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Thomas L. Mumaw
Senior Attorney
(602) 250-2052
Direct Line

May 1, 2006

Jeff Hatch-Miller, Chairman
William A. Mundell, Commissioner
Marc Spitzer, Commissioner
Mike Gleason, Commissioner
Kristin K. Mayes, Commissioner
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Re: APS' Application for Emergency Interim Rate Increase and Interim Amendment to Decision No. 67744 Docket No. E-01345A-06-0009--Moody's Downgrade

Dear Commissioners:

Attached is the Credit Opinion from Moody's which provides the rating rationale and rating outlook relating to the credit ratings that reflect the downgrade which took place on April 27, 2006.

Sincerely,

Thomas L. Mumaw

Thomas L. Mumaw

TLM/na
Enclosure

cc: Parties to the Docket;
Original and 13 copies to
Docket Control

APS • APS Energy Services • Pinnacle West Energy • SunCor • El Dorado

Law Department, 400 North Fifth Street, Mail Station 8695, Phoenix, AZ 85004-3992
Phone: (602) 250-2052 · Facsimile (602) 250-3393
E-mail: Thomas.Mumaw@pinnaclewest.com

Moody's Investors Service

Global Credit Research
Credit Opinion
1 MAY 2006

Credit Opinion: Arizona Public Service Company

Arizona Public Service Company

Phoenix, Arizona, United States

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Baa2
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Subordinate Shelf	(P)Baa3
Commercial Paper	P-2
Parent: Pinnacle West Capital Corporation	
Outlook	Rating(s) Under Review
Issuer Rating	*Baa3
Sr Unsec Bank Credit Facility	*Baa3
Senior Unsecured Shelf	*(P)Baa3
Subordinate Shelf	*(P)Ba1
Preferred Shelf	*(P)Ba2
Commercial Paper	*P-3

* Placed under review for possible downgrade on April 27, 2006

Contacts

Analyst	Phone
Laura Schumacher/New York	1.212.553.1653
A.J. Sabatelle/New York	
Daniel Gates/New York	

Key Indicators

Arizona Public Service Company[1]

	2005	2004	2003	2002
(CFO Pre-W/C + Interest) / Interest Expense [2][3]	3.6x	3.8x	4.5x	4.7x
(CFO Pre-W/C) / Debt [2][3]	14.7%	16.0%	20.0%	22.7%
(CFO Pre-W/C - Dividends) / Debt [2][3]	9.9%	11.3%	15.1%	17.1%
(CFO Pre-W/C - Dividends) / Capex [2][3]	26.3%	73.3%	112.1%	95.3%
Debt / Book Capitalization	47.8%	54.0%	52.1%	48.4%
EBITA Margin %	19.9%	24.5%	23.4%	25.7%

[1] All ratios are calculated using Moody's Standard Adjustments [2] Excludes the impact of a tax refund in 2002 and tax reversal in 2004. [3] $131 million of change in risk management and trading assets and liabilities backed out of the 2005 CFO Pre-W/C

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Rationale

The Baa2 senior unsecured rating of Arizona Public Service Company (APS) reflects key strengths: the stability of its regulated cash flows, the economic strength of its service territory and its position as the primary wholly owned subsidiary of Pinnacle West Capital Corporation (Pinnacle: Baa3 Issuer Rating, under review for possible downgrade). The key concerns are the challenging regulatory environment in Arizona and near term expected financial ratios that are weak for the rating category.

Almost all of APS operations are regulated and its low level of unregulated activities (80%-99% regulated) ranks the company in Category 2 of 4 in accordance with the global rating methodology for electric utility companies. A strong ranking on this key factor is offset by a weak regulatory position with Arizona being ranked in global category 3 of 4, with Arizona being below average for U.S. regulatory jurisdictions.

APS' operations are regulated by the Arizona Corporation Commission (ACC). As evidenced by the recent rate case activity noted below, the company's weak regulatory positon reflects below average assurance of timely recovery of costs and investments. APS' 2003 rate case was not concluded until April 2005, and the increase received was less than half of the amount requested. A fuel surcharge mechanism requested as part of the 2003 rate case was not implemented until February 2006. Fuel and purchased power costs continue to rise and accumulate as a deferred expense. In January 2006, APS requested a 14% emergency interim rate increase to begin recovery of these excess costs in 2006. An Administrative Law Judge (ALJ) recommended implementation of an approximately 6% increase to recover a portion of these costs beginning in May. In its pending general rate case, APS has requested an increase of approximately 21% (inclusive of the 14% increase for fuel and purchased power costs), to be effective January 2007. Hearings will begin in October 2006. It is possible the case could take longer than expected or result in an increase that is less than requested. In light of its challenging regulatory environment, Moody's would look for APS to have financial metrics that are somewhat stronger than comparably rated utility operating companies that operate in more supportive environments.

APS' key financial metrics reflect the fact that it has been unable to recover increased costs for fuel and purchased power on a timely basis. For example, the ratio of funds from operations (FFO) to adjusted debt (incorporating Moody's standard analytic adjustments) is in the mid-teens and expected to remain there through at least 2006. This is at the lower end of the 13% to 25% range in the global rating methodology for Baa rated entities on a stand-alone basis within the medium risk category and suggests a rating that could be Baa3 or Baa2. The Baa2 rating considers the potential for key financial ratios to strengthen beyond 2006 if regulatory treatment is supportive of timely cost recovery. The rating also is supported by on-going strong growth in APS' service territory.

Customer growth has been above 3.5% per annum and the company growth will remain at this level through 2007. APS increasing customer base has resulted in a need for capital investment, but also provides a source of revenue growth outside of base rate increases which, assuming relatively timely recovery of fuel costs, could be expected to improve financial metrics.

Pinnacle, APS' parent company, derives approximately 90% of its operating cash flow from APS. In comparison to other U.S. utility holding companies, Pinnacle's unregulated business represents a small portion of the consolidated company and the amount of debt at the holding company level is also lower than average at about 10% of consolidated debt. Pinnacle's non-regulated operations, which include energy-related products and services, and a commercial and residential real estate development subsidiary that completed an accelerated asset sales program in 2005, are not expected to meaningfully contribute to, or detract from, consolidated cash flows.

Rating Outlook

The outlook for APS is negative, reflecting the potential for downward pressure on the ratings if regulators do not grant rate increases that provide for relatively timely recovery of increased costs for fuel and purchased power, or if the Palo Verde nuclear facility does not return to normal operating performance by mid-summer as expected.

What Could Change the Rating - Up

In light of the negative outlook, APS' rating is not likely to be revised upward in the near-term. Longer term, the rating could be revised upward if there were to be a sustainable improvement in key credit metrics, such as a ratio of FFO to adjusted debt in the high teens to low twenty percent.

What Could Change the Rating - Down

A downgrade could result if regulatory outcomes at APS result in rate increases that do not provide relatively timely recovery of increased costs for fuel and purchased power, or if Palo Verde does not return to normal operating performance by mid-summer as is planned.