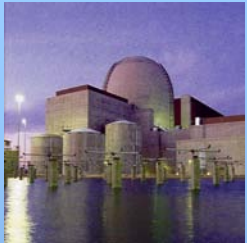




PINNACLE WEST
CAPITAL CORPORATION



THE POWER TO MAKE IT HAPPEN



Regulatory Overview

Steve Wheeler

**Analyst Conference
November 7, 2008**

Today's Agenda

- **Regulatory goals**
- **Significant developments in recent years**
- **Retail rate cases pending**
 - **Interim base rate request**
 - **General rate case**
- **Transmission rate settlement**
- **ACC election results**
- **Focusing on regulatory improvements**

APS' Primary Regulatory Goals

- **Timely cost recovery and return on investment**
- **Financial strength and stability**
- **APS integrated resource plan approval**
- **Improved regulatory processes**
- **Establishment of prudent, comprehensive state energy policy**
- **Support for beneficial customer programs**

Significant Developments Since 2005

- **Unification of PWEC assets**
- **Retail cost recovery mechanisms**
 - **Fuel and purchased power adjustor (PSA)**
 - **Transmission cost adjustor (TCA)**
 - **Renewables surcharge (RES)**
 - **Demand-side management adjustor (DSM)**
 - **Environmental improvement surcharge (EIS)**
- **Retail line extension fees**
- **FERC “formula” transmission rates**

APS Interim Base Rate Request Details

- **Application filed with ACC June 6, 2008**
- **Base rate surcharge to be effective until general rate case decision**
 - **\$0.004 per kWh (approximately 4%)**
 - **\$115 million annual pretax retail revenues**
- **Subject to refund pending outcome of general rate case**
- **Hearings September 15-19, 2008**
- **Requested effective date November 2008**

Interim Rate Request Themes

- **Address APS' financial condition pending general rate case proceedings**
 - **Preserve investment-grade credit ratings**
 - **Provide cash flow**
 - **Strengthen credit metrics and earnings**
- **Protect customers against higher future costs**
- **Reduce rate volatility for customers**
- **Recognize cost management essential, but not enough**
- **Implement as part of broader four-part plan to restore APS' financial strength**

Summary of Staff and Intervenor Positions on Interim Relief Request

ACC Staff

- Does not support interim increase
- If Commission grants request
 - \$65 million annual revenue increase recommended
 - No equity infusion pre-condition

Residential Utility Consumer Office (RUCO)

- Does not support interim increase

Arizonans for Electric Choice and Competition (AECC)

- Supports \$42.4 million annual revenue increase effective January 1, 2009
- Equal percentage increase

Arizona Investment Council (AIC)

- Supports APS request

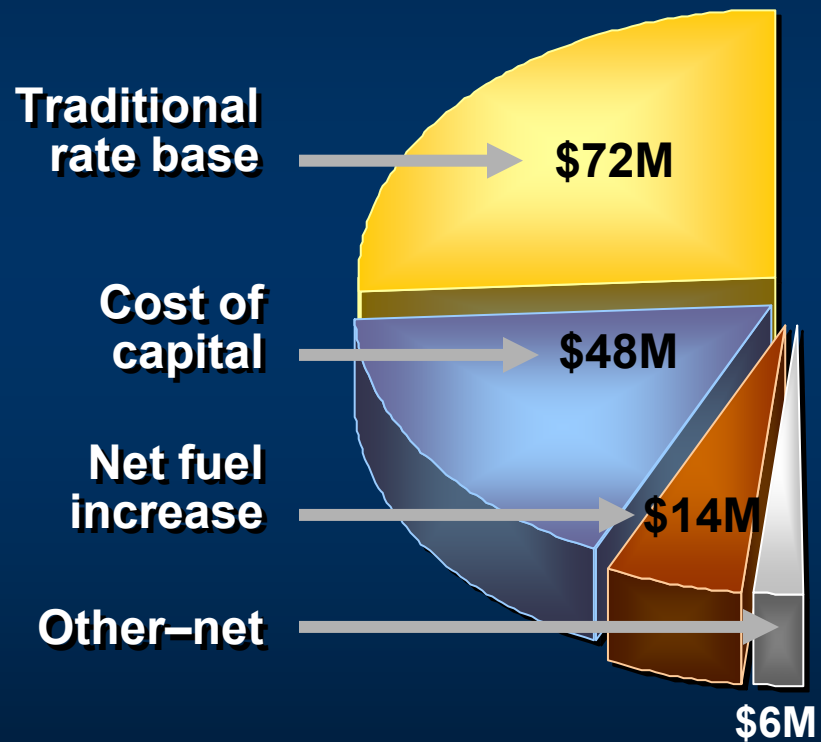
Mesquite Group (merchant generators)

- Supports APS request

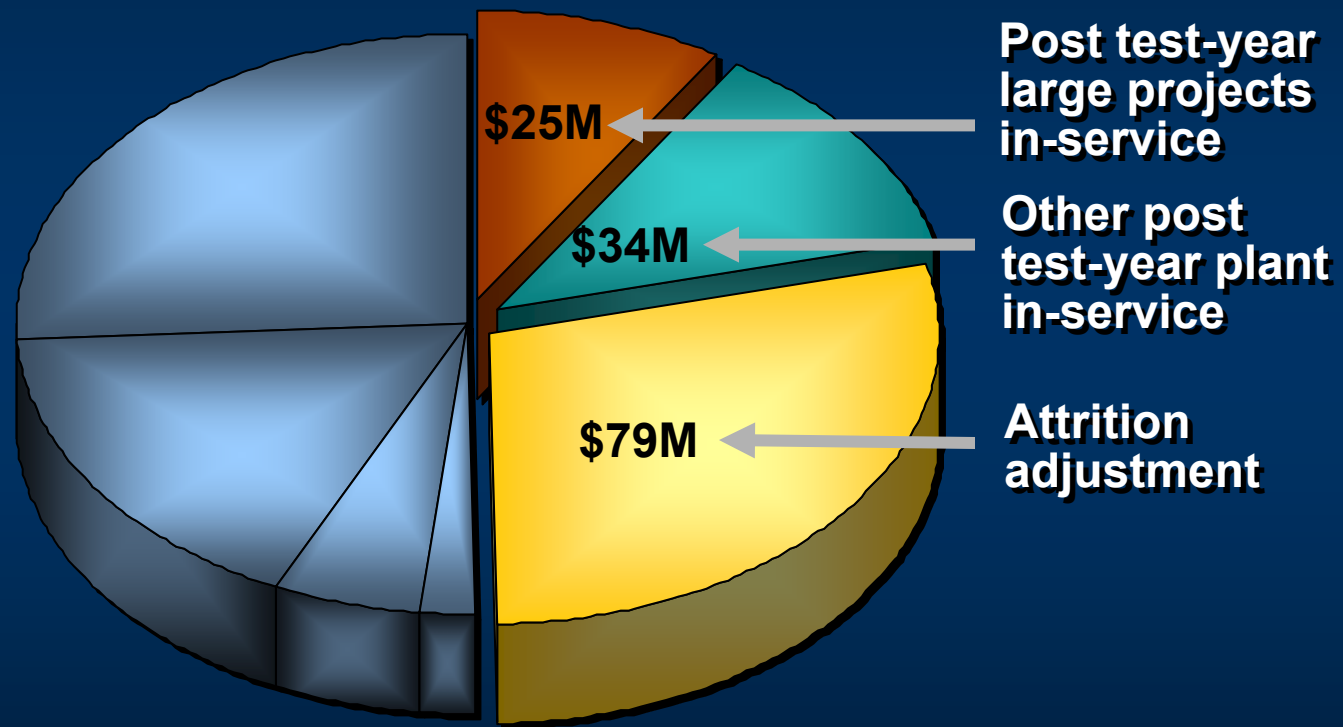
APS Retail Rate Case Elements

- **Adjusted 2007 test year**
- **Recognize \$1.7 billion of capital expenditures since last rate case**
- **Address earnings attrition**
- **Implement new growth impact fee**
- **Encourage energy efficiency programs**
- **New conservation rates**

Composition of \$278 Million APS Rate Increase



Composition of \$278 Million APS Rate Increase



Proposals to Mitigate Earnings Attrition

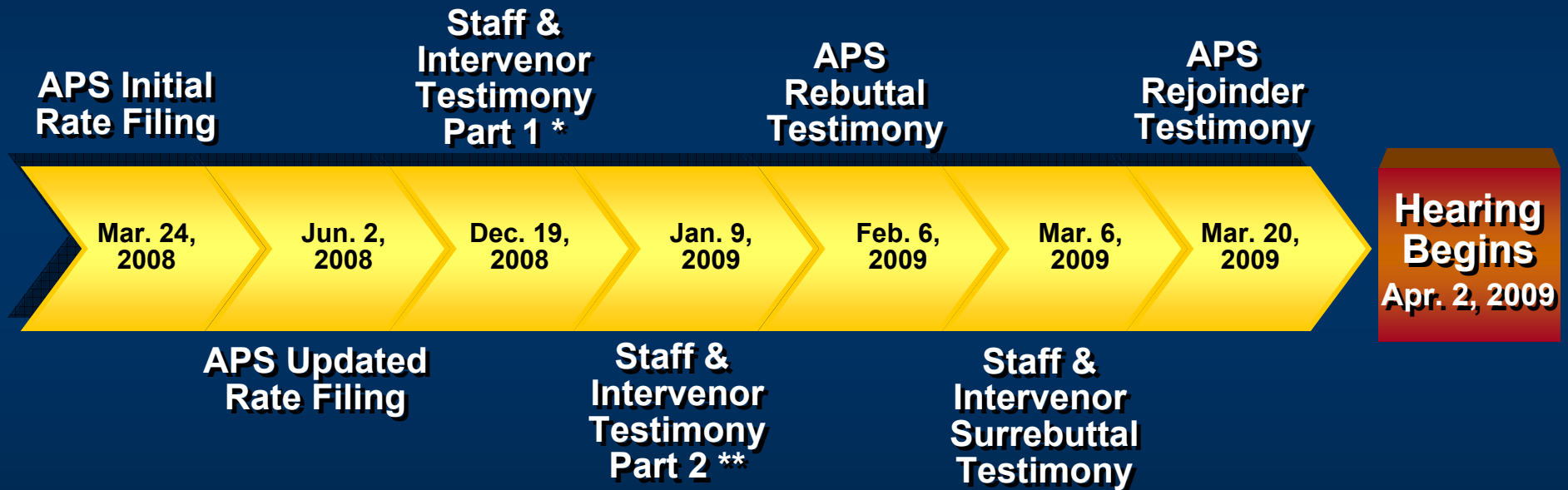
- **Post test-year plant additions**
 - **Consistent with ACC historic test-year methodology**
 - **\$174 million large projects in service by mid-2008**
 - **\$245 million other plant in service by time rates go into effect**
- **\$79 million attrition adjustment to capture revenue shortfall of projected 2010 cost levels**
- **Removal of disincentives to DSM programs**

Growth Impact Fee Proposal

- Helps “growth pay for itself”
- Reduces increase for existing customers
- Supplements line extension payments approved in early 2008
- Captures additional growth-related costs
 - Carrying costs of tax asset related to line extension payments
 - Incremental operating costs

Net base rate increase	\$ 278 million	10.5 %
Proposed growth impact fee	<u>(53) million</u>	<u>(2.0)%</u>
Increase for existing customers	<u>\$ 225 million</u>	<u>8.5 %</u>

APS Retail Rate Case Schedule



* All issues except rate design and cost of service

** Rate design and cost of service issues



Timely Transmission Rate Updates

- **Annual formula-based rate adjustments (based on prior-year FERC Form 1 data)**
- **Retail transmission cost adjustor**
- **Key implementation dates**
 - **APS FERC request filing** **July 10, 2007**
 - **Initial increases (wholesale and retail adjustor)** **March 1, 2008**
 - **Second increase**
 - **Wholesale** **June 1, 2008**
 - **Retail adjustor** **July 3, 2008**
 - **FERC settlement approval** **July 25, 2008**
 - **Next adjustment** **June 1, 2009**



Transmission Revenue Increases

	1 st Increase			2 nd Increase	
	Annual Revenue				
	Request	Settlement	Effective Date	Annual Revenue	Effective Date
Retail Portion (TCA)	\$30M	\$27M	3/1/2008	\$13M	7/3/2008
Wholesale Portion	\$ 7M	\$ 1M	3/1/2008	\$ 2M	6/1/2008
Total Increase	\$37M	\$28M		\$15M	

Arizona Corporation Commissioners

Terms Expire January 2009



Mike Gleason
Republican



Jeff Hatch-Miller
Republican



William Mundell
Republican

Terms Expire January 2011



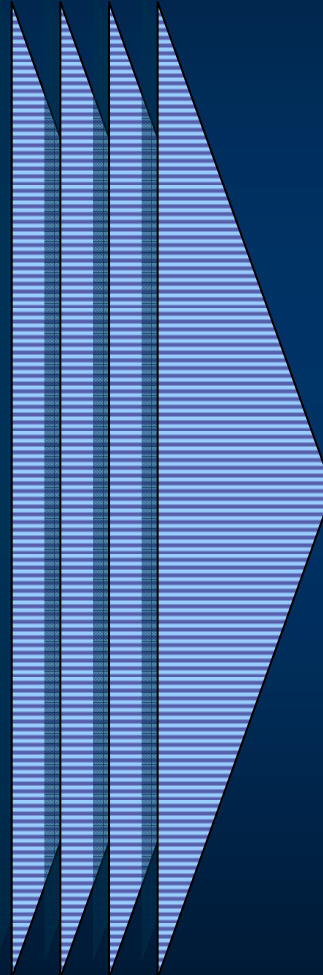
Kristin Mayes
Republican



Gary Pierce
Republican

Focusing on Regulatory Improvements

- **Substantial APS capital expenditures driven by growth and reliability**
- **APS commodity prices increases**
- **Historic test year**
- **Significant regulatory lag**
- **Inadequate earnings**
- **Weak credit metrics**
- **No comprehensive state energy policy**



Partner with ACC and stakeholders to:

- **Assure financial strength**
- **Address regulatory lag**
- **Improve alignment of goals**
- **Implement integrated resource planning**
- **Increase efficiency through new technology**
- **Enhance customer service**
- **Promote sustainable energy resources**