

PINNACLE WEST CAPITAL CORP
Form 10-Q
November 03, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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 | No |
| ARIZONA PUBLIC SERVICE COMPANY | Yes | No |

Edgar Filing: PINNACLE WEST CAPITAL CORP - Form 10-Q

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 No
ARIZONA PUBLIC SERVICE COMPANY Yes No

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

PINNACLE WEST CAPITAL CORPORATION

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

Emerging growth company

ARIZONA PUBLIC SERVICE COMPANY

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 No
ARIZONA PUBLIC SERVICE COMPANY Yes No

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 27, 2017: 111,729,775 |
| ARIZONA PUBLIC SERVICE COMPANY | Number of shares of common stock, \$2.50 par value, outstanding as of October 27, 2017: 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.

TABLE OF CONTENTS

| | Page |
|--|---------------|
| <u>Forward-Looking Statements</u> | <u>2</u> |
| <u>Part I</u> | <u>3</u> |
| <u>Item 1. Financial Statements</u> | <u>3</u> |
| <u>Pinnacle West Capital Corporation</u> | <u>4</u> |
| <u>Arizona Public Service Company</u> | <u>10</u> |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>59</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>83</u> |
| <u>Item 4. Controls and Procedures</u> | <u>83</u> |
| <u>Part II</u> | <u>85</u> |
| <u>Item 1. Legal Proceedings</u> | <u>85</u> |
| <u>Item 1A. Risk Factors</u> | <u>85</u> |
| <u>Item 5. Other Information</u> | <u>85</u> |
| <u>Item 6. Exhibits</u> | <u>86</u> |
| <u>Signatures</u> | <u>88</u> |

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 Combined Notes to 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," "project" and similar 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, 2016 ("2016 Form 10-K"), Part II, Item 1A of the Pinnacle West/APS Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 ("2017 2nd Quarter 10-Q"), Part II, Item 1A of this report 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, seasonality, 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, ballot initiatives and regulation, including those relating to environmental requirements, regulatory policy, 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 and of debt and equity capital investment;
- 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, including in real estate markets;
- the development of new technologies which may affect electric sales or delivery;
- the cost of debt and equity capital and the ability to access capital markets when required;
- environmental, economic and other concerns surrounding coal-fired generation, including regulation of greenhouse gas emissions;
- volatile fuel and purchased power costs;
- the investment performance of the assets of our nuclear decommissioning trust, 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 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; 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 2016 Form 10-K, Part II, Item 1A of our 2017 2nd Quarter 10-Q, and in Part II, Item 1A of this report, 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.

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

| | Page |
|--|-----------|
| <u>Pinnacle West Condensed Consolidated Statements of Income for Three and Nine Months Ended September 30, 2017 and 2016</u> | <u>4</u> |
| <u>Pinnacle West Condensed Consolidated Statements of Comprehensive Income for Three and Nine Months Ended September 30, 2017 and 2016</u> | <u>5</u> |
| <u>Pinnacle West Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016</u> | <u>6</u> |
| <u>Pinnacle West Condensed Consolidated Statements of Cash Flows for Nine Months Ended September 30, 2017 and 2016</u> | <u>8</u> |
| <u>Pinnacle West Condensed Consolidated Statements of Changes in Equity for Nine Months Ended September 30, 2017 and 2016</u> | <u>9</u> |
| | |
| <u>APS Condensed Consolidated Statements of Income for Three and Nine Months Ended September 30, 2017 and 2016</u> | <u>10</u> |
| <u>APS Condensed Consolidated Statements of Comprehensive Income for Three and Nine Months Ended September 30, 2017 and 2016</u> | <u>11</u> |
| <u>APS Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016</u> | <u>12</u> |
| <u>APS Condensed Consolidated Statements of Cash Flows for Nine Months Ended September 30, 2017 and 2016</u> | <u>14</u> |
| <u>APS Condensed Consolidated Statements of Changes in Equity for Nine Months Ended September 30, 2017 and 2016</u> | <u>15</u> |
| | |
| <u>Combined Notes to Condensed Consolidated Financial Statements</u> | <u>16</u> |
| <u>Note 1. Consolidation and Nature of Operations</u> | <u>16</u> |
| <u>Note 2. Long-Term Debt and Liquidity Matters</u> | <u>17</u> |
| <u>Note 3. Regulatory Matters</u> | <u>18</u> |
| <u>Note 4. Retirement Plans and Other Postretirement Benefits</u> | <u>30</u> |
| <u>Note 5. Palo Verde Sale Leaseback Variable Interest Entities</u> | <u>31</u> |
| <u>Note 6. Derivative Accounting</u> | <u>32</u> |
| <u>Note 7. Commitments and Contingencies</u> | <u>37</u> |
| <u>Note 8. Other Income and Other Expense</u> | <u>45</u> |
| <u>Note 9. Earnings Per Share</u> | <u>46</u> |
| <u>Note 10. Fair Value Measurements</u> | <u>46</u> |
| <u>Note 11. Nuclear Decommissioning Trusts</u> | <u>53</u> |
| <u>Note 12. New Accounting Standards</u> | <u>54</u> |
| <u>Note 13. Changes in Accumulated Other Comprehensive Loss</u> | <u>57</u> |
| <u>Note 14. Asset Retirement Obligations</u> | <u>58</u> |

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(dollars and shares in thousands, except per share amounts)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-------------|-------------------|-------------|
| | September 30, | | September 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| OPERATING REVENUES | \$1,183,322 | \$1,166,922 | \$2,805,637 | \$2,759,483 |
| OPERATING EXPENSES | | | | |
| Fuel and purchased power | 310,469 | 336,120 | 777,475 | 832,253 |
| Operations and maintenance | 224,305 | 217,568 | 658,294 | 703,042 |
| Depreciation and amortization | 133,912 | 120,428 | 387,278 | 362,977 |
| Taxes other than income taxes | 45,169 | 41,284 | 133,294 | 125,902 |
| Other expenses | 3,385 | 264 | 5,479 | 2,141 |
| Total | 717,240 | 715,664 | 1,961,820 | 2,026,315 |
| OPERATING INCOME | 466,082 | 451,258 | 843,817 | 733,168 |
| OTHER INCOME (DEDUCTIONS) | | | | |
| Allowance for equity funds used during construction | 12,728 | 10,194 | | |