



DELIVERING SUPERIOR SHAREHOLDER VALUE

REGULATORY OVERVIEW

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PINNACLE WEST
CAPITAL CORPORATION

REGULATORY OVERVIEW AGENDA

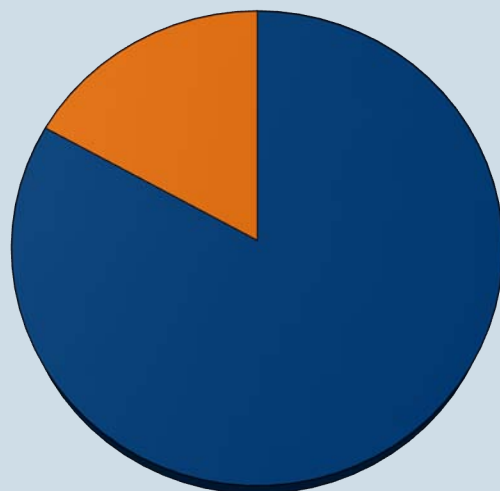
- **Regulatory Landscape**
- **Regulatory Strategic Framework**
- **Goals and Initiatives**
- **FERC Developments**
- **Conclusions**



OUR REGULATORY MIX

The bulk of APS's revenues comes from a regulated retail rate base and a meaningful transmission business.

\$6.9 Billion Total Approved Rate Base



- **Generation & Distribution (83%)**
- **Transmission (17%)**

Most Recent Rate Decisions

| | ACC | FERC |
|----------------------|-------------|------------|
| Rate Effective Dates | 7/1/2012 | 6/1/2012 |
| Test Year Ended | 12/31/2010* | 12/31/2011 |
| Rate Base | \$5.7 B | \$1.2 B |
| Equity Layer | 54% | 55% |
| Allowed ROE | 10.00% | 10.75% |

*Adjusted to include post test-year plant in service through March 31, 2012



CONSTRUCTIVE REGULATORY ENVIRONMENT

Enables creative solutions towards a common goal: healthy utility that will help Arizona's sustainable energy future.

Constructive Environment



- **Commission and Stakeholder Engagement**
- **Productive and Constructive Regulatory Relationships**
- **Culture of Compliance**



IMPROVING OUR REGULATORY ENVIRONMENT: HISTORICAL PERSPECTIVE

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We have reduced our rate case cycle length significantly while achieving increasingly constructive outcomes.



CURRENT REGULATORY FRAMEWORK

Traditional themes are trending towards sustained constructive outcomes.

Themes

Regulatory Lag

Historical Test Year

Critical Regulatory Relationships

Multiple Active Stakeholders

Four Year Stay Out

Progress

Recovery of post-test year plant in rates and certain capital through adjustors.

Enhanced Commission engagement, constructive regulatory relationships.

More collegial environment, willingness to pursue creative solutions.

Supported by structure of ongoing financial support.



BEYOND A HISTORICAL TEST YEAR

Retail rate mechanisms mitigate strict historical test-year framework.

Current Arizona Retail Rate Structure

Traditional Historical Test Year

- Rates based on finances experienced during 12 months preceding rate application preparation, adjusted only for known and measurable changes

Post-Test Year Plant in Rate Base

- Fifteen months or more past test year

Adjustors that Recover Revenue Requirements

- AZ Sun
- Environmental costs

Cost Deferrals

- Property taxes
- Four Corners acquisition costs

Enhanced Fixed Cost Recovery

- Lost Fixed Cost Recovery Mechanism
- Rate design changes for commercial customers



FERC OVERVIEW

We have achieved constructive transmission rate treatment and actively engage in key policy matters.

- **Ratemaking**
 - **Formula rates updated annually**
 - **Retail transmission cost adjuster**
- **Policy Development**
 - **Transmission returns on equity**
 - **FERC Order 1000 compliance**
 - **Non-RTO performance metrics**



REGULATORY INITIATIVES

We have a near-term business plan that supports the Company's overall objectives

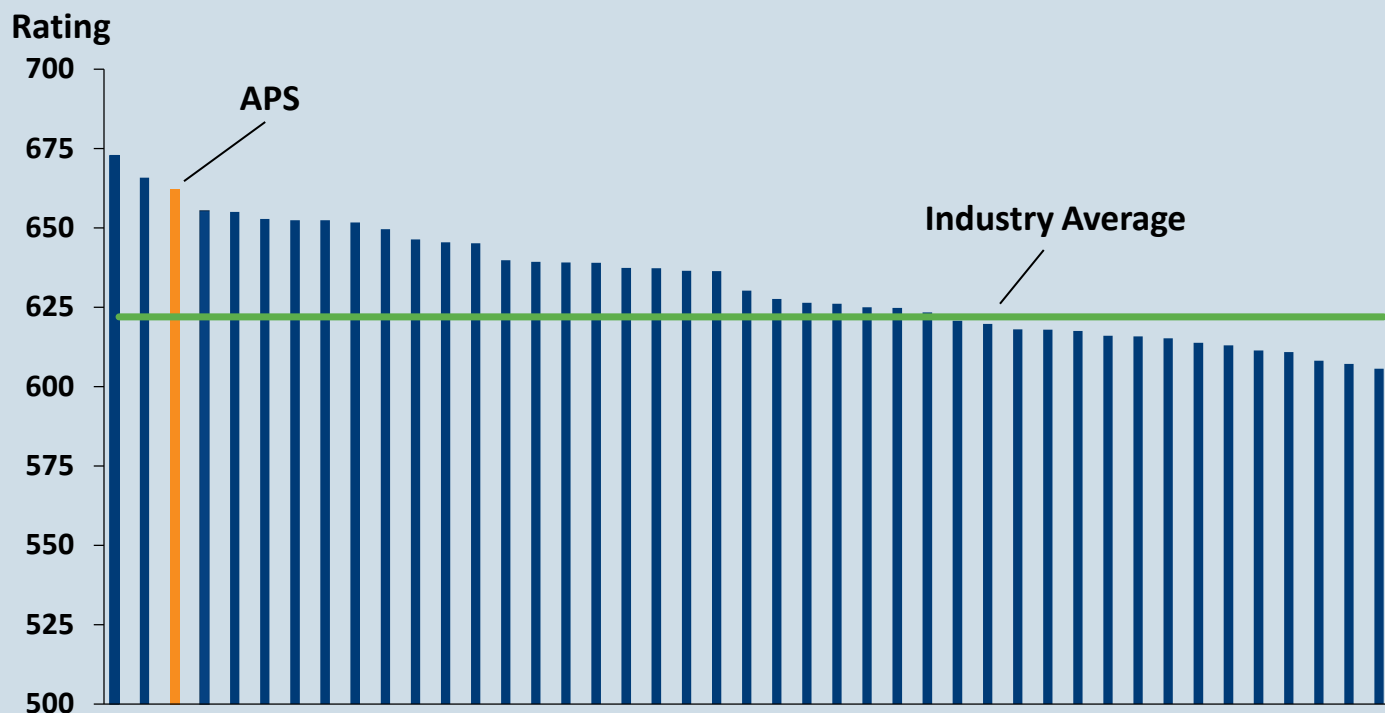
- **Begin recovery of Four Corners acquisition by end of 2013**
- **Target next retail rate decision by mid-2016**
- **Continue active engagement of stakeholders in integrated resource planning process to meet long-term customer needs for reliable, cost effective power**
- **Continue active engagement with regional FERC Order 1000 compliance team to achieve structure that supports customer and shareholder needs**



CUSTOMER SATISFACTION: A KEY PRIORITY

Strong customer service supports constructive regulatory outcomes.

Outstanding Residential Customer Satisfaction Rating



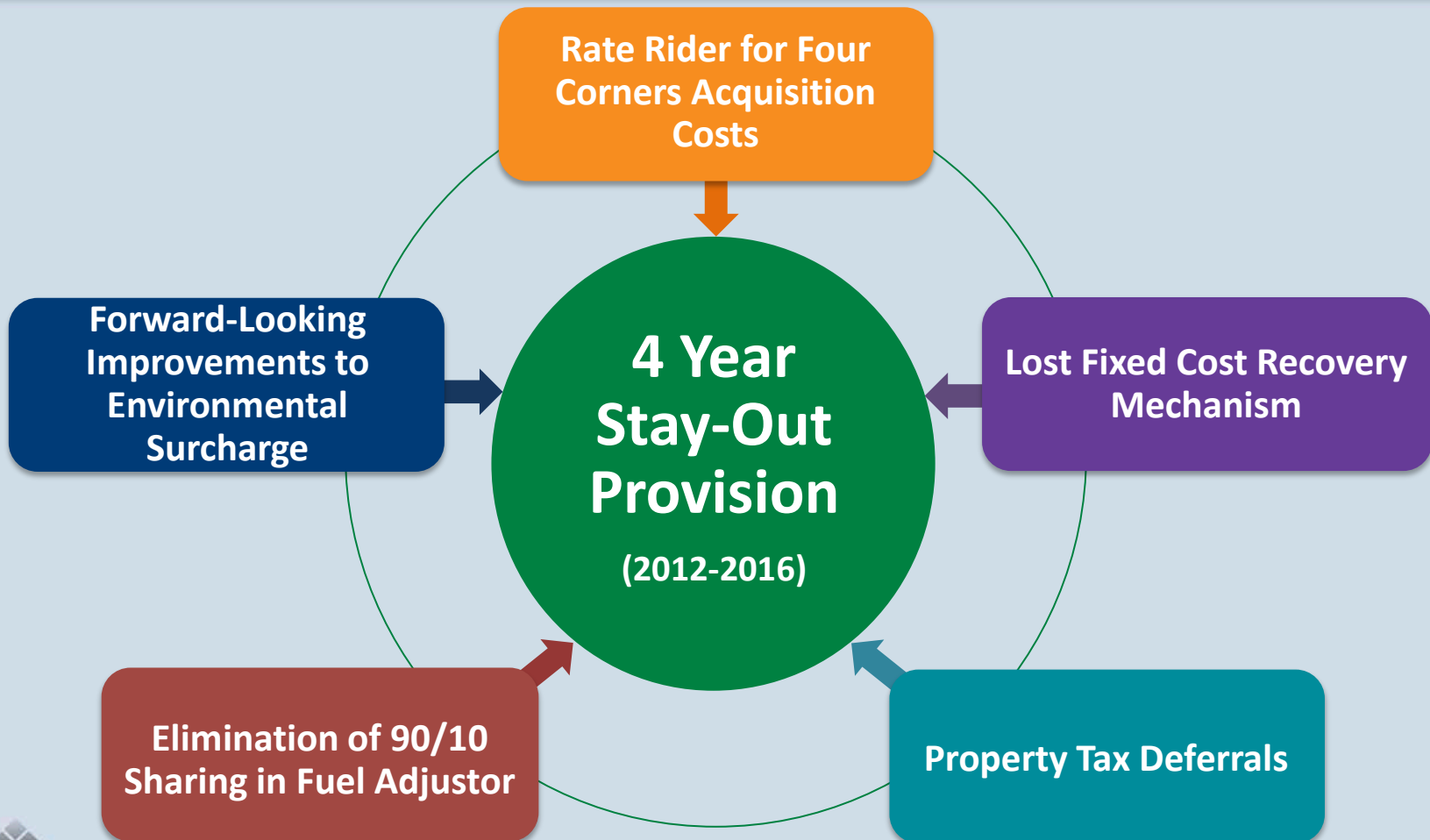
2012 J.D. Power Residential Customer Survey



2012 REGULATORY SETTLEMENT POSITIONED APS WELL THROUGH 2016

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An intentional structure of on-going financial support buttresses a four-year stay-out.



CONCLUSIONS

We remain focused on achieving supportive regulatory structures and productive cost recovery process and timing.

- **Positive regulatory developments**
- **Constructive on-going relationships**
- **Address future of continuing change**





Regulatory Overview Appendix



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CAPITAL CORPORATION

2012 RETAIL RATE CASE SETTLEMENT KEY BENEFITS

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The settlement contains a number of benefits for shareholders and customers.

Shareholder Benefits

- **Regulatory certainty**
 - Base rate stay-out until at least mid-2016
 - Rate gradualism through adjustment mechanisms
- Financial support APS needs to achieve Arizona's energy goals
- 10% allowed return on equity

Customer Benefits

- **Rate certainty**
 - No base rate change until at least mid-2016
 - Rate gradualism through adjustment mechanisms
- Support for renewable energy and energy efficiency

Mutual Benefits

- Encourages progress toward sustainable energy future
- Continuation of constructive regulatory framework established in 2009 settlement
- Collaboration and cooperation among APS, ACC and numerous stakeholders



2012 RETAIL RATE CASE SETTLEMENT KEY FINANCIAL PROVISIONS – BASE RATES & TIMING

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The provisions of the settlement became effective July 1, 2012, as originally requested by APS.

| | Annual Revenue Change |
|---|--------------------------------------|
| Annualized Base Rate Revenue Changes (\$ millions) | |
| Non-fuel base rate increase | \$ 116.3 |
| Fuel-related base rate decrease | (153.1) |
| Revenues related to AZ Sun and other solar projects to be transferred from Renewable Energy Surcharge to base rates | 36.8 |
| Net base rate change | \$ -0- |



2012 RETAIL RATE CASE SETTLEMENT KEY PROVISIONS – OTHER THAN BASE RATES

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Other key provisions continue constructive regulatory treatment and limit regulatory lag.

- **Post test-year plant additions – 15 months' additions included in rate base**
- **Constructive new or modified adjustment mechanisms**
 - **Lost Fixed Cost Recovery (LFCR) rate mechanism to address ratemaking effects of energy efficiency and distributed renewable energy**
 - **Power Supply Adjustor (PSA) – 100% pass-through**
 - **Transmission Cost Adjustor (TCA) – streamlined for future rate changes**
 - **Environmental Improvement Surcharge (EIS) – recovery of certain carrying costs for government-mandated environmental capital expenditures**
- **Four Corners transaction – procedure to allow APS to request related rate adjustments, if transaction consummated**
- **Property tax expense deferrals for future tax rate changes**
- **Current PSA credit on customer bills to continue until February 1, 2013, rather than reset when base rates change effective July 1, 2012**
- **Next general rate case may be filed on or after May 31, 2015 for rates to become effective on or after July 1, 2016 (4-year stay-out)**



2012 RETAIL RATE CASE SETTLEMENT KEY FINANCIAL ASSUMPTIONS

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Updated rate base, cost of capital and fuel prices underpin the settlement amounts.

| | |
|--|----------------------|
| Rate base | \$5.7 billion |
| Allowed return on equity | 10% |
| Capital structure | |
| Long-term debt | 46.1% |
| Common equity | 53.9% |
| Base fuel rate (¢/kWh) | 3.21¢ |
| Projected fuel-price year for base fuel rate | 2012 |
| Test year ended December 31, 2010 adjusted for post-test year plant additions | |

