this thinking into every aspect of our operations; from making environmentally sensitive purchasing decisions to promoting reuse and recycling efforts. Our systems are being integrated to help manage purchasing, chemical use and reuse of company equipment. Our in-house chemical review team is responsible for examining and approving chemical purchases.

Our purchasing and inventory system, called Materials Logistics Information System (MLIS), allows us to better manage purchasing and inventory activities and increase employee awareness of purchasing practices. We also use our electronic Material Safety Data Sheet (MSDS) system in conjunction with the MLIS program to facilitate tracking and reporting the types and quantities of chemicals purchased and stored. These two systems allow us to create baselines to more effectively plan and set goals.

### ***Environmentally Preferred Procurement***

Our EHS policy confirms our corporate support for green procurement, including sections on use of safe products and services, sustainable use of natural resources, stewardship of natural resources and pollution prevention. Our internal corporate procurement procedures further defines this policy: The purchase of all products, including chemicals and hazardous materials, will only be made after consideration of the products' total life cycle. Prior to procurement, materials must be evaluated for environmental attributes such as recycled content, toxicity and disposal options. Employees making procurement decisions must share in this responsibility in order to minimize adverse environmental impacts and future liability.

APS has committed to the LEED principles in construction of new facilities, and has developed a LEED policy that incorporates LEED green procurement parameters for use by our facility services departments.

### ***Investment Recovery***

APS also has a very successful Investment Recovery department that manages surplus materials. The first objective is to re-deploy useful material within the company. For materials that can not be re-deployed, Investment Recovery may sell, recycle or donate materials. Disposal is the last option. In 2006, Investment Recovery recorded \$4,400,006 of total recovered dollars (up from \$2.5 million in 2005), and an additional \$361,368 of avoided costs (e.g. avoided landfill costs on recycled materials), up from \$200,000 in 2005.

In 2006, more than 11.4 million pounds of materials were recycled through Investment Recovery's programs, up from 6.4 million pounds recycled in 2005.

### ***Chemical Management***

All hazardous materials that are used by the company are required to be reviewed by a Chemical Review Team prior to purchase in order to help insure the use of materials with lower environmental and safety impacts. The teams review new products and compares them to existing products to see which provides the greatest overall benefit to the company. These teams also provide on-going reviews of current products to evaluate for "greener" alternatives.

All chemical products are assigned a "EHS Rating" based on the Chemical Abstract Numbers (CAS) of the ingredients in the product and the products National Fire Protection Association (NFPA) rating. This allows us to quickly evaluate and compare the potential risks and hazards of the products we use, and to make better informed decisions regarding the approval of new products.

Through this process, APS has been able to reduce the number of chemical products across our system by about 50 percent over the past 10 years, and to also reduce the potential risk of the chemical products we use by substituting products with a lower potential for health or environmental impacts.

### ***MSDS***

All chemical products used at APS are included in an electronic Material Safety Data Sheet (MSDS) system which is available to any employee across the company. APS facilities may use only those products approved for use and which are coded on this system. The electronic MSDS system provides other benefits to our EHS efforts since it allows us to quickly identify the specific chemical ingredients contained in the products at our facilities, while highlighting the risk profile of specific products. The MSDS system also allows users to print labels for secondary containers, and improves our ability to identify hazardous materials, in order to ensure such materials are properly stored and handled.

### ***PCB Management***

Over the past seven years, APS has been successful in reducing the use of PCBs in electrical equipment by targeting suspected equipment based on manufacturer name and serial numbers. From 2000 through 2004, APS removed 3,212 pieces of PCBs (> 500 ppm) or PCB-contaminated (> 50 to 499 ppm) equipment from service, resulting in the disposal of 425,336 kilograms (kg) of PCB material. During 2005 and 2006 APS has removed an additional 6,615 pieces of PCB-containing equipment from our transmission and distribution system representing 583,484 kilograms of disposed material, including the following: 5,983 large PCB capacitors (317,458 kg), 287 PCB-contaminated and PCB bushings (29,965 kg), and 345 PCB-contaminated and PCB transformers (236,061 kg).

### Facility Energy Management

Our company has long been a leader in energy efficiency and energy conservation, and many of our facility energy management efforts have been described in our past EHS Annual Reports. We continued our efforts with positive results in 2006.

Our facilities implement a variety of energy-efficiency measures including:

- Operating air conditioning systems with energy-efficiency software that manages duty-cycling and set-backs
- Replacing out-dated air conditioning with high-efficiency equipment
- Writing all new construction specifications with energy efficiency in mind
- Requiring energy-efficient Energy Star computers whenever new computer equipment is needed

More than 97 percent of our facility space is equipped with energy-efficient fixtures. We estimate energy savings of more than 13 million kilowatt-hours (kWh) per year from the use of energy-efficient products.

In 2003, our corporate headquarters in downtown Phoenix was converted to the Northwind Cooling system which uses an industrial grade, ice-based chiller that manufactures three million pounds of ice each night when utility loads and rates are lowest. The conversion to Northwind eliminated the on-site requirement need for cooling towers and their associated air-conditioning chillers, resulting in a significant reduction in water consumption in the cooling towers, and the elimination of CFC refrigerant R-11 from the chillers.

### APS LEEDs By Example

APS is a registered member of the U.S. Green Building Council and has committed to a goal of incorporating Leadership in Energy and Environmental Design (LEED) principles in our building design and maintenance. LEED principles encourage "design and construction practices that significantly reduce or eliminate the negative impact of buildings on the environment and occupants in five broad areas: sustainable site planning, safeguarding water and water efficiency, energy efficiency and renewable energy, conservation of materials and resources, and indoor environmental quality."

The LEED rating system ensures buildings meet a minimum set of criteria in each of five categories, contributing to a sustainable environment, ensuring a healthy and safe workplace and reducing operational costs.

APS is taking an active role in LEED in order to ensure the sustainability of our own facilities, and to allow us to generate interest for the program as well as educate our customers who may be interested in participating in the LEED program.

In 2006, APS had three registered LEED projects: the Wickenburg and Flagstaff Service Centers and the new Ocotillo Service Center.

### Mobile Fleet

APS has 2,209 company-owned vehicles, which are managed by the APS Transportation Services department. These vehicles are used to operate and maintain our electric generation, transmission and distribution facilities, business offices and other operations which are located through-out the state of Arizona.

Fleet Fuel Consumption					
Vehicle Fuel (gallons)	2002	2003	2004	2005	2006
Gasoline	1,738,575	1,742,686	1,565,433	1,513,811	1,586,446
Diesel	1,311,557	1,338,797	1,141,865	1,193,090	1,75,304
Biodiesel	53,718	62,209	55,402	60,244	67,568
<b>Total</b>	<b>3,103,850</b>	<b>3,143,692</b>	<b>2,521,725</b>	<b>2,526,170</b>	<b>2,729,318</b>

We have been able to significantly increase our fleet fuel efficiency over the past several years, as shown in the chart below, primarily by accelerating our purchases of new vehicles with improved mileage.

Fleet Statistics						
	2001	2002	2003	2004	2005	2006
<b>Avg miles per gallon for gas/dieseel fleet</b>	<b>4.900</b>	<b>5.110</b>	<b>7.500</b>	<b>9.237</b>	<b>9.798</b>	<b>9.326</b>

## Land Use & Biodiversity

APS operates a large number of facilities located throughout Arizona and in the Farmington, New Mexico area that generate, transmit and distribute electricity to our customers. One of our highest priorities is to construct and operate these facilities in a safe, sustainable and environmentally conscious manner, protecting our land and our wildlife.

### APS' infrastructure "Footprint"

#### Transmission and Distribution

Transmission lines are the power lines that bring electricity from power plants to substations in customer areas, where the voltage is lowered. Distribution lines carry electricity at lower voltages and go from substations to transformers near homes and businesses. The transformers, often located on power poles, decrease the voltage lower still so it can be used by appliances in homes or businesses.

#### Power Plants

Facility	Acres
Cholla	7,624 owned, 9,052 leased
Palo Verde	4,287 owned
4-Corners	3,486 owned
Redhawk	1,874 owned
Saguaro	974 owned
Sundance	310 owned
West Phoenix	141 owned
Ocotillo	126 owned
Yucca	38 owned
Douglas	6 owned
<b>Total Acres</b>	<b>27,917</b>

transformers, often located on power poles, decrease the voltage lower still so it can be used by appliances in homes or businesses.

**Distribution Lines:** The company owns and operates a total of 26,196 miles of distribution lines

Overhead : 12,323 miles  
Underground: 14,873 miles  
Number of Distribution Substations: 34

**Transmission Lines:** The company owns and operates a total of 5,121 miles of transmission lines

69kV: Overhead: 2,416 miles, Underground: 25 miles  
115kV and larger: Overhead: 2,663, Underground: 18  
Number of Transmission Substations: 5

While the majority of APS' customers reside in the metropolitan Phoenix area, we serve a large portion of the rest of Arizona, which is largely rural. APS averages 23 customers per square mile of service territory.

#### Office and Support Facilities

At the end of 2005, PNW owned or leased 106 facilities to support our operations, with a total of 1,558,073 square feet of building space. This included 18 APS Service Centers and 32 APS Customer Service Business Offices located across Arizona.

### **Transmission and Distribution Line Siting**

APS conducts extensive environmental reviews for siting new transmission and distribution systems. For new power lines rated at greater than 115 kilovolts (kV), the Arizona Corporation Commission requires a Certificate of Environmental Compatibility (CEC) to be issued prior to construction. APS conducts a thorough siting process covering a broad range of environmental issues and factors including, land use, cultural resources, biological resources and habitat studies for rare and endangered species.

APS also conducts a multi-faceted public process which consists of direct mailings, open houses, newspaper advertising and multiple jurisdictional, governmental and public meetings. APS also maintains a Transmission and Facility Siting website that providing on-going information about siting projects to the public.

Beyond the regulatory programs, APS has a voluntary siting process for new transmission lines that are less than 115kV and are not required to follow the state process. This voluntary process is much like the CEC process where numerous environmental factors are evaluated and the public participation process seeks to communicate transmission line siting information to local citizenry to obtain their input. This allows APS to site transmission lines in the most sustainable manner that meets project requirements.

### **Wildlife Protection Programs**

The APS Forestry and Special Programs Department (APS F&SP) is responsible for administering a variety of operations-related environmental programs associated with vegetation management, wildlife protection, landscaping, wood preservation and electrical hardware inspection. To meet the compliance requirements of the National Environmental Policy Act (NEPA) and other pertinent regulations, the department has evolved to include a dedicated staff of degreed natural resource professionals including foresters, arborists, wildlife specialists, biologists, an environmental resources specialist, a herpetologist, and an archaeologist.

Arizona's environment provides ideal habitats for a variety of birds of prey, or raptors. Raptors are naturally drawn to power poles because they offer a high place to perch, roost, nest and hunt. The large wing spans of raptors, however, make them vulnerable to harm by the electricity being carried on the power lines. The most common raptors affected in the APS territory include Harris hawks, red-tailed hawks and great horned owls.

APS F&SP, in partnership with the U.S. Fish and Wildlife Service (USFWS), has developed a comprehensive Avian Protection Plan. Also, the company has implemented new construction design standards that require the installation of raptor protection devices and coverings to shield electrical components. In 2006, all new construction was installed in accordance with these raptor safe standards and hardware on over 700 existing poles was modified with protection coverings. Likewise, on all new substation installations, wildlife protective coverings are installed. In addition, 90 substations were retrofitted with wildlife protection devices in 2006.

Protecting birds from electrical contact also increases safety for members of the cat family, raccoons, squirrels and other wildlife whose curiosity and foraging habits draw them to climb power

poles and other electrical facilities. APS is a member of the Avian Power Line Interaction Committee and has worked closely with this group to revise the industry's "Suggested Practices for Raptor Protection on Power Lines" manual.

In 2005, APS partnered with the USFWS on the agency's California Condor Restoration Project by installing a series of poles and mildly-electrified overhead wires at the project area located at the upper end of the Grand Canyon. Because power poles and lines pose a significant hazard to condors with their nine-foot wingspan, these artificial power lines are used to train young condors to avoid electric lines before they are released.

As a continuation of the Condor Project, in 2006 APS donated and installed a 1.5-ton array of nine solar panels – enough to supply 30 amps of power to the holding pen and to a field lab on top of the cliffs. This will keep the water supply thawed through the winter, make it possible for the staff to utilize video cameras for remote observation and supply electricity directly to the field lab. [Click here to learn more about the this program.](#)

APS has completed habitat enhancement projects in partnership with the National Wild Turkey Federation and has developed right-of-way corridor vegetation management plans that will improve habitat for wild turkeys and other wildlife. APS is currently collaborating with the Federation, the Forest Service, and the Arizona Game and Fish Department on a wild turkey habitat restoration project on Mingus Mountain in central Arizona.

The company also conducts a comprehensive nest-management program. When birds build their nests on electrical equipment it becomes necessary to take action. If the nest is occupied, permits must be obtained from the USFWS permitting office. APS has developed a nest platform that is installed on the pole in a safe place, the nest is relocated to this platform, and the chicks are placed back in the nest. The adults return soon after to care for their young. In most cases birds return year after year to these same nests. A specification for this work was developed in 2006.

APS is involved in many other environmental and wildlife protection efforts:

- Wildlife specialists work closely with wildlife rehabilitation organizations to construct artificial homes for burrowing owls displaced as a result of development. APS provides the equipment and people necessary to construct underground burrows that serve to hold an entire colony of burrowing owls
- The department is currently involved in a biological-assessment project in conjunction with the USFWS. More than 1,000 miles of the company's right-of-way corridors are being evaluated to determine their value to wildlife habitat and to identify areas of concern as they relate to the company's field operations. This multi-year project began in 2006. The company has dedicated two degreed biologists to this project on a full-time basis
- PS collaborates on projects and partnerships with other agencies and non-profit groups for public awareness and education. In 2006 APS partnered with Liberty Wildlife at several birding events

including the Tres Rios Nature and Earth Festival, ASU Earth Day, and National Public Lands Day

•he company works closely with the Southwest Bald Eagle Association. Each year the company donates approximately 20 hours of helicopter flight time to transport Arizona Game and Fish personnel on their annual Bald Eagle Nest inspections. Highlights of the 2006 patrol include finding a new active nest, four baby Eaglets that had fallen out of their nest were rescued, ten nest sites were inspected and 8 new fledglings were tagged and registered

### **Cultural Resource Program**

Arizona's landscape has experienced a significant amount of history spanning from the wild-west era to pre-historic civilizations. To reduce the possibility of damaging national historical treasures and to ensure the company is in compliance with current regulations, APS added a professional archaeologist to its staff. In addition to coordinating the cultural resource compliance component of new construction projects, efforts are underway to survey the majority of the company's existing transmission system.

### **Forestry Program**

The Forestry Program includes the maintenance and control of trees, shrubs and brush growing around APS facilities and equipment – including overhead power lines, poles, guys and underground electrical equipment. Our Vegetation Management program follows professional industry tree-trimming standards to limit damage and improve overall tree health. We follow the Edison Electric Institute's (EEI) strategy on minimizing pesticide use.

Staff arboricultural professionals including both degreed Foresters and Arborists direct these programs. All operations are performed in accordance to ANSI A-300 Standards for Tree Care. All supervisors and crew leaders are required to earn and maintain professional certification as International Society of Arboriculture (ISA) Certified Arborists. Crew members are required to earn and maintain certification as ISA Tree Workers. APS provides an extensive amount of ongoing arboricultural training.

The high-quality standards of the Forestry and Special Programs' vegetation management efforts have been recognized for the tenth consecutive year with the National Arbor Day Foundation's "Tree Line USA Utility" distinction. The department was lauded for administering a superior program of professional tree care, providing annual worker training, as well as implementing tree planting and public education programs related to proper tree care.

It is often necessary to remove established tall-growing species of trees that are growing near power lines. In many circumstances the company provides the customer with low-growing replacement trees. The department has launched a massive tree replacement project in the Phoenix metropolitan area. Thousands of existing street trees which normally require routine trimming in order to provide safe clearances from overhead wires are being removed and replaced with appropriate low-water use trees that do not grow tall enough to affect power lines. This is truly a win-win project.

Every year, APS F&SP visits at least ten local elementary schools to host Arbor Day celebrations. These events involve an educational component involving the importance of trees in the environment. This is followed by a tree-planting ceremony on the school's grounds.

APS F&SP has developed a Web site to educate and inform customers about the department's various programs, and to address questions and concerns.

### **Decommissioning of the Childs-Irving Hydroelectric Power Plants**

In 2006, APS continued its efforts to decommission APS' Childs and Irving hydroelectric power plants and restore Fossil Creek to its original flow. So far, the crews at the Childs-Irving Power Plant decommission site have successfully removed more than 8,700 feet of steel flume on wood trestle, more than 5,400 feet of concrete and steel flume below the Irving Power Plant site, and the majority of facilities at the Childs Power Plant site. Recently the crews combined to complete one of the largest construction projects to date, removal of Bridge 10, also known as the Big Red Pipe.

In 2007, crews will continue to remove wood, steel and concrete flume and the Fossil Springs Dam.

The entire project removal is expected to be completed in June 2010.

Recently, this effort was the subject of a documentary film narrated by actor Ted Danson and produced by five-time Emmy award-winning producer, Paul Bockhorst.

In explaining the decision to support decommissioning of these facilities, Bill Post, Pinnacle West CEO and Chairman of the Board, told producers: "As we looked at the opportunity to give the residents of the state of Arizona a perennial stream in the desert...there is no option to that. We can find other ways to generate electricity. We cannot find other perennial streams in the desert."

## **Spills & Remediation Programs**

### **Potentially Responsible Party (PRP) Issues**

APS was named in 2003 as a Potential Responsible Party in the Motorola 52nd Street Operable Unit 3 Superfund Site located in Phoenix, Arizona. In July 2004, APS completed negotiations with the EPA and signed a formal agreement, an Administrative Order of Consent. The agreement obligates APS to determine the extent, if any, of its contribution to the regional groundwater impacts, and if so, to identify options for addressing the company's contribution to those impacts under the EPA's oversight and guidelines.

APS is currently implementing the scope of work specified in the Administrative Order on Consent to evaluate potential groundwater impacts at our facility. The results of the groundwater investigation to date, indicate that volatile organic compounds have been detected in both the up and down gradient monitor wells at the APS facility at concentrations below the EPA's Maximum Contaminant Level for drinking water. Additional characterization of the soil and groundwater are scheduled for 2007 to 2008.

APS continues to provide funding for the clean-up of the EPA CERCLA Hassayampa Landfill superfund site. APS sent industrial solid waste to this municipal landfill until it closed in the late 1970s. The facility was later designated as a Federal superfund site and APS named as one of a number of PRPs. APS' contribution to this clean-up effort is small, representing approximately 1.5 percent of the total annual assessment.

### MGP Voluntary Remediation Program Status

Manufactured Gas Plants (MGPs) operated from the late 1800s to about 1950, making synthetic gas for domestic heating and lighting purposes. Several predecessors of APS operated plants in Arizona communities including Phoenix, Globe, Miami, Prescott, Douglas and Yuma. The manufactured gas process created by-products including lampblack, tar and oils, some of which remained at the sites after operations ceased.

APS has voluntarily investigated and characterized our historical MGP sites. We have entered the MPG sites into the Arizona Department of Environmental Quality Voluntary Remediation Program, which is a program specifically addressing the voluntary investigation and remediation of environmentally impacted sites in Arizona. The company began evaluating each site in 1993 to address any remaining material that may have been generated by MGP activities. We began remediating the sites in 1996. Below is the current status of our MGP remediation sites:

MGP Remediation Program Status			
Site Location/ Name	Media Impacted	Remedial Option	Status
Prescott	Soils, Groundwater Surface Water	Excavation	Post Remediation Monitoring
Yuma	Soils, Groundwater	Excavation	Post Remediation Monitoring
Phoenix/ Washington St	Soils	Excavation	Remediation Complete
Phoenix/ Grant St	Soils	Interim-Courtyard Cap Final Excavation	Interim Remedy Completed 2003 Final Remedial Action Plan Scheduled 2013
Phoenix 505	Soils	Not Selected	Site Characterization Complete Remedial Action Plan Scheduled 2009-2010
Globe	Soils	Excavation	Site Characterization Completed Development Final Remediation Scheduled 2007-2008
Miami	Soils	Not Selected	Site Characterization Complete Remedial Action Plan Scheduled 2011
Douglas	Soils	Not Selected	Site Characterization Complete Remedial Action Plan Scheduled 2011

Other Remediation Projects			
Site Location/Name	Media Impacted	Remedial Option	Status
Buckeye Service Center - Fueling Island	Soil, Groundwater	Soil Vapor Extraction/Sparge, Wells/Barrier Wall	System Installed Remediation on-going
Cholla Power Plant - Fuel Oil Building	Groundwater	Assisted Monitored Natural Attenuation	On-going Monitoring
Cholla Power Plant - Diesel Fuel Pipeline Release	Soil	Not Required	Site Closure Anticipated 2007
West Phoenix Power Plant	Soils, Groundwater	Risk Assessments Bioventing	On-going monitoring Site evaluation 2007
Cholla Power Plant - DR2	Groundwater	Under Evaluation	Initial Characterization Scheduled 2007

### Other Remediation Projects

The following table describes the current status of APS' non-MGP remediation projects. Each of these sites is also anticipated to be completed under guidance of the Arizona Department of Environmental Quality (ADEQ) through the Voluntary Remediation Project.

### Spill Summary

We take many precautions to avoid spills. However, despite our efforts, on occasion an accidental spill occurs. In 2006, APS had the following releases. These releases do not include small releases of non-PCB mineral oil from electrical equipment, or releases of water.

(Note: releases to water are defined as materials that went into a Water of the USA, as defined in the federal regulations)

Oil Spills:

- Release of PCB oil from a Potential Transformer malfunction with the lid and bottom releasing approximately 3 gallons at our Four Corners Power Plant
- A Pothead was damaged and released between 600-1000 gallons of mineral oil inside a substation

Chemical Spills:

Approximately 150 gallons of 10 percent sodium hypochlorite (bleach) leaked from the Cholla Power Plant lake storage/transport system onto the surrounding concrete/asphalt. The spill was completely contained on plant site

<b>Spill History</b>						
	<b>Oil Spills</b>		<b>Chemical Spills</b>		<b>Other Releases (please specify)</b>	
	<b>Number</b>	<b>Gallons</b>	<b>Number</b>	<b>Gallons</b>	<b>Number</b>	<b>Gallons</b>
<b>2006</b>						
Release to land	2	1003	1	150	0	0
Release to water	0	0	0	0	0	0
Release to air	0	0	0	0	0	0
<b>2005</b>						
Release to land	6	184	3	305	1	1000
Release to water	0	0	0	0	1	1000
Release to air	0	0	0	0	0	0
<b>2004</b>						
Release to land	2	330	2	60	2(a)	5150
Release to water	2	68	2	2	1	20
Release to air	0	0	0	0	0	0
<b>2003</b>						
Release to land	6	144	1	1300(b)	2	50002
Release to water	0	0	2	63	2	129000
Release to air	0	0	0	0	0	0
<b>2002</b>						
Release to land	1	58	0	0	4	133500
Release to water	2	3	0	0	1	50
Release to air	0	0	0	0	0	0

(a) The vast majority of other releases are releases of cooling water. In 2004, 5,000 gallons of the 5,170 gallons reported were cooling water and the remainder was sewage. Cumulative between 2000 and 2004, 604,945 gallons of other releases were cooling water, 329,500 gallons were releases of ash sluice water, and 37,500 gallons were releases of treated effluent. The remainder includes 1,000 gallons of reverse osmosis blowdown water and 50 gallons of sewage.

(b) 1,300 gallons of sulfuric acid were released into the facilities drainage system at Saguaro Power Plant. The acid was contained by the facilities surface impoundment where it was neutralized.

### Toxic Release Inventory

Our company is required by the Environmental Protection Agency (EPA) to report applicable releases of chemicals listed by the EPA through its Toxic Release Inventory (TRI) program. Our reportable releases under the TRI program are primarily contained in our air emissions from power plant smokestacks, or are contained within coal ash. While the TRI quantities reported by our company are fairly large (as is the case with all utility companies), the majority of these releases are captured by pollution control equipment, or are contained with our waste coal ash (much of which is recycled for beneficial use). The below chart lists our 2005 TRI summary (2006 TRI report is due in July 2007 and was not available at the publication of this report)

<b>2005 TRI Release Estimate (APS Operations)</b>				
	<b>Released to Land</b>	<b>Released to water</b>	<b>Released to Air</b>	<b>Total Released</b>
<b>Barium</b>	<b>4,188,071</b>	<b>0</b>	<b>3,697</b>	<b>4,191,768</b>
<b>Benzo(g,h,l) perylene</b>	<b>0</b>	<b>0</b>	<b>0.34</b>	<b>0.34</b>
<b>Beryllium</b>	<b>28,009</b>	<b>0</b>	<b>32</b>	<b>28,041.00</b>
<b>Chromium</b>	<b>170,298</b>	<b>0</b>	<b>628</b>	<b>170,926</b>
<b>Cobalt</b>	<b>48,479</b>	<b>0</b>	<b>143</b>	<b>48,622</b>
<b>Dioxin</b>	<b>0</b>	<b>0</b>	<b>0.01</b>	<b>0.01</b>
<b>Copper</b>	<b>215,516</b>	<b>6</b>	<b>679</b>	<b>216,201</b>
<b>Hydrochloric Acid</b>	<b>0</b>	<b>0</b>	<b>219,110</b>	<b>219,110</b>
<b>Hydrofluoric Acid</b>	<b>0</b>	<b>0</b>	<b>506,834</b>	<b>506,834</b>
<b>Lead</b>	<b>179,276</b>	<b>4</b>	<b>684</b>	<b>179,964</b>
<b>Manganese</b>	<b>522,829</b>	<b>1,405</b>	<b>910</b>	<b>525,144</b>
<b>Mercury</b>	<b>568</b>	<b>0</b>	<b>903</b>	<b>1,471</b>
<b>PACS</b>	<b>0</b>	<b>0</b>	<b>8.53</b>	<b>8.53</b>
<b>Nickel</b>	<b>97,235</b>	<b>1</b>	<b>612</b>	<b>97,848</b>
<b>Selenium</b>	<b>21,569</b>	<b>0</b>	<b>744</b>	<b>22,313</b>
<b>Sulfuric Acid</b>	<b>0</b>	<b>0</b>	<b>120,688</b>	<b>120,688</b>
<b>Vanadium</b>	<b>407,344</b>	<b>730</b>	<b>319</b>	<b>408,393</b>
<b>Zinc</b>	<b>185,866</b>	<b>50</b>	<b>2,411</b>	<b>188,327</b>
<b>Total</b>	<b>6,065,060</b>	<b>2,196</b>	<b>858,403</b>	<b>6,925,659</b>
<b>2004 TOTAL</b>	<b>4,961,737</b>	<b>5,435</b>	<b>651,338</b>	<b>5,618,510</b>
<b>2003 TOTAL</b>	<b>4,741,688</b>	<b>3,690</b>	<b>591,209</b>	<b>5,336,586</b>
<b>2002 TOTAL</b>	<b>4,014,728</b>	<b>7,405</b>	<b>658,932</b>	<b>4,681,065</b>
<b>2001 TOTAL</b>	<b>4,194,285</b>	<b>8,698</b>	<b>805,123</b>	<b>5,008,106</b>

### **Palo Verde Tritium**

In February of 2006, Palo Verde personnel found tritium — a radioactive form of hydrogen — in shallow subsurface water around Unit 3. Although low levels of tritium were detected in water collected in shallow “potholes” excavated in the RCA yard, none has ever been detected in any wells or aquifers beneath the plant property or in offsite wells. The Arizona Department of Environmental Quality (ADEQ) and the Nuclear Regulatory Commission were notified in a “non-hazardous spill” report.

In response to the discovery, a team was formed to conduct exhaustive studies, establish the source of tritium and ultimately remediate the condition. The likely source was determined to be tritium from normal releases of plant gasses from which tritium was washed from the air by rain and from condensation from air ducts. Working closely with ADEQ, Palo Verde has enacted additional procedural controls and made physical changes, including drilling new monitoring wells, at the plant to enhance monitoring and minimize the potential for re-occurrence. During this same period, Palo Verde took an industry leadership role in defining proactive guidance on groundwater protection. Once approval is received from ADEQ, water trapped in the shallow sand lenses will soon be pumped out and eliminated.

### **EHS Compliance**

Compliance is our minimum standard of performance and we strive to perform beyond compliance in all areas of our business. All our managers and employees are required to uphold regulatory compliance as part of their daily activities and business planning. When non-compliance issues do arise, we take appropriate steps to address those issues and prevent them from happening again.

As an energy supplier and producer, we are subject to environmental, health and safety regulations on the federal, state, county and local levels. In addition, the Four Corners Power Plant located on the Navajo Nation near Farmington, New Mexico, works with the Navajo Nation Environmental Protection Agency to address certain environmental issues.

We maintain a goal of zero notices of violation (NOVs) resulting in fines or penalties. Success in meeting this target is reflected in individual employee performance evaluations and compensation.

In 2006, we received the following citations:

- The Four Corners Power Plant received an OSHA citation for \$1500, which we paid. This citation was for conductors not protected from abrasion and a missing junction box cover.
- 2 Notices of Violation (NOV) were issued by Maricopa County Air Quality Department to Palo Verde for failure to comply with dust control requirements, including failure to install trackout control measures. Maricopa County has not yet sought any penalties for these NOVs at the time of this report.
- A Notice of Violations (NOV) was received by Palo Verde from the Maricopa Air Quality Department for exceeding the annual PM-10 emission limit resulting from a failure of the cooling tower performance test conducted in December of 2005. PNW is contesting this NOV. Maricopa County has not yet sought any penalties for these NOVs at the time of this report.
- A Notice of Violation was received by SunCor Development and two of its vendors from the Maricopa Air Quality Department related to dust control requirements. This resulted in a penalty totaling \$17,690, of which SunCor was responsible for \$5,440.

## eco-efficiency

Product responsibility and eco-efficiency at a company like PNW takes on many forms, as we respond to the challenge of providing a sustainable energy future for our customers. It includes the research, development and implementation of various forms of renewable energies, including solar, wind, biogas and geothermal. Renewable energy will be an increasing important part of our overall energy mix into the future.

Technology innovation is critical, because the technologies of the past will not achieve our sustainability goals. We actively participate in a number of industry lead research programs. In addition, we have an active internal technology innovation department that has provided cutting edge research in areas such as solar energy, batteries and hydrogen power. This department is constantly searching for new ways to improve our ability to deliver the energy of the future.

We are also active in the responsible use of our product by our customers. Demand Side Management is a critical component of our overall program to achieve a sustainable energy future. We are helping our customers to understand how they can more effectively use energy, and providing resources and incentives for them to accomplish that goal.

### Clean Energy Programs

Since its inception, APS has been committed to providing affordable and reliable electricity to the people of Arizona. Today, Arizona faces the challenge of an exploding population. As the state's largest and longest-serving utility, APS is diligently working to find solutions that work not only for today but for tomorrow. A big part of this solution includes renewable energy.

APS is dedicated to increasing the role of renewable energy in Arizona's future. A long-time leader in solar energy research and development, APS in 2006 added another major component to its renewable energy portfolio with 90 megawatts (MW) of wind generation. In addition to the wind power, APS added 10 MW of geothermal capacity and increased its solar generation output to 10 million kilowatt-hours – a record for both the company and the state of Arizona.

The company is also developing other renewable technologies such as biomass, biofuels, algae and solar trough among others. The company utilizes consumer programs, education

and outreach, technology development, and generating and procurement to further the development of these sustainable energy resources which will power Arizona's future. The company recently issued a request for proposals for renewable energy, which will help meet the requirements of the Renewable Energy Standard (RES) set by the Arizona Corporation Commission (ACC).

### Renewable Energy Standard

In 2006, the ACC gave approval to the RES, which requires regulated utilities, including APS, to generate 15 percent of their energy from renewable sources – solar, wind, biomass, biogas and geothermal – by 2025. The RES replaces the previous Environmental Portfolio Standard, which went into effect in 2001. (Placeholder for our new proposal if submitted by time of publication)

Under the RES, in 2007 APS is required to have 1.5 percent of retail energy sold to come from renewable sources, increasing to 5 percent by 2015 and further increasing by 1 percent each year until 2025, when it reaches 15 percent. There is no specific obligation to fulfill any portion of that 15 percent with a particular renewable resource. The standard does require that nearly one-third of the total renewable portfolio consist of distributed energy. Distributed energy includes customer-owned, customer-generated electricity, such as solar photovoltaic (PV) rooftop systems.

The distributed generation requirement begins at 5 percent in 2007, increasing 5 percent each year until it reaches 30 percent in 2012. In addition to this requirement, one-half of the distributed generation must come from residential applications, the other half from non-residential projects.

If all goes as planned, by 2025, around 4.5 percent (30 percent of 15 percent) of APS' total energy sales will be generated by customers. Since it's not practical to put up a windmill or start a biogas plant in most backyards, a large proportion of the residential distributed generation requirement likely will be met with solar projects. One measure of the popularity of APS' distributed renewable incentive program, primarily roof-top solar installations, is the number of incentive payments that have been processed. The expansion of the program from more than 200 payments processed in 2005 to almost 500 in 2006 is evidence of its increasing popularity.

Since the cost to generate power from renewable resources is almost always more expensive than conventional sources, the RES provides for a surcharge on customer's bills as a funding mechanism to finance these initiatives. The amount of the surcharge that APS will seek has not been determined at the time of this report, and will depend on the plan developed by APS to meet the goal.

### APS Renewable Energy Programs

APS' commitment to renewable energy is divided into four initiatives:

**Procurement and Generation** - producing and purchasing renewable energy for our customers

**Consumer Programs** - facilitating customers use of and support for renewable energy generation, including photovoltaic grid-tied and remote solar (off grid) systems and small solar hot water systems

**Technology Development** - developing new, more-efficient ways of producing renewable energy. This is discussed further in the Technology Section of this report

**Education and Outreach** - educating teachers and consumers about the availability of renewable energy today and tomorrow

### Procurement and Generation

APS is building a portfolio of renewable energy in a cost-effective and prudent manner. As of January 1, 2007 APS has the capacity to provide 106.5 megawatts of renewable energy, enough for almost 30 thousand customers. This marks a near 1,800 percent increase from the previous year. While some of this energy is generated by APS, most is purchased through long-term contracts.

Generation Type	Total (approximate MW, including pending contracts)
Solar	6.5
Wind	90
Geothermal	10

Current Renewable Energy Projects			
Project	Fuel Source	Capacity (MW)	Status
CE Turbo	Geothermal	10	In operation
Pinal County CAF O	Biogas (Manure)	30	Under investigation
Snowflake White Mountain Power	Biomass (Wood)	14	Under construction
Clifton Hot Springs	Geothermal	20	Under investigation
Various Solar PLants	Solar	>3	In operation
Prescott Airport	Solar	2.5	In operation
Prescott Airport Expansion	Solar	3	Under construction
Saguaro Trough Plant	Solar	1	In operation
North Star	Wind	15	Under construction
Skunk Creek Landfill	Biogas	3	Under development
27th Ave Landfill	Biogas	3	Under development
Aragonne	Wind	90	In operation

### Green Rates

APS has proposed a green rate structure to the Arizona Corporation Commission (ACC). Under this proposal, customers can purchase either 100 kwh of green energy for \$1.00 or 35, 50 or 100% of their total energy from green resources for what is effectively a \$0.01/kwh premium today. The current mix includes wind and geothermal. Subscriptions are limited to available supply. The energy sold under this program will not count toward RES goals, which allows us to go beyond regulatory mandates through customer choice.

This proposal was under review by the ACC at the time this report was written.

## Solar Energy

Solar power is potentially the greatest energy source we have here on earth. It's powerful; it's renewable; it's safe; and APS and its customers are key players in harnessing this incredible energy.

In 2006, the APS Saguaro Solar Power Plant was named Energy Project of the Year by the Association of Energy Engineers (AEE). This honor came on the heels of the facility being named one of the top 12 power plants in the world by Power Magazine. Located near Red Rock, Arizona, the one-megawatt plant is the first solar trough generator in the state and the first solar trough built in the United States in almost 20 years. Unlike a photovoltaic solar plant, which uses sunlight to produce electricity, a solar trough uses heat from the sun to create electricity. The sun heats oil, which is then used to drive a turbine/generator. This technology can easily be combined with a storage facility, allowing it to hold energy, and to provide electricity when needed - not just when the sun is shining. The APS Saguaro Solar Power Plant also is the first to combine solar trough technology with an Organic Rankine Cycle Power Block, typically used in geothermal and biomass applications. The block allows the plant to produce more power at lower temperatures.

## APS Solar Generation

APS now has more than 6.55 megawatts (MW) of installed solar capacity statewide providing energy to APS customers. APS' distributed generation capacity currently comes from our solar energy facilities installed at customer locations. Below are some of the solar power plants that APS currently has in operation.

- Flagstaff- The Flagstaff solar power plant inaugurated the APS Solar Partner® Program. The Flagstaff plant is housed within the APS service yard and produces 82 kilowatts of solar energy. Built in 1997, the plant employs the use of single axis tracking technology to maximize the sun's energy.
- Glendale- The City hosts APS' first municipal application of high-concentration photovoltaic arrays at the Glendale Municipal Airport. This technology tracks the sun's movement and employs special lenses to concentrate the sun's rays 250 times onto each solar cell.
- Gilbert- The 125-kW plant is adjacent to the Town's original ground water recharge site. The one-acre site consists of 10 solar arrays, which will track the sun from east to west on a single axis. Each solar array (or series of panels) is about 150-feet long and eight-feet wide and sits relatively low to the ground.
- Prescott- APS and Embry Riddle Aeronautical University joined to construct a 190-kilo-watt (kW) plant, which feeds solar power to the electric grid. The plant uses a single axis tracking system that allows the photovoltaic arrays to track the sun through the sky. The plant was dedicated in April 2001.
- Prescott Airport Solar Plant - APS and the City of Prescott teamed to build a plant near the Prescott Airport which currently produces 3.5 MW of solar energy, our largest solar facility to date.
- Scottsdale- In 1999, the City of Scottsdale formed a unique alliance with APS in an effort to meet the need for covered parking at commercial buildings with a practical way of generating clean energy. An 8,500-square-foot parking structure covered with photovoltaic panels began generating 34 kW of solar energy at a City of Scottsdale service yard.
- Scottsdale Water Campus - APS and Scottsdale officials joined to build a single-axis tracking, photovoltaic plant atop of the City's domestic water tanks which produces 230 kW of solar energy.
- STMicro Rooftop Solar System - This system was the first solar application in Arizona installed for commercial grid-connected customers.
- Tempe- Located on the grounds of the APS Solar Test and Research Center (APS STAR Center®) in Tempe, this solar plant generates 480 kW of solar energy for use by all APS customers.
- Yuma- APS built a new solar power plant near Yuma, which will generate 100 kW of energy. The plant is located at the Yucca Power Plant and will generate enough energy to serve about 31 homes.
- Phoenix- The Arizona Department of Environmental Quality (ADEQ) hosts a 127-kW flat panel solar plant built atop the facility's parking canopy. The facility is a partnership between ADEQ and APS that makes the facility one of the most energy efficient of all City facilities.

## Customer Solar Programs

### APS Solar Partners Rate Program

Under its Solar Partners Rate Program, APS customers are invited to purchase 15 kilowatt-hour blocks of energy generated by the solar power plants. The cost to customers is a \$2.64 per month premium. Solar Partners offers residential and business customers an affordable way to take advantage of the state's most abundant source of renewable energy, the sun, while helping APS develop a secure energy source for our future. At year's end, APS had more than 4,000 Solar Partners.

### APS Solar Partner Incentive Program

This program offers financial incentives to customers (residential and commercial) who install qualified solar systems. Each year APS sets aside a certain amount of money to fund the Solar Partner Incentive Program. In 2006 the company originally set aside \$4.25 million dollars. However, after such a strong demand, the company increased the pool to \$8.5 million dollars in 2006.

For the period from 2002 through 2006, 317 customers have installed a cumulative total of 1.7 MW of grid-tied PV systems, and 331 customers have installed a cumulative total of 0.5 MW of off-grid PV systems. In addition, since 2003, APS has purchased EPS credits from customers who have installed solar water heating systems. Since the program started, 393 solar water heating systems have been installed offsetting an estimated equivalent of 954,900 kWh of conventional generation.

### Wind Energy Projects

You normally wouldn't think of wind resources when you think of Arizona. Our state is better known for its abundance of another natural resource, the sun. But, recently APS signed a long-term contract with a Santa Rosa, New Mexico company to bring 90 megawatts (MW) of wind energy to the Valley of the Sun.

The 90-megawatt (MW) Aragon Mesa Wind Farm will serve about 22,500 APS customers. Aragonne Wind, LLC, a wholly-owned subsidiary of Babcock & Brown Operating Partners LLC owns and operates the facility. APS has a 20-year agreement to purchase all the power from the farm. When completed in December, 2006, it was the largest purchase power agreement for renewable energy ever signed by APS. It increased APS' renewable energy portfolio from 16 MW (10 MW geothermal, 6 MW solar) to 106 MW — a 563 percent increase.

Pinnacle West is proud of its efforts in expanding its renewable energy portfolio, and in researching innovative solutions to achieve a better energy future. Through technology development and by working with industry leaders, we believe we can find a balance of diverse generation sources that will help power a stronger, more sustainable tomorrow. PNW is actively involved with organizations such as the Electric Power Research Institute (EPRI) and the Edison Electric Institute (EII) in research into new technologies and business methods. In addition, we have an aggressive internal research and development program that has achieved some amazing results. Our solar power research and solar power plant development is one of those areas.

Please view our online report to learn more about some of the other exciting technology development programs APS is involved in:

### Emissions to Biofuels Project

Using algae to convert power plant smokestack emissions into bio-fuels. This innovative project won the Emissions Energy Project of the Year award for 2006 at the eighth annual Platts Global Energy Awards in New York.

### APS Coal to Substitute Natural Gas Project

Manufacturing substitute natural gas (SNG) from coal via a carbon hydro-gasification process.

### Manure to Renewable Energy

Converting animal wastes into methane for power generation.

### APS Hydrogen Park

Generating hydrogen from water using solar energy for use in vehicles, and other innovative hydrogen power research.

### ECObus - Hydrogen-Powered Bus

Arizona's first hydrogen-powered bus.

## Demand Side Management

Helping our customers improve the efficiency in which they use electricity is a key component of Pinnacle West's sustainability programs. Our overall Demand-Side Management (DSM) program is comprised of numerous individual programs and educational tools to help achieve that goal.

APS has had demand-side management programs in place for a number of years. In the five-year period of 2000 to 2004, the company estimates that its programs saved approximately 167,000 megawatt-hours (MWh) of energy use and 138 megawatts (MW) of peak energy demand. In 2006, an estimated 85,458 MWh of energy use was saved through APS' DSM program.

DSM efforts received a substantial boost in 2006, with the approval by the Arizona Corporation Commission (ACC) of an expanded DSM effort at APS. As part of its rate case, APS has committed to spend a minimum of 16 million dollars per year in DSM programs, more than double previous expenditures. In 2006, nine additional DSM programs were approved by the ACC (to make a total of 10 current approved DSM programs). As these programs were implemented and started-up in 2006, APS spent a total of 8.4 million dollars for DSM in 2006. That is projected to increase to at least our 16 million dollars baseline in 2007.

Here is a summary of APS' DSM programs:

### Energy-Efficient Lighting Program

The U.S. Environmental Protection Agency (EPA) and the Department of Energy (DOE) named APS an ENERGY STAR Partner of the Year for outstanding contributions in reducing greenhouse gas emissions by promoting energy-efficient compact fluorescent light bulbs (CFLs) to customers. Specifically, APS was recognized for its "Program Delivery of Residential Lighting" initiative.

"Partners like APS have had an outstanding year in helping consumers help themselves," said Bill Wehurm, acting assistant administrator for the EPA Office of Air and Radiation. "In addition to leading the way in promoting products that earn the ENERGY STAR, APS also works to educate consumers about the importance of energy efficiency. These efforts are a win for consumers and for the environment."

Tom Hines, program manager, Customer Information and Programs, said, "The award supports our vision for a more sustainable future. By helping our customers use smarter technology like CFLs, we are able to save energy, improve the environment and shape a better future for us all. Our program is making a difference one bulb at a time."

According to ENERGY STAR, when you use less energy at home, you lessen greenhouse gas emissions in the atmosphere. The EPA estimates every CFL can prevent more than 450 pounds of emissions from a power plant over the life of the bulb compared to an incandescent bulb. "The EPA calculation translates into reduced greenhouse gas emissions of 450,000 tons over the life of the CFLs sold in the APS program," said Hines.

Since APS introduced the program in the fall of 2005, more than two million CFLs have been sold at reduced pricing in the APS service territory. Those sales also mean estimated energy savings of more than 500 million kWh — enough energy to power more than 40,000 homes for one year and save consumers about \$50 million in energy costs over the life of the bulbs. That's because CFLs use up to 75 percent less energy than incandescent light bulbs, generate less heat and last up to 10 times longer than traditional bulbs.

APS more than doubled its original 2006 sales target of 600,000 bulbs to more than 1.2 million bulbs. The program was approved by the Arizona Corporation Commission and is paid for by APS customers. APS is expanding the program in 2007:

#### **High-Efficiency AC Rebate Program**

The APS High-Efficiency Air Conditioner (AC) Rebate Program offers rebates to APS residential customers who replace their existing heat pump or AC unit with a new high-efficiency system.

#### **APS Energy Star® Homes**

In cooperation with APS, a number of Arizona builders are incorporating energy-saving building techniques and features in their new homes. APS Energy Star Homes meet or exceed new, stringent 2006 Environmental Protection Agency Energy Star efficiency standards. A certified independent contractor tests the homes to ensure they perform efficiently.

#### **APS Energy Wise Low Income Weatherization Program**

Participants must be an APS customer and have a household income of less than 150 percent of the federal poverty guideline. Community Action Agencies identify needy customers, assess their homes for potential energy efficiency improvements, and install the measures that save energy. Measures typically installed include insulation, conduct repairs, window and door replacement, and evaporative cooler and air conditioner repair and replacement. The ACC recently approved an increase to \$1.1 million per year for the Low Income Weatherization program, a doubling of previous funding.

#### **Reducing Peak Demand**

APS also promotes peak demand management for both residential and commercial customers. APS has one of the most successful residential time-of-use (TOU) rate programs in the country, with participation from more than 40 percent of all residential customers. In addition, APS conducts a voluntary summer peak-reduction program with large commercial customers who commit to saving energy on the hottest days of the summer.

#### **APS' Business Solutions Program**

The APS Business Solutions Program provides funding to APS business customers who upgrade their facilities with energy efficient equipment, or those who are building new energy efficient facilities.

The program offers:

- Prescriptive incentives for customers who make energy-efficiency equipment upgrades and improvements in lighting, cooling, refrigeration and motors applications for retrofit and new construction projects.
- Custom incentives for large business customers installing energy-efficient measures that fall outside of the prescriptive list in major renovation and new construction projects.
- Assistance with energy-study incentives for large business customers. This includes energy-feasibility studies, design assistance, commissioning studies and retro-commissioning studies. Customers are eligible to apply for study incentives that cover up to 50 percent of the qualifying study cost or \$10,000 maximum per customer.

The APS Business Solutions Program is available to schools, institutional customers, large existing facilities, new construction projects and small, non-residential customers.



## community & customers

### ***Pinnacle West in the Community***

At Pinnacle West, we believe the development of communities is one of the cornerstones of civilization. We believe it is also a principle that underlies the success of our company.

As a good corporate neighbor, we understand we play a role that goes beyond simply providing reliable electricity and excellent service. We embrace the role of collaborator and partner with the communities we live in and serve — not only because it is the right thing to do — but because we realize that the strength of our company parallels the strength of our state, its economy, its communities and its residents.

At APS and Pinnacle West, giving back to the community means more than simply writing checks to support organizations. Instead, we choose to take a more proactive approach. We have for the past 120 years, chosen to be an integral part of what goes on around us, and that commitment will never change.

As you'll find throughout this report, our family of companies are inextricably tied to the communities we serve. From our programs for supporting children and education; to our commitment to helping small and minority-owned businesses; to our patronage of the arts and culture; to our encouragement of economic development, APS sees itself as an active participant in the continued well-being of our entire state.

But while our various programs are the vehicles we use to give back, our dedication to the community is showcased best through the sweat equity of employees who represent our company each day. Our employees serve on the boards of some of the most important organizations in the state and spend thousands of hours volunteering at events and on organizations that make an impact on the lives of many of our neighbors.

Each year, our employees distinguish themselves and our company through their support of the United Way and other charitable organizations. Each year our employees and corporation donated millions of dollars in community support; dollars that are channeled directly into the hands of social service organizations that are making a difference each day.

We will always consider community involvement an integral

part of our company's culture and place it at the head of our sustainability efforts.

### **Community Support**

Pinnacle West and its family of companies share a partnership with the communities they serve. Community involvement is an integral part of our company's culture and we encourage each employee, from the newly-hired to our officers, to actively participate in community events and issues. From corporate giving to volunteering to public safety programs, the company participates in the community on many levels. As you'll see in this section, the company is proud to be a good neighbor and partner and is inextricably tied to the health and vitality of this state and its communities.

#### ***Charitable Giving***

##### **APS Volunteer Matching Gifts Program**

One only need look at projects like the APS Volunteer Matching Gifts program as a benchmark of the company's spirit of giving. The APS Volunteer Matching Gifts program encourages and recognizes the generosity of employees, retirees and company board members who volunteer their time and talents to educational, cultural, environmental, health and human services and community-development organizations dedicated to enhancing our quality of life.

In 2006, the Volunteer Matching Gifts program yielded more than \$30,000 for non-profit organizations in addition to the hundreds of volunteer hours put in by employees. The program provides \$125 grants to qualified non-profit agencies getting at least 25 volunteer hours from APS employees. It also matches any financial gift from an employee to a qualified non-profit organization by providing 50 cents to every employee dollar, up to \$1,000.

#### ***Charitable Giving***

Through its Corporate Giving program, the company cherishes a leadership position in corporate citizenship in Arizona. We support non-profit organizations with a 501(c)(3) Internal Revenue Service tax exempt status through cash and/or in kind services. We support our communities in five strategic areas: health and human services, community development, education, arts and culture and the environment.

### 2006 Community Giving

Arts & Culture	\$640,384
Community Development	\$1,554,483
Education	\$978,382
Environment	\$50,142
Health & Human Services	\$1,696,216

**\*\$4,919,607**

**2006 APS Foundation Giving \$1,448,000**

**2006 Total Giving \$6,367,607**

*\*Total includes APS and SunCor charitable giving, but does not include in-kind giving or volunteer hours. The above cash donations are from the company and do not include any donations made by our employees.*

APS Corporate Giving does not fund individual requests, charter or private schools, religious, political, fraternal, legislative or lobbying efforts or organizations, travel related or hotel expenses, private or family foundations, private non-profit organizations, salaries and/or debt reduction. APS prefers to give directly to recipient organizations/agencies.

PNW reported a net income of \$327,255,000 in 2006. Therefore the percentage of net income donated to charity is approximately 1.95%.

### In-Kind Giving

In addition to cash donations and employee volunteerism, Pinnacle West provides a high level of support to community organizations through in-kind giving, especially printing services. In 2006, the company produced 258 in-kind printing projects to community organizations, with an estimated total market value of \$407,535.

### Volunteerism

The APS Volunteer Program is active in the more than 200 cities and towns in Arizona served by APS as well as northwestern New Mexico, where APS is a major employer. All it takes for a community, school or other non-profit organization to benefit from the APS Volunteer Program is the presence of a single employee or retiree who wants to contribute his or her time and talents to help others. APS employees, friends and family donated nearly 170,000 hours in 2006. The APS Volunteer Program sponsors and supports efforts ranging from non-profit organizations supported by small, loosely organized teams to projects that involve hundreds of employees, retirees and their families in dozens of communities.

Volunteer projects may be initiated by employees anywhere in the company, regardless of their job classification, work location or time with the company. APS also has a full-time Volunteer Program Coordinator whose job includes identifying and organizing volunteer projects and partnerships.

APS employees volunteer activities range from helping at clothing and food drives and Special Olympics to mentoring in schools, coaching amateur athletics, serving on boards of directors and as members and docents for hospitals and museums. APS also sponsors one-time projects such as parks trail building, neighborhood cleanups and community fund-raisers.

Sponsored activities must meet APS' general standards for social responsibility, wise use of resources and positive impact on APS customers or employees. Optimally, APS prefers to direct its resources to service efforts and organizations in health and human services, youth and education, arts and culture, the environment and community development.

Below, we've included a list of only a handful of the many projects and hours invested by APS volunteers. In many instances, these charitable projects span more than a decade, bringing annual support to non-profits. Frequently, APS volunteers are leaders setting the course for these events. Among the most notable are the chambers of commerce, United Way, the Boys and Girls Club and the Fiesta Bowl. But the list, which isn't comprehensive, doesn't begin to describe the hard work of our volunteers:

- American Cancer Society – In February 2006, 11 APS teams totaling 500 APS employees, friends and family members participated in the Climb to Conquer Cancer at Phoenix's South Mountain Park. In August, 75 APS employees, friends and family members made the 7-mile trek up the Arizona Snowbowl near Flagstaff. Through these events, participants raised more than \$55,000 for the American Cancer Society. APS has participated for more than 20 years.
- American Diabetes Association – APS volunteers have been instrumental in the planning and implementation of the ADA's key fundraising events – America's Walk for Diabetes, Tour de Cure and Team Diabetes. Jack Davis, APS CEO, served as Walk chairman in 2004 and 2005. The Power Peddlers, APS bicycle team help plan and participate in the Tour de Cure, and other APS employees served on planning committees. Team APS has contributed more than \$60,000 in donations and in-kind services.
- American Heart Association – in 2006, more than 40 Team APS members participated in the Heart Walk, collecting nearly \$12,000. These funds supported research, education and community outreach by the AHA.
- Back-to-School Clothing Drive Association – APS volunteers impacted the lives of more than 4,300 low-income children through this organization by distributing clothes, shoes and a back-pack filled with personal hygiene items. APS has participated for more than 10 years, and APS employees serve on the board.

- Black Heritage Celebration – Drawing a large attendance, APS volunteers supported this event, which funds two \$1,000 scholarships for Phoenix-area students. The celebration began in 1999.
- Day for Downtown – APS volunteers joined a city-wide effort to beautify downtown Phoenix producing 2,600 community service hours to 19 non-profit organizations and schools. APS employees did interior painting at KEYS Community Center, a non-profit agency that offers pre-school, after-school, youth development and GED programs.
- Holiday Food Drive – APS employees and retirees collected more than \$16,200 and 3,000 cans of food to benefit St. Mary's/Westside Food Bank Alliance. Our employee's generous donations helped provide more than 113,484 meals to families in need.
- Junior Achievement – APS volunteers are directly involved in the education process by being in the classroom and teaching students about topics such as entrepreneurship, personal finance, career exploration and economics. Volunteers also participated in the Hula Bowl, an annual bowl-a-thon, in which APS employees raised \$6,100 in 2006, plus an additional \$615 in company-paid registration fees to send nearly 200 Arizona children to Junior Achievement, a non-profit economic education program.
- Pappas School – Thirty APS volunteers brightened the lives of the 750 homeless children in grades K-6 attending Thomas J. Pappas School by coordinating a Fall Festival, complete with games and face painting by the APS Clown Troupe. In addition, volunteers donated items to stuff goodie bags with healthy treats and hygiene items for each of the kids.
- Ronald McDonald House – For years, APS volunteers have cooked meals for the resident families at Ronald McDonald House. For families with children in the hospital, this is just one way APS Volunteers can make their lives a little less stressful. By providing dinner to the families three times a month, APS Volunteers are helping to feed over 3,000 families per year.
- The Salvation Army – volunteers provided donated items, supported holiday activities such as the Turkey Drive and Christmas Angel project and provided bell ringers. APS employees also serve on the board.
- Santa Letters – More than 90 APS volunteers, also known as Santa's elves, answered more than 700 letters in December from boys and girls of all ages.
- Smoke Alarm Awareness Project – Armed with screwdrivers and fresh batteries, APS volunteers, along with City of Phoenix firefighters, worked to install 340 smoke alarms in one day during the Smoke Alarm Awareness Project. The project was created to install new smoke alarms in homes without alarms and test and change batteries of existing alarms.
- Special Olympics – In 2006, about 60 APS Volunteers helped to coordinate the Special Olympics Indoor Athletics for over 75 special athletes. APS volunteers have participated in this event for more than 20 years, and employees serve on the board.
- St. Mary's/Westside Food Bank Steak Fry – In 2006, 94 APS employees, friends and family cooked, served, and bused tables to fight hunger. Volunteers served 867 people, earning \$15,100 for the non-profit. APS volunteers have worked the steak fry for more than 16 years.
- Susan G. Komen Race for the Cure – Team APS, with more than 170 employees, their family and friends, joined more than 38,000 other participants in downtown Phoenix at the 14th annual Race for the Cure. The event raises money to fund breast cancer treatment and research. Team APS raised more than \$4,000 for the event.

### **APS Volunteer Clown Troupe**

The APS Volunteer Clown Troupe consists of more than 125 employees and family members who each perform a minimum of 50 hours of community service activities annually throughout Arizona and northwest New Mexico.

An outgrowth of APS' volunteer program, the clown troupe was established in 1989 by a group of employees who, through their involvement in volunteer activities, identified the need for a group of creative, positive individuals who could entertain at fundraisers and special events for the elderly, disabled, disadvantaged, children, hospitals and non-profit organizations. The Troupe entertains thousands each year and is widely known in the Valley for its performances in the APS Fiesta of Light Parade, Fiesta Bowl Parade and Parada del Sol.

### **Corporate Citizenship**

Pinnacle West enjoys a tradition of supporting employees who hold elected office in their communities and who serve on the boards of non-profit organizations across the state.

Company representatives work to strengthen business alliances throughout the Phoenix metropolitan area, including membership in the Greater Phoenix Economic Council (GPEC), Greater Phoenix Leadership (GPL), WESTMARC and the East Valley Partnership. In addition, APS is involved in the Valley Business Council, which consists of representatives from all the Phoenix-area chambers of commerce.

The Pinnacle West Government and Federal Affairs department gives APS and Pinnacle West a voice in the law-making process at all levels, focusing on areas such as air quality, education, energy and transportation. Pinnacle West is active in alliances with governors, legislative leaders, trade groups and associations in the West, which focus on western-specific issues. Examples include West Connect, West Associates, Western Business Roundtable and the Western Regional Air Partnership.

The company also funds and supports civic organizations and sponsors events in a number of areas, including the arts and culture, community and economic development, education, the environment, and health and human services. Corporate grants in these areas for 2006 totaled over \$4.2 million. In addition, APS In-Kind donations totaled over \$450,000 in 2006.

## **Some of the significant company initiatives that address community needs throughout Arizona include:**

- The Character Education Initiative, a program that fortifies the lives of America's young people with consensus ethical values called the "Six Pillars of Character" – trustworthiness, respect, responsibility, fairness, caring and citizenship
- The APS Power Players program, an APS program aimed at character-building education, sports-field building and sports-related opportunities for kids. Power Players is a historic partnership between APS, Phoenix Suns and Phoenix Mercury, Arizona Diamondbacks and the Arizona Character Education Foundation
- Statewide crime prevention initiatives such as National Night Out and GAIN (Getting Arizona Involved in Neighborhoods)
- APS' Healthy Students/Healthy Schools Partnership – a cooperative effort among APS, Arizona school districts and hospitals that brings primary healthcare and disease prevention to students in need
- The APS/Phoenix Suns Education Mini-Grants Program. In 2005, the program gave away more than \$10,000 to Arizona students
- The Partners Advancing Student Success© program through which APS, Motorola and Communities in Schools have created a public/private/nonprofit partnership designed to bring business and education together and give students the skills they need to succeed in today's business world
- Diversity activities including the annual Black Heritage Celebration, which is organized and produced by APS employees, as well as partnerships throughout the state with organizations like Chicanos Por La Causa, the Phoenix Urban League, the National Association for the Advancement of Colored People (NAACP), the Chinese Cultural Community, Native American Connections, Valle Del Sol, Friendly House, the National Center for American Business Development and the Opportunity Industrialization Center
- The Challenger Space Center, which fosters science and math literacy and helps students develop the higher-level critical thinking skills. The company also sponsors the Arizona Science Center, teacher memberships, and related field trips and events
- APS Generation's Summer Teachers' Workshop, which provides new and exciting ways to teach about energy while providing real-world experiences about the electric industry from people who work in it every day

### **Assisting Our Customers**

At APS, we have a long history of supporting the communities where we live and work. And we take our role as a corporate citizen very seriously. Through various programs such as Project SHARE, the Energy Support Program and our Low-Income Weatherization Program, we help customers who are in financial need afford much-needed energy services.

**Project SHARE (Service to Help Arizonans with Relief on Energy)** is an emergency fund created to help those who find themselves in a financial emergency and are unable to pay their energy bills. It is for those families who face unexpected financial hardships such as unemployment, a death in the family or unexpected medical expenses, and who have exhausted other potential sources of assistance and received a disconnect notice.

Managed by The Salvation Army, Project SHARE is a unique community-assistance program with no administrative or pass-through costs. One hundred percent of the funds collected are used to help those in need. The Salvation Army selects the recipients and disburses the funds after they assess a family's needs. APS' participation in Project SHARE is funded by employees, retirees, shareholders and customers of APS. APS matches employee payroll contributions to the plan dollar for dollar.

**APS' E-3 and E-4 Energy Support Program** offers a discount of up to 40 percent off the cost of electricity for customers that meet certain income guidelines. The income guidelines are based on 150 percent of the federal poverty guidelines as determined by the Department of Economic Security (DES). DES is responsible for processing the application and determining the eligibility of the applicant.

E-3 customers get a discount based on the number of kilowatt hours (kWh) used each month. The discount varies depending on how much electricity is used each month. Additionally, customers on E-3 are insulated from Power Supply Adjuster (PSA) charges, which is a commonly used mechanism that allows utilities to recover from customers the actual and reasonable costs of power supplies. The PSA is adjusted annually – up or down – based on the prior year's actual fuel and purchased power costs. E-4 customers must have electrically operated medical equipment, such as oxygen generators, and the discounts are applied to a larger number of kWh. The discounts range from 13 percent to 40 percent. E-4 customers also are exempt from the PSA charge and surcharge.

**The APS Energy Wise Low-Income Weatherization Program**, which began in 1996, has contributed nearly \$4 million toward making 3,000 homes more energy efficient. Some funds have and can be used to assist customers in paying past-due electric bills when the customer is in a crisis situation. Participants must be an APS customer and have a household income of less than 150 percent of the federal poverty guideline. APS works through several Community Action Agencies that identify needy customers, assess their homes for potential energy-efficiency improvements, and install the measures that save energy. APS funds are used in combination with several other funding sources from the federal government and other utilities. Community Action Agencies determine who is qualified to receive assistance.

Measures that typically are installed include insulation, duct repairs, window and door replacement, and evaporative cooler and air conditioner repair and replacement.

## Customer Satisfaction

Customer satisfaction is at the essence of everything we do, and because of that focus, we continue to get high marks from our customers. In the most recent J.D. Power and Associates business and residential customer satisfaction surveys, APS ranked second among investor-owned utilities in the West, in overall customer satisfaction.

The company also conducts its own surveys to gauge customer satisfaction. APS' Customer Satisfaction Tracking Survey measures the satisfaction levels of residential, small-to-midsize and large business customers regardless of whether they have had any recent company contact.

Additionally, the company conducts Customer Contact Tracking surveys among its residential and business customers who recently made a transaction through the company's call center, in a business office, or on-line at [aps.com](http://aps.com). This ongoing customer satisfaction research is used to assess and continuously improve customers' experiences with APS.

Customer service is an area of emphasis in our 2005-2010 APS Business Plan, which states:

We will strengthen our relationships with our customers by providing continued excellent service and responsive products and services. These efforts will allow us to evolve beyond customer satisfaction to true customer loyalty. Customer loyalty becomes critical especially in light of our high growth, when customers must act as references for activities such as franchise elections, rate cases, and substation and line sitings. Satisfied customers are pleased with the service we provide them; loyal customers are willing to make a personal investment in APS by supporting our efforts

The Challenge: Our customer base continues to grow at a rate three times the national average. This growth, coupled with ever greater customer expectations, increases the demand on each employee to create sustained value by providing safe, reliable, fairly priced energy; friendly and knowledgeable service; and community involvement. We will measure our progress through customer satisfaction tracking surveys. The rapid growth within our service territory provides both opportunities and challenges

An important part of a sustainable energy future is an educated public. APS provides a variety of information and support services to help our customers become better informed users of electricity. Much of this information is available to the public on our APS Web site ([www.aps.com](http://www.aps.com)), including:

- Online management of customer accounts
- Residential and Business Energy Survey
- Energy Saving Ideas
- Using Energy Wisely
- Home Energy Test (online)
- Energy Use History
- Low Income Rate Plans
- Resources for Realtors

## Suppliers

### **Supplier Code of Conduct**

In 2006, Pinnacle West created a new pamphlet called "Doing the Right Thing-Contractors," which communicates our expectations of our contractors with regard to our Ethics Program and Standards of Business Practices. One section of the pamphlet states that our contractors are responsible to help protect the environment by complying with all Company environmental rules and practices, as well as all federal, state, county and municipal environmental laws and regulations. The pamphlet is distributed to key contractors in partnership with the company's contract labor vendors. This pamphlet is available for viewing by the public on our corporate Web site (click on the link above).

### **Vendor Audits**

Pinnacle West and APS perform audits of all vendors that provide waste disposal or recycling activities and services to company facilities. This is discussed in the vendor audits of the Waste section of this report.

### **Pinnacle West Supplier Diversity Program**

Supplier Diversity is a significant part of APS' business strategy locally, regionally and globally. As a major purchaser of goods and services, APS has a significant opportunity to facilitate diverse business growth and to strengthen the state and local economies in all our customer service areas. APS' success depends on our ability to understand our diverse consumers' needs and to work effectively with customers and suppliers.

We have a strong commitment towards supporting the development of Minority and Women Owned Business Enterprises (MWBE). This includes educating and informing APS employees with purchasing authority, setting specific MWBE targets, and providing mentoring and other assistance to MWBE suppliers. While every department has responsibility to help meet our MWBE goals, we have also established an internal department, the Supplier Diversity & Development (SDD) Team, which is committed to facilitating and expanding competitive business opportunities with Minority, Women, Veteran, Service-Disabled Veterans and HUBZone Enterprises primarily in Arizona and the Southwest.

Our efforts are driven by the diversity of the communities, in which we live and serve. We work with these diverse suppliers to provide greater value, innovative thinking and improve the availability of competitive goods and services to Pinnacle West. Our success is attributed to strategic relationships built on direct, honest and equitable communications.

Visit the [Pinnacle West Supplier Diversity and Development Program](#) online to learn more.

## 2006 PNW MWBE Targets and Results

As shown in the chart below, PNW set an aggressive MWBE spending

	Direct	Indirect	Total 2nd Tier Spend
1ST QTR	\$ 703,132	\$ 12,726,873	\$ 13,430,005
2ND QTR	\$ 718,021	\$ 12,346,754	\$ 13,064,775
3RD QTR	\$ 696,874	\$ 13,346,734	\$ 14,043,608
4TH QTR	\$ 699,964	\$ 11,184,464	\$ 11,884,428
<b>Totals</b>	<b>\$ 2,817,991</b>	<b>\$ 49,604,825</b>	<b>\$ 52,422,816</b>

	2005 Totals	Corporate Minimum Target	Corporate Stretch Target	Year End 2006
Falo Verde	\$7,746,328	\$7,950,000	\$8,125,000	\$10,763,182
Cholla	\$325,323	\$695,000	\$787,000	\$387,552
Four Corners	\$5,124,418	\$6,275,000	\$6,645,000	\$5,574,561
Redhawk		\$295,000	\$320,000	\$1,059,316
Saguaro		\$82,000	\$88,000	\$72,688
Yucca		\$52,000	\$58,000	\$29,198
West Phoenix		\$308,000	\$340,000	\$702,170
Ocotillo		\$157,000	\$176,000	\$362,387
Sundance		\$69,200	\$95,000	\$135,114
Gen Engineering (Meyer)		\$448,000	\$500,000	\$405,188
Gen Other	\$1,055,323			
CO 75 PNWCO	\$1,834,692			
<b>TOTAL GENERATION</b>	<b>\$16,116,084</b>	<b>\$16,331,200</b>	<b>\$17,135,000</b>	<b>\$19,501,770</b>
<b>DELIVERY</b>	<b>\$12,264,378</b>	<b>\$10,440,000</b>	<b>\$11,175,000</b>	<b>\$15,781,711</b>
<b>CO 20 PWR MARKETING</b>	<b>\$1,983,043</b>	<b>\$2,895,000</b>	<b>\$3,010,000</b>	<b>\$32,055</b>
Finance	\$1,732,421	\$1,699,000	\$1,740,000	\$2,745,962
Corporate Business Services	\$11,668,461	\$8,275,000	\$10,004,000	\$10,364,991
Finance and Planning	\$10,962	\$9,800	\$11,000	\$30,651
Law and Business Practices	\$321,397	\$255,000	\$275,000	\$308,329
<b>TOTAL SHARED SERVICES</b>	<b>\$12,912,975</b>	<b>\$10,238,800</b>	<b>\$12,030,000</b>	<b>\$13,342,669</b>
<b>CO 80 APSES</b>	<b>\$360,816</b>	<b>\$595,000</b>	<b>\$650,000</b>	<b>\$625,537</b>
<b>MWBE SPEND TOTALS</b>	<b>\$43,646,933</b>	<b>\$40,500,000</b>	<b>\$44,000,000</b>	<b>\$49,301,996</b>

target in 2006, and exceeded that target by over \$5 million dollars. PNW's MWBE program is a major driver for MWBE business development in Arizona.

### 2006 Subcontractor Utilization

APS assures that the clause entitled: "Utilization of Small Business Concerns" will be included in all subcontracts that offer further subcontracting opportunities, and all subcontractors (except small business concerns) who receive subcontracts in excess of \$500,000 (\$1,000,000 for construction of any public facility) will be required to adopt a plan that complies with the requirements of this plan. We urge our prime contractors and major suppliers to support supplier diversity by providing opportunities to small business subcontractors and suppliers to the greatest extent possible.

### 2006 Second-Tier Spending

APS encourages our major suppliers to incorporate the strategic advantage of utilizing MWBE's by offering subcontracting opportunities both directly and indirectly for products and services. APS also directs them to utilize whenever possible qualified and certified MWBE's

from available existing resources. We also request that our suppliers and contractors submit quarterly reports on their MWBE utilization activities in Second Tier reports to APS.

### ***APS Academy for the Advancement of Minority and Women-owned Enterprises (AAAME)***

Since 1997, APS has solely funded, designed and administered an innovative and successful business mentoring program that has assisted more than 100 small, minority and/or women owned business to grow in Arizona. The APS Academy for the Advancement of Small, Minority and Women Owned Enterprises, also known as AAAME is offered at no charge to its participants. The AAAME program was developed on the idea that APS could 'do more'; that APS could lead the community in providing innovative ways to assist minority and women owned business in addition to its successful Supplier Diversity Program.

AAAME is an integrated and focused business mentoring program combining business skill training, one on one mentoring, group projects, peer to peer networking and support with individualized goal setting and action plans. It utilizes many resources from the community as presenters, advisors and curriculum collaborators to provide implement able solutions and guidance to the AAAME CEOs. AAAME participants attend group meetings twice a month and advisor meetings at least once a month during their two year commitment to AAAME. As a result, many AAAME companies have experienced growth in gross revenues and net profit, an increase in employees, the ability to lease or purchase additional commercial space and many other significant goals. They have been honored through out the community for their business success and are seen as the new leaders of our community.

### **Public Safety**

The safety of our customers and the general public is our top priority. We staff a Public Safety department to ensure the public is safe and informed about any possible dangers of electricity.

Both our Customer Service and Public Safety departments work to ensure our customers have access to accurate information on the proper use and handling of electricity. In an effort to educate and protect children, our Public Safety employees target students throughout Arizona through an outreach program aimed at safety and awareness. The department also has reached hundreds of maintenance workers, city employees, firefighters and arborists with targeted electrical safety presentations.

The Energy Delivery organization maintains three electrical safety trailers that provide live demonstrations of the potential danger of electrical conductors and the dramatic impact of electrical current on living tissue to audiences across Arizona..

### ***Emergency Response***

At Pinnacle West and APS, we train our employees and continually improve and test our systems in order to be ready for emergencies.

APS employs and trains fire and emergency response teams at the Palo Verde Nuclear Generating Station plant and the Four Corners and Cholla coal plants. Emergency response plans at each facility detail the roles of APS employees in responding to emergencies. We actively participate in local emergency planning committees and provide emergency planning and on-site chemical storage and hazard information to state and local agencies through SARA (Superfund Reauthorization Act of 1986) Tier I and Tier II reports.

The Palo Verde Nuclear Generating Station annually provides neighbors with information on plant operations, emergency planning zone maps, emergency classifications, important telephone numbers, procedures, locations of care centers and suggested protective actions. Palo Verde also conducts joint emergency planning drills with local, state and federal emergency response agencies at least twice per year.

The APS Energy Delivery and Sales division also maintains an emergency response plan that helps the organization quickly respond to disasters, both natural and man-made. Periodic reviews and drills help the division improve its emergency response procedures for use during potentially dangerous emergency outages.

PNW and APS also cooperate with local fire and police departments, and state and federal emergency response agencies in homeland security planning, and participates in periodic drills with various agencies, particularly with respect to electric utility system security issues.

## workplace performance

The businesses of Pinnacle West are built upon a foundation of skilled, diverse and dedicated employees. We consider our employees a competitive advantage, and in order to retain and attract this talented workforce, we offer competitive compensation, strong benefits and a variety of career opportunities.

Our workforce is an area of core emphasis in our 2005-2010 Business Plan, and PNW recognizes that our employees are the critical factor in making our business successful.

Over the next five years, we face the challenge of planning for and supporting significant workforce transition. Core skills and capabilities, including leadership, must be developed as long tenured employees retire and new employees are integrated into the workforce. Also, new skills and capabilities will be required to implement improved processes, new infrastructure and new technology. Success in this area depends on planning and executing knowledge transfer, workforce planning and development, and human performance improvement

### Labor Practices & Work Environment

Pinnacle West's number one asset is its employees. The company offers a wide array of career opportunities in leadership, professional, technical, administrative and internship positions, as well as union and non-union positions. At Pinnacle West, our goal is to treat every employee equitably, professionally and with respect. We have a highly-skilled human resources group dedicated to ensure that labor and employment issues are addressed. We also have internal policies that spell out employees' rights, and an established code of conduct that all employees are expected to follow (See our ethics policy in the Governance Section of this report). The company also offers an Employee Concerns Program (ECP) through which employees can anonymously report any suspected wrongdoing.

#### Attracting Employees

Our company's Web site connects potential job seekers with employment opportunities as well as information about our family of companies.

The company's School-To-Work (STW) internship program and scholarships introduce students to virtually every part of

our business from engineering to trades and crafts to information systems. Students are recruited for positions throughout the Pinnacle West family of companies. STW targets students who are attending community colleges or universities, or who are enrolled in vocational programs tailored for the utility industry.

#### Total Rewards

Our company offers competitive compensation and rewards for outstanding performance. APS offers competitive salaries, comprehensive benefits and a sound work environment. All of our full-time employees are covered by a defined benefit plan and approximately 80 percent of our employees participate in our defined contribution pension. As of January 1, 2006, our projected benefit obligation for the defined benefit plan is at a funded percentage of 71 percent.

About 3.5 percent of the outstanding shares of Pinnacle West stock are held by employees. Pinnacle West's compensation and benefits plan are discussed in more detail on the Pinnacle West Web site.

#### Family-Friendly Benefits

- The company offers unpaid sabbaticals to employees who have been employed for five years. General leaves of absence are also available
- Time off for mothers after giving birth falls under the company's Short-Term Disability policy. No additional paid maternity leave is available
- We have a listing of child care centers that provide a discount to Pinnacle West employees
- We have a Healthcare flexible spending account and a dependent care flexible spending account for our employees
- Where appropriate, flextime/job share schedules are used in the company
- Based on business needs, part-time work is available upon return in certain circumstances
- The company provides adoption aid reimbursement up to certain limits of qualified adoption expenses

### **Union Representation**

The Company has Collective Bargaining Agreements (CBAs) with three Unions: The International Brotherhood of Electrical Workers Local #387 (IBEW 387), the Security, Police, Fire Professionals of America (SPFPA), and the United Brotherhood of Carpenters and Affiliated Local Union #408 International. Nearly 30 percent of the company's employees are represented by one of these Unions.

In each case there is a negotiated Labor agreement that establishes the working rules and other terms and conditions of employment. The company's philosophy is to work cooperatively with unions where they are in effect and to honor the agreements we have made in our negotiations.

Pinnacle West and APS enjoy a healthy mutual respect with IBEW Local 387, the largest union representing employees within the company. Through this partnership with IBEW, several initiatives have been implemented, including a multi-skill-training program, a process to hire supplemental workers, a drug-free workplace program, an apprenticeship program, a driver qualification program and numerous safety projects. The union and the company often join in community-minded causes such as the Valley of the Sun United Way's Community Service Fund campaign and a baseball field building program with Major League Baseball's Arizona Diamondbacks.

As far as the company's relationship with its union employees, Human Resources Manager Kevin Salcido outlines the company's philosophy as follows: "We respect the rights of our union employees to bargain collectively. We strive to retain positive labor relations and we always try to resolve issues internally and at the lowest level possible to ensure positive outcomes for the employee and for the company."

The company also has a positive discipline program in which leaders work in conjunction with employees and human resources representatives to achieve positive resolution.

### **Workforce Succession Planning**

As our workforce gets older, the company faces the daunting task of replacing many years of experience as employees plan their retirements. The company has taken steps to ensure that not only are key positions filled when experienced employees leave; but also they are filled with employees who are ready and well trained.

"It's been said there's no substitute for experience," Ray Gonzales, Vice President Human Resources, said. "The difficulty lies in the transferring of the nuances of a particular job or discipline. It's that type of detail and familiarity and experience that has to be passed down to the employees who are stepping into positions."

Gonzales added that although our workforce is aging, our turnover rate including retirements remains low, which gives the company the time needed to accelerate our training, development and recruitment efforts.

"It is a positive affirmation that APS is a good place to work, with low turnover and where employees feel like they have a stake in the company. Working for a company with an aging workforce is a sign of stability," he said. "The challenge is in filling the pipeline and making sure that new people are trained and that knowledge gets transferred," Gonzales said.

Pinnacle West has had a formal succession planning processes for years, which includes all key leaders throughout the enterprise. This means the company has identified potential successors for key positions and has a strong focus on their development.

So while the company stands to lose half of its current employee population to retirement in the next ten years, Gonzales said "we're putting together tools to look at the entire organization to ensure we fill those positions and maintain a transfer of that knowledge."

One of the tools is the "dashboard," a matrix (resembling the layout of a car's dashboard) that can be tailored for any business unit in the company. It provides a snapshot of an individual business unit's workforce, taking into account turnover statistics and more. The dashboard allows each unit to better plan which positions require backup and knowledge transfer.

Another key way to help business units understand their potential staffing and training needs is the "Knowledge Management Tool," which ensures that business units plan for positions that are either "critical" or "unique."

Gonzales said succession planning really is a multi-pronged approach which includes:

- Developing and preparing current employees with a focus placed on succession planning
- Transferring knowledge
- Attracting new talent
- Process improvement for succession planning

“We have to look at the work to see what it is we need,” said Gonzales. “We not only have to look ten years out but we also have to focus on the next three to five years. By taking a short- and long-term approach to filling positions that are either critical or unique, we can be proactive in making sure we train people to ascend into open positions by training or hiring them ahead of time, before retirements occur.”

And, APS’ succession-planning efforts aren’t confined to the company. For many years APS has recruited interns and employees from the community as well.

The company sponsors several apprentice programs through local high schools and colleges aimed at recruiting, training and retaining talented students into the workforce.

## Employment Profile and Diversity

At Pinnacle West and APS, we share a strong diversity commitment in our workplaces, in our procurement practices and in our community activities.

In 2006, Pinnacle West had 6,556 employees, compared to 6,430 in 2005.

2006 PNW EEO Employer Information Report						
Job Categories	Overall Totals	White (not of Hispanic origin)	Black (not of Hispanic origin)	Hispanic	Asian or Pacific Islander	American Indian or Alaskan Native
Officials/Managers	803	564 (M) 114 (F)	9 (M) 4 (F)	44 (M) 14 (F)	13 (M) 1 (F)	36 (M) 4 (F)
Professionals	1834	1091 (M) 379 (F)	30 (M) 17 (F)	108 (M) 59 (F)	80 (M) 19 (F)	27 (M) 24 (F)
Technicians	475	327 (M) 62 (F)	15 (M) 3 (F)	40 (M) 9 (F)	6 (M) 0 (F)	10 (M) 3 (F)
Sales Workers	13	8 (M) 3 (F)	0 (M) 0 (F)	1 (M) 1 (F)	0 (M) 0 (F)	0 (M) 0 (F)
Office /Clerical	907	225 (M) 393 (F)	12 (M) 26 (F)	56 (M) 140 (F)	4 (M) 6 (F)	10 (M) 35 (F)
Craft Workers (skilled)	2020	1325 (M) 33 (F)	37 (M) 3 (F)	194 (M) 8 (F)	4 (M) 0 (F)	361 (M) 55 (F)
Operatives (semi-skilled)	239	168 (M) 14 (F)	8 (M) 1 (F)	30 (M) 6 (F)	2 (M) 0 (F)	10 (M) 0 (F)
Laborers	57	35 (M) 2 (F)	0 (M) 0 (F)	19 (M) 1 (F)	0 (M) 0 (F)	0 (M) 0 (F)
Service Workers	208	131 (M) 27 (F)	12 (M) 2 (F)	26 (M) 5 (F)	3 (M) 0 (F)	2 (M) 0 (F)
<b>Total</b>	<b>6556</b>	<b>3874</b>	<b>123</b>	<b>518</b>	<b>112</b>	<b>456</b>
<b>Previous Report Total</b>	<b>6430</b>	<b>3803</b>	<b>119</b>	<b>483</b>	<b>105</b>	<b>457</b>
*(M)Male, (F)Female						

## Employee Development and Training

Employee/Management Count					
	2002	2003	2004	2005	2006
<b>Employee Count</b>					
Total Employees	6300	6368	6416	6430	6556
Total Female	24%	23%	23%	22%	22.5%
Total Minorities	24%	25%	25%	26%	25.3%
<b>Management</b>					
Total Management	640	766	740	785	803
Total Female	19%	15%	15%	17%	17.6%
Total Minorities	16%	13%	13%	15%	15.6%

On-going employee training and development is critical to the success of our company. Pinnacle West offers employees excellent opportunities for career and employee development training. This includes numerous internal training opportunities as well as external training and tuition reimbursement for formal college and university training.

The company has created an internal training organization

called Pinnacle West University, which offers more than 1,100 online courses covering business topics relevant to our industry and specific disciplines. Courses range in topic from safety to ethics to diversity and are available to employees with Internet access from the office or home.

We are committed to being an equal-employment and affirmative-action employer. We understand the value of diversity in our workforce and actively seek opportunities for incorporating diversity within our company. Pinnacle West strives to provide every employee an equal opportunity to succeed professionally. Our work environment is one wherein every employee is treated with dignity and respect. Decisions about employment, training, compensation and promotion are based on job-related qualifications. Not only does our company prohibit discrimination, our policy explicitly prohibits sexual harassment or harassment of any nature in the workplace. Annual affirmative-action training is required of all leaders.

### Full-time Staff Dedicated to Providing Training, Development and Consulting Services

The company has more than 124 full-time professional staff members dedicated to providing engineering, craft, trade, technical, customer service, professional, business practices, environmental, health and safety training and individual and team development. The ratio is one full-time professional for every 50 employees.

APS has a dedicated corporate Affirmative Action/Diversity Team, headed by the manager of Workforce Services, that focuses on workforce analysis, compliance, affirmative action, diversity, maintaining a harassment-free workplace, and training and education.

### Dedicated Training Facilities and Resources

The company has six dedicated training facilities which include a plant-specific nuclear control room training simulator; other power plant operations simulators; maintenance, electrical, instrumentation, chemistry, customer service, line worker and other technical training laboratories and equipment mock-ups. Employees have access to fully-equipped classrooms for instructor-led as well as computer-based training. The company also provides online business and information technology "referenceware" and courses that are accessible to employees at work or at home, 24-hours-a-day.

APS also sponsors many cultural events in the Phoenix community such as The Black History Heritage Festival, and the "Diversity Among Nations" Native American celebration.

### Significant Dollar Investment

The company spends more than \$30 million annually for facilities, staff, materials, supplies, tuition, fees and travel to provide training and development for its employees. This is an average of more than \$4,800 per employee. This figure does not include cost of the participants' time spent in training and development activities.

In 2006, we received the following awards in recognition of our workplace diversity efforts:

- The 2006 Freedom to Compete award to APS by the U.S. Equal Opportunity Commission in recognition of excellence in equal employment opportunity practices that promote access and inclusion that can be emulated by other employers or organizations
- APS was identified as a 2006 National Industry Liaison Group "Best Practices Winner"
- APS was awarded the first American Corporate Leadership Award by the National Center for American Indian Enterprise Development for its leadership on behalf of Native American businesses and economic development with Native American communities

## Accredited, Certified Training Programs

- Eleven nuclear training programs are accredited by the Institute of Nuclear Power Operations (INPO)
- Six craft apprenticeship programs meet state certification requirements
- Environmental, health and safety training programs meet and exceed requirements of the Occupational, Safety and Health Administration (OSHA), Environmental Protection Agency (EPA), Department of Transportation (DOT) and Nuclear Regulatory Commission (NRC)

## Formal Training Requirements

- All employees are required to complete annual ethics, safety, environmental and business practices training, averaging four hours per employee. Training completion is tracked and reported
- Approximately 70 percent of the company's employees work in highly specialized craft, operations, technical, engineering, and customer service positions and have annual job specific training requirements. These training requirements range in duration from 16 to 400 hours annually, for an average of 46 hours of annual continuing training per employee in these job groups. Training completion is tracked and reported

## Formal Development Processes

- The company has a formal succession planning processes. Succession planning development plans are directed by a panel comprised of the CEO and the executive vice-presidents for officers and candidates to officer positions. Succession planning development plans for senior managers and candidates to senior management positions are directed by panels comprised of executive vice-presidents, vice-presidents and appropriate senior managers.

The company has formal leadership development processes:

- Employees have access to an e-Learning system which can assist them in identifying their aptitude and/or interest in becoming a leader
- Once an employee is identified to fill a leadership role he or she is provided with additional e-Learning and in person training opportunities. First-time leaders are provided with courses covering leadership, communication, performance management, and business skills which prepares them for their formal leadership role. Leaders receive ongoing communications on leadership development topics and business relevant materials throughout the year
- All company leaders at the manager level and above participate in three to four Leadership Forums per year, to stay focused on the company's business direction, results and challenges
- Each business unit executive directs an annual program for his or her leaders to address changes in management, culture, and human-performance improvement issues unique to the business unit

The company has formal employee development processes:

- The company provides an educational assistance program for employees seeking college credit or degrees. Employees are reimbursed 80 percent of tuition upon successful completion of a course. Within the annual limit of \$5,000, employees may also be reimbursed the remaining 20 percent of tuition costs upon successful completion of a degree
- Performance Review (non-union) employees receive an annual performance plan, which includes identification of learning and development objectives. Approximately 70 percent of the company's employees are performance review

## Employee Health and Productivity

Pinnacle West provides a variety of programs that encourage healthy lifestyles and informed decision making to better manage health costs and positively impact individual health and productivity.

We view health management as a corporate business strategy that focuses upon prevention and health promotion to control escalating health benefit costs while improving the success and health of our employees and the company as a whole. We know that disability costs and the effects of an aging workforce can be minimized through effective implementation of processes and programs designed to promote healthy behaviors and lifestyle practices.

We continue to invest in comprehensive programs that improve the health, productivity and well being of our employees by promoting healthy behaviors, disease management and healthy lifestyles. Through these efforts we have been able to control escalating health-benefit costs while improving the success of our employees and our company and will continue our medical strategy focus to:

- Reduce health risks and improve long-term health status
- Reduce medical claims costs
- Motivate positive change in modifiable health risk behaviors
- Integrate health promotion, preventive services and care management for employees along the health care continuum

The company offers a variety of programs to employees to assist with, and support individual personal health management, including:

**Healthquest** is a voluntary, company-paid health screening conducted by an outside worksite wellness vendor at more than 28 site locations throughout the company. Healthquest offers a convenient way for employees to help identify and support healthy lifestyle behaviors. Participants receive a health evaluation and comprehensive lab screening. After the screening, a confidential report is sent to the participant's home, along with information and resources to help interpret results and take action in managing personal health

**Employee Assistance Program** provides no-cost, employee-assistance counseling and referral services to all employees and their family members seeking solutions to personal difficulties such as (but not limited to): emotional stress, marital and family discord, drug or alcohol abuse, financial or legal burden, death of a loved one, grief, anxiety, depression or other personal problems which may occur

**Weight/Lifestyle Management Classes** provides educational instruction and resources to support a healthy lifestyle and promote behavioral change

**Flu Shots** are provided for free to employees

**Mobile Onsite Mammogram (MOM)** screening services at company facilities

**Healthy Lifestyle loans** which are interest-free loan up to \$1,500 toward healthy lifestyle programs and services. These include annual fitness center membership, home use fitness equipment, personal training, nutritional counseling/weight management and programs to help employees quit smoking/tobacco

**Ergonomics Program** which was created to minimize the potential health impacts to employees from ergonomic stress related injuries and illnesses

**Mayo Clinic Web Access** provides online health information and resources, including a health risk assessment and interactive lifestyle management tools and programs

**Healthy Returns Care Management** offers care-management services to assist those in better managing chronic diseases or conditions

### **Flu pandemic plan**

Since APS is a critical part of the local infrastructure, a flu pandemic scenario is one possible crisis being addressed in the company's Business Resumption Plan (BRP). A cross-functional team of employees from Energy Delivery, Generation and Shared Services is developing plans to address the impact of sustaining operations during a flu outbreak. Such an outbreak could affect employees and the company's business operations.

In addition, recognizing that a good defense is a healthy offense, the company's Health Services team is providing employees with information on good health practices. By following this information, employees and their families can minimize their risk of becoming part of the flu pandemic.

## Safety Performance

Safety is the overriding value of all aspects of our business. The first job of all employees at APS is to ensure their safety, that of their co-workers and the public at large. While the growth of our service territory dictates greater efficiency and productivity, these added demands cannot come at the expense of the health and safety of our employees.

With the amount of work necessary to meet our rapidly growing service territory, the challenge to work safely will continue into the future. This challenge is increasingly significant as many experienced employees reach retirement age and new members of our team are trained. In the APS 2005-2010 Business Plan, the management team asks each employee to "Own the Challenge." Until APS employees can achieve zero recordable injuries and sustain that performance, there will always be room for improvement.

Specifically, employees have been asked to focus on six fundamental principles of safety:

- Use the right tool for the job
- Get the necessary training
- Wear appropriate personal protective equipment
- Conduct thorough tailboard (pre-job) briefings
- Stop work if there is a safety concern or question
- Report all close calls

### Leading Safety Performance

The sustained safety performance of APS employees has resulted in our company being in the top five performers in the past five years (twice listed as number one) as compared to like-sized investor-owned utilities by the Edison Electric Institute. Our management team is responsible and accountable for safety performance. However, leadership recognizes that the expertise in safe work practice design, application and performance resides with frontline employees and their immediate supervision. APS' success in safety is the result of the efforts of labor and management teams. These teams are supported by full-time safety and health professionals working cooperatively, in the various divisions and at each power plant. We believe this approach works best at APS and will continue to drive personal behaviors and safe work practices. The following describes three of the many teams approaches used to drive the safety program at APS:

#### Safety and Health Advisory Team

The Safety and Health Advisory Team is responsible for providing cross-functional strategic direction and leadership on companywide health and safety issues. The team consists of safety and health professionals and management from each business unit of the company. Each team member represents his or her respective business unit and communicates health and safety issues between the team and the facilities. The team makes recommendations to the EHS vice president on all matters requiring executive oversight.

The Safety and Health Advisory Team is supported by two different issue teams, a Prevention Team and a Compliance Team. The Prevention Team advances programs and practices that promote employee wellness and accident prevention. The Compliance Team addresses regulatory compliance matters and interpretation of best management practices.

#### Joint Health and Safety Committee

The Accident Prevention Manual (APM) Rules/Revision Committee is comprised of a group of company and Local IBEW employees who meet to review the safety rules and any employee requests for revisions to the manual. The committee, which is indicative of the partnership shared between the company and IBEW, in addition to fielding these requests will take individual sections of the manual and review them to determine if updating is necessary. Once a review is completed and change is deemed necessary, the manual is updated and brought to the committee for final discussion and signature. After the committee has signed off on the rule, it goes to the Safety and Health Advisory Team and the IBEW Executive Board for review, acceptance and implementation.

#### Craft Observation Teams

The Energy Delivery business unit at APS has established four full-time IBEW positions that conduct field observations of membership work practices and work conditions. These employees conduct on-site interventions to improve work practices and environments on a real-time basis. They are not required to report specifics of the observations to local supervision or management. They simply provide a summary of observations on a periodic basis. This technique enhances trust among union membership and creates an environment that is open to immediate corrective or improvement actions.

This same approach is used at several APS Generation facilities during critical overhauls and outages. Just as with the Energy Delivery personnel, generation employees welcome the intervention by peers and collaborate to achieve improved practices and conditions.

### Critical Success / Performance Indicators

We recognize the need to track and report safety performance in the form of numbers of injured employees. However, we never lose sight of the fact that these statistics are not just numbers; they are our fellow employees, peers and friends. Their injuries may have been the result of a management system failure, or an individual performance error and may have been non-preventable. Regardless of the cause of the accident, we must learn from the incident in order to prevent similar injuries in the future.

As a corporation, we report on safety statistics in order to measure and improve our performance. In its 2005 - 2010 business Plan, "Owning the Challenge," APS has challenged its entire staff to be "the best of the best" as judged against liked-sized investor-owned utilities. APS' goal is to be ranked number one among its peer utilities by 2010 as measured by:

All Injury Incident Rate - total OSHA Recordable injuries reported;

Lost Work Incident Rate - total number of OSHA Recordable injuries resulting in lost workdays; and,

Severity Incident Rate - total number of workdays lost due to OSHA Recordable injuries.

While APS continues to be a top performer in safety performance in the electric & gas utility industry, our safety performance metrics did decrease a bit in 2006, as shown in the chart below. Safety is a top priority at APS, and we are taking steps to improve that performance in 2007.

*(Note: 2006 Edison Electric Institute utility industry safety statistics were not available at the time this report was published.)*

Accidents occur for a variety of reasons, preventable and non-preventable. For a number of years, we have used an internal indicator to help assess safety performance, which we call "Preventable Recordable Accidents." This was used to help employees focus on preventing accidents in the workplace, and to provide incentives for successful performance in reducing accidents in which management and/or the employee have control over the events leading to an accident. This indicator was useful in helping APS establish its industry leading safety record. However, we also believe that the use of this indicator has achieved its purpose, and retired its use at the end of 2006. Beginning in 2007, APS will exclusively use the industry standard safety statistics (e.g. OSHA Total Recordable) for both external reporting and internal performance indicators and incentives.

APS Safety Performance					
	2002	2003	2004	2005	2006
<b>Total Recordable Cases</b>					
<b>APS Total</b>	117	130	98	152	156
<b>Target Maximum</b>	0	0	0	0	0
<b>APS Injury Incident Rate (AIIR)<sup>(a)</sup></b>	1.81	2.04	1.52	2.28	2.31
<b>Target Maximum</b>	0	0	0	0	0
<b>Electric &amp; Gas Utility Industry Average<sup>(b)</sup></b>	3.33	3.12	3.7	3.07	N/A
<b>Lost Work Day Cases</b>					
<b>APS Total</b>	15	16	31	43	41
<b>Target Maximum</b>	0	0	0	0	0
<b>APS Injury Incident Rate (LWIR)<sup>(a)</sup></b>	0.23	0.25	0.49	0.64	0.61
<b>Target Maximum</b>	0	0	0	0	0
<b>Electric &amp; Gas Utility Industry Average<sup>(b)</sup></b>	0.8	0.61	0.70	0.73	N/A
<b>Lost Work Days</b>					
<b>APS Total</b>	313	691	1149	1070	1218
<b>Target Maximum</b>	0	0	0	0	0
<b>APS Injury Incident Rate (SIR)<sup>(a)</sup></b>	4.81	10.83	17.81	16.02	18.00
<b>Target Maximum</b>	0	0	0	0	0
<b>Electric &amp; Gas Utility Industry Average<sup>(b)</sup></b>	22.17	18.48	35.7	30.85	N/A
<b>APS Fatalities</b>	1	0	0	0	0

(a) All Injury Incident Rate (AIIR) : The total of all recordable cases multiplied by 200,000 and divided by the actual employee exposure hours worked. Lost Work Day Incident Rate (LWIR) : The total of all recordable cases multiplied by 200,000 and divided by the actual employee exposure hours worked. Severity Incident Rate (SIR) : The total of all recordable cases multiplied by 200,000 and divided by the actual employee exposure hours worked.

(b) Source: Edison Electric Institute Safety Survey.

### APS Preventable OSHA Recordable History

	2002	2003	2004	2005	2006
Fatalities	1	0	0	0	0
Loss Time Injuries	10	15	22	25	28
Medical Attention Recordable Injuries	84	73	48	66	70
<b>Total</b>	<b>91</b>	<b>88</b>	<b>70</b>	<b>91</b>	<b>98</b>

We have a formal electronic Event Notification and Tracking System, and strongly encourage reporting of all close-call events so that we can evaluate the circumstances behind the close-call in order to further improve our safety program, whether that be by changing procedures, improved training, equipment changes, etc. By evaluating close calls and making corrections when appropriate, we believe we can identify potential problem areas before they result in an accident.

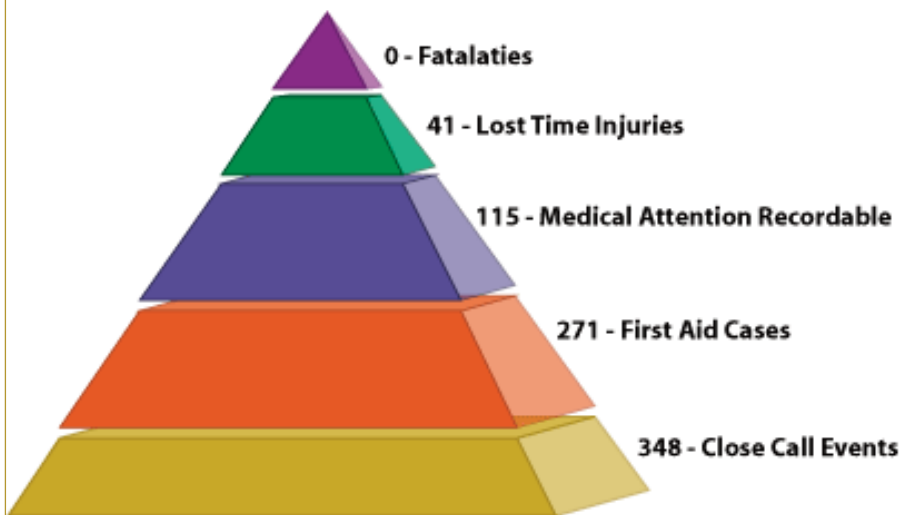
Our close call event numbers have increased over the past several years as we have been successful in improving employee cooperation in this important part of our overall safety effort.

### APS Preventable OSHA Recordable History

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The Pinnacle West/APS Safety Pyramid shown below helps us visualize the relationship of safety events, as we continue to move our safety efforts to the very front of the accident evaluation process in order to prevent future accidents.

### 2006 PNW/APS Safety Pyramid



Despite the decrease in our performance in 2006, the fact remains that when compared to the rest of industry, APS is a leader; a benchmark utility with an exceptional safety performance record. We are confident that we will reverse our downward performance of 2006 as we work toward meeting our 2010 goal of being the top utility in our sector for safety performance.

## *gri content table*

Indicator	Description	PNW Report Reference
<b>1. Strategy and Analysis</b>		
1.1	Statement from senior decision-maker	<a href="#"><u>Executive Message</u></a>
1.2	Description of key impacts, risks, and opportunities	<a href="#"><u>Key Issues</u></a>
<b>2. Organizational Profile</b>		
2.1	Organization's name	<a href="#"><u>Company Profile</u></a>
2.2	Major products	<a href="#"><u>Company Profile</u></a>
2.3	Operational structure and major divisions	<a href="#"><u>Company Profile</u></a>
2.4	Location of headquarters	<a href="#"><u>Company Profile</u></a>
2.5	Countries of operation	<a href="#"><u>Company Profile</u></a> <a href="#"><u>PNW Subsidiaries</u></a>
2.6	Nature of ownership	<a href="#"><u>Company Profile</u></a>
2.7	Markets served including geographic breakdown/sectors served/customers	<a href="#"><u>Company Profile</u></a> <a href="#"><u>PNW Subsidiaries</u></a>
2.8	Scale of organization including number of employees, nets sales/revenues, total capitalization	<a href="#"><u>Company Profile</u></a> <a href="#"><u>Financial Performance</u></a> <a href="#"><u>Employment Profile &amp; Diversity</u></a>
2.9	Significant changes during reporting period	<a href="#"><u>Report Introduction</u></a> <a href="#"><u>PNW's Approach to Sustainability</u></a>
2.10	Awards	<a href="#"><u>Awards &amp; Recognitions</u></a>
<b>3. Report Parameters</b>		
3.1	Reporting period	<a href="#"><u>Report Introduction</u></a>
3.2	Date of previous report	<a href="#"><u>Report Introduction</u></a> <a href="#"><u>Archives</u></a>
3.3	Reporting cycle	<a href="#"><u>Report Introduction</u></a>
3.4	Contact point	<a href="#"><u>Company Profile</u></a>
3.5	Process for defining report content	<a href="#"><u>Report Introduction</u></a>
3.6	Boundary of the report	<a href="#"><u>Report Introduction</u></a>
3.7	Limitations on the scope or boundary of the report	<a href="#"><u>Report Introduction</u></a>
3.8	Basis for reporting on joint ventures, etc.	<a href="#"><u>Report Introduction</u></a>

3.9	Data measurement techniques and bases of calculations including assumptions	<a href="#"><u>Report Introduction</u></a>
3.10	Restatements of information	<a href="#"><u>Report Introduction</u></a>
3.11	Significant changes from previous reporting periods	<a href="#"><u>Report Introduction</u></a>
3.12	GRI Content Index table	<a href="#"><u>GRI Content Table</u></a>
<b>4. Governance, Commitments &amp; Engagement</b>		
4.1	Governance structure including committees	<a href="#"><u>Corporate Governance</u></a>
4.2	Indicate whether chair of highest governance body is also an executive officer	<a href="#"><u>Corporate Governance</u></a>
4.3	Percent of independent directors	<a href="#"><u>Corporate Governance</u></a>
4.4	Mechanisms for shareholders and employees to provide recommendations/direction to highest governance body	<a href="#"><u>Corporate Governance</u></a>
4.5	Linkage between compensation and organization's performance for members of highest governance body/senior executives	<a href="#"><u>Corporate Governance</u></a>
4.6	Process for the Board to ensure conflicts of interest are avoided	<a href="#"><u>Corporate Governance</u></a>
4.7	Processes for determine qualifications and expertise for guiding strategy	<a href="#"><u>Corporate Governance</u></a>
4.8	Mission and values statements, codes of conduct, principles relevant to economic, environmental and social performance, and status of implementation	<a href="#"><u>Corporate Governance</u></a> <a href="#"><u>EHS Policy, Organization and Management</u></a> <a href="#"><u>Company Profile</u></a>
4.9	Procedures of highest governance body for overseeing economic, environmental and social performance including compliance, codes of conduct	<a href="#"><u>Corporate Governance</u></a>
4.10	Processes for evaluating performance of governance body with respect to economic, environmental and social performance	<a href="#"><u>Corporate Governance</u></a>
4.11	Explanation of how precautionary approach/principle is addressed by organization	<a href="#"><u>Corporate Governance</u></a>
4.12	Externally developed, voluntary economic, environmental, and social charters, sets of principles, or other initiatives	<a href="#"><u>Corporate Governance</u></a> <a href="#"><u>Environmental Performance</u></a> <a href="#"><u>Community &amp; Customers</u></a>

4.13	Significant memberships in associations and/or advocacy organizations	<b><u>Affiliations and Memberships</u></b>
4.14	List of stakeholder groups	<b><u>Stakeholder Engagement</u></b>
4.15	Basis for identification and selection of stakeholders with whom to engage	<b><u>Stakeholder Engagement</u></b>
4.16	Approaches to stakeholder engagement, including frequency and type	<b><u>Stakeholder Engagement</u></b>
4.17	Key issues raised through stakeholder engagement and how organization has responded	<b><u>Stakeholder Engagement</u></b>
<b>Economic Performance Indicators</b>		
EC1	Direct economic value generated and distributed	<b><u>Economic Impacts</u></b> <b><u>Economic Development</u></b>
EC2	Financial implications and other risks and opportunities due to climate change	<b><u>Climate Change</u></b>
EC3	Coverage of the defined benefit plan obligations	<b><u>Financial Performance</u></b>
EC4	Significant government assistance	<b><u>Corporate Governance</u></b>
EC8	Development and impact of infrastructure investments and services provided for public benefit	<b><u>Economic Impacts</u></b> <b><u>Community Support</u></b>
<b>Environmental Performance Indicators</b>		
EN2	Recycled Materials	<b><u>Waste</u></b>
EN3	Direct energy consumption	<b><u>Material &amp; Chemical Management</u></b>
EN4	Indirect energy consumption	<b><u>Material &amp; Chemical Management</u></b>
EN8	Total water withdrawal	<b><u>Water</u></b>
EN11	Land Use	<b><u>Land Use &amp; Biodiversity</u></b>
EN12	Biodiversity	<b><u>Land Use &amp; Biodiversity</u></b>
EN16	Direct and indirect greenhouse gas emissions	<b><u>Climate Change</u></b>
EN17	Other indirect GHG emissions	<b><u>Climate Change</u></b>
EN20	NO, SO, and other air emissions	<b><u>Air Emissions</u></b>
EN21	Water discharge	<b><u>Water</u></b>
EN22	Wastes	<b><u>Waste</u></b>
EN23	Spills	<b><u>Spills &amp; Remediation Programs</u></b>
EN28	Compliance	<b><u>EHS Compliance</u></b>
EN29	Transportation	<b><u>Mobile Fleet</u></b>
<b>Social Performance Indicators</b>		
LA1	Total employees	<b><u>Employment Profile &amp; Diversity</u></b>
LA3	Benefits	<b><u>Labor Practices &amp; Work Environment</u></b>
LA7	Health and safety rates	<b><u>Safety Performance</u></b>

LA8	Programs to assist employees, families, or community members regarding serious diseases	<b><u>Labor Practices &amp; Work Environment</u></b>
LA10	Employee training	<b><u>EHS Training</u></b>
LA11	Skills management and lifelong learning	<b><u>Workplace Performance</u></b>
LA13	Diversity	<b><u>Employment Profile &amp; Diversity</u></b>
HR6	Operations having significant risk for incidents of child labor	<b><u>Labor Practices &amp; Work Environment</u></b>
HR7	Operations having significant risk for incidents of forced labor	<b><u>Labor Practices &amp; Work Environment</u></b>
SO5	Public policy development and lobbying	<b><u>Corporate Governance</u></b>
SO6	Total value of contributions to political parties, politicians, and related institutions	<b><u>Corporate Governance</u></b>
SO11	Community Engagement	<b><u>Corporate Governance</u></b>
PR6	Program for adherence to laws, standards, and voluntary codes related to marketing communications	<b><u>Corporate Governance</u></b> <b><u>Environmental Performance</u></b>
<b>Electric Utility Supplement</b>		
EU3	Reliability	<b><u>Electric System Reliability</u></b>
EU5	Generation mix	<b><u>APS Generation</u></b>
EU8	Research & Development	<b><u>Technology Innovation</u></b>
EU13	Water Management	<b><u>Water</u></b>
EU21	PCB Management	<b><u>Material &amp; Chemical Management</u></b>