

2006 Top Accomplishments and Highlights

At the beginning of each year, officers, organizations and departments companywide compile a list of our top accomplishments, events and awards for the prior year. On these pages, we present the company's major efforts and achievements for 2006 as shared with the PNW Board of Directors.

APS planning/acting for reliability and to meet growth demands

Infrastructure and reliability

In 2006, APS achieved its best ever year-end clear weather System Average Interruption Frequency Index (SAIFI), which measures the average number of service interruptions per customer. In 2006, APS customers saw an average of 1.0 outages, down from 1.66 in 1996. With weather factored, APS customers saw an average of 1.78 outages down from 2.78 in 1996.

The company invested about \$400 million in 2006 on transmission and distribution infrastructure to keep pace with customer growth and maintain reliability. APS expects to spend \$2.6 billion in just the next five years on transmission and distribution infrastructure.

APS constructed 10 distribution substations, upgraded 14 others and installed 52 distribution feeders in 2006. This compares with an average of just two substations per year from 1991 to 1998.

The Arizona Corporation Commission's (ACC) Siting Committee approved APS' proposed 500-kilovolt (kV)/230-kV TS-9 to Pinnacle Peak transmission siting project in north Phoenix.

Exceptional customer growth

APS' retail service territory had customer growth above 4 percent, three times the national average. The company connected about 44,000 new customers — 122 new meters a day. In 2006, Arizona became the fastest-growing state in the nation, serving well more than 1 million customers. The average customer today uses about 20 percent more electricity than just 10 years ago.

APS establishes all-time system peak

On July 21, 2006, APS maintained reliability while hitting a new system peak of 7,652 megawatts (MW) — 9.3 percent above the previous year's peak of 7,000 MW. In addition, the Yuma load pocket achieved a system peak of 404 MW, significantly surpassing the previous peak of 370 MW.

Proposed Wyoming-to-Arizona completes Phase 1, enters Phase 2

APS led a group of western utilities and intergovernmental entities through the critical first phase of the proposed TransWest Express Project, which will improve the reliability of the western grid while taking advantage of an abundance of wind and coal resources in Wyoming.

Originally proposed in October 2005, the project would include the construction of two 500,000-volt (500-kV) transmission lines from Wyoming to northern Arizona. The project would have the capability of transporting up to 3,000 megawatts of clean, low-cost coal and renewable wind energy from Wyoming to utilities in Arizona, California, Colorado, New Mexico, Nevada and Utah.

APS gained support for this important project from The Salt River Project, Tucson Electric Power and Southern California Edison. In addition, the project received vast governmental support and the endorsements of Arizona Gov. Janet Napolitano and Wyoming Gov. Dave Freudenthal.

APS regulatory progress

Company takes giant step toward revamped regulatory platform

After obtaining its first rate increase in 14 years in 2005, the company last year followed up that success with the most sustained, complex and proactive regulatory effort in its history, including filing for the largest emergency rate request in APS history. In early 2006, the company received fuel-related emergency rate increases totaling 14 percent. This amount, nearly all of the company's initial request, was well above recommendations from the ACC staff and administrative law judge.

Power supply adjustor key component of regulatory platform

Working with the ACC, APS received several fuel-related emergency adjustments in early 2006 – a 5 percent power supply adjustor (PSA) increase in February, an 8.3 percent interim PSA increase in May and a 0.7 percent PSA surcharge, also in May.

Revenues for 2006 are expected to be 17 percent higher than 2005. Efforts in this area remain crucial to the company maintaining an investment-grade credit rating and achieving key financial metrics.

Company manages complex 2006 rate case seeking 20.4 percent increase

The company filed a new general rate case in November 2005 seeking what is now a 20.4 percent rate increase. Two-thirds is dedicated to fuel cost recovery and the rest is to cover higher costs associated with Arizona's rapid growth and other items.

December marked the conclusion of testimony in APS' general rate case with the ACC. A recommendation from the ACC's administrative law judge is expected in the spring of 2007 with a final ACC decision thereafter.

Other crucial regulatory platform testing in 2007

During 2006, APS submitted a proposal asking the ACC to allow the company the option of building or buying a 90-MW power plant in the Yuma "load pocket." This additional capacity must be available locally by the summer of 2008.

In December the company submitted to the ACC a comprehensive financial plan requesting an increase in the company's debt limit (which could be reached next year depending on rate case results) by more than \$1 billion.

Strategic relationship management and multi-stakeholder analysis

In 2006, the company completed the most integrated, comprehensive, rigorous and multilayered stakeholder analysis in its history to define rate messages for various target audiences and to shape response to current rate requests. This analysis is the underlying basis of the company's current regulatory communications strategy.

Fossil performance

Fossil units set production records

The company's coal-fired power plants established all-time production marks in 2006.

The 44-year-old Cholla Unit 1 surpassed its previous net generation record. Its 895,717 megawatt hours (MWh) of net generation surpassed 2005's record by more than 15,000 MWh. Units 1, 2 and 3 combined for a net generation of 4,774,186 MWh to eclipse the old record of 4,608,054 MWh, also set last year. Meanwhile, with a net generation of 15,969 million MWh, Four Corners' five units, exceeded 1992's previous record-setting production of 15,781 million MWh, and also surpassed the 2006 generation target of 15,835 million MWh.

The units at Cholla and Four Corners combined to achieve an 87 percent capacity factor, compared with the industry average of 72 percent.

On the natural gas side, the company's newest combined cycle units – Redhawk Units 1 and 2 and West Phoenix Units 4 and 5 – produced 25 percent of the company's total generation for 2006. And, all gas and oil plants increased their combined equivalent availability factor to 93.6 percent up from 91.5 percent in 2005.

Palo Verde performance

Site performance falls short of goals, improvement efforts begin

Palo Verde completed 2006 as one of a few U.S. nuclear plants in the NRC's "degraded cornerstone" category and faced additional inquiry regarding diesel generator operability. The technical issue was settled in 2006, although regulatory issues remain unresolved.

Earlier this year, Palo Verde implemented a Performance Improvement Plan designed to restore the operation to historical levels of excellence by realigning the organization where needed, identifying and permanently fixing problems, and giving employees the tools they need to do their jobs. In addition, there have been a number of senior management changes intended to help restore plant performance and regulator confidence in Palo Verde.

In July 2006, plant workers resolved a troublesome vibration issue in Unit 1 by moving a valve the size of a small truck 100 feet within containment. The vibration problem idled the plant for most of the first six months of the year. Unit 2 had an 85.2 percent capacity factor at year's end

and Unit 3 finished with a capacity factor of 85.5 percent – closer to the industry average of 88.3 percent in 2005.

All three Palo Verde units concluded 2006 operating at 100 percent power.

Customer satisfaction and products

Customer Service/Customer Interaction

The Customer Care Center received a record number of calls in 2006 with about the same number of call-center employees as the year before. The Center handled 4,640,071 customer calls, compared to 4,582,497 in 2005. Although dealing with an additional 57,574 calls (a 1.2 percent increase), the call center met its goal of answering 80 percent of calls within 20 seconds for eight of the 12 calendar months.

In 2006, there were 110,169 new registrations for customer accounts at aps.com, compared with 96,302 registrations in 2005 – a 14 percent increase in participation. aps.com experienced a 31 percent increase in customer transactions.

The number of customers enrolling to receive *APS Web News*, the electronic newsletter of the APS Web site, aps.com, grew to 165,000 customers by the end of October 2006. Just two months later, this number reached almost 200,000.

Survey results

Employees' focus on reliability and quality of customer service was recognized by J.D. Power and Associates in its 2006 surveys. APS was rated the top investor-owned electric utility in the West by business customers and number two by residential customers.

Equalizer, SurePay participation increases

In 2006, more than 15,000 new customers enrolled in Equalizer, a 52 percent increase from 2005. SurePay added more than 10,000 new participants – a 9 percent increase from last year. The Equalizer and SurePay programs are designed to help budget for and transact monthly electric bills.

New time-of-use rates introduced

New time-of-use rates that featured fewer on-peak hours were offered this summer. As of Dec. 1, more than 15,000 customers had applied for the new rates. More than 40 percent of APS customers currently are enrolled in the company's time-of-use plans – the highest percentage in the country.

Renewable energy

Wind power comes on line

With the largest agreement for renewable energy ever signed by APS, 90 megawatts (MW) of wind power came on line just before year's end. The wind energy is being procured from the Aragonne Mesa Wind Farm located 40 miles southwest of Santa Rosa, N.M. In December 2005,

APS had the capacity to generate – or had contracts to purchase – 6 MW of renewable energy. One year later, that amount was 106 MW of renewable energy, a 1,770 percent increase.

Customer participation doubles in solar programs

APS doubled participation in its Solar Partners Incentive Program, which offers financial incentives to customers who add photovoltaic solar systems or solar water heaters to their home or business. In 2006, the company added 483 new participants. Program participants have the capacity to generate 2.2 MW of electricity.

In addition, APS customers who took advantage of the solar water-heater incentive are expected to displace more than 900,000 kilowatts of demand.

Meeting future demand through renewable energy

APS is adopting the new renewable portfolio standard set by the ACC in November. The standard states by 2025, Arizona's regulated utilities must obtain at least 15 percent of their total electricity sold from renewable energy sources. It also requires increasing the amount of distributed renewable energy APS customers install, eventually ramping up to 30 percent of the renewable requirement by 2012.

Environmental and social responsibility/stewardship

International recognition

The company continued to earn recognition from prominent groups for its approach to addressing environmental, social and governance issues. These honors are significant because research shows that companies that perform well on environmental, social and strategic governance issues typically are more competitive, more profitable; and have higher share price performance. In 2006, the company:

- received its third-consecutive highest rating (AAA) and was graded as one of the top two utilities in the United States by Innovest Strategic Value Advisors.
- was listed for the second time in the 2005 Dow Jones World Sustainability Index and the 2005 Dow Jones North America Sustainability Index as a sustainability leader in the electric industry;
- was named – for the second year in a row – one of the *Global 100 Most Sustainable Corporations in the World* by Corporate Knights;
- earned “best in class” distinction from Storebrand’s Social Responsibility Index (a European investment group with more than \$25 billion [Euro] of management assets); and
- received the 2006 EPA Climate Protection Award, which recognizes exceptional leadership, personal dedication and technical achievements in protecting the Earth's climate.

Saguaro Solar Power Plant among world's best

APS built the first solar trough power plant in the country in almost 20 years. The facility was named one of the top 12 power plants in the world by the trade publication, *Power Magazine*. Located near Red Rock, Ariz., the 1-megawatt plant was one of two solar projects to make the 2006 list.

Emissions Energy Project of the Year

APS manufactured biodiesel and ethanol by processing algae grown using the carbon dioxide (CO₂) emissions from the company's Redhawk power plant. This accomplishment is a major step toward addressing two national challenges: reducing greenhouse gas emissions at power plants and finding new sources of domestic renewable fuel.

APS and its partner, GreenFuel Technologies, were recognized with the Emissions Energy Project of the Year award at the *8th Annual Platts Global Energy Awards*.

Conservation and energy efficiency

Demand side management programs launched

APS introduced a portfolio of demand side management (DSM) programs to help customers manage their electricity use and help APS manage its growing customer load. These programs are approved by the ACC and funded by APS customers.

APS spent \$8 million on energy efficiency programs in 2006. Over the next few years, the company's DSM portfolio is estimated to produce peak demand savings of approximately 52 MW and lifetime savings of 3.4 million megawatt hours (MWh).

1.3 million compact fluorescent lights sold

In 2006, more than 1.3 million energy efficient light bulbs were sold as a result of the APS Compact Fluorescent Lighting (CFL) Program. By using the CFLs instead of traditional incandescent bulbs, APS expects energy consumption to be reduced by 454,980 MWh over the expected lifespan of the bulbs. This reduced consumption will translate into customer savings of almost \$41 million.

In partnership with local manufacturers and retailers, APS offers discounts on the CFLs to make them cost-competitive with incandescent bulbs. The sales goal was 600,000 light bulbs.

Commercial and Industrial customers save big

In 2006, APS paid almost \$1 million in incentives to more than 60 commercial and industrial customers who installed energy saving equipment – including lighting upgrades, efficient cooling and HVAC systems.

These establishments collectively will reduce their energy consumption by more than 182,000 MWh and contribute to almost \$10 million in bill savings over the life of the equipment.

Company reaches out to customers on limited incomes

In addition to hosting five low-income energy summits around the state and collaborating with social service agencies charged with assisting thousands of in-need customers, APS aggressively promoted its Energy Service Program (E-3). This outreach in 2006 resulted in record enrollment of 43,158 eligible customers in APS' E-3 program, up from 29,234 registered customers.

The E-3 program, which can reduce qualified customers' monthly electricity bills by as much as 40 percent, is administered in cooperation with the Arizona Department of Economic Security (DES).

Employee safety

Power plants turn in impressive safety performances

In 2006, the number of recordable injuries declined slightly – 155 total recordable injuries in 2006 compared with 158 in the prior year. The Yucca and Ocotillo power plants completed their 22nd and 24th years, respectively, without a lost-time injury and Cholla had no lost-time accidents.

Financial/shareholder performance

Stock performance

Pinnacle West's stock price increased 22.6 percent in 2006, compared with 19.2 percent for the Standard & Poor's (S&P) 1500 Electric Utilities Index and 13.6 percent for the S&P 500 Index. Pinnacle West's total return was 28.4 percent in 2006, compared with 23.3 percent for the S&P 1500 Electric Utilities Index and 15.8 percent for the S&P 500 Index.

Dividend growth

In October 2006, the company increased its common stock dividend for the 13th consecutive year. The annual dividend rate increase of \$0.10 per share, or about 5 percent, resulted in a new indicated annual dividend rate of \$2.10 per share. From 2001 to 2006, Pinnacle West increased its dividends at an average annual growth rate of 5.6 percent, ranking in the top quartile of U.S. electric utilities for dividend growth.

Treasury raises more than \$1 billion of new capital

In 2006, the treasury raised \$175 million of five-year notes at PNW to refinance maturing debt; \$400 million of 10- and 30-year notes at APS primarily for construction financing needs; and \$500 million of an additional revolver at APS to meet growing liquidity needs.

Company maintains investment-grade status; cash flow improves

APS maintained investment grade credit ratings by all three rating agencies during 2006. These ratings are critical to attain the necessary financing for system improvements and to ensure reliability.

Cash flow improved over the prior year primarily driven by much-needed regulatory relief in the form of the 4 mill annual Power Supply Adjustor in February (approximately \$100 million) and the 7 mill emergency adjustor in May (approximately \$140 million). In addition, Pinnacle West provided an equity infusion of approximately \$210 million in January with the proceeds from the sale of the Silverhawk Power Plant.

APS Energy Services/Northwind

APS Energy Services breaks ground on biomass facility

APS Energy Services and the Northern Nevada Correctional Center in September broke ground on a 1,000-kilowatt biomass co-generation plant that will utilize forest waste (wood chips)

produced from forest-thinning operations in the Sierra Nevada. The system also will include a 30-kilowatt photovoltaic solar system.

Downtown district cooling expands

In 2006, Northwind increased demand in its cooling system by 25 percent. New connections include the Phoenix Convention Center expansion, the new Arizona State University Campus (APS' old 411 building) and the University of Arizona College of Medicine.

SunCor

SunCor achieves record earnings

SunCor Development Co., Pinnacle West's real estate subsidiary, recorded record net income of about \$60 million in 2006, while continuing its diversified approach to real estate development of commercial and residential properties. In addition to its earnings, SunCor up-streamed \$10 million to the parent company in 2006. Over the past five years, SunCor has provided cash distributions of more than \$266 million to Pinnacle West, providing critical cash flow.

Energizing communities through charitable giving, volunteerism

APS employees set record for giving

APS employees set an all-time contribution record in 2006 by pledging more than \$2.7 million to the United Way Community Services Fund (CSF). Combined with the company match of 50 cents for every dollar pledged, APS' total contribution will exceed \$4 million, a 9 percent increase over last year's result of \$3.8 million.

The number of employees giving at the Leadership Giver level of \$1,000 or more annually totaled 1,240, one in four CSF participants and an 18 percent increase over last year's 1,053 Leadership Givers.

Investing time and dollars to make a difference

In 2006, APS received the *Community Sustainer Award* for its long-time commitment to community service. Citing the more-than 127,000 volunteer hours logged by 4,000-plus APS employees, family members and friends, the Volunteer Center and *Business Journal* recognized the company's for its outstanding corporate citizenship and volunteer program. Through employees' efforts – as well as company and APS Foundation charitable contributions of \$5.9 million (through November 2006) – APS partnered with more than 200 civic, educational, environmental, cultural, charitable and human service organizations throughout Arizona and New Mexico to positively impact the communities in which our employees live and work.

Company Ambassadors
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