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BEFORE THE ARIZONA CORPORATION

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COMMISSIONERS

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MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND TO AMEND DECISION NO. 67744.	DOCKET NO. E-01345A-05-0816 Arizona Corporation Commission DOCKETED JUN 11 2007 DOCKETED BY nr
IN THE MATTER OF THE INQUIRY INTO THE FREQUENCY OF UNPLANNED OUTAGES DURING 2005 AT PALO VERDE NUCLEAR GENERATING STATION, THE CAUSES OF THE OUTAGES, THE PROCUREMENT OF REPLACEMENT POWER AND THE IMPACT OF THE OUTAGES ON ARIZONA PUBLIC SERVICE COMPANY'S CUSTOMERS	DOCKET NO. E-01345A-05-0826
IN THE MATTER OF THE AUDIT OF THE FUEL AND PURCHASED POWER PRACTICES AND COSTS OF THE ARIZONA PUBLIC SERVICE COMPANY	DOCKET NO. E-01345A-05-0827

APS'S NOTICE OF DOCUMENTS PROPOSED TO BE USED AT OPEN MEETING

APS hereby gives notice that it will seek to use the four attachments to this Notice at the open meeting beginning on June 13, 2007 in this proceeding. APS realizes that the Commission has the discretion to direct the amount of discussion permitted by the parties during such open meeting, but believes these attachments will aid in those discussions and wanted to provide this advance notice to the Commission and other parties of their potential use.

These attachments are based on the evidence in the record, the calculated results of the recommendations set forth in the Recommended Order of April 27, 2007, a recent release from a leading financial analyst and a mathematical calculation of the impact of a proposed amendment to the Recommended Order. Consistent with the arguments set forth in APS's Exceptions filed May 15, 2007, APS will use these documents to demonstrate, among other things, that the Recommended Order is unconstitutionally deficient for the following reasons: (1) it fails to provide APS a "fair and reasonable" rate of return on invested equity; (2) it ignores the undisputed fact that, in truth, APS has virtually no opportunity to earn the 10.75% recommended allowed rate of return and, beyond a doubt, will earn far less; (3) it refuses to recognize that APS can never recover in future rate cases the under-earnings that will inevitably result from the inadequate rates the Recommended Order proposes; (4) it fails to provide for adequate recovery of necessary and prudent costs incurred by APS; and (5) it fails to provide an adequate financial basis for APS to maintain its credit and raise necessary capital.

Indeed, within weeks after the Recommended Order was issued, Daniel Ford of Lehman Brothers Equity Research, a prominent utility equity analyst, downgraded APS's stock rating from "equal weight" (*i.e.*, "hold") to "underweight" (*i.e.*, "sell") -- a report that caused Pinnacle West's stock to drop by almost 7% in a matter of days. (As of Friday, June 8, 2007, Pinnacle West's stock had declined more than 11%.) Mr. Ford's report is attached hereto at Tab C. If the Commission adopts the

Recommended Order, this downward trend will almost certainly continue, severely compromising not only APS's financial well-being but also its ability to raise the capital necessary to meet Arizona's growing energy demand. For these reasons, the rates proposed in the Recommended Order are confiscatory, unconstitutionally insufficient, and otherwise contrary to law.

Although not an issue at the time of the filing of the Company's Exceptions, attached hereto at Tab D is a chart that will be used to explain what APS believes could be the unintended impact of one of the proposed Amendments to the Recommended Order, specifically, Mundell Amendment No. 1. By proposing the same peak and off-peak charges for ET-2 and ECT-2 as are approved by the Recommended Order for ET-1 and ECT-1 (even though the peak and off-peak billing determinants of the two sets of rates are vastly different), the potential loss to APS is approximately $95.7 million per year.

Consistent with its Exceptions, APS looks forward to having the opportunity to address the attached exhibits and related issues in greater detail at the Open Meeting.

RESPECTFULLY SUBMITTED this 11th day of June, 2007.

Thomas L. Mumaw
Deborah R. Scott
Meghan H. Grabel
PINNACLE WEST CAPITAL CORP.
Law Department

William J. Maledon
Ronda R. Fisk
OSBORN MALEDON, P.A.

Michael Healy
MORGAN, LEWIS & BOCKIUS LLP

Attorneys for Arizona Public Service Company

By ______________________
Thomas L. Mumaw

ORIGINAL and 15 copies of the foregoing filed this 11th day of June, 2007, with:

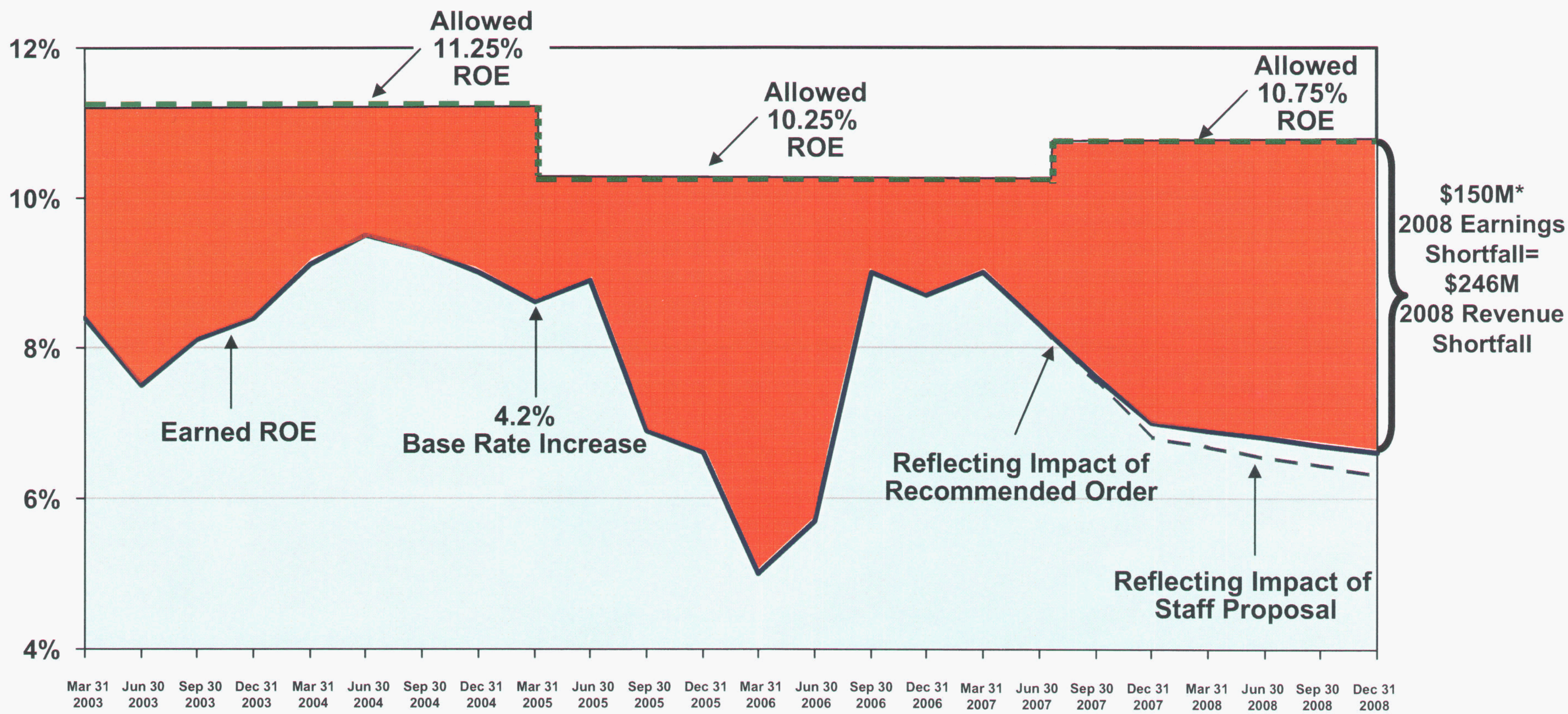
Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

AND copies of the foregoing mailed, faxed or transmitted electronically this 11th day of June, 2007, to:

All Parties of Record

____
Donna Turner

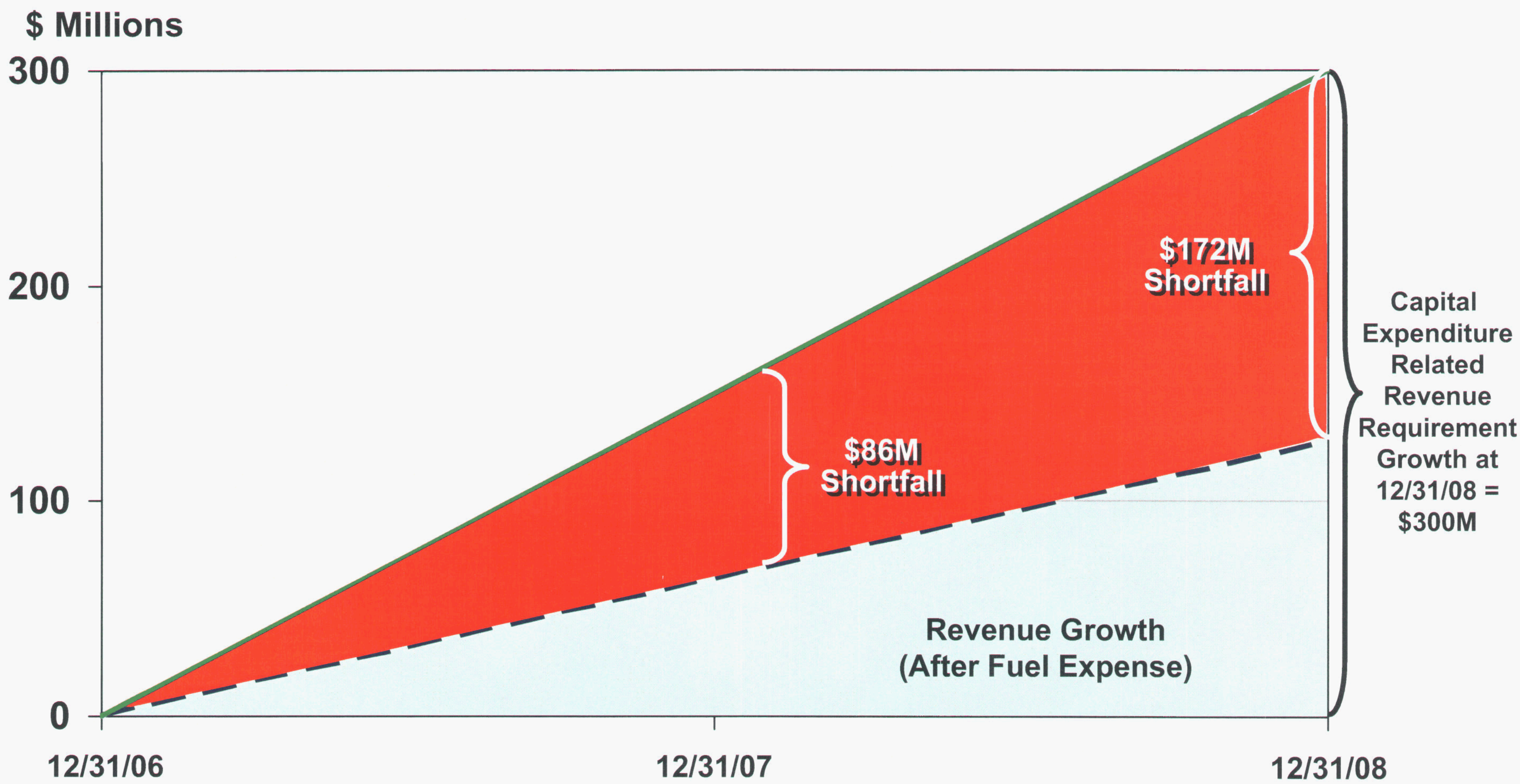
Arizona Public Service Company
Return on Equity (1) (2)
Twelve-Month Periods Ended March 31, 2003 to December 31, 2008



* 2007-2008 Earnings Shortfall = $280 Million

1) March 2003 through June 2006 from Attachment DEB – 10RB, page 4
2) 2007 – 2008 projected results with Staff recommendation from Attachment DEB-2RB

Arizona Public Service Company
Average 2007 – 2008 Projected Revenue Growth Versus Capital Expenditure Related Revenue Requirement Growth (1) (2)
(Excludes Existing Revenue Deficiency as of December 31, 2006)



1) Excludes revenue deficiency caused by O&M expense growth due to inflation, benefit cost increases, etc.
2) From APS' Exhibit 77, Attachment 1

ATTACHMENT C

LEHMAN BROTHERS

EQUITY RESEARCH

May 22, 2007

United States of America
Power and Utilities
Regulated Utilities

Daniel Ford, CFA
1.212.526.0836
daford@lehman.com
LBI, New York

Pinnacle West Capital (PNW - US$ 48.68) 3-Underweight

Recommendation Change

Downgrading to 3-Underweight

Investment Conclusion

- We are downgrading PNW from a 2-EW to a 3-UW mainly due to regulatory lag and free cash flow strain. We are updating our EPS est from \$2.82/\$3.20E to \$2.90/\$3.04E for '07/'08E respectively. We are also publishing '09E EPS of \$3.10. We are lowering our price target to \$45 premised upon a 10% discount to the '09E regulated utility multiple of 15.2x our '09E non-SunCor EPS of \$2.78, plus \$7 for SunCor, premised on an average P/BV for homebuilders of 1.16x. Our prior target of \$48 was premised upon a 10% discount to the then utility avg '08E P/E multiple of 16.8x our prior '08E EPS of \$3.20.

Summary

- We continue to view Arizona as a challenging regulatory district. While allowed ROEs have been above 10%, the two year lag between filing of a GRC and settlement pressure ROE levels into the mid 8% range. This lag also prevents cash from being recovered on a timely basis which creates a greater financing need. While top line growth somewhat mitigates this problem, we believe this is a double edged sword as greater growth will also exacerbate lag issues.
- Below we review our updated model assumptions and the Arizona environment in greater detail.

Stock Rating

New:	3-Underweight
Old:	2-Equal weight

Target Price

New:	US\$ 45.00
Old:	US\$ 48.00

Sector View: 3-Negative

EPS (US\$) (FY Dec)

	2006	2007			2008			% Change	
	Actual	Old	New	St. Est.	Old	New	St. Est.	2007	2008
1Q	0.12A	0.17A	0.17A	0.16A	N/A	N/A	0.23E	42%	N/A
2Q	1.03A	N/A	N/A	0.85E	N/A	N/A	0.89E	N/A	N/A
3Q	1.83A	N/A	N/A	1.79E	N/A	N/A	1.77E	N/A	N/A
4Q	0.18A	N/A	N/A	0.23E	N/A	N/A	0.30E	N/A	N/A
Year	3.17A	2.82E	2.90E	3.00E	3.20E	3.04E	3.19E	-9%	5%
P/E			16.8			16.0			

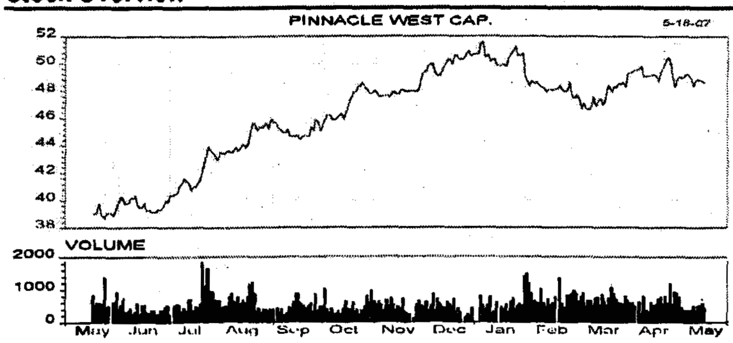
Market Data

Market Cap (Mil.)	4951
Shares Outstanding (Mil.)	100.62
Float (%)	100
Dividend Yield	4.10
Convertible	No
52 Week Range	51.67 - 38.31

Financial Summary

Revenue FY07 (Mil.)	3492.0
Five-Year EPS CAGR	2.0
Return on Equity	9.30
Current BVPS	34.45
Debt To Capital (%)	48.70

Stock Overview



Introduction

We are downgrading PNW based upon our view of the overall regulated space as we enter the next capital cycle and our ranking of Arizona as one of the most challenging regulatory districts in the nation. We are updating our earnings estimates from \$2.82/\$3.20E to \$2.90/\$3.04 for '07/08E respectively and publishing a '09E EPS of \$3.10. We believe the current market valuation of the shares does not fully incorporate the effects of regulatory lag or the most likely outcome (as indicated by the recent ALJ recommendation) of the 2007 GRC and other risks. We are updating our price target methodology to split earnings between SunCor and non-SunCor businesses and moving our

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 7 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 8

valuation to a '09 basis. As a result, we are lowering our price target from $48 to $45 premised upon the methodologies detailed in the investment conclusion above.

Below we review the Arizona Corporation Commission and the current 2007 GRC, followed by a review of Arizona Public Service (APS) and SunCor, PNW's real estate subsidiary. Following this we review the key assumptions we have made in our model, a review of the risks around our forecast, our valuation methodology, and lastly our summary financial projections.

Arizona Corporation Commission (ACC)

Arizona, in our view remains one of the more challenging regulatory environments in the nation. There are several metrics by which to judge a regulatory district. We rank regulators based upon whether they typically settle or fully litigate rate cases, what kind of performance based ratemaking (if any) is used, historical allowed ROEs vs. the treasury yield, whether commissions are elected or appointed, absolute rate levels in the state and our own subjective investor friendliness rating.

The Arizona Corporation Commission consists of 5 elected commissioners that serve out 4 year terms on a staggered basis. Commissioners are prohibited from serving more than 2 consecutive terms. The Chairman is elected by his or her fellow commissioners and usually serves a 2 year term in that post. The Governor will fill any mid-term vacancies with the filled seat being up for election at the end of the current term. The Arizona regulatory environment has historically been, and in our view will continue to be, highly politicized due to the elected nature of the commissioner posts. In Arizona, commissioners typically run higher touch campaigns relative to other jurisdictions in which utility commission elections are held. The commissioners currently on the ACC are shown in the table below:

Commissioner	Party Affiliation	Term Ends
Chairman Mike Gleason	R	Jan-09
Gary Pierce	R	Jan-11
William A. Mundell	R	Jan-09
Kristin K. Mayes	R	Jan-11
Jeff Hatch-Miller	R	Jan-09

Source: ACC Website, Regulatory Research Associates (RRA)

While APS's 2003 General Rate Case was settled we have seen a move in Arizona to prefer full litigation. In fact, in APS's 2007 General Rate Case the ACC essentially took the settlement option off the table by clearly signally their preference for a fully litigated rate case. The ACC is typically far more focused upon cost of service, fuel costs, and price than any incentive based ratemaking. Historical allowed ROE's vs the 10 year treasury yield at the time of decision have averaged a comparatively low 483 bp vs. the national average of 560 bp. Absolute rate levels in Arizona where 8.51 c/kWh in 2006, up 8.0% from 2005. While this is below the national average of 9.81 c/kWh a future dependency on purchased power and natural gas may continue to push rates higher without any bottom line impact. This will make base rate additions, which would improve the bottom line increasingly more difficult to pass along into higher rates.

One area of improvement at the ACC has been the standardization of the fuel pass through mechanism, in Arizona termed the PSA. While we view this as a positive, we feel that the overall pressure on general rates will outweigh the gains from full fuel recovery. Our overall investor friendliness rating for the ACC on a scale of 1-5 (1 – best, 5 –worst) is a 4. There are two main reasons driving this low ranking. First, regulatory lag is of significant concern as the time from filing to settlement has averaged 2 years for APS's last two rate cases. This means achieved ROE at APS remains in the 8-9% range despite an allowed ROE in the 10.5-10.75% range. Second, staff at the ACC is often supplemented, due to workload factors, by consultants throughout the rate case process. This can lead to both inconsistent policy and treatment from rate case to rate case. We would view the expansion and enhancement of the ACC Electric Staff as a positive longer term factor. However, we do not expect any near term developments in this area.

Palo Verde Replacement Power Costs

In early 2007 the Nuclear Regulatory Commission (NRC) issued a "white" finding following an inspection at Palo Verde Nuclear station. This followed a "yellow" finding and will lead to an increased NRC inspection regime at this plant. On January 9th, 2007 PNW hired Randy Eddington as Chief Nuclear Officer, who previously turned around the Cooper Nuclear Station in Oklahoma from being on the NRC shut down list to capacity factors in the mid-80's. We expect that increased costs will be incurred related to turning Palo Verde around. These additional expenses would likely not be recoverable through regulation and would therefore directly impact the bottom line. The ALJ stated that there was not sufficient evidence or detail to propose a Nuclear Performance Standard (NPS) at the current time, however the company and staff were directed by the ALJ to work out a NPS, together with a plan of administration for the plant that the commission could then consider in a separate proceeding. This could add additional costs to the operations of Palo Verde, once implemented.

The ALJ also recommended that of the 2005 Palo Verde outages the August 2005 reactor trip and the October 2005 outages were the result of imprudence and that the replacement power costs from these outages in '05 are not recoverable as they were imprudently incurred. The ALJ did, however, recommended that the other work performed during the outages that were imprudently occurred was a prudent action by APS and the $5.1M the company requested as an offset to unrecoverable imprudent outage costs should be shared equally between ratepayers and shareholders, and, therefore that $2.55M should be netted off of these costs. This yields the final recommended deduction from the PSA of $13.9M, pre-tax. Post-tax this equates to approximately $9M and if not covered by other cost cuts or savings would impact the bottom line by (-$0.09). There are an additional $79 million in 2006 replacement power costs before the commission in a separate docket. Applying a similar disallowance ratio to these costs would imply a disallowance of approximately $28 million post-tax which if not covered by other cost cuts or savings would impact the bottom line by (-$0.28). We have not added any of these additional costs into our current modeling as management continues to maintain that all cost were prudently incurred and are fully recoverable. Moreover, the timing and exact amount of this impact is yet to be determined by any final commission order.

2005 General Rate Case

On 6/27/03 APS filed a rate case with the ACC premised upon a 12/1/02 test year which requested a $175.1 million revenue increase, a rate base of $4.2 billion, an ROE of 11.50%, and an equity ratio of 50%. All parties reached a settlement that was approved by the ACC on 4/7/2005 (a 28 month lag from filing) which authorized a $75.5 million revenue increase, a rate base of $3.8 billion, and an ROE of 10.25% on an equity ratio of 45%. This settlement also included an agreement to a self build moratorium by APS until 2014.

2007 General Rate Case

On 11/4/2005 APS filed another rate case with the ACC that should be finally approved by the commission in mid-June of this year, with new rates being made effective for July 1st. APS's request, and the Residential Utility Consumer Office (RUCO, the AZ consumer advocate body), Staff and the ALJ's recommendation are all provided in the table below:

2007 General Rate Case	Request	Staff	RUCO	ALJ
Test Year	9/30/2005	9/30/2005	9/30/2005	9/30/2005
Filing Date	11/4/2005	8/18/2006		4/27/2007
Revenue Increase %	20.40%	9.62%	10.90%	11.09%
Revenue Increase	$ 425.80	$ 208.30	$ 232.30	$ 286.20
Rate Base	$ 4,457.00	$ 4,400.00	$ 4,457.00	$ 4,400.00
R Base Valuation	Year-End	Year-End	Year-End	Year-End
ROE	11.50%	10.25%	9.25%	10.75%
Equity %	54.50%	54.50%	50.00%	54.50%

Source: Regulatory Filings

We have incorporated the ALJ recommendation into our model projections. The company had requested several mechanisms to help mitigate Arizona's severe regulatory lag. The first of these was an attrition revenue item that would mitigate or remove the lag between the end of the test year and the point in time of the ACC's decision. Also requested were cash CWIP and accelerated D&A which would both speed up cash recovery but have no net income impact. The ALJ recommendation dismissed these items as not consistent with historical test year based cost of service ratemaking, and indicated such cost of service basis ratemaking resulted in fair and reasonable rates for the company. While we anticipate that the exceptions will include filings to allow the ACC to consider these mitigation items we anticipate that none of them will gain ultimate approval.

Assumptions for Future Rate Relief

Based on the above decisions we view the regulatory environment in Arizona as one in which APS will be caught in continual regulatory lag which will shave between 175-275 basis points off of its allowed ROE. We have assumed, given top line sales growth (3.2% through 2011) that APS will need to file for rate relief after the 2007 GRC is resolved. We have estimated the next filing to occur in Spring 2008 based upon a year-end '07 or Q1 '08 test year. Given the average time to decision of 24 months for the last two rate cases we estimate that this future filing will be ruled on by the ACC in December of 2009 for rates effective on 1/1/2010. We have estimated net income relief of $80 million post tax in the 2010 year premised upon a $5.2B rate base, a 10.75% ROE, and a 49.1% equity ratio.

Arizona Public Service

APS has forecast the following capital budget through 2009:

CAPEX FORECAST	2007E	2008E	2009E	TOTAL
Distribution	362	411	459	1,232
Transmission	173	200	288	661
Generation	388	298	335	1,021
Other	26	39	40	105
TOTAL	949	948	1,122	3,019

Source: Company Q1 10-Q Filing

We have further estimated, an additional spend of $50 million annually beyond 2009, leading to total cap-ex of $1.17B and $1.22B in 2010 and 2011, respectively. This capital plan combined with under earning on both a cash and net income basis due to regulatory lag will cause PNW to run FCF deficits throughout our forecast period that will average, on a pre-dividend basis approximately $380 million annually.

We are using the company's guidance with regard to customer and ultimate sales growth for the long term of 4.0% and 3.2%, respectively, which implies usage attrition of 0.80% per year. While this demand elasticity may or may not materialize we remain comfortable with our 3.2% sales growth assumption as ultimate customer growth may trend down in the next few years toward lower levels that are more comparable with the rest of the country.

Lastly, given that a self build moratorium exists in Arizona, APS will continue to serve this top line growth with higher and higher levels of purchased power, which, given their location in the west, leaves them with increasing annual exposure to natural gas. While, as mentioned above, we believe that the pass through of fuel costs is a settled issue with the ACC, increasing fuel costs that cause increases in rates could make the base rate increases necessary to attained level ROEs increasingly difficult to obtain.

SunCor Development Co.

Management has released guidance related to SunCor of $0.30-$0.35 in EPS for 2007. They have guided down to a more normalized level of a sustainable earnings level with gross margins from land sales reverting to the levels seen in 2002 rather than the 2003-2006 when increased land sale opportunities drove gross margins higher. Historical and projected gross margins by business line are provided in the table below:

SunCor Gross Margins	2001A	2002A	2003A	2004A	2005A	2006A	2007E	2008E	2009E	2010E	2011E
Homes	20	26	33	41	48	58	65	72	79	86	93
Condos	0	0	0	0	0	4	4	5	5	6	6
Land	11	21	35	66	54	58	21	32	37	42	45
Asset Sales	6	0	25	0	0	1	1	1	1	1	1
Commercial Property & Management	4	3	4	4	3	4	4	5	5	6	6
TOTAL	41	50	97	110	105	125	95	115	127	141	151

Source: SunCor Annual Reports, Lehman Brothers Estimates

The national slowdown in the residential real estate market is no secret. Arizona, while growing fast in the past has also slowed down significantly, although so far it still remains in better shape than the rest of the nation. While SunCor is a diversified commercial and residential real estate business, most gross margin is embedded in land or home sales. We are comfortable with our growth rate in gross margins as illustrated above, although continued pressure or a significant recovery in the Arizona and national real estate picture could materially impact our forecasts.

Modeling Assumptions

Some of our model assumptions have been discussed above, however, some of those and other key assumptions we have made are summarized, for convenience, in the table below:

Key Modeling Assumptions	
Dividends	+$0.10/share annually
Cost of New Debt	5.92%
Annual Tax Rate	35%
Depreciable Life	31 years
CapEx	Company Guidance thru '09; +$50 million annually thereafter
Annual Customer Growth	+4.0%
Annual Ultimate Sales Growth	+3.2%
O&M $/MWh Cost Growth	+1.0% in 2007 and 2010 for additional maintenance at new Sundance plant and inflation
Equity Issuance	5 million shares in 2009 and 15 million shares in 2010 to maintain leverage ratios in a reasonable range

Source: Lehman Brothers Estimates

Resultant summary financials from our model have been made available at the end of this note.

Risks

We believe the material risks to our downgrade case would be the following:

(1) The Arizona economy could bounce back from its recent slowdown and top line growth could be greater than our assumed 3.2% per year.

(2) Real Estate growth, via a recovery in that industry could be faster than we currently have embedded in our SunCor assumptions.
(3) Arizona could undergo an, in our view, unexpected shift toward a less challenging regulatory environment where case resolution time would accelerate and lag mitigation factors would be adopted.

Factors that are not in our model that would have negative impacts are:

(1) Disallowance of costs related to the Palo Verde replacement power needs in 2005 and 2006, as discussed above.
(2) A further real estate slowdown in Arizona which would pressure gross margins at SunCor
(3) A slower overall economy in Arizona that would cause top line growth to be less than our anticipated 3.2% per year
(4) Continued issues at Palo Verde which would cause further correction costs and, perhaps unrecoverable purchased power costs to flow to the bottom line.

Valuation

We are updating our valuation methodology to reflect the divergent business subsidiaries embedded within PNW. We are now valuing SunCor at $7/share premised upon 1.16x its $6/share Book Value based upon the following group of Real Estate comps:

SunCor Real Estate Comps P/BV

Symbol	Company Name	BV	5/21/07 Price	P/BV
CTX	Centex Corporation	$41	$47.48	1.17x
DHI	DR Horton Inc	$21	$22.82	1.11x
HOV	Hovnanian Enterprises	$28	$24.45	0.87x
KBH	KB Home	$37	$44.93	1.20x
LEN	Lennar Corporation	$36	$45.41	1.26x
PHM	Plute Corporation	$25	$26.57	1.05x
RYL	Ryland Group	$34	$45.38	1.32x
TOL	Toll Brothers	$21	$28.81	1.34x
Average P/BV Multiple				**1.16x**

Source: Lehman Brothers estimates.

We are valuing the non-SunCor (APS and Parent) at a 10% discount to the '09E regulated utility multiple of 15.2x our '09E non-SunCor EPS of $2.78, plus $7 for SunCor, as noted above. Our prior target of $48 was premised upon a 10% discount to the then utility average '08E P/E multiple of 16.8x our prior '08E EPS of $3.20. Our 10% discount is applied as a result of the issues related to the challenging nature of Arizona regulation. As a result of our viewpoint on Arizona regulatory lag, and our projections of cash flow strain, the potential for regulatory disallowances related to Palo Verde, a slowdown in real estate, and a slowdown in top line growth in sales, we are downgrading PNW from a 2-EW to a 3-UW. We are also updating our EPS estimates from $2.82/$3.20E to $2.90/$3.04E for '07/'08E respectively. We are also publishing '09E EPS of $3.10. The summary financials from our updated model follow below.

ATTACHMENT C

LEHMAN BROTHERS
EQUITY RESEARCH

LEHMAN BROTHERS
US Equity Research

PINNACLE WEST CAPITAL CORP.

FINANCIAL SUMMARY	2004A	2005A	2006A	2007E	2008E	2009E	2010E	2011E	4-Yr CAGR
Valuation Ratios									
EV/EBITDA	8.0x	8.7x	8.0x	8.6x	8.3x	8.5x	8.2x	8.3x	
P/E	17.9x	20.9x	15.2x	16.7x	15.9x	15.6x	14.2x	13.8x	
Dividend Yield		4.0%	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	
Income Statement									
APS, Regulated	2,035	2,237	2,641	2,765	2,895	2,983	3,153	3,250	4.12%
Marketing & Trading/Other	444	413	361	361	361	361	361	361	0.00%
SunCor	350	338	400	372	432	470	521	555	10.49%
Revenues Total	**$2,829**	**$2,988**	**$3,402**	**$3,499**	**$3,687**	**$3,814**	**$4,035**	**$4,165**	**4.46%**
APS, Regulated	1,468	1,642	1,675	1,751	1,858	1,922	2,068	2,139	5.13%
Marketing & Trading/Other	80	59	40	40	40	40	40	39	-0.25%
SunCor	66	60	72	42	52	59	66	70	14.04%
Corporate	5	9	9	10	10	10	10	10	0.00%
Gross Income Total	**$1,619**	**$1,770**	**$1,796**	**$1,842**	**$1,959**	**$2,031**	**$2,183**	**$2,259**	**5.23%**
Margin	**57.2%**	**59.2%**	**52.8%**	**52.7%**	**53.1%**	**53.2%**	**54.1%**	**54.2%**	
APS, Regulated	802	735	918	948	1,045	1,099	1,225	1,284	7.89%
SunCor	69	60	83	53	63	70	77	81	11.52%
Corporate, Other	76	75	2	(1)	(1)	(4)	(10)	(10)	NM%
EBITDA	**$947**	**$870**	**$1,003**	**$1,000**	**$1,108**	**$1,165**	**$1,292**	**$1,356**	**7.92%**
Margin	**33.5%**	**29.1%**	**29.5%**	**28.6%**	**30.0%**	**30.5%**	**32.0%**	**32.5%**	
APS	337	325	353	384	414	450	488	528	8.29%
Other	55	23	6	6	6	6	6	6	0.00%
Depreciation	**$392**	**$348**	**$359**	**$390**	**$420**	**$456**	**$494**	**$534**	**8.18%**
APS	20	(129)	23	23	23	23	23	23	0.00%
Other	17	(3)	8	8	8	8	8	8	0.00%
Other Income	**$37**	**($132)**	**$31**	**$31**	**$31**	**$31**	**$31**	**$31**	**0.00%**
APS	145	142	156	173	240	209	215	222	6.39%
Other	27	31	20	16	30	49	47	49	32.93%
Interest	**$172**	**$173**	**$176**	**$189**	**$270**	**$258**	**$262**	**$271**	**9.44%**
APS	120	98	139	122	105	121	121	124	0.52%
SunCor	27	20	32	17	18	19	21	21	5.66%
Corporate	(11)	8	(15)	(5)	(7)	(13)	(14)	(14)	31.16%
Income Tax	**$136**	**$126**	**$156**	**$134**	**$116**	**$127**	**$129**	**$132**	**-0.42%**
APS	200	170	270	270	286	318	400	411	11.10%
SunCor	45	56	61	30	32	33	36	37	5.66%
Corporate	2	(3)	(13)	(10)	(15)	(26)	(27)	(27)	29.00%
Net Income	**$247**	**$223**	**$318**	**$290**	**$304**	**$325**	**$409**	**$421**	**9.79%**
Shares Diluted	**92**	**97**	**100**	**100**	**100**	**105**	**120**	**120**	**4.66%**
APS	$ 2.19	$ 1.76	$ 2.70	$ 2.70	$ 2.86	$ 3.03	$ 3.34	$ 3.42	6.15%
SunCor	$ 0.49	$ 0.58	$ 0.61	$ 0.30	$ 0.32	$ 0.32	$ 0.30	$ 0.31	0.95%
Corporate, Other	$ 0.03	$ (0.03)	$ (0.13)	$ (0.10)	$ (0.15)	$ (0.25)	$ (0.23)	$ (0.23)	23.26%
Adjusted EPS Total	**$ 2.70**	**$ 2.31**	**$ 3.18**	**$ 2.90**	**$ 3.04**	**$ 3.10**	**$ 3.41**	**$ 3.51**	**4.90%**
Dividend per Share	**$ 1.825**	**$ 1.925**	**$ 2.025**	**$ 2.125**	**$ 2.225**	**$ 2.325**	**$ 2.425**	**$ 2.525**	**4.41%**
Guidance Range				~$3.00					

ATTACHMENT C

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Cash Flow									
FFO	$675	$558	$715	$674	$718	$776	$898	$949	5.82%
CFO	$851	$730	$394	$574	$623	$696	$809	$855	16.77%
APS	(514)	(610)	(649)	(949)	(948)	(1,122)	(1,172)	(1,222)	13.49%
SunCor	(2)	(79)	(104)	(131)	(101)	(100)	(100)	(100)	-0.75%
Capex	**($516)**	**($689)**	**($753)**	**($1,080)**	**($1,049)**	**($1,222)**	**($1,272)**	**($1,322)**	**11.92%**
Dividends	(167)	(187)	(201)	(213)	(223)	(244)	(291)	(303)	8.56%
Free Cashflow Pre-div	159	(131)	(38)	(406)	(331)	(446)	(374)	(373)	58.05%
Free Cashflow Post-div	(8)	(318)	(239)	(619)	(554)	(690)	(665)	(676)	23.14%
Free Cashflow Yield	-0.2%	-6.8%	-4.9%	-12.8%	-11.4%	-13.6%	-11.5%	-11.7%	
Balance Sheet									
Cash	$163	$154	$87	$83	$71	$77	$173	$54	
Short Term Debt	688	401	37	37	37	37	37	37	
Long Term Debt	2,585	2,608	3,233	3,843	4,405	4,872	4,932	5,517	
Preferred Stock	0	0	0	0	0	0	0	0	
Shareowners Equity	2,950	3,425	3,446	3,523	3,605	3,928	4,771	4,890	
Total Capital	6,223	6,434	6,716	7,403	8,047	8,837	9,740	10,444	
Equity/Capital	47.4%	53.2%	51.3%	47.6%	44.8%	44.4%	49.0%	46.8%	
Return on Equity (ROE)	8.4%	7.0%	9.3%	8.3%	8.5%	8.6%	9.4%	8.7%	
Return on Invested Capital	8.9%	8.2%	9.8%	8.6%	8.9%	8.4%	8.6%	8.1%	
Earned ROE at APS Utility	9.0%	6.5%	8.7%	8.4%	8.5%	8.4%	9.2%	8.7%	
Credit Ratios									
Interest Coverage	5.5x	5.0x	5.7x	5.3x	4.1x	4.5x	4.9x	5.0x	
Debt/EBITDA	3.5x	3.5x	3.3x	3.9x	4.0x	4.2x	3.8x	4.1x	

Notes: FFO = Net Income + Depreciation; Interest Coverage = EBITDA/Interest Expense; ROIC = EBIT/Avg. Total Capital.
Source: Lehman Brothers Estimates; Company Reports

Analyst Certification:

I, Daniel Ford, CFA, hereby certify (1) that the views expressed in this research Company Note accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

Other Team Members:

Fowler, Ross (LBI, New York) 1.617.330.5893 rofowler@lehman.com

Company Description:

ATTACHMENT C

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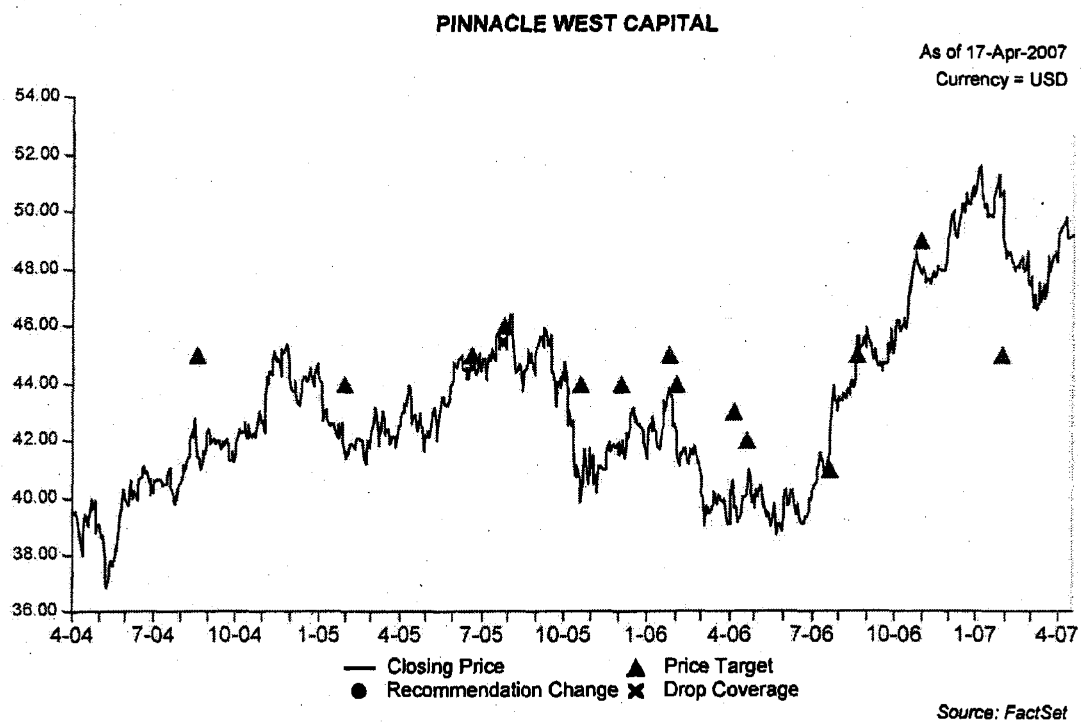
Important Disclosures:

Pinnacle West Capital (PNW) **US$ 48.68 (21-May-2007)** **3-Underweight / 3-Negative**

Rating and Price Target Chart:



Currency=US$

Date	Closing Price	Rating	Price Target
30-Jan-07	49.12		45.00
30-Oct-06	47.80		49.00
21-Aug-06	45.65		45.00
21-Jul-06	42.22		41.00
20-Apr-06	40.13		42.00
06-Apr-06	39.95		43.00
02-Feb-06	41.64		44.00
25-Jan-06	43.88		45.00

Date	Closing Price	Rating	Price Target
02-Dec-05	41.59		44.00
20-Oct-05	39.85		44.00
27-Jul-05	45.60		46.00
21-Jun-05	44.49		45.00
31-Jan-05	41.70		44.00
19-Aug-04	41.44		45.00

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART.

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Valuation Methodology: Our price target of $45 is premised upon a 10% discount to the '09E regulated utility multiple of 15.2x our '09E non-SunCor EPS of $2.78, plus $7 for SunCor, premised on an average P/BV for homebuilders of 1.16x.

Risks Which May Impede the Achievement of the Price Target: Key risks are commodity prices, refinancing and interest rate risk, credit risks, Arizona state and Federal regulation.

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Company Name	Ticker	Price (21-May-2007)	Stock / Sector Rating
Pinnacle West Capital	PNW	US$ 48.68	3-Underweight / 3-Negative

Related Stocks	Ticker	Price (21-May-2007)	Stock / Sector Rating
Centex Corp	CTX	US$ 47.48	1-Overweight / 2-Neutral
DR Horton Inc	DHI	US$ 22.82	1-Overweight / 2-Neutral
Hovnanian Enterprises	HOV	US$ 24.45	2-Equal weight / 2-Neutral
KB Home	KBH	US$ 44.93	2-Equal weight / 2-Neutral
Lennar Corp	LEN	US$ 45.41	1-Overweight / 2-Neutral
Pulte Corp	PHM	US$ 26.57	2-Equal weight / 2-Neutral
Rayonier Inc.	RYN	US$ 44.71	1-Overweight / 1-Positive
Toll Brothers	TOL	US$ 28.81	2-Equal weight / 2-Neutral

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Aquila, Inc (ILA)
Consolidated Edison (ED)
DTE Energy (DTE)
Duquesne Light Holdings (DQE)
Hawaiian Electric Inds (HE)
NiSource, Inc (NI)
OGE Energy (OGE)
Pinnacle West Capital (PNW)
Progress Energy (PGN)
Sierra Pacific Resources (SRP)
TECO Energy (TE)
Wisconsin Energy (WEC)
American Electric Power (AEP)
CMS Energy (CMS)
DPL Inc (DPL)
Duke Energy (DUK)
Great Plains Energy (GXP)
ITC Holdings (ITC)
Northeast Utilities (NU)
PG&E Corp (PCG)
Portland General Electric Co. (POR)
Puget Energy (PSD)
Southern Co (SO)
Westar Energy (WR)
Xcel Energy (XEL)

In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating
1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View
1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

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Estimated Revenue Target of Mundell Proposed Amendment #1

	Revenue Proposed By ALJ Order (1)	Revenue Mundell Amendment #1 (2)(3)	Potential Revenue Loss
ET-1, ET-2	$ 584,597,875	$ 493,812,745	$ 90,785,130
ECT-1R, ECT-2	$ 117,866,544	$ 112,967,767	$ 4,898,777
Total	$ 702,464,420	$ 606,780,512	$ 95,683,908

(1) Procedural Order on May 2, 2007 to the Recommended Opinion and Order

(2) Assumes the Mundell Amendment's reference to "Staff's" proposed ET-1 and ECT-1 rates was intended to mean those rates proposed in the Recommended Order.

(3) Assumes all ET-1 customers will switch to ET-2 and all ECT-1R customers will switch to ECT-2 because all customers will save under the new rates.

Proof of Revenue ET-1, ET-2 ALJ ROO vs. Mundell Amendment #1

	ALJ Proposed Revenue: ET-1 Billing Determinants with 12-7 peak	ALJ Proposed Revenue: ET-2 ROO proposed Charges		Mundell Amendment #1: ET-1 ROO proposed charges	
Base Revenue	Billed				
Summer	Units	Charge	Revenue	Charge	Revenue
Basic Service Charge	61,161,060	0.4930	$ 30,152,403	0.4930	$ 30,152,403
On-peak kWh	954,821,530	0.213070	$ 203,443,823	0.155920	$ 148,875,773
Off-peak kWh	2,781,047,878	0.053400	$ 148,507,957	0.050470	$ 140,359,486
Winter					
Basic Service Charge	58,951,412	0.4930	$ 29,063,046	0.4930	$ 29,063,046
On-peak kWh	360,796,171	0.172780	$ 62,338,362	0.126550	$ 45,658,755
Off-peak kWh	1,724,799,076	0.053390	$ 92,087,023	0.048590	$ 83,807,987
Total			$ 565,592,614		$ 477,917,451
Adjustments	kWh	$/kWh	Revenue	$/kWh	Revenue
Weather Adjustment					
summer	31,675,000	0.09409	$ 2,980,158	0.07730	$ 2,448,409
winter	13,774,000	0.07397	$ 1,018,865	0.06200	$ 854,029
total	45,449,000	0.08688	$ 3,999,023	0.07182	$ 3,302,438
Customer Adjustment					
summer	73,625,000	$ 0.1021	$ 7,515,103	$ 0.0853	$ 6,279,276
winter	98,366,000	$ 0.0878	$ 8,636,608	$ 0.0758	$ 7,459,053
total	171,991,000	0.09696	$ 16,151,712	0.08190	$ 13,738,329
E3, E4 discounts			$ 1,145,473		$ 1,145,473
Total Adjusted Revenue Less Discounts			$ 584,597,875		$ 493,812,745
Potential Revenue Loss	$ 90,785,130				

Proof of Revenue ECT-1R, ECT-2 ALJ ROO vs. Mundell Amendment #1

	ALJ Proposed Revenue: ECT-1R Billing Determinants with 12-7 peak	ALJ Proposed Revenue: ECT-2 ROO proposed Charges		Mundell Amendment #1: ECT-1R ROO proposed charges	
Base Revenue	Billed				
Summer	Units	Charge	Revenue	Charge	Revenue
Basic Service Charge	8,552,985	0.4930	$ 4,216,622	0.4930	$ 4,216,622
kW	2,758,332	11.87107	$ 32,744,358	11.86195	$ 32,719,202
On-peak kWh	204,807,590	0.076080	$ 15,581,761	0.06401	$ 13,109,734
Off-peak kWh	643,924,068	0.037510	$ 24,153,592	0.03579	$ 23,046,042
Winter					
Basic Service Charge	8,356,564	0.4930	$ 4,119,786	0.4930	$ 4,119,786
kW	1,909,881	8.14738	$ 15,560,526	8.14798	$ 15,561,672
On-peak kWh	85,600,081	0.05000	$ 4,280,004	0.04830	$ 4,134,484
Off-peak kWh	414,783,563	0.03673	$ 15,235,000	0.03419	$ 14,181,450
Total			$ 115,891,649		$ 111,088,992
Adjustments	kWh	$/kWh	Revenue	$/kWh	Revenue
Weather Adustment					
summer	6,737,000	0.04681	$ 315,389	0.04260	$ 286,975
winter	2,981,000	0.03899	$ 116,229	0.03659	$ 109,085
total	9,718,000	0.04391	$ 431,617	0.04037	$ 396,060
Customer Adjustment					
summer	8,027,000	$ 0.0903	$ 725,069	0.08608	$ 690,979
winter	11,056,000	$ 0.0783	$ 865,668	0.07590	$ 839,195
total	19,083,000	0.08587	$ 1,590,737	0.08231	$ 1,530,174
E3, E4 discounts			$ 47,459		$ 47,459
Total Adjusted Revenue Less Discounts			$ 117,866,544		$ 112,967,767
Potential Revenue Loss	$ 4,898,777				
Total Potential Revenue Loss	$ 95,683,908				