PINNACLE WEST CAPITAL CORP
Form 10-Q
October 31, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

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

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

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

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

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

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

PINNACLE WEST CAPITAL CORPORATION

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

ARIZONA PUBLIC SERVICE COMPANY

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

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

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

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

PINNACLE WEST CAPITAL CORPORATION	Number of shares of common stock, no par value, outstanding as of October 24, 2014: 110,450,009
ARIZONA PUBLIC SERVICE COMPANY	Number of shares of common stock, $2.50 par value, outstanding as of October 24, 2014: 71,264,947

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

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This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation ("Pinnacle West") and Arizona Public Service Company ("APS"). Any use of the words "Company," "we," and "our" refer to Pinnacle West. Each registrant is providing on its own behalf all of the information contained in this Form 10-Q that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is providing any information that does not relate to such registrant, and therefore makes no representation as to any such information. The information required with respect to each company is set forth within the applicable items. Item 1 of this report includes Condensed Consolidated Financial Statements of Pinnacle West and Condensed Consolidated Financial Statements of APS. Item 1 also includes Notes to Pinnacle West's Condensed Consolidated Financial Statements, the majority of which also relate to APS, and Supplemental Notes, which only relate to APS's Condensed Consolidated Financial Statements.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations. These forward-looking statements are often identified by words such as “estimate,” “predict,” “may,” “believe,” “plan,” “expect,” “require,” “intend,” “assume” a words. Because actual results may differ materially from expectations, we caution readers not to place undue reliance on these statements. A number of factors could cause future results to differ materially from historical results, or from outcomes currently expected or sought by Pinnacle West or APS. In addition to the Risk Factors described in Part I, Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (“2013 Form 10-K”), Part II, Item 1A of the Pinnacle West/APS Quarterly Report on Form10-Q for the quarter ended June 30, 2014 ("2014 Second Quarter 10-Q") and in Part I, Item 2 — “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report, these factors include, but are not limited to:

- our ability to manage capital expenditures and operations and maintenance costs while maintaining reliability and customer service levels;
- variations in demand for electricity, including those due to weather, the general economy, customer and sales growth (or decline), and the effects of energy conservation measures and distributed generation;
- power plant and transmission system performance and outages;
- competition in retail and wholesale power markets;
- regulatory and judicial decisions, developments and proceedings;
- new legislation or regulation, including those relating to environmental requirements, nuclear plant operations and potential deregulation of retail electric markets;
- fuel and water supply availability;
- our ability to achieve timely and adequate rate recovery of our costs, including returns on debt and equity capital;
- our ability to meet renewable energy and energy efficiency mandates and recover related costs;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- current and future economic conditions in Arizona, particularly in real estate markets;
- the cost of debt and equity capital and the ability to access capital markets when required;
- environmental and other concerns surrounding coal-fired generation;
- volatile fuel and purchased power costs;
- the investment performance of the assets of our nuclear decommissioning trusts, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;
- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- generation, transmission and distribution facility and system conditions and operating costs;
- the ability to meet the anticipated future need for additional baseload generation and associated transmission facilities in our region;
- the willingness or ability of our counterparties, power plant participants and power plant land owners to meet contractual or other obligations or extend the rights for continued power plant operations;
- technological developments affecting the electric industry; and
- restrictions on dividends or other provisions in our credit agreements and Arizona Corporation Commission (“ACC”) orders.

These and other factors are discussed in the Risk Factors described in Part I, Item 1A of our 2013 Form 10-K and in Part II, Item 1A of the 2014 Second Quarter 10-Q, which readers should review carefully before placing any reliance on our financial statements or disclosures. Neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by law.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended September 30,	
	2014	2013
OPERATING REVENUES	$1,172,667	$1,152,392
OPERATING EXPENSES		
Fuel and purchased power	382,361	350,953
Operations and maintenance	223,418	233,323
Depreciation and amortization	103,660	107,388
Taxes other than income taxes	40,850	43,256
Other expenses	603	1,784
Total	750,892	736,704
OPERATING INCOME	421,775	415,688
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	7,038	5,569
Other income (Note 10)	2,366	160
Other expense (Note 10)	(4,193)	(7,435)
Total	5,211	(1,706)
INTEREST EXPENSE		
Interest charges	47,626	50,587
Allowance for borrowed funds used during construction	(3,479)	(3,235)
Total	44,147	47,352
INCOME BEFORE INCOME TAXES	382,839	366,630
INCOME TAXES	134,753	131,912
NET INCOME	248,086	234,718
Less: Net income attributable to noncontrolling interests (Note 6)	4,125	8,555
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$243,961	$226,163
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — BASIC	110,686	110,009
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — DILUTED	111,103	111,053
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Net income attributable to common shareholders — basic	$2.20	$2.06
Net income attributable to common shareholders — diluted	$2.20	$2.04

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

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(dollars in thousands)

	Three Months Ended September 30,	
	2014	2013
NET INCOME	$248,086	$234,718
OTHER COMPREHENSIVE INCOME, NET OF TAX		
Derivative instruments:		
Net unrealized loss, net of tax benefit of $58 and $95	(91)	(145)
Reclassification of net realized loss, net of tax benefit of $3,833 and $9,348	5,939	14,310
Pension and other postretirement benefits activity, net of tax expense of $3,852 and $625	5,967	957
Total other comprehensive income	11,815	15,122
COMPREHENSIVE INCOME	259,901	249,840
Less: Comprehensive income attributable to noncontrolling interests	4,125	8,555
COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$255,776	$241,285

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

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

	Nine Months Ended September 30,	
	2014	2013
OPERATING REVENUES	$2,765,182	$2,754,866
OPERATING EXPENSES		
Fuel and purchased power	923,001	859,216
Operations and maintenance	647,522	685,873
Depreciation and amortization	310,582	317,410
Taxes other than income taxes	130,699	124,091
Other expenses	2,320	5,853
Total	2,014,124	1,992,443
OPERATING INCOME	751,058	762,423
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	21,979	18,698
Other income (Note 10)	7,514	1,387
Other expense (Note 10)	(9,385)	(13,421)
Total	20,108	6,664
INTEREST EXPENSE		
Interest charges	152,346	151,372
Allowance for borrowed funds used during construction	(11,039)	(10,861)
Total	141,307	140,511
INCOME BEFORE INCOME TAXES	629,859	628,576
INCOME TAXES	215,698	221,424
NET INCOME	414,161	407,152
Less: Net income attributable to noncontrolling interests (Note 6)	21,976	25,338
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$392,185	$381,814
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — BASIC	110,579	109,935
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — DILUTED	110,962	110,913
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Net income attributable to common shareholders — basic	$3.55	$3.47
Net income attributable to common shareholders — diluted	$3.53	$3.44
DIVIDENDS DECLARED PER SHARE	$1.14	$1.09

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

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(dollars in thousands)

	Nine Months Ended September 30, 2014	2013
NET INCOME	$414,161	$407,152
OTHER COMPREHENSIVE INCOME, NET OF TAX		
Derivative instruments:		
Net unrealized loss, net of tax (expense) benefit of $(566) and $162	(472)	(247)
Reclassification of net realized loss, net of tax benefit of $6,417 and $15,471	11,009	23,685
Pension and other postretirement benefits activity, net of tax expense of $3,724 and $807	5,114	1,235
Total other comprehensive income	15,651	24,673
COMPREHENSIVE INCOME	429,812	431,825
Less: Comprehensive income attributable to noncontrolling interests	21,976	25,338
COMPREHENSIVE INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$407,836	$406,487

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

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

	September 30, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$10,471	$9,526
Customer and other receivables	391,179	299,904
Accrued unbilled revenues	156,036	96,796
Allowance for doubtful accounts	(3,462)	(3,203)
Materials and supplies (at average cost)	230,220	221,682
Fossil fuel (at average cost)	32,836	38,028
Deferred income taxes	61,201	91,152
Income tax receivable (Note 5)	—	135,517
Assets from risk management activities (Note 7)	11,863	17,169
Deferred fuel and purchased power regulatory asset (Note 3)	15,911	20,755
Other regulatory assets (Note 3)	94,004	76,388
Other current assets	40,673	39,895
Total current assets	1,040,932	1,043,609
INVESTMENTS AND OTHER ASSETS		
Assets from risk management activities (Note 7)	17,438	23,815
Nuclear decommissioning trust (Note 13)	690,226	642,007
Other assets	60,427	60,875
Total investments and other assets	768,091	726,697
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	15,251,009	15,200,464
Accumulated depreciation and amortization	(5,308,661)	(5,300,219)
Net	9,942,348	9,900,245
Construction work in progress	673,265	581,369
Palo Verde sale leaseback, net of accumulated depreciation (Note 6)	122,222	125,125
Intangible assets, net of accumulated amortization	127,560	157,689
Nuclear fuel, net of accumulated amortization	138,179	124,557
Total property, plant and equipment	11,003,574	10,888,985
DEFERRED DEBITS		
Regulatory assets (Note 3)	836,618	711,712
Assets for other postretirement benefits (Note 4)	180,527	—
Other	150,606	137,683
Total deferred debits	1,167,751	849,395
TOTAL ASSETS	$13,980,348	$13,508,686

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

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

	September 30, 2014	December 31, 2013
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$278,835	$284,516
Accrued taxes (Note 5)	249,932	130,998
Accrued interest	41,289	48,351
Common dividends payable	—	62,528
Short-term borrowings (Note 2)	19,150	153,125
Current maturities of long-term debt (Note 2)	368,841	540,424
Customer deposits	73,468	76,101
Liabilities from risk management activities (Note 7)	27,622	31,892
Liabilities for asset retirements	39,416	32,896
Regulatory liabilities (Note 3)	154,027	99,273
Other current liabilities	195,938	158,540
Total current liabilities	1,448,518	1,618,644
LONG-TERM DEBT LESS CURRENT MATURITIES (Note 2)	3,037,801	2,796,465
DEFERRED CREDITS AND OTHER		
Deferred income taxes	2,505,150	2,351,882
Regulatory liabilities (Note 3)	1,034,515	801,297
Liabilities for asset retirements (Note 16)	350,211	313,833
Liabilities for pension and other postretirement benefits (Note 4)	233,292	513,628
Liabilities from risk management activities (Note 7)	24,385	70,315
Customer advances	123,136	114,480
Coal mine reclamation	209,695	207,453
Deferred investment tax credit	177,567	152,361
Unrecognized tax benefits (Note 5)	14,601	42,209
Other	177,464	185,659
Total deferred credits and other	4,850,016	4,753,117
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 8)		
Common stock, no par value; authorized 150,000,000 shares, 110,468,956 and 110,280,703 issued at respective dates	2,502,217	2,491,558
Treasury stock at cost; 22,293 and 98,944 shares at respective dates	(106)	(4,308)
Total common stock	2,502,111	2,487,250
Retained earnings	2,052,207	1,785,273
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(49,881)	(54,995)
Derivative instruments	(12,521)	(23,058)
Total accumulated other comprehensive loss	(62,402)	(78,053)
Total shareholders' equity	4,491,916	4,194,470
Noncontrolling interests (Note 6)	152,097	145,990
Total equity	4,644,013	4,340,460

TOTAL LIABILITIES AND EQUITY	$13,980,348	$13,508,686

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

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

	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$414,161	$407,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	371,722	377,971
Deferred fuel and purchased power	(26,880)	13,093
Deferred fuel and purchased power amortization	31,724	23,158
Allowance for equity funds used during construction	(21,979)	(18,698)
Deferred income taxes	136,777	256,132
Deferred investment tax credit	25,206	16,164
Change in derivative instruments fair value	300	537
Changes in current assets and liabilities:		
Customer and other receivables	(149,053)	(178,029)
Accrued unbilled revenues	(59,240)	(37,710)
Materials, supplies and fossil fuel	(3,346)	(8,914)
Income tax receivable	135,517	(131,128)
Other current assets	(4,428)	(12,246)
Accounts payable	(7,171)	44,704
Accrued taxes	118,934	58,919
Other current liabilities	48,407	4,096
Change in margin and collateral accounts — assets	(475)	(327)
Change in margin and collateral accounts — liabilities	(20,875)	15,000
Change in long-term income tax receivable	—	137,270
Change in unrecognized tax benefits	1,744	(57,585)
Change in other long-term assets	(50,005)	(24,345)
Change in other long-term liabilities	(54,122)	(2,884)
Net cash flow provided by operating activities	886,918	882,330
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(618,658)	(581,515)
Contributions in aid of construction	8,537	34,910
Allowance for borrowed funds used during construction	(11,039)	(10,861)
Proceeds from nuclear decommissioning trust sales	269,276	363,944
Investment in nuclear decommissioning trust	(282,212)	(376,881)
Other	339	(1,553)
Net cash flow used for investing activities	(633,757)	(571,956)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	574,126	136,307
Repayment of long-term debt	(503,583)	(72,777)
Short-term borrowings and payments — net	(133,975)	(92,175)
Dividends paid on common stock	(187,778)	(174,485)
Common stock equity issuance	14,860	10,396
Distributions to noncontrolling interests	(15,869)	(9,197)

Other	3	812
Net cash flow used for financing activities	(252,216)	(201,119)
NET INCREASE IN CASH AND CASH EQUIVALENTS	945	109,255
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	9,526	26,202
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$10,471	$135,457

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

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PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Consolidation and Nature of Operations

The unaudited condensed consolidated financial statements include the accounts of Pinnacle West and our subsidiaries: APS, Bright Canyon Energy Corporation ("BCE") and El Dorado Investment Company ("El Dorado"). Intercompany accounts and transactions between the consolidated companies have been eliminated. The unaudited condensed consolidated financial statements for APS include the accounts of APS and the Palo Verde Nuclear Generating Station ("Palo Verde") sale leaseback variable interest entities ("VIEs") (see Note 6 for further discussion). Our accounting records are maintained in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

Our condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in conformity with GAAP have been condensed or omitted pursuant to such regulations, although we believe that the disclosures provided are adequate to make the interim information presented not misleading.

Supplemental Cash Flow Information

The following table summarizes supplemental Pinnacle West cash flow information (dollars in thousands):

	Nine Months Ended September 30,	
	2014	2013
Cash paid (received) during the period for:		
Income taxes, net of refunds	$(131,154)	$3,412
Interest, net of amounts capitalized	145,285	141,047
Significant non-cash investing and financing activities:		
Accrued capital expenditures	$24,135	$11,377

2. Long-Term Debt and Liquidity Matters

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs.

Pinnacle West

On May 9, 2014, Pinnacle West replaced its $200 million revolving credit facility that would have matured in November 2016, with a new $200 million facility that matures in May 2019. At September 30, 2014, the facility was available to refinance indebtedness of the Company and for other general corporate

purposes, including credit support for its $200 million commercial paper program. Pinnacle West has the option to increase the amount of the facility up to a maximum of $300 million upon the satisfaction of certain conditions and with the consent of the lenders. At September 30, 2014, Pinnacle West had no outstanding borrowings under its credit facility, no letters of credit outstanding and no commercial paper borrowings.

APS

On July 12, 2013, APS purchased all $33 million of the Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 1994 Series A, due 2029. On October 11, 2013, APS purchased all $32 million of the City of Farmington, New Mexico Pollution Control Revenue Bonds, 1994 Series C, due 2024. On January 15, 2014, both of these series of bonds were canceled and refinanced as described below.

On January 10, 2014, APS issued $250 million of 4.70% unsecured senior notes that mature on January 15, 2044. The proceeds from the sale were used to repay commercial paper which was used to fund the acquisition of Southern California Edison's ("SCE") 48% ownership interest in each of Units 4 and 5 of the Four Corners Power Plant ("Four Corners") and to replenish cash used in 2013 to re-acquire the two series of tax-exempt indebtedness listed above.

On May 1, 2014, APS purchased a total of $100 million of the Maricopa County, Arizona, Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A, D and E, due 2029 in connection with the mandatory tender provisions for this indebtedness. On May 14, 2014, APS remarketed all $36 million of the 2009 Series A Bonds, which are classified as long-term debt on our Condensed Consolidated Balance Sheets at September 30, 2014. We expect to remarket or refinance all $64 million of the 2009 Series D Bonds and 2009 Series E Bonds within the next twelve months, which were classified as current maturities of long-term debt at December 31, 2013.

On May 9, 2014, APS replaced its $500 million revolving credit facility that would have matured in November 2016, with a new $500 million facility that matures in May 2019.

On May 30, 2014, APS purchased all $38 million of the Navajo County, Arizona, Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A, due 2034, and on June 1, 2014, APS purchased a total of $64 million of the Navajo 2009 Series B Bonds and 2009 Series C Bonds, in each case, in connection with the mandatory tender provisions for this indebtedness. On September 23, 2014, APS remarketed all $38 million of the 2009 Series A Bonds, which are classified as long-term debt on our Condensed Consolidated Balance Sheets at September 30, 2014. On October 1, 2014, APS remarketed all $32 million of the 2009 Series C Bonds. We expect to remarket or refinance all $32 million of the 2009 Series B Bonds within the next twelve months. These bonds were classified as current maturities of long-term debt on our Condensed Consolidated Balance Sheets at December 31, 2013.

On June 1, 2014, APS remarketed all $13 million of the Coconino County, Arizona Pollution Control Corporation Pollution Control Revenue Refunding Bonds, 2009 Series A, due 2034. These bonds are classified as long-term debt on our Condensed Consolidated Balance Sheets at September 30, 2014.

On June 18, 2014, APS issued $250 million of 3.35% unsecured senior notes that mature on June 15, 2024. The net proceeds from the sale were used along with other funds to repay at maturity APS's $300 million aggregate principal amount of 5.80% senior notes due September 30, 2014.

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At September 30, 2014, APS had two credit facilities totaling $1 billion, including a $500 million credit facility that matures in April 2018 and the $500 million facility that matures in May 2019 (see above). APS may increase the amount of each facility up to a maximum of $700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use these facilities to refinance indebtedness and for other general corporate purposes. Interest rates are based on APS's senior unsecured debt credit ratings.

The facilities described above are available to support APS's $250 million commercial paper program, for bank borrowings or for issuances of letters of credit. At September 30, 2014, APS had $19 million of commercial paper borrowings and no outstanding borrowings or outstanding letters of credit under these credit facilities.

See "Financial Assurances" in Note 9 for a discussion of APS's separate outstanding letters of credit.

Debt Fair Value

Our long-term debt fair value estimates are based on quoted market prices for the same or similar issues, and are classified within Level 2 of the fair value hierarchy. Certain of our debt instruments contain third-party credit enhancements and, in accordance with GAAP, we do not consider the effect of these credit enhancements when determining fair value. The following table represents the estimated fair value of our long-term debt, including current maturities (dollars in millions):

	As of September 30, 2014		As of December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	$125	$125	$125	$125
APS	3,282	3,662	3,212	3,454
Total	$3,407	$3,787	$3,337	$3,579

Debt Provisions

An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At September 30, 2014, APS was in compliance with this common equity ratio requirement. Its total shareholder equity was approximately $4.6 billion, and total capitalization was approximately $8.1 billion. APS would be prohibited from paying dividends if the payment would reduce its total shareholder equity below approximately $3.2 billion, assuming APS's total capitalization remains the same.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Regulatory Matters

Retail Rate Case Filing with the Arizona Corporation Commission

On June 1, 2011, APS filed an application with the ACC for a net retail base rate increase of $95.5 million. APS requested that the increase become effective July 1, 2012. The request would have increased the average retail customer bill by approximately 6.6%. On January 6, 2012, APS and other parties to the general retail rate case entered into an agreement (the "2012 Settlement Agreement") detailing the terms upon which the parties agreed to settle the rate case. On May 15, 2012, the ACC approved the 2012 Settlement Agreement without material modifications.

Settlement Agreement

The 2012 Settlement Agreement provides for a zero net change in base rates, consisting of: (1) a non-fuel base rate increase of $116.3 million; (2) a fuel-related base rate decrease of $153.1 million (to be implemented by a change in the base fuel rate for fuel and purchased power costs ("Base Fuel Rate") from $0.03757 to $0.03207 per kilowatt hour ("kWh"); and (3) the transfer of cost recovery for certain renewable energy projects from the Arizona Renewable Energy Standard and Tariff ("RES") surcharge to base rates in an estimated amount of $36.8 million.

APS also agreed not to file its next general rate case before May 31, 2015, and not to request that its next general retail rate increase be effective prior to July 1, 2016. The 2012 Settlement Agreement allows APS to request a change to its base rates during the stay-out period in the event of an extraordinary event that, in the ACC's judgment, requires base rate relief in order to protect the public interest. Nor is APS precluded from seeking rate relief, or any other party to the 2012 Settlement Agreement precluded from petitioning the ACC to examine the reasonableness of APS's rates, in the event of significant regulatory developments that materially impact the financial results expected under the terms of the 2012 Settlement Agreement.

Other key provisions of the 2012 Settlement Agreement include the following:

- An authorized return on common equity of 10.0%;

- A capital structure comprised of 46.1% debt and 53.9% common equity;

- A test year ended December 31, 2010, adjusted to include plant that is in service as of March 31, 2012;

- Deferral for future recovery or refund of property taxes above or below a specified 2010 test year level caused by changes to the Arizona property tax rate as follows:

- Deferral of increases in property taxes of 25% in 2012, 50% in 2013 and 75% for 2014 and subsequent years if Arizona property tax rates increase; and

- Deferral of 100% in all years if Arizona property tax rates decrease;

- A procedure to allow APS to request rate adjustments prior to its next general rate case related to APS's acquisition of additional interests in Units 4 and 5 and the related closure of Units 1-3 of Four Corners (APS made its filing under this provision on December 30, 2013, which would

result in an average bill impact to residential customers of approximately 2% if approved as requested);

- Implementation of a Lost Fixed Cost Recovery ("LFCR") rate mechanism to support energy efficiency and distributed renewable generation;

- Modifications to the Environmental Improvement Surcharge ("EIS") to allow for the recovery of carrying costs for capital expenditures associated with government-mandated environmental controls, subject to an existing cents per kWh cap on cost recovery that could produce up to approximately $5 million in revenues annually;

- Modifications to the Power Supply Adjustor ("PSA"), including the elimination of the 90/10 sharing provision;

- A limitation on the use of the RES surcharge and the Demand Side Management Adjustor Charge ("DSMAC") to recoup capital expenditures not required under the terms of APS's 2009 retail rate case settlement agreement (the "2009 Settlement Agreement");

- Allowing a negative credit that existed in the PSA rate to continue until February 2013, rather than being reset on the anticipated July 1, 2012 rate effective date;

- Modification of the transmission cost adjustor ("TCA") to streamline the process for future transmission-related rate changes; and

- Implementation of various changes to rate schedules, including the adoption of an experimental "buy-through" rate that could allow certain large commercial and industrial customers to select alternative sources of generation to be supplied by APS.

The 2012 Settlement Agreement was approved by the ACC on May 15, 2012, with new rates effective on July 1, 2012. This accomplished a goal set by the parties to the 2009 Settlement Agreement to process subsequent rate cases within twelve months of sufficiency findings from the ACC staff, which generally occurs within 30 days after the filing of a rate case.

Cost Recovery Mechanisms

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

Renewable Energy Standard. In 2006, the ACC approved the RES. Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include a RES surcharge as part of customer bills to recover the approved amounts for use on renewable energy projects. Each year APS is required to file a five-year implementation plan with the ACC and seek approval for funding the upcoming year's RES budget.

On July 12, 2013, APS filed its annual RES implementation plan, covering the 2014-2018 timeframe and requesting a 2014 RES budget of approximately $143 million. In a final order dated January 7, 2014, the ACC approved the requested budget. Also in 2013, the ACC conducted a hearing to consider APS's proposal

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to establish compliance with distributed energy requirements by tracking and recording distributed energy, rather than acquiring and retiring renewable energy credits. On February 6, 2014, the ACC established a proceeding to modify the renewable energy rules to establish a process for compliance with the renewable energy requirement that is not based solely on the use of renewable energy credits. On September 9, 2014, the ACC authorized a rulemaking process to modify the RES rules. The proposed changes would permit the ACC to find that utilities have complied with the distributed energy requirement in light of all available information.

In accordance with the ACC's decision on the 2014 RES plan, on April 15, 2014, APS filed an application with the ACC requesting permission to build an additional 20 MW of APS-owned utility scale solar under the AZ Sun Program. In a subsequent filing, APS also offered an alternative proposal to replace the 20 MW of utility scale solar with 20 MW of APS-owned residential solar. This matter is still pending with the ACC and the ACC staff has recommended that it be addressed in our 2015 RES implementation plan.

On July 1, 2014, APS filed its 2015 RES implementation plan and proposed a RES budget of approximately $154 million.

Demand Side Management Adjustor Charge. The ACC Electric Energy Efficiency Standards require APS to submit a Demand Side Management Implementation Plan ("DSM Plan") for review by and approval of the ACC.

On June 1, 2012, APS filed its 2013 DSM Plan. In 2013, the standards required APS to achieve cumulative energy savings equal to 5% of its 2012 retail energy sales. Later in 2012, APS filed a supplement to its plan that included a proposed budget for 2013 of $87.6 million.

On March 11, 2014, the ACC issued an order approving APS's 2013 DSM Plan. The ACC approved a budget of $68.9 million for each of 2013 and 2014. The ACC also approved a Resource Savings Initiative that allows APS to count towards compliance with the ACC Electric Energy Efficiency Standards, savings for improvements to APS's transmission and delivery system, generation and facilities that have been approved through a DSM Plan. Consistent with the ACC's March 11, 2014 order, APS intends to continue its approved DSM programs in 2015.

On June 27, 2013, the ACC voted to open a new docket investigating whether the Electric Energy Efficiency Rules should be modified. The ACC held a series of three workshops in March and April 2014 to investigate methodologies used to determine cost effective energy efficiency programs, cost recovery mechanisms, incentives, and potential changes to the Electric Energy Efficiency and Resource Planning Rules.

PSA Mechanism and Balance. The PSA provides for the adjustment of retail rates to reflect variations in retail fuel and purchased power costs. The following table shows the changes in the deferred fuel and purchased power regulatory asset for 2014 and 2013 (dollars in millions):

	Nine Months Ended September 30,	
	2014	2013
Beginning balance	$21	$73
Deferred fuel and purchased power costs — current period	27	(13)
Amounts charged to customers	(32)	(23)
Ending balance	$16	$37

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The PSA rate for the PSA year beginning February 1, 2014 is $0.001557 per kWh, as compared to $0.001329 per kWh for the prior year. This new rate is comprised of a forward component of $0.001277 per kWh and a historical component of $0.000280 per kWh. Any uncollected (overcollected) deferrals during the 2014 PSA year will be included in the calculation of the PSA rate for the PSA year beginning February 1, 2015.

Transmission Rates, Transmission Cost Adjustor and Other Transmission Matters. In July 2008, the United States Federal Regulatory Commission ("FERC") approved an Open Access Transmission Tariff for APS to move from fixed rates to a formula rate-setting methodology in order to more accurately reflect and recover the costs that APS incurs in providing transmission services. A large portion of the rate represents charges for transmission services to serve APS's retail customers ("Retail Transmission Charges"). In order to recover the Retail Transmission Charges, APS was previously required to file an application with, and obtain approval from, the ACC to reflect changes in Retail Transmission Charges through the TCA. Under the terms of the 2012 Settlement Agreement, however, an adjustment to rates to recover the Retail Transmission Charges will be made annually each June 1 and will go into effect automatically unless suspended by the ACC.

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

Effective June 1, 2014, APS's annual wholesale transmission rates for all users of its transmission system increased by approximately $5.9 million for the twelve-month period beginning June 1, 2014 in accordance with the FERC-approved formula. An adjustment to APS's retail rates to recover FERC-approved transmission charges went into effect automatically on June 1, 2014.

Lost Fixed Cost Recovery Mechanism. The LFCR mechanism permits APS to recover on an after-the-fact basis a portion of its fixed costs that would otherwise have been collected by APS in the kWh sales lost due to APS energy efficiency programs and to distributed generation such as rooftop solar arrays. The fixed costs recoverable by the LFCR mechanism were established in the 2012 Settlement Agreement and amount to approximately 3.1 cents per residential kWh lost and 2.3 cents per non-residential kWh lost. The LFCR adjustment has a year-over-year cap of 1% of retail revenues. Any amounts left unrecovered in a particular year because of this cap can be carried over for recovery in a future year. The kWh's lost from energy efficiency are based on a third-party evaluation of APS's energy efficiency programs. Distributed generation sales losses are determined from the metered output from the distributed generation units or if metering is unavailable, through accepted estimating techniques.

APS filed its first LFCR adjustment on January 15, 2013 and will file for a LFCR adjustment every January thereafter. On February 12, 2013, the ACC approved a LFCR adjustment of $5.1 million, representing a pro-rated amount for 2012 since the 2012 Settlement Agreement went into effect on July 1, 2012. APS filed its 2014 annual LFCR adjustment on January 15, 2014, requesting a LFCR adjustment of $25.3 million,

effective March 1, 2014. The ACC approved APS's LFCR adjustment without change on March 11, 2014, which became effective April 1, 2014.

Deregulation

On May 9, 2013, the ACC voted to re-examine the facilitation of a deregulated retail electric market in Arizona. The ACC subsequently opened a docket for this matter and received comments from a number of interested parties on the considerations involved in establishing retail electric deregulation in the state. One of these considerations is whether various aspects of a deregulated market, including setting utility rates on a "market" basis, would be consistent with the requirements of the Arizona Constitution. On September 11, 2013, after receiving legal advice from the ACC staff, the ACC voted 4-1 to close the current docket and await full Constitutional authority before any further examination of this matter. The motion approved by the ACC also included opening one or more new dockets in the future to explore options to offer more rate choices to customers and innovative changes within the existing cost-of-service regulatory model that could include elements of competition. The ACC opened a new docket on November 4, 2013 to explore technological advances and innovative changes within the electric utility industry. A series of workshops in this docket were held in 2014 and no future workshops are currently scheduled.

Net Metering

On July 12, 2013, APS filed an application with the ACC proposing a solution to fix the cost shift brought by the current net metering rules. On December 3, 2013, the ACC issued its order on APS's net metering proposal. The ACC instituted a charge on customers who install rooftop solar panels after December 31, 2013, and directed APS to provide quarterly reports on the pace of rooftop solar adoption to assist the ACC in considering further increases. The charge of $0.70 per kilowatt became effective on January 1, 2014, and is estimated to collect $4.90 per month from a typical future rooftop solar customer to help pay for their use of the electricity grid. The new policy will be in effect until the next APS rate case.

In making its decision, the ACC determined that the current net metering program creates a cost shift, causing non-solar utility customers to pay higher rates to cover the costs of maintaining the electrical grid. ACC staff and the state's Residential Utility Consumer Office, among other organizations, also agreed that a cost shift exists. The fixed charge does not increase APS's revenue because it is credited to the LFCR, but it will modestly reduce the impact of the cost shift on non-solar customers. The ACC acknowledged that the new charge addresses only a portion of the cost shift. The ACC also required APS to file its next rate case in June 2015, the earliest date contemplated in the 2012 Settlement Agreement.

In May 2014, the ACC began conducting a series of workshops to, among other things, evaluate the role and value of the electric grid as it relates to rooftop solar and other issues regarding net metering.

On July 22, 2014, the ACC Commissioners voted to reopen the December 2013 net metering decision for the limited purpose of deciding whether to eliminate the requirement that APS file its next rate case in June 2015. The vote included a request that parties comment in the docket about their thoughts on removing the filing date requirement and on the process for the broader discussion regarding rate design. On August 12, 2014, the ACC Commissioners voted to lift the requirement that APS file its next general rate case by June 2015. On September 29, 2014, the staff of the ACC filed in a new docket a proposal for permitting a utility to request ACC approval of its proposed rate design outside of and before a general rate case. On October 20, 2014, APS and other interested stakeholders filed comments to this proposal. APS supports the concept of considering rate design outside of its next rate case, but cannot predict whether the ACC will ultimately approve staff's proposal.

Four Corners

On December 30, 2013, APS purchased SCE's 48% ownership interest in each of Units 4 and 5 of Four Corners. The 2012 Settlement Agreement includes a procedure to allow APS to request rate adjustments prior to its next general rate case related to APS's acquisition of the additional interests in Units 4 and 5 and the related closure of Units 1-3 of Four Corners. APS made its filing under this provision on December 30, 2013. If approved, these adjustments would result in an average bill impact to residential customers of approximately 2%. This includes the deferral for future recovery of all non-fuel operating costs for the acquired SCE interest in Four Corners, net of the non-fuel operating costs savings resulting from the closure of Units 1-3 from the date of closing of the purchase. The 2012 Settlement Agreement also provides for deferral for future recovery of all unrecovered costs incurred in connection with the closure of Units 1-3. The deferral balance related to the acquisition of SCE's interest in Units 4 and 5 and the closure of Units 1-3 was $67 million as of September 30, 2014. ACC staff and other intervenors have filed testimony in this matter with the ACC, and APS has filed rebuttal testimony. Both ACC staff and the Residential Utility Customer Office have proposed adjustments to the return to be applied to the Four Corners investments until APS's next rate case, which would result in a lower level of recovery than proposed by APS. Hearings on this matter are completed and we anticipate a decision by the end of 2014. APS cannot predict the outcome of this matter.

As part of APS's acquisition of SCE's interest in Units 4 and 5, APS and SCE agreed, via a "Transmission Termination Agreement," that upon closing of the acquisition, the companies would terminate an existing transmission agreement ("Transmission Agreement") between the parties that provides transmission capacity on a system (the "Arizona Transmission System") for SCE to transmit its portion of the output from Four Corners to California. APS previously submitted a request to FERC related to this termination, which resulted in a FERC order denying rate recovery of $40 million that APS agreed to pay SCE associated with the termination. APS and SCE negotiated an alternate arrangement under which SCE would assign its 1,555 MW capacity rights over the Arizona Transmission System to third-parties, including 300 MW to APS's marketing and trading group. However, this alternative arrangement was not approved by FERC. In late March 2014, APS and SCE filed requests for rehearing with FERC. Both requests for rehearing were denied on August 14, 2014. Although APS and SCE continue to evaluate potential paths forward, it is possible that the terms of the Transmission Termination Agreement may again control. As we previously disclosed, APS believes that the original denial by FERC of rate recovery under the Transmission Termination Agreement constitutes the failure of a condition that relieves APS of its obligations under that agreement. If APS and SCE were unable to determine a resolution through negotiation, the Transmission Termination Agreement requires that disputes be resolved through arbitration. APS is unable to predict the outcome of this matter if it proceeds to arbitration. If the matter proceeds to arbitration and APS is not successful, APS may be required to record a charge to its results of operations.

Cholla

In the third quarter of 2014, after considering the costs to comply with environmental regulations, APS determined that it was probable that it will retire Unit 2 at the Cholla Power Plant ("Cholla") in April 2016. Specifically, on September 11, 2014, APS announced that it will close Unit 2 of Cholla by April 2016 and stop burning coal at the other APS-owned units (Units 1 and 3) at the plant by the mid-2020s, if EPA approves a compromise proposal offered by APS to meet required environmental and emissions standards and rules. Previously, APS estimated Cholla Unit 2's end of life to be 2033. APS is currently recovering depreciation and

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a return on the net book value of the unit in base rates and plans to seek recovery of all of the unit's retirement-related costs in its next retail rate case.

If APS closes Cholla Unit 2, APS believes it will be allowed recovery of the remaining net book value of Unit 2 ($130 million as of September 30, 2014), in addition to a return on its investment. In accordance with GAAP, in the third quarter of 2014, Unit 2's remaining net book value was reclassified from property, plant and equipment to a regulatory asset. If the ACC does not allow full recovery of the remaining net book value of Cholla Unit 2, all or a portion of the regulatory asset will be written off and APS's net income, cash flows, and financial position will be negatively impacted.

Regulatory Assets and Liabilities

The detail of regulatory assets is as follows (dollars in millions):

	Remaining Amortization Period	September 30, 2014		December 31, 2013	
		Current	Non-Current	Current	Non-Current
Pension and other postretirement benefits	(a)	$—	$ 286	$—	$ 314
Income taxes — allowance for funds used during construction ("AFUDC") equity	2043	4	117	4	105
Deferred fuel and purchased power — mark-to-market (Note 7)	2016	14	20	5	29
Transmission vegetation management	2016				