



A subsidiary of Pinnacle West Capital Corporation

James M. Levine
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102-04813-JML/SAB
July 11, 2002

VIA: UPS Overnight

U.S. Nuclear Regulatory Commission
ATTN: Samuel J. Collins, Director, Office of Nuclear Regulation
Mail Stop O-5 E7
One White Flint North
11555 Rockville Pike
Rockville, MD 20852-2738

References:

1. APS letter 102-04686, dated April 15, 2002, from Mr. James M. Levine, APS/PWE, to Mr. Samuel J. Collins, NRC, "Application for Order and Conforming Administrative Amendments for License Transfer".
2. NRC letter dated June 17, 2002, from Jack Donohew, NRC, to Mr. James M. Levine, Arizona Public Service Company/Pinnacle West Energy Corporation, "Request for Additional Information for Palo Verde Nuclear Generating Station, Units 1, 2, and 3 – Regarding Application for Order and Conforming Administrative Amendments for License Transfers (TAC Nos. MB4824, MB4825, and MB4826)".

Dear Sirs:

**Subject: Palo Verde Nuclear Generating Station (PVNGS), Units 1, 2 and 3
Facility Operating License Nos. NPF-41, NPF-51 and NPF-74
Docket Nos. 50-528, 50-529 and 50-530
Response to Request for Additional Information Regarding
Application for Order and Conforming Administrative Amendments
for License Transfers and Request to Amend the Application**

By letter dated April 15, 2002 (Reference 1), Pinnacle West Energy Corporation (PWE) and Arizona Public Service Company (APS)(collectively the "Applicants") submitted their Application for Order and Conforming Administrative Amendments for License Transfer ("Application") requesting NRC's consent to the transfer of APS' existing operating licenses for PVNGS Units 1, 2 and 3 to PWE, and approval of certain conforming administrative amendments to the PVNGS operating licenses to reflect the proposed transfer to PWE.

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U.S. Nuclear Regulatory Commission
ATTN: Mr. Samuel J. Collins, Director, Office of Nuclear Reactor Regulation
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By letter dated June 17, 2002, the NRC requested additional information regarding the Application through the issuance of Reference 2. Specifically, the NRC requested a finalized, or an up-to-date copy of the power sales agreement between PWE and its parent, Pinnacle West Capital Corporation (PNW), and any agreement concerning nonbypassable wires charges that will be collected by APS and dedicated to the decommissioning trusts for the PVNGS units.

Enclosure 1 provides a copy of the proposed Power Sales Agreement between PWE and PNW, as submitted to the Arizona Corporation Commission (ACC) on November 21, 2001. Implementation of this agreement is contingent on the transfer of generation assets from APS to PWE. The ACC recently initiated a generic docket to consider, among other things, generation divestiture, market power, and market monitoring issues. To date, the ACC has taken no action that directly affects its approval of APS' restructuring settlement agreement.

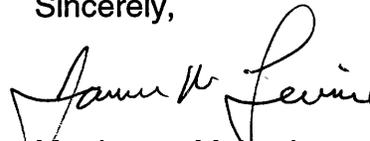
Enclosure 2 is a draft of the Decommissioning Funds Collection Agent Agreement between APS and PWE addressing the collection of decommissioning funds by APS from consumers as part of a System Benefit Charge, and the transfer of those funds to the nuclear decommissioning trust funds for the PVNGS units.

Enclosure 3 provides a request to amend Reference 1. This proposed request would amend Appendix C, "Antitrust Conditions", to each of the three PVNGS licenses. The Applicants propose that the NRC substitute "Pinnacle West Energy Corporation" for "APS" as a conforming administrative amendment in accordance with 10 CFR 2.1315(b), to better reflect the separate functional, legal, and regulatory responsibilities of APS and PWE following the license transfers.

No regulatory commitments are being made to the NRC in this letter.

Please contact Mr. Scott Bauer at 623-393-5978 if you have any questions or require additional information.

Sincerely,



Mr. James M. Levine
Executive Vice President, Generation
Arizona Public Service Company, and
Chief Operating Officer,
Pinnacle West Energy Corporation

U.S. Nuclear Regulatory Commission
ATTN: Mr. Samuel J. Collins, Director, Office of Nuclear Reactor Regulation
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JML/SAB

Enclosures:

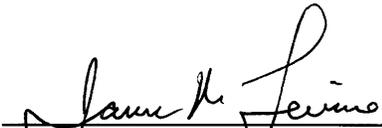
1. Proposed Power Sale Agreement between Pinnacle West Capital Corporation (PNW) and Pinnacle West Energy Corporation (PWE)
2. Draft of Decommissioning Funds Collection Agent Agreement between Arizona Public Service Company (APS) and Pinnacle West Energy Corporation (PWE)
3. Request to Amend the Application for Order and Conforming Administrative Amendments for License Transfers

cc (w/encl.):

Nuclear Regulatory Commission, Document Control Desk
E. W. Merschoff, Regional Administrator, Region IV, NRC
J. N. Donohew, PVNGS Project Manager, NRR
D. G. Naujock, PVNGS Project Manager, NRR
NRC Resident Inspector for PVNGS
Aubrey V. Godwin, Arizona Radiation Regulatory Agency

STATE OF ARIZONA)
) ss.
COUNTY OF MARICOPA)

I, James M. Levine, represent that I am Executive Vice President - Generation, Arizona Public Service Company (APS), that the foregoing document has been signed by me on behalf of APS with full authority to do so, and that to the best of my knowledge and belief, the statements made therein are true and correct.



James M. Levine

Sworn To Before Me This 11th Day Of July, 2002.



Notary Public



Notary Commission Stamp

ENCLOSURE 1

**Proposed Power Sale Agreement
between Pinnacle West Capital Corporation (PNW)
and Pinnacle West Energy Corporation (PWE)**

NRC Request 1:

Provide a finalized, or an up-to-date, copy of a power sale agreement between Pinnacle West Energy Corporation (PWE) and Pinnacle West Capital Corporation (PNW), the owner of PWE and Arizona Public Service Company (APS).

Applicants' Response

This enclosure provides the requested information. Please note that this is a proposed agreement. It has not yet been executed by PNW or PWE, and may be subject to future negotiations and change. The Applicants will keep the staff informed of any substantive changes to the power sale agreement up to the time that the staff issues its evaluation of the Applicants' application for order and conforming administrative amendments for license transfers.

**POWER SALE AGREEMENT
BETWEEN
PINNACLE WEST CAPITAL CORPORATION AND
PINNACLE WEST ENERGY CORPORATION**

Introduction

- A. Parties.** The Parties to this Agreement (the "Agreement") are Pinnacle West Capital Corporation ("PWCC") and Pinnacle West Energy Corporation ("PWEC").
- B. Agreement.** This Agreement is made under PWEC's Tariff and includes all attached exhibits and schedules, all of which are incorporated by reference. Defined terms used in this Agreement are set forth in Exhibit A.
- C. Purpose.** The Parties enter into this Agreement to provide for the sale by PWEC of any and all output from any of its existing generation units, as well as certain specified future generation units, which are collectively identified in Exhibit A and referenced herein as the "Dedicated Units".

**Article 1
Services Provided**

1.1 Purchase and Sale of Power.

- (A) PWEC shall sell to PWCC, and PWCC shall purchase from PWEC, any and all Energy Products from the Dedicated Units during the term of this Agreement.
- (B) PWCC shall pay PWEC for the sales as provided in the attached Service Schedule.

1.2 Relationship to Tariff.

- (A) If the Agreement is inconsistent with PWEC's Tariff, the Tariff shall control with respect to such inconsistency.
- (B) The Tariff and this Agreement together form a single agreement. The Parties would not have entered into this Agreement without such a relationship.
- (C) This Agreement does not amend the Tariff.

1.3 Transfer of Title and Risk of Loss.

- (A) As between the Parties, and except as expressly limited in the attached Service Schedule or Exhibit A, or unless the Parties have agreed in writing otherwise:
- (1) Before Energy Products subject to this Agreement are delivered to PWCC, PWEC will be deemed to have exclusive control and possession of the Energy Products and will be responsible for all damages, injuries, and other losses occurring before such delivery.
 - (2) After Energy Products subject to this Agreement are delivered to PWCC, PWCC will be deemed to have exclusive control and possession of the Energy Products and PWCC will be responsible for all damages, injuries, and other losses occurring after such delivery.
 - (3) Ownership of the Energy Products and risk of loss shall pass from PWEC to PWCC at the Delivery Points.
- (B) Except as provided in Section 1.3(C), the Parties each assume full responsibility for and shall indemnify and hold harmless the other Party for, from and against all liability, costs and expenses, including but not limited to those relating to the injury or death of persons, arising or caused after title to the Energy Product has passed to the indemnifying Party. Expenses include but are not limited to court costs, reasonable attorneys' fees, and litigation expenses.
- (C) The indemnifying Party shall not be liable to the indemnified Party to the extent the liability, costs or expenses resulted from gross negligence or willful misconduct of the indemnified Party or from the indemnified Party's breach of this Agreement.

1.4 Transmission Arrangements.

- (A) Except as expressly limited in the attached Service Schedule or Exhibit A, or unless the Parties have agreed otherwise in writing:
- (1) PWEC shall be responsible for all Dedicated Unit interconnection arrangements and/or making all other arrangements necessary for transmission of the Energy Products to the Delivery Points.
 - (2) PWEC is responsible for remitting all costs, including but not limited to losses, associated with the arrangements covered in Section 1.4(A)(1) above.

- (3) PWCC shall make all arrangements necessary for transmission of the Energy Products from the Delivery Points.
- (4) PWCC is responsible for all costs, including but not limited to losses, associated with the transmission of the Energy Products from the Delivery Points.

Article 2
Reliability Guidelines

2.1 Reliability Guidelines.

(A) Each Party shall:

- (1) adhere to Good Utility Practice in the operation and dispatch of the Dedicated Units; and
- (2) meet all applicable operating policies, criteria, and guidelines of the NERC, the WSCC, the NRC, the control area operator, the applicable regional transmission organization(s), and their respective successors, and any PWEC interconnection agreements.

- 2.2 RTO.** This Agreement shall be modified as necessary and as mutually agreed to by the Parties to comply with the operating requirements of any applicable RTO.

Article 3
Metering

- 3.1 Metering Procedures.** All provisions in this section will be consistent with PWEC's Interconnection and Operating Agreements ("IOA") with APS, including as they may be amended from time to time with the express written consent of PWCC. If the terms of the IOA are inconsistent with this Agreement, the terms of the IOA shall control for the purpose of the relevant condition.

(A) Inspection and Testing.

- (1) PWEC shall conduct or provide for periodic inspection and testing of meters used to perform this Agreement. Inspection and testing shall conform to applicable generator interconnection and transmission interconnection agreements.
- (2) Inspection and testing under Section 3.1(A) shall be conducted as necessary to maintain a commercial standard of accuracy for the

meters. PWEC shall arrange for required maintenance to maintain such standard.

- (3) Upon request to PWEC, PWCC shall be provided the results of meter tests, be given notice of meter tests and inspections, and be given the opportunity to attend meter tests and inspections, to the extent allowed under applicable generator interconnection and transmission interconnection agreements.
 - (4) PWEC shall conduct or provide for additional meter testing at PWCC's request and in the presence of PWCC's representatives to the extent allowed under applicable generator interconnection and transmission interconnection agreements.
- (B) Corrections for Inaccurate Meters.** If testing or inspection in Section 3.1(A) shows that a meter is inaccurate by more than the amount specified in applicable generator interconnection and transmission interconnection agreements, then:
- (1) PWEC shall correct the billings based on the meter error difference outside of the accuracy level specified in the IOA from the date of the last meter calibration or for the previous six billing months, whichever is most recent; and
 - (2) the Parties shall correct the meter records for the elapsed period of the month in which the test was conducted.
- (C) Costs for Additional Testing.** The cost of inspection and testing requested by PWCC shall be borne by PWCC if the test does not require a correction under Section 3.1(B). Otherwise, PWEC shall pay the cost of inspection and testing.
- (D) Estimated Meter Data.** If at any time a meter fails to register or its registration is too erratic to be meaningful, then:
- (1) the registration for billing purposes shall be based on the records of check meters, if available;
 - (2) the Parties shall mutually agree on the best available data to estimate the registration if check meters are not available; and
 - (3) PWEC shall in good faith remedy the meter inaccuracy using commercially reasonable means and in a reasonable period of time.

3.2 Availability of Meter Data.

- (A) Upon request by PWCC, PWEC shall provide meter data or estimates to PWCC no later than 3 Business Days following the last day of each calendar month. In addition, PWCC shall have the rights and ability to access generation output information on a real-time basis as needed.

Article 4
Billing, Payment and Netting

4.1 Invoices.

- (A) PWEC shall endeavor to provide PWCC with a written invoice, in a mutually agreed upon form, showing the Purchase Price and all other charges due by the 20th day of the month following such delivery of Energy Products.
- (B) Invoices issued pursuant to Section 4.1(A) shall contain sufficient detail for PWCC to confirm all calculations on the invoice.
- (C) If data needed to calculate an invoice is unavailable, PWEC shall estimate the necessary data. PWEC shall revise such estimates when the necessary data becomes available and include a true-up adjustment in the next invoice, but all revisions must be made within 12 months of the estimated invoice.
- (D) Invoices may be provided to PWCC by facsimile or another method agreed upon by the Parties.

4.2 Payment.

- (A) **Payment Due Dates.** Invoices shall be paid by the later of:
- (1) the 20th day of the month in which the invoice is received; or
 - (2) 10 calendar days after receipt of the invoice.
- (B) **Next Business Day.** If the payment due date specified in Section 4.2(A) is not a Business Day, the payment shall be due no later than the next Business Day.
- (C) **Method of Payment.** PWCC shall pay by electronic funds transfer or another method that results in the payment being available for the account

of PWEC on or before the payment date specified in Section 4.2(A) or Section 4.2(B).

- (D) **Late Payments.** If either Party fails to remit an amount payable when due, Interest shall accrue on the net unpaid amount.
- (E) **Netting of Payments.** If both Parties owe amounts accruing under this Agreement, such amounts shall be netted with the Party owing the greater amount paying the other Party the difference in the amounts owed.

4.3 Disputed Invoices or Payments.

- (A) If either Party disputes an invoice, it shall nonetheless pay the full amount due on or before the due date and submit a written statement detailing the dispute to the other Party.
- (B) Within 15 calendar days after receipt of the written statement described in Section 4.3(A), a written response shall be submitted to the Party disputing the invoice.
- (C) The statement and response described in Section 4.3(A) and Section 4.3(B) shall each include a statement of the Party's position, a summary of the arguments supporting that position, the name and title of the person who will represent that Party, and any other person who may accompany the Party's representative if known at that time.
- (D) The Parties shall attempt in good faith to resolve the dispute promptly through negotiation as follows:
 - (1) Within 30 calendar days after delivery of the statement described in Section 4.3(A), the Parties shall meet at a mutually agreed upon place and time.
 - (2) The Parties shall continue to meet as often as necessary to attempt to resolve the dispute in good faith.
 - (3) All negotiations pursuant to this Section 4.3 shall be confidential and subject to Rule 408 of state and federal rules of evidence.
 - (4) Each Party is responsible for its own costs, fees and expenses incurred in the negotiations.
- (E) If the dispute has not been resolved within 60 calendar days after delivery of the statement described in Section 4.3(A), or if the Parties fail to meet

in accordance with Section 4.3(D), then either Party may initiate the alternative dispute resolution provisions in Article 12.

- 4.4 Refunds.** If either Party is owed a refund or additional payment, such refund or additional payment shall include Interest, unless otherwise directed by FERC.

Article 5
Representations and Warranties

- 5.1 Mutual Representations and Warranties.** Each Party represents and warrants to the other Party that, as of the date it signs this Agreement and as of the date of its performance under this Agreement, that:
- (A) It is duly organized, validly existing, and in good standing, under the laws of the jurisdiction of its organization or incorporation.
 - (B) It has the corporate, governmental and legal capacity, authority and power to execute, deliver, and perform this Agreement.
 - (C) The execution, delivery, and performance of this Agreement does not violate or conflict with any:
 - (1) laws or regulations applicable to the Party;
 - (2) organizational or corporate documents applicable to the Party;
 - (3) orders or judgments of any court or regulatory body applicable to the Party or its assets; or
 - (4) contractual restrictions applicable to the Party or its assets.
 - (D) No Event of Default under Article 7, including an event which with notice or lapse of time would constitute an Event of Default:
 - (1) has occurred and is continuing for the Party; or
 - (2) would occur as a result of the execution, delivery, or performance of this Agreement for the Party.
 - (E) It has executed this Agreement in connection with the conduct of its business and it has the ability to make or take delivery of Energy Products as provided in this Agreement.

- (F) It is not relying on any representation of the other Party except for those expressly set forth in this Agreement, or on any Credit Support of the obligations of the other Party.
- (G) It has executed this Agreement with a full understanding of the material terms and risks and is capable of assuming those risks.
- (H) It has made its trading and investment decisions, including the suitability of such decisions, based solely on its own judgment and advice from its advisors, and not in reliance on information or opinion from the other Party or the other Party's advisors.
- (I) It has not received from the other Party any assurances or promises regarding financial results or benefits from this Agreement.

5.2 Representations and Warranties of PWEC. Unless otherwise agreed upon and as expressly limited in the attached Service Schedule, PWEC further represents and warrants, as of the date of delivery of Energy Products as provided in this Agreement, that:

- (A) PWEC is the owner of and has good title to the Energy Products;
- (B) the Energy Products are transferred to PWCC free and clear of all liens, taxes, claims, security interests and other encumbrances;
- (C) the Energy Products are transferred to PWCC free of any right or interest in or to the Energy Products by any other person or entity; and
- (D) PWEC is currently and shall throughout the term of this Agreement maintain and operate the Dedicated Units pursuant and in accordance with Good Utility Practices.

5.3 LIMITATION OF WARRANTIES. ALL OTHER WARRANTIES, WHETHER WRITTEN OR ORAL, EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO ANY WARRANTY OF MERCHANTABILITY OR WARRANTY OF FITNESS FOR ANY PARTICULAR PURPOSE, ARE DISCLAIMED.

5.4 Survival. This Article 5 survives the termination of this Agreement.

Article 6 **Assurances**

6.1 Adequate Assurances. If a material change occurs such that a Party can reasonably call the continued performance of this Agreement by the Affected Party into question, then:

- (A) A Party may request in writing that the Affected Party provide Credit Support, in a commercially reasonable amount and in a form acceptable to the requesting Party.
- (B) Upon receipt of the request described in Section 6.1(A), the Affected Party shall provide Credit Support within 5 Business Days.
- (C) If the Affected Party fails to comply with Section 6.1(B), then an Event of Default shall occur.
- (D) If the Affected Party complies with Section 6.1(B), then no Event of Default shall have occurred as a result of the Affected Party incurring a material change.

Article 7
Default and Remedies

7.1 Default.

- (A) **Events of Default.** Events of Default are as follows:
 - (1) **Failure to Deliver or Receive.** A Party defaults if it fails to deliver or receive Energy Products as required in the Service Schedule.
 - (2) **Failure to Pay.** A Party defaults if it or its Credit Support Provider fails within 5 Business Days after receiving written notice from the other Party to make any payment when due, whether under this Agreement or under the Credit Support.
 - (3) **Failure to Deliver Assurances.** A Party defaults if it or its Credit Support Provider fails, within 5 Business Days after receiving written notice from the other Party, to provide adequate assurances pursuant to Section 6.1.
 - (4) **Failure to Perform Agreement.** A Party defaults if it fails, within 5 Business Days after receiving written notice from the other Party, to comply with or perform any material term of this Agreement.
 - (5) **Failure to Maintain Credit Support.** A Party defaults if:
 - (a) it fails to maintain Credit Support in full force and effect pursuant to the terms of and during the duration specified in

this Agreement, unless the other Party agrees to the failure in writing; or

- (b) the Credit Support Provider disaffirms, repudiates, rejects, or challenges the validity of the Credit Support, whether in whole or in part.

(6) Failure to Remain Solvent. A Party defaults if it or its Credit Support Provider:

- (a) is dissolved other than pursuant to a merger;
- (b) becomes insolvent, or is unable to pay its debts, or fails or admits in writing its inability generally to pay its debts as they become due;
- (c) makes a general assignment, arrangement or composition with or for the benefit of its creditors;
- (d) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights;
- (e) has a resolution passed for its winding-up, official management or liquidation, other than pursuant to a merger;
- (f) seeks or becomes subject to the appointment of an administrator, provisional liquidation, conservator, receiver, trustee, custodian or other similar official for all or substantially all of its assets;
- (g) has a secured party take possession of all or substantially all of its assets;
- (h) has a distress, execution, attachment, sequestration or other legal process levied, enforced or sued on against all or substantially all its assets and within 30 calendar days from the initiation of such process:
 - (i) the secured party maintains possession of the assets;
or

- (ii) the legal process is not dismissed, discharged, or stayed;
 - (i) causes or is subject to any event with respect to it which has an analogous effect to any of the events listed in Section 7.1(A)(4)(a) – (h); or
 - (j) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the events listed in Section 7.1(A)(4)(a) - (i).
- (7) Failure Following Merger or Transfer. A Party defaults if it or its Credit Support Provider:**
- (a) merges with or into, or transfers all or substantially all its assets to, another entity and at that time:
 - (i) the resulting, surviving, or transferee entity fails to assume all the obligations of the Party or Credit Support Provider under this Agreement or any required Credit Support; or
 - (ii) the benefits of any Credit Support fail to extend, without consent of the other Party, to the performance of the resulting, surviving or transferee entity; or
 - (b) merges with or into, or transfers all or substantially all its assets to, another entity, and:
 - (i) the merger or transfer is not itself an Event of Default; and
 - (ii) the creditworthiness of the successor is materially weaker than the creditworthiness of the assignor before the merger or transfer, taking into account Credit Support; and
 - (iii) the transferee fails to make collateral arrangements with and provide collateral to the other Party or provide adequate assurances pursuant to Section 6.1.

- (B) **Notices of Default.** Each Party shall notify the other Party promptly of any event that, with the giving of notice or the passage of time or both, would constitute an Event of Default with respect to the other Party.
- (C) **Remedies Upon Event of Default.** If an Event of Default is continuing and not cured for a period of 3 Business Days after the Defaulting Party receives written notice of the Event of Default, the Performing Party may, at its sole option, do one or more of the following:
- (1) Withhold or suspend all or part of the payments to the Defaulting Party required under this Agreement until the default is cured.
 - (2) Withhold or suspend all or part of the deliveries of Energy Products to the Defaulting Party required under this Agreement until the default is cured.
 - (3) Designate an Early Termination Date by providing written notice to the Defaulting Party. The Early Termination Date shall be no earlier than 3 Business Days following the date written notice is received by the Defaulting Party.

The foregoing remedies are cumulative and in addition to all other remedies that may then be available to the Performing Party under applicable law.

(D) **Liquidation on Early Termination.**

Except as otherwise agreed upon by both parties, liquidation upon Early Termination shall be as follows:

- (1) On the Early Termination Date, the Parties shall liquidate all transactions, including any portion of transactions not yet fully delivered, that are then outstanding.
- (2) Liquidation shall occur by canceling each transaction being liquidated and calculating a Net Settlement Amount pursuant to Section 7.1(E).
- (3) To the extent that, in the reasonable opinion of the Performing Party, a transaction is *commercially or legally impracticable* to terminate and liquidate on the Early Termination Date, then that transaction shall be terminated and liquidated as soon thereafter as is reasonably practicable, but the determination of the liquidated amount for that transaction shall not delay the payment or calculation of the Net Settlement Amount.

- (4) Except for the payment of the Net Settlement Amount, no further planned payments or deliveries under this Agreement shall be required after the Early Termination Date.
- (5) The Performing Party shall notify the Defaulting Party in writing of the amount and basis for calculation of the Net Settlement Amount.
- (6) The Net Settlement Amount shall be paid as follows:
 - (a) If the Net Settlement Amount is a positive number, the Defaulting Party shall, within 5 Business Days of receipt of such notice, pay to the Performing Party an amount equal to the Net Settlement Amount plus Interest.
 - (b) If the Net Settlement Amount is a negative number, the Performing Party shall pay to the Defaulting Party an amount equal to the Net Settlement Amount within 5 Business Days of determining the Net Settlement Amount.

(E) Calculation of Net Settlement Amount.

- (1) **Net Settlement Amount.** The Net Settlement Amount is calculated for each transaction as follows:
 - (a) If a Market Quotation can be determined:
 - (i) the Market Quotation, determined in accordance with Section 7.1(E)(2), for the transactions, whether positive or negative; plus
 - (ii) Unpaid Amounts, determined in accordance with Section 7.1(E)(3), owed by the Defaulting Party to the Performing Party; less
 - (iii) Unpaid Amounts, determined in accordance with Section 7.1(E)(3), owed by the Performing Party to the Defaulting Party.
 - (b) If a Market Quotation cannot be determined, or in the reasonable belief of the Performing Party would not produce a commercially reasonable result:

- (i) the amount the Performing Party reasonably and in good faith determines to be its aggregate losses and costs (net of gains) associated with this Agreement, including but not limited to brokerage fees and commissions, loss of bargain damages, and cost of funds; or
 - (ii) at the election of the Performing Party, all losses and costs (net of gains) incurred to terminate, liquidate, obtain, or reestablish hedges and related trading positions.
- (2) **Market Quotation.** The Market Quotation is an amount that would be paid by Reference Market Makers to enter into a transaction that would preserve for the Performing Party the economic benefits of this Agreement after the Early Termination Date. The Market Quotation shall be determined as follows:
- (a) The Performing Party shall request quotations from at least 3 Reference Market Makers on a date and time selected in good faith by the Performing Party.
 - (b) The quotations from Reference Market Makers shall consider existing Credit Support and would be subject to such documentation to which the Performing Party and Reference Market Maker agree in good faith.
 - (c) The quotations from Reference Market Makers shall exclude Unpaid Amounts, but shall include any payment or delivery that would have been required after the Early Termination Date assuming the satisfaction of all conditions precedent.
 - (d) A quotation to be paid by the Performing Party shall be expressed as a positive number and a quotation to be paid to the Performing Party shall be expressed as a negative number.
 - (e) Each Reference Market Maker shall provide its quotation as of the same date and local time as the Early Termination Date to the extent reasonably practicable, or otherwise as soon as practicable after the Early Termination Date.
 - (f) The Market Quotation shall be the arithmetic mean of all quotations after disregarding the highest and lowest

quotation. If more than one quotation has the same highest or lowest value, then only one such quotation shall be disregarded.

- (g) If less than 3 quotations are provided by Reference Market Makers, then the Market Quotation cannot be determined and the Net Settlement Amount shall be determined under Section 7.1(E)(1)(b).

(3) Unpaid Amounts. Unpaid Amounts are determined as follows:

- (a) The amount for all terminated transactions that became or would have become payable on or prior to the Early Termination Date and which remain unpaid as of the Early Termination Date; plus
- (b) The fair market value, as reasonably determined by the Performing Party as of the delivery date, of Energy Products that were required to be delivered on or prior to the Early Termination Date and which have not been settled as of the Early Termination Date; plus
- (c) All non-duplicative Direct Actual Damages incurred prior to the Early Termination Date; plus
- (d) Interest on all such amounts to the extent permitted by law.

(4) Disputes Regarding Net Settlement Amount. If the Defaulting Party disputes the calculation of the Net Settlement Amount by the Performing Party, then:

- (a) the dispute shall be resolved as provided in Article 12;
- (b) pending resolution of the dispute, the Defaulting Party shall pay the full amount of the Net Settlement Amount as provided in Section 7.1(D)(6); and
- (c) if the dispute results in a refund of any portion of the Net Settlement Amount, the Performing Party shall make the refund within 3 Business Days of such determination plus Interest.

7.2 Remedies Upon Breach of Agreement.

- (A) If there is no express remedy or measure of damages for breach of the Agreement, then the breaching Party shall be liable for the Direct Actual Damages for any breach of this Agreement.

7.3 Forward Contracts. The Parties agree that transactions for the forward sale and purchase of Energy Products entered into under this Agreement are "forward contracts" and the Parties are "forward contract merchants" within the meaning of the United States Bankruptcy Code.

7.4 Enforcement of Remedies.

- (A) Except as otherwise provided in this Agreement, the rights, powers, remedies and privileges provided in this Agreement are cumulative and not exclusive of any rights, powers, remedies and privileges provided by law.
- (B) A single or partial exercise of any right, power or privilege will not be presumed to preclude any subsequent or further exercise of that right, power or privilege or the exercise of any other right, power or privilege.

7.5 Duty to Mitigate.

- (A) Except as provided in Section 7.5(B), each Party has a duty to mitigate damages in good faith and covenants that it will use commercially reasonable efforts to minimize any damages it may incur as a result of an Event of Default.
- (B) Neither Party is required to utilize or change the utilization of its owned or controlled assets, including contractual assets, or its market positions, or to curtail load, to minimize the other Party's liability for damages.

7.6 Set-Off.

- (A) At the option of the Performing Party and without prior notice to the Defaulting Party or breaching Party, any amounts payable to one Party by the other Party may be set-off against any amounts payable, whether at that time or in the future or upon the occurrence of a contingency and irrespective of the currency, place of payment or booking office of the obligation, under any other agreements or obligations between the Parties.
- (B) If the Performing Party exercises a set-off under Section 7.6(A), it shall give notice to the Defaulting Party or breaching Party of the set-off.

- (C) If an obligation used for a set-off under Section 7.6(A) is unascertained, the Performing Party may in good faith estimate that obligation and set-off in respect of that estimate, but the Performing Party shall account to the Defaulting Party or breaching Party when the obligation is ascertained.

7.7 LIMITATIONS OF LIABILITY.

- (A) THE EXPRESS REMEDIES AND MEASURES OF DAMAGES PROVIDED IN THIS AGREEMENT SATISFY THE ESSENTIAL PURPOSES OF THIS AGREEMENT.
- (B) FOR BREACH OF ANY PROVISION FOR WHICH AN EXPRESS REMEDY OR MEASURE OF DAMAGES IS PROVIDED, SUCH EXPRESS REMEDY OR MEASURE OF DAMAGES IS THE SOLE AND EXCLUSIVE REMEDY FOR SUCH BREACH.
- (C) IF NO REMEDY OR MEASURE OF DAMAGES IS EXPRESSLY PROVIDED FOR, LIABILITY IS LIMITED TO DIRECT ACTUAL DAMAGES AND SUCH DIRECT ACTUAL DAMAGES IS THE SOLE AND EXCLUSIVE REMEDY.
- (D) EXCEPT WHERE SPECIFICALLY SET FORTH IN THIS AGREEMENT, NEITHER PARTY SHALL BE REQUIRED TO PAY OR BE LIABLE FOR SPECIAL, CONSEQUENTIAL, INCIDENTAL, PUNITIVE, EXEMPLARY OR INDIRECT DAMAGES, INCLUDING BUT NOT LIMITED TO LOST PROFITS OR BUSINESS INTERRUPTION DAMAGES AND WHETHER BY STATUTE, IN TORT, IN CONTRACT, OR OTHERWISE.
- (E) THE PARTIES INTEND THAT THE LIMITATIONS OF LIABILITY IMPOSED IN THIS AGREEMENT ARE WITHOUT REGARD TO THE CAUSE OR CAUSES, INCLUDING BUT NOT LIMITED TO THE NEGLIGENCE OF ANY PARTY, WHETHER SUCH NEGLIGENCE IS SOLE, JOINT, CONCURRENT, ACTIVE OR PASSIVE, OR OTHERWISE.
- (F) IF ANY DAMAGES UNDER THIS AGREEMENT ARE DEEMED LIQUIDATED, THE PARTIES ACKNOWLEDGE THAT SUCH DAMAGES ARE DIFFICULT OR IMPOSSIBLE TO DETERMINE, THAT OTHERWISE OBTAINING AN ADEQUATE REMEDY IS INCONVENIENT, AND THAT THE LIQUIDATED DAMAGES CONSTITUTE A REASONABLE APPROXIMATION OF THE HARM OR LOSS.

7.8 Survival. This Article 7 survives the termination of this Agreement.

Article 8
Force Majeure

8.1 Suspension of Obligations.

- (A) Except with regard to any obligation to pay money under the Agreement, if either Party cannot, in whole or in part, carry out its obligations under this Agreement as a result of Force Majeure, then
- (1) The Party claiming Force Majeure shall give the other Party written notice and full particulars of the Force Majeure as soon as reasonably possible after the occurrence of the cause relied upon.
 - (2) Only to the extent affected by the Force Majeure, the obligations of the affected Party are suspended.
 - (3) During the pendency of the Force Majeure, the affected Party is not liable to the other Party for:
 - (a) any claims relating directly or indirectly to the failure of the affected Party to perform under this Agreement as a result of the Force Majeure; and
 - (b) any loss, damage, injury or expense resulting from, or arising out of, the Force Majeure.

8.2 Due Diligence.

- (A) A Party claiming Force Majeure shall use due diligence to fulfill its obligations under this Agreement and to remove any disability caused by such event at the earliest practicable time.
- (B) Nothing in this Article 8 shall require a Party to settle any strike or labor dispute.
- (C) A Party claiming Force Majeure shall continue to perform immediately after the Force Majeure has been removed.

Article 9
Taxes and Other Charges

9.1 Responsibility for Taxes and Other Charges.

- (A) Except as otherwise provided in this Section 9.1, PWEC is responsible for remitting all Taxes on or with respect to the Energy Products incurred prior to delivery to PWCC up to and at the Delivery Points.
- (B) PWCC is responsible for remitting all Taxes on or with respect to the Energy Products incurred from the Delivery Points except for ad valorem or income taxes which relate to the sale of the Energy Products and which are the responsibility of PWEC.
- (C) Except as defined in Section 9.1(H) below, if during the term of this Agreement, any increased costs associated with the Dedicated Units are incurred as a result of any Governmental Authority or any judicial order, PWCC shall be responsible for all such increased costs through an annualized charge.
- (D) If PWEC is required by law or regulation to remit or pay Taxes that are PWCC's responsibility under Section 9.1(B), PWCC shall promptly reimburse PWEC for such Taxes.
- (E) If PWCC is required by law or regulation to remit or pay Taxes that are PWEC's responsibility under Section 9.1(A), PWCC may deduct the amount of any such Taxes from the sums due to PWEC under this Agreement.
- (F) Nothing in this Agreement obligates a Party to be responsible for any taxes for which it is exempt by law.
- (G) Each Party shall indemnify, defend and hold the other Party harmless for, from and against all liability for remitting payment of Taxes for which the indemnifying Party is responsible.
- (H) Any fines, penalties and/or judgments issued, rendered or assessed by any Governmental Authority or any judicial order which occur after the execution of this Agreement and directly out of the operations and/or administration of the Dedicated Units shall be the responsibility of PWEC, unless the fines, penalties or judgments are caused directly by PWCC's dispatch of the Dedicated Units.

Article 10
Notices and Other Communications

10.1 Methods of Providing Notice. All invoices, payments, statements, notices, and communications made under this Agreement shall be in writing as follows:

(A) By registered or certified or express mail, with a return receipt requested, postage prepaid, or by comparable delivery service, or by hand with a receipt, or by facsimile with the original sent by first class mail, to the following individuals:

(1) For PWEC: ~~NEED TO COMPLETE~~

Contract Administration to:

PINNACLE WEST ENERGY CORPORATION
400 N. 5th Street, Station ---
Phoenix, AZ 85004
ATTN:

Payments to:

PINNACLE WEST ENERGY CORPORATION
Bank Name:
Acct No:
ABA No.

Operations to:

PINNACLE WEST CAPITAL CORPORATION

(2) For PWCC: ~~NEED TO COMPLETE~~

Contract Administration to:

PINNACLE WEST CAPITAL CORPORATION
400 N. 5th Street, Station _____
Phoenix, AZ 85004
ATTN: _____
PHONE: _____
FAX: _____

Invoices to:

PINNACLE WEST CAPITAL CORPORATION

400 N. 5th Street, Station _____
Phoenix, AZ 85004
ATTN: _____

Operations:

PINNACLE WEST CAPITAL CORPORATION

- (B) Either Party may modify any information specified in Section 10.1(A) by giving written notice to the other Party.

10.2 Receipt of Notice. All written communications made as provided in Section 10.1 are deemed given upon receipt by the addressee. In the case of facsimiles, receipt occurs on the date that the facsimile is received by the addressee in legible form.

Article 11

Effective Date and Term

11.1 Effective Date. This Agreement shall become effective upon the completion of all the following:

- (A) The grant of a variance to APS of Arizona Administrative Code Rule R14-2-1606 (B) by the Arizona Corporation Commission consistent with the APS/PWCC Agreement.
- (B) The transfer by APS to PWEC of the existing non-nuclear generation assets that comprise a portion of the Dedicated Units.
- (C) The acceptance of this Agreement by FERC without modification or condition, except that if FERC or any court imposes any condition, limitation, or qualification, then:
- (1) each Party shall determine whether the condition, limitation or qualification individually, or in the aggregate, has a material adverse effect on the Party with respect to this Agreement;
 - (2) a Party determining an adverse effect under Section 11.1(C)(1) shall as soon as practicable, but in no case after more than 30 calendar days of the FERC or court action, notify the other Party;
 - (3) after notification, the Parties shall cooperate on a commercially reasonable basis to renegotiate the terms of this Agreement to preserve the original economic relationship of the Parties with respect to this Agreement; and

- (4) if the parties fail to renegotiate the terms of this Agreement, the Agreement is null and void and have no further force and effect.

11.2 Termination Date.

- (A) Unless earlier terminated pursuant to the terms of this Agreement or extended pursuant to Section 11.2(B), this Agreement shall terminate at midnight on December 31, 2015.
- (B) This Agreement shall automatically be renewed for up to three additional 5-year terms unless either Party provides to the other Party a notice of termination at least 12 months prior to the scheduled termination of this Agreement.

- 11.3 Regulatory Approvals.** Each Party shall use commercially reasonable efforts to obtain the necessary regulatory approvals so that this Agreement shall become effective on the earliest practicable date.

Article 12

Dispute Resolution

- 12.1 Alternative Dispute Resolution.** Except as provided in Section 12.4, and except as otherwise agreed upon by the Parties, all claims or disputes, whether sounding in tort or contract or otherwise, between the Parties, including their agents and representatives, arising under or relating to this Agreement are subject to alternative dispute resolution as provided in this Article 12.

- 12.2 Mediation.** Any dispute between the Parties shall first be submitted to non-binding mediation using the following procedures:

- (A) A Party shall provide a written request for mediation to the other Party.
- (B) The mediation shall commence within 60 calendar days from receipt of the request in Section 12.2(A).
- (C) A mediator shall be chosen by mutual agreement of the Parties within 15 calendar days of receipt of the request in Section 12.2(A).
- (D) All discussions or materials presented during or for purposes of the mediation shall be considered Confidential Information and subject to Rule 408 of the federal and state rules of evidence and any similar regulatory rules.

12.3 Arbitration. If a dispute cannot be resolved after mediation under Section 12.2 and except as provided in Section 12.4, the dispute shall be submitted to binding arbitration as follows:

- (A) The arbitration shall be conducted in Phoenix, Arizona in accordance with the Federal Arbitration Act and by the then-prevailing Commercial Arbitration Rules of the American Arbitration Association. The arbitration proceedings, decision and award under this Section 12.3 shall be governed by the Federal Arbitration Act.
- (B) The validity, construction, and interpretation of this Article 12 and all procedural aspects of the arbitration shall be governed by the Federal Arbitration Act and shall be decided by the arbitrators.
- (C) Submission to arbitration shall be made upon the request of either Party.
- (D) There shall be 3 arbitrators. Each Party shall appoint a single arbitrator within 20 calendar days after service of the notice of arbitration. The 2 arbitrators so appointed shall select the third arbitrator, who shall be the chairperson of the tribunal, within 20 calendar days after the both arbitrators are appointed. The chairperson shall have over 8 years of experience in energy-related transactions.
- (E) None of the arbitrators shall be employees or former employees of either Party or have any direct interest in either Party or the subject matter of the arbitration, unless the conflict is expressly acknowledged and waived in writing by both Parties.
- (F) The chairperson shall schedule and hear the dispute within 6 months after appointment and shall render the panel's decision within 30 calendar days after the hearing concludes.
- (G) The arbitrators shall have no authority to award consequential, treble, exemplary, or punitive damages of any type or kind regardless of whether such damages may be available under any law or right. The Parties waive their rights, if any, to recover or claim such damages.
- (H) All discussions or materials presented during or for purposes of the arbitration shall be considered Confidential Information.
- (I) All costs and expenses of the arbitrators shall be borne equally by the Parties. The arbitration shall take place in Phoenix, Arizona.
- (J) The arbitration award shall be final and binding on the Parties and may be entered in any court of competent jurisdiction. If required by applicable

law, the arbitration award shall be filed with FERC and subject to FERC approval.

- 12.4 Equitable Relief.** Either Party may petition a court of appropriate jurisdiction, as described in Section 13.6, for non-monetary relief relating to any claim of breach of this Agreement to prevent undue hardship relating to the claimed breach pending the completion of mediation or arbitration under Sections 12.2 and 12.3.

Article 13
General Provisions

13.1 Entire Agreement; Amendments and Counterparts.

- (A) Except as provided in Section 1.2, the terms of this Agreement constitute the entire agreement between the Parties with respect to its subject matter.
- (B) The terms of this Agreement may be changed only by mutual written agreement executed by both Parties after the date of this Agreement.
- (C) This Agreement may be executed in counterparts.

13.2 No Waiver.

- (A) No waiver of a default constitutes a waiver of any other default or defaults whether of a like kind or different nature.
- (B) Any delay in asserting or enforcing any right under this Agreement does not waive such right, unless barred by an applicable statute of limitation.

13.3 Headings. Headings and titles are for convenience only and do not affect the meaning or interpretation of any provision of this Agreement.

13.4 Confidentiality.

- (A) Each Party and their agents shall maintain all Confidential Information in confidence and shall use such information solely in connection with this Agreement.
- (B) Neither Party may disclose Confidential Information to third parties without the prior written consent of the other Party, except to the extent necessary to effectuate the transfer of Energy Products after providing the other Party with prompt written notice of the intent to disclose to the third party.

- (C) This Section 13.4 shall survive the termination of this Agreement for a period of one year.

13.5 Governing Law.

- (A) This Agreement shall be governed by, construed and enforced in accordance with the laws of Arizona, without regard to principles of conflict of laws.
- (B) The Parties agree that for purposes of this Agreement the products sold herein are not "goods" within the meaning of any Uniform Commercial Code.

13.6 Jurisdiction and Costs.

- (A) Subject to Article 12 and Section 13.6(B), any judicial action relating in any way to this Agreement shall be brought only in a state or federal court located in Phoenix, Arizona.
- (B) An action to enforce an arbitration award may be brought in any jurisdiction.
- (C) The Parties waive any right to trial by jury in an action relating to this Agreement.
- (D) The prevailing Party in any judicial action is entitled to recover its costs, litigation and other expenses, and reasonable attorneys' fees incurred in connection with such proceedings.

13.7 No Third-Party Beneficiaries.

- (A) There are no third-party beneficiaries to this Agreement.
- (B) This Agreement does not create, nor shall it be construed to create, any standard of care, duty or liability to any third party.

13.8 Binding Effect. This Agreement is binding on and inures to the benefit of the Parties and their respective successors and permitted assigns.

13.9 Recording.

- (A) Either Party may record telephone conversations and other discussions regarding matters arising under this Agreement.

- (B) Each Party agrees to obtain the consent of its employees and agents to such recording to the extent required by applicable law.
- (C) All recordings of telephone conversations and other discussions are deemed Confidential Information.

13.10 Regulatory Jurisdiction. This Agreement and any actions under this Agreement shall be subject to applicable regulatory jurisdiction and approvals, but this Agreement shall not be construed as subjecting either Party to the jurisdiction of any regulatory agency that would not otherwise have jurisdiction over such Party.

13.11 Assignment.

- (A) Neither Party may transfer or assign any of its rights, title, interests or obligations in or under this Agreement without the prior written consent of the other Party, except:
 - (1) an assignment, including but not limited to a transfer or pledge, made as security for any financing if:
 - (a) the assigning Party provides prompt notice to the other Party of the assignment, including the effective date; and
 - (b) the assignment does not release the assigning Party from any obligations or liabilities under this Agreement prior to the effective date of the assignment; or
 - (2) PWCC may make an assignment of this Agreement, including but not limited to a transfer or delegation, to an Affiliate if:
 - (a) PWCC provides prompt notice to PWEC of the assignment, including the effective date;
 - (b) the assignee Affiliate agrees to be fully bound by the Agreement;
 - (c) the assignment does not release PWCC from any obligations or liabilities under this Agreement prior to the effective date of the assignment.
- (B) Any transfer that does not comply with Section 13.11(A) is null and void.

13.12 Records.

- (A) Each Party shall maintain records of all transactions under this Agreement for 3 years from the billing date of the transaction.
- (B) Each Party may require the other Party to produce the other Party's records to the extent reasonably necessary to verify the accuracy of any statement, charge or computation made pursuant to this Agreement.
- (C) If the records produced under Section 13.12(B) reveal any inaccuracy in any invoice or similar statement, a refund shall issue to the Party owed money plus Interest, except that if the invoice or statement resulting in the refund is over 12 months old, no refund shall issue.

13.13 Negotiated Agreement. The Parties agree that they have had meaningful discussions and negotiations over the provisions of this Agreement and therefore no provision is to be construed against the Party who drafted and prepared this Agreement.

13.14 Severability. If any provision of this Agreement is determined to be unenforceable, illegal or otherwise invalid, then that provision shall be severed and the remainder of the Agreement shall remain in full force and effect if:

- (A) the Parties can legally, practically, and commercially continue without the severed provision; and
- (B) the severance does not defeat the purpose of either or both Parties in entering into this Agreement.

13.15 Time of the Essence. Time is of the essence of this Agreement.

Signed:

PINNACLE WEST CAPITAL CORPORATION

PINNACLE WEST ENERGY CORPORATION

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____

Date: _____

Date: _____

EXHIBIT A**Definitions**

When initially capitalized, the following terms used in the Agreement, including the Service Schedule and exhibits, have the meanings set forth below:

"Affected Party" means a Party affected by a material change under Section 6.1.

"Affiliate" means: (a) an entity directly or indirectly controlling the other entity; (b) an entity directly or indirectly controlled by the other entity; or (c) an entity commonly controlled directly or indirectly with the other entity.

"APS" means Arizona Public Service Company.

"Base Rate" means the lesser of (a) the annual interest rate published as the "Prime Rate" in the *Wall Street Journal's* "Money Rates" section, unless the *Wall Street Journal* no longer publishes the "Prime Rate," in which case a comparable rate agreed to by the Parties, plus 2 percent; or (b) the maximum interest rate allowed by law.

"Business Day" means a weekday during which United States banks are open for general commercial business and ending at 5:00 p.m. Phoenix time.

"Capacity" means electric generating capability, expressed in kilowatts (kW) or megawatts (MW).

"Confidential Information" means any information relating to or provided under this Agreement that is designated by a Party as confidential, except (a) information in a Party's possession prior to its receipt from the other Party; (b) information obtained from a third person who, as far as the obtaining Party is aware, was not prohibited by a contractual, legal or fiduciary obligation from transmitting the information; (c) information that has become publicly available through no fault of the obtaining Party; and (d) information that a Party is required by law, regulation, or administrative or judicial order to disclose, including information related to satisfying regulatory requirements, if the Party disclosing such information has provided prompt notice of the requirement and allowed a reasonable period of time for the other Party to seek to restrain such disclosure.

"Contract Term" or **"Term"** means the period beginning on the Effective Date and ending on the termination date specified in Section 11.2.

"Contract Year" means (a) for the initial contract year, 12:01 A.M. on the date delivery of Energy Products commences pursuant to Section 1 of the attached Service Schedule, and ending 12:00 Midnight, December 31 of the same calendar year; and (b) for each subsequent

calendar year, the period of time between 12:01 A.M., January 1 and ending 12:00 Midnight, December 31.

“Credit Support” means: (a) a Letter of Credit, (b) a Guaranty, or (c) such other form of commercially reasonable security acceptable to the secured Party.

“Credit Support Provider” means: (a) a Guarantor, (b) an Issuer, or (c) a provider of another form of Credit Support who is acceptable to the secured Party.

“Dedicated Units” means PWEC’s interest in the following, to the extent such units are dedicated by contract to serve the requirements of APS: Palo Verde Units 1-3, West Phoenix Units 1-5, CTs 1-2, and Steam Units 4 and 6, Saguaro Steam Units 1-2 and CTs 1-3, Navajo Units 1-3, Four Corners Units 1-5, Yucca CTs 1-4, Douglas CT, Cholla Units 1-3, Ocotillo Steam Units 1-2 and CTs 1-2 and Redhawk Units 1-2, from commercial operation as to Dedicated Units not yet operational and from the effective date of this Agreement as to all other Dedicated Units until such units are retired, as applicable.

“Defaulting Party” means a Party who itself or through its Credit Support Provider is subject to an Event of Default.

“Delivery Point” means the point of interconnection, as specified in the applicable IOA, at which PWEC will provide deliverable Energy to PWCC from the Dedicated Units, or any other mutually agreed upon delivery point(s).

“Direct Actual Damages” shall mean the actual damages suffered by the Performing Party as a direct result of a breach of the terms of this Agreement by the non-performing Party, subject to the restrictions and conditions of Sections 7.2 through 7.6 herein.

“Early Termination Date” means a date on which the Agreement is terminated that is earlier than the date specified in Section 11.2 of the Agreement.

“Energy” means three-phase, sixty-hertz electric energy delivered at the nominal voltage of the Delivery Point expressed in megawatt hours (MWh) or kilowatt hours (kWh).

“Energy Products” means Energy, Capacity and reactive capability.

“Event of Default” means an event of default described in Section 7.1.

“FERC” means the Federal Energy Regulatory Commission or its successor.

“Force Majeure” means an event that: (a) is not anticipated on the date the Agreement is signed; (b) is not within the reasonable control of the Party claiming Force Majeure; (c) could not, in the exercise of reasonable diligence and Good Utility Practice by the Party claiming Force Majeure, have been prevented or avoided; and (d) renders the Party claiming Force Majeure unable to carry out, wholly or in part, its obligations under this Agreement. Subject to the

foregoing, Force Majeure includes, but is not limited to, the following events: (1) act of God; (2) act of public enemy, war, terrorism, blockade, insurrection, civil disturbance, disobedience or riot; (3) strike, lockout, material shortage or other industrial disturbance; (4) epidemic, landslide, earthquake, fire, storm, lightning, flood or other natural catastrophe; (5) failure of the transmission or distribution grid, including third parties' transmission facilities, to transmit or distribute Energy; (6) reductions or interruptions in services which may be required by the control area operator or regional transmission organization; (7) material failure of performance by any PWEC supplier, including failures as a result of Force Majeure, which results in a shutdown or material reduction of any of the generation capacity or output owned or controlled by PWEC or a PWEC Affiliate; (8) shutdown or reduction by the Nuclear Regulatory Commission of a material portion of the generation capacity or output which is owned or controlled by PWEC or a PWEC Affiliate; (9) act, omission, failure to act, or order of a civil, judicial, regulatory or government authority, if the Party claiming Force Majeure has acted to the fullest extent reasonable to prevent or correct the act, omission, failure to act or order; and (10) any other act or omission similar to the foregoing examples which by the exercise of a Party's reasonable diligence cannot be overcome. Force Majeure specifically excludes PWEC's ability to sell Energy Products at a more advantageous price.

"Good Utility Practice" means (a) any of the practices, methods, and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period; and (b) any of the practices, methods, and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Good Utility Practice does not necessarily require the optimum practice, method, or act to the exclusion of all others.

"Governmental Authority" means (a) a city, municipality, county, state or other governmental board or authority; (b) a regulatory or public power board or authority; (c) a public utility or public power district; (d) a joint action agency; (e) a federally recognized tribal board, authority or agency; or (e) other similar political subdivisions or public entities of the United States, or any state or a territory, acting individually or in combination.

"Guarantor" means an entity or entities executing a Guaranty of the obligation of one Party to the other Party. A Guarantor must be reasonably acceptable to the Party receiving the Guaranty.

"Guaranty" means a guaranty, hypothecation agreement, security agreement, or any other document containing an obligation of a Guarantor in favor of, and supporting obligations of, one Party to the other Party. The Guaranty must be in a form and substance reasonably acceptable to the Party receiving the Guaranty.

"Interest" means interest accruing at the Base Rate, compounded daily based on a 360-day year, from and including the due date to and including the payment date or, if applicable, interest as ordered by FERC.

“Issuer” means a person executing and delivering to a Party a Letter of Credit or another form of Credit Support document that is not a Guaranty. An Issuer must be reasonably acceptable to the receiving Party.

“Letter of Credit” means an instrument or agreement, revocable or irrevocable, entered into by a bank or other financial institution providing that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit.

“Market Quotation” means a quotation determined under Section 7.1(E)(2).

“NERC” means the North American Electric Reliability Council and any successor.

“Net Settlement Amount” means the amount calculated under Section 7.1(E)(1).

“NRC” means the Nuclear Regulatory Commission.

“Parties” means both PWCC and PWEC.

“Party” means either PWCC or PWEC.

“Performing Party” means the non-defaulting Party upon an Event of Default or the non-breaching Party in the case of a breach.

“Purchase Price” means the price in United States dollars, unless otherwise agreed, to be paid by PWCC to PWEC in exchange for the Energy Products. The Purchase Price may be stated in a per unit price for a specific Energy Product or Products or as a total price for all Energy Products.

“Reference Market Makers” means the leading dealers in the relevant market selected by either Party determining a Market Quotation in good faith from among dealers of the highest credit standing which satisfy all the criteria that a Party applies generally at the time of deciding whether to enter into similar transactions

“Replacement Costs” means the cost at which PWCC acting in a commercially reasonable manner purchases a replacement for Energy Products not delivered by PWEC, plus costs reasonably incurred by PWCC in purchasing the substitute product; plus additional transmission charges reasonably incurred by PWCC in purchasing the substitute product.

“Replacement Energy Products” means Energy Products required to be provided by PWCC under the Service Schedule.

“RTO” means a FERC-approved regional transmission organization, including but not limited to a transco, gridco or the WestConnect RTO.

"Sales Price" means (a) the price at which the Performing Party, acting in a commercially reasonable manner, effects a resale of undelivered Energy Products; or, (b) the market price for the quantity of Energy Products at the Delivery Points agreed upon by the Parties; less (c) costs reasonably incurred by the Performing party in reselling Energy Products, additional transmission charges incurred by the Performing Party in delivering Energy Product to third party buyers, and, penalties, ratcheted demands or similar charges.

"Tariff" means PWEC's Market-Based Rate Tariff on file and approved by FERC, as amended from time to time.

"Taxes" means all taxes, fees, levies, penalties, licenses or charges imposed by any Governmental Authority.

"Transmission Provider" means an entity or entities transmitting or transporting the Energy Product on PWEC's or PWCC's behalf to or from the Delivery Points.

"Unpaid Amounts" means the amounts determined under Section 7.1(E)(3).

"WSCC" means the Western Systems Coordinating Council.

SERVICE SCHEDULE

This Service Schedule further defines the obligations of the Parties with respect to the Agreement.

1. Effective Date.

- 1.1 This Service Schedule is for the purchase by PWCC of PWEC's full output from the Dedicated Units, beginning on the Effective Date of the Agreement and continuing through December 31, 2015, unless otherwise terminated or extended pursuant to this Agreement.

2. Pricing.

- 2.1 Facilities Charge. PWEC will receive a Facilities Charge as detailed in Attachment 1 to this Service Schedule.
- 2.2 Base Fuel Charge. PWEC will receive a Base Fuel Charge ("BFC") for fuel and related costs associated with the full output of the Dedicated Units, as detailed in Attachment 2 to this Service Schedule.
- 2.3 Fuel and Purchased Power Adjustment. PWEC will receive a Fuel and Purchased Power Adjustment ("FPPA"), as detailed in Attachment 2 to this Service Schedule.
- 2.4 Pricing of Total Output of the Dedicated Units.
- 2.4.1 Based on Section 2.1 above and Attachment 1 to this Service Schedule, the initial Facilities Charges for Dedicated Units shall be:

Facilities Charge	
<u>Year</u>	<u>(\$000/Month)</u>
2002	\$ 31,230 (excludes Palo Verde)
2003	\$ 63,600
2004	\$ 67,120

- 2.4.2 For Contract Years following 2004, the Facilities Charge shall be calculated as provided in Attachment 1 to this Service Schedule.
- 2.4.3 The BFC shall be \$0.0210 per kWh for 2002 and \$0.0174 per kWh for 2003 and thereafter for the remaining term of this Agreement, as provided in Attachment 2 to this Service Schedule.

2.4.4 Beginning March 1, 2003, a FPPA to the BFC will be applied each month to the billing for Dedicated Units energy. The FPPA shall be calculated annually prior to March of each calendar year as provided in Attachment 2 to this Service Schedule.

2.4.5 For billing purposes, the BFC and the FPPA shall be applied to the total Energy Products produced by the Dedicated Units.

2.5 Schedules for Operations of Dedicated Units. PWCC will make payment to PWEC for all of the deliverable output of the Dedicated Units commencing on the Effective Date of the Agreement.

2.6 Operations and Maintenance Expense Adjuster. Beginning March 1, 2003 an annual Operations and Maintenance Expense Adjuster (OMA) will be calculated for the gas/oil fired Dedicated Units to reflect certain O&M costs associated with their actual level of operation during the prior calendar year. In this regard, at the end of each calendar year, PWCC will pay PWEC for any positive OMA and PWEC will pay PWCC for any negative OMA accumulated during the prior calendar year. The OMA will be calculated at the end of each calendar year during which this Agreement is in effect based upon the following:

(1) Any variable operations and maintenance costs associated with the change in dispatch of the Dedicated Units at levels above or below the operational levels contemplated in the APS/PWCC Agreement; and

(2) Any variable operations and maintenance costs associated with unplanned or rescheduled outages or overhauls which result from the change in dispatch of the Dedicated Units at levels above or below the operational levels contemplated in the APS/PWCC Agreement, provided however, that any such costs paid pursuant to section 2.6 (1) above shall be netted against the payments for costs contemplated under this section 2.6 (2).

3. Operations.

3.1 Dispatch Rights. PWCC will have full and exclusive dispatch rights to all Dedicated Units during the term of the Agreement, provided, however, that PWCC will be subject to and abide by any "must run" or "minimum take" requirements, or similar or related requirements, as to the operations of the Dedicated Units, including as to Palo Verde Units 1-3.

3.2 Transfer of Dedicated Units. Except as expressly provided in the terms of this Agreement, PWEC shall not sell, assign or in any other way transfer or encumber its rights, title, interest or ownership, or any portion thereof, of any of the Dedicated Units, or any output therefrom, to any entity other than PWCC without the express written consent of PWCC, and which consent may be withheld at PWCC's sole discretion.

4. **Performance Levels Regarding the Dedicated Units.**

4.1 **Forecasting of Outages at the Dedicated Units.** PWEC shall work in conjunction with PWCC to provide a rolling 2-year forecast as to scheduled outages of the Dedicated Units, forecasting for each such outage the specific unit involved and the corresponding duration of such outage, 60 days prior to each calendar year. Further, PWEC shall use its best efforts, and work in conjunction with PWCC, to schedule outages in a manner that attempts to maximize the productivity of the Dedicated Units for PWCC, consistent with Good Utility Practice. . The first scheduled outage forecast will be provided by PWEC within 30 days of the execution of this Agreement. In the event that PWEC learns or becomes aware that an unscheduled outage or a change in a scheduled outage may, is or will occur, PWEC shall immediately notify PWCC of the same, including information as to the unit at issue and the corresponding expected duration of the outage. PWCC shall, at its cost, have the sole authority to enter into agreements involving products that assist in the reduction and/or management of risk related to potential outages at, and/or volumetric uncertainty as to output of, the Dedicated Units.

4.2 **Minimum Availability of Dedicated Units ("Minimum Output Levels").**

4.2.1 **Capacity.** At a minimum, PWEC shall make Capacity from the Dedicated Units available as follows: (a) for 2002, prior to the transfer of Palo Verde Nuclear Generating Station Assets, the lesser of 3440 MW at APS' annual system peak or actual APS load at the annual system peak; and (b) for 2003 and later, after the transfer of Palo Verde Nuclear Generating Station Assets, the lesser of 4720 MW at APS' annual system peak or actual APS load at the annual system peak, subject to adjustment as Dedicated Units are retired or brought into service.

4.2.2 **Energy.** At a minimum, PWEC shall make available Energy from the Dedicated Units in the amount of: (a) for 2002, prior to the transfer of Palo Verde Nuclear Generating Station Assets, 15,370 GWh annually; and (b) for 2003 and later, after the transfer of Palo Verde Nuclear Generating Station Assets, 21,090 GWh annually, subject to adjustment as Dedicated Units are retired or brought into service.

4.3 **Failure to Make Delivery of Minimum Output Levels.** In the event PWEC fails to make available Energy Products at or above the Minimum Output Levels as described in Section 4.2 above, and such non-performance is not excused under the terms of the Agreement, PWCC will use commercially reasonable efforts to obtain Replacement Energy Products up to the Minimum Output Levels. PWEC shall be responsible for all Replacement Costs relating to the acquisition by PWCC of the corresponding Replacement Energy Products.

Calculation of the Facilities Charge in the Pinnacle West Energy Contract

1. Facilities Charge (FC).

The FC for 2002-04 as specified in Section 2.4 of the Service Schedule was derived using the method below. Effective January 1, 2005 and every three years thereafter the FC shall include the reasonable costs of owning and operating the Dedicated Units as recalculated below:

$$\text{FC \$/Month} = \frac{[(\text{ROR \%}) \times (\text{Net Dedicated Units Assets \$}) + (\text{Dedicated Units Operating Annual Expenses \$}) - \text{Annual Ancillary Service Revenues}^1]}{12 \text{ Months}}$$

Where:

Rate of Return (ROR) is 9.38% which is the cost of capital assuming a 50/50 debt-equity capital structure, at a 7.5% cost of debt and a 11.25% return on equity.

$\text{Net Dedicated Units Assets}^2 = \text{Original Plant-in-Service Cost}^3 - \text{Accumulated Depreciation} - \text{Accumulated Deferred Income Taxes}$
 $+ \text{Material \& Supplies} + \text{Prepayments} + \text{Working Cash} + \text{Miscellaneous Deferred Credits}$

$\text{Dedicated Units Annual Operating Expenses}^4 = \text{Operation \& Maintenance Expenses}^5 + \text{Administrative \& General Expenses}$
 $+ \text{Depreciation \& Amortization Expenses}^6 + \text{Ad Valorem Taxes}^7$
 $+ \text{Income Tax Expense}^8 + \text{Other Taxes or Assessments}^9$

¹ Includes revenues paid to PWEC by PWCC for ancillary services pursuant to the terms of a separate contract.

² Projected three year average of year end balances. Each component shall be defined pursuant to the FERC system of accounts or if no applicable FERC system of accounts exists, then on General Accepted Accounting Principles (GAAP). All A&G related expenses, not directly charged, shall be allocated on wages and salaries for the Dedicated Units as a percent of total Pinnacle West Energy wages and salaries.

³ Original Plant-in-Service Costs will include all capitalized costs of the Dedicated Units plus improvements including common and intangible.

⁴ Projected three year average. Each component shall be defined pursuant to the FERC system of accounts or if no applicable FERC system of accounts exists, then on General Accepted Accounting Principles (GAAP). All A&G related expenses, not directly charged, shall be allocated on wages and salaries for the Dedicated Units as a percent of total Pinnacle West Energy wages and salaries.

⁵ Costs and expenses associated with the Dedicated Units excluding fuel.

⁶ Costs and expenses associated with the Dedicated Units, including related common facilities.

⁷ Costs and expenses associated with the Dedicated Units, including related common facilities.

⁸ Based on the statutory tax rate, both state and federal, for PWEC on stand alone basis.

⁹ Taxes and assessments based on generation or gross revenue.

Calculation of the BFC and FPPA in the Pinnacle West Energy Contract

1. Base Fuel Charge (BFC).

The BFC shall be set at \$0.021/kWh for the calendar year 2002, and at \$0.0174 /kWh effective January 1, 2003 for the remainder of the Agreement, and is the Projected Average Fuel Costs associated with the Dedicated Units (AFCDU) for 2002-2004.

Where:

$$\text{AFCDU } \$/\text{kWh} = (\text{Total fuels cost of Dedicated Units}^1 \text{ } \$) / (\text{Total generation of the Dedicated Units MWh})$$

2. Fuel & Purchased Power Adjustment (FPPA).

Beginning March 1, 2003 a FPPA to the BFC will be applicable each month to the billing for the total output of the Dedicated Units. The FPPA shall be calculated annually prior to March of each calendar year as follows:

$$\text{FPPA } \$/\text{kWh} = [(\text{Projected AFCDU}^2 - \text{BFC}) \text{ } \$/\text{kWh}] + \frac{[(\text{Actual AFCDU}^3 - \text{Projected AFCDU}^4) \text{ } \$/\text{kWh}] \times \text{Actual kWh}}{\text{Projected kWh}}$$

Where:

“Actual kWh” is the actual output of the Dedicated Units on a kWh basis for the prior contract year.

“Projected kWh” is the projected kWh output of the Dedicated Units for the period March 1 of the current Contract Year through the last day of February of the next Contract Year.

¹ Total fuels costs of Dedicated Units shall include all coal, gas including transportation, oil, nuclear fuel expenses, costs and benefits of fuel-related financial instruments, nuclear spent fuel costs, any applicable surcharges, nuclear decommissioning expense to the extent it is not recovered from the System Benefits charge authorized by the Arizona Corporation Commission, and any other fuel related expenses, including but not limited to costs associated with emissions allowances.

² For current Contract Year.

³ For prior Contract Year.

⁴ For prior Contract Year.

ENCLOSURE 2

**Draft of
Decommissioning Funds Collection Agent Agreement
between Arizona Public Service Company (APS)
and Pinnacle West Energy Corporation (PWE)**

NRC Request 2:

Provide a finalized, or an up-to-date, copy of any relevant or applicable agreements that have been or will be executed concerning the nonbypassable wires charges that have been or will be collected by Arizona Public Service Company (APS) and dedicated to the decommissioning trusts for Palo Verde, Units 1, 2 and 3.

Applicants' Response

This enclosure provides the requested information. Please note that this is a draft agreement. It has not yet been executed by APS or Pinnacle West Energy Corporation (PWE), and may be subject to future negotiations and change. The Applicants will keep the staff informed of any substantive changes to the decommissioning funds collection agent agreement up to the time that the staff issues its evaluation of the Applicants' application for order and conforming administrative amendments for license transfers.

DRAFT

7/9/2002

DECOMMISSIONING FUNDS COLLECTION AGENT AGREEMENT

THIS DECOMMISSIONING FUNDS COLLECTION AGENT AGREEMENT ("Agreement") is effective as of January 1, 2003 (the "Effective Date"), by and between ARIZONA PUBLIC SERVICE COMPANY, an Arizona corporation ("APS") and PINNACLE WEST ENERGY CORPORATION, an Arizona corporation ("PWEC").

RECITALS

WHEREAS, APS is a Participant in the Arizona Nuclear Power Project ("ANPP") and accordingly owns an undivided interest in Units 1, 2 and 3 of the Palo Verde Nuclear Generating Station and all related facilities ("PVNGS") (hereinafter, such interest in PVNGS, whether held by APS or PWEC, may be referred to in this Agreement from time to time as the "PVNGS Interest"); and

WHEREAS, all of APS's right, title and interest in PVNGS Units 1, 2 and 3, and its nuclear generation business have been transferred to PWEC, as of the Effective Date, and PWEC has assumed certain liabilities associated with APS's interest in PVNGS and its nuclear generation business; and

WHEREAS, this transfer and assumption of liabilities resulted from the restructuring of APS's generation assets pursuant to a Settlement Agreement approved by the Arizona Corporation Commissions on October 6, 1999, Decision No. 61973 (the "ACC Order"); and

WHEREAS, APS's United States Nuclear Regulatory Commission ("NRC") licenses to own and operate PVNGS have been transferred to PWEC, as of the Effective Date; and

WHEREAS, the regulations promulgated by the NRC require each licensed owner of PVNGS to provide financial assurance for its pro rata share of PVNGS's decommissioning expenses; and

WHEREAS, pursuant to (a) a Decommissioning Trust Agreement (PVNGS Unit 1) between APS and Mellon Bank, N.A. ("Mellon"), dated as of July 1, 1991 (the "Unit 1 Trust Agreement"); (b) an Amended and Restated Decommissioning Trust Agreement (PVNGS Unit 2) among APS, The First National Bank of Boston and Mellon, dated as of January 31, 1992 (the "Unit 2 Trust Agreement"); and (c) a Decommissioning Trust Agreement (PVNGS Unit 3), between APS and Mellon, dated as of July 1, 1991 (the "Unit 3 Trust Agreement") (the Unit 1 Trust Agreement, the Unit 2 Trust Agreement and the Unit 3 Trust Agreement are collectively referred to herein as the "Trust Agreements"), APS established three (3) separate Decommissioning Trusts (the trusts established under the Unit 1 Trust Agreement, the Unit 2 Trust Agreement and the Unit 3 Trust Agreement, respectively, may each be referred to from time to time in this Agreement as a "Decommissioning Trust" and collectively, the "Decommissioning Trusts") in order to fund its pro rata share of the costs associated with the future decommissioning of PVNGS; and

WHEREAS, APS's interest in the Decommissioning Trusts has been assigned by APS to PWEC as of the Effective Date;

WHEREAS, the ACC's rules and regulations at A.A.C. Rule R14-2-1608 authorize APS to collect funds through a non-bypassable systems benefit charge to all its retail customers (the "Decommissioning Charge") to provide for PVNGS' decommissioning costs (the "Decommissioning Funds"). Consequently, APS has agreed to continue to remit to the Decommissioning Trusts all of the Decommissioning Funds to be collected by APS through its Decommissioning Charge, subject to the provisions of this Agreement.

NOW THEREFORE, the parties, for adequate consideration and intending to be legally bound, hereby agree as follows:

1. Collections. In accordance with A.A.C Rule R14-2-1608 and the ACC Order, APS will continue to collect the Decommissioning Charge in the amount determined and approved by the ACC by the ACC as a System Benefit Charge, as a non-bypassable charge from retail electric customers for the decommissioning of PVNGS.
2. Remittance. Beginning February __, 2003, APS will remit monthly in arrears to the Decommissioning Trusts any and all Decommissioning Funds actually received by APS from its retail electric customers.
3. Collection Agent Only. APS's obligations hereunder are limited to the collection and remittance of Decommissioning Funds as specifically set forth in this Agreement. PWEC, as the settlor and beneficiary of the Decommissioning Trusts, is solely responsible for the proper use of the Decommissioning Funds in accordance with applicable law for decommissioning of the PVNGS Interest.
4. Allocation of Costs of Administering the Agreement.
 - a. APS shall bear responsibility for, pay or be obligated to pay, all costs associated with administration of this Agreement, including costs of Decommissioning Charge rate design and collection and remittance of the Decommissioning Funds pursuant to A.A.C. Rule R-14-2-1608.
 - b. PWEC shall submit to APS for payment its costs and expenses associated with determination of the funding requirement for decommissioning of the PVNGS Interest to be included in the APS Systems Benefit Charge (the "Funding Requirement"), including fees, costs and expenses of expert witnesses and participation in proceedings before the ACC to establish the Funding Requirement. Notwithstanding the foregoing, in the event and to the extent that APS is unable to recover its costs and expenses of administering this Agreement through cost of service rates, PWEC shall reimburse APS for costs and expenses of administering this Agreement, as contemplated under subsection a. of this Section 4.

5. Funding Requirement.

a. Cooperation in Regulatory Proceedings.

- (1) PWEC and APS shall cooperate and make available to one another adequate supporting documentation and other information necessary to support the Funding Requirement in accordance with the requirements set forth in A.A.C. Rule R-14-2-1608.
- (2) For purposes of determining the Funding Requirement in accordance with Section (b) hereof, APS shall cooperate with PWEC and make personnel and information available to PWEC so that PWEC may determine the appropriate level or amount of Funding Requirement to be sought.
- (3) Neither party shall utilize confidential information obtained from the other for any purpose other than determining the appropriate Funding Requirement to be sought in any review by the ACC.

b. Control of Regulatory Proceedings.

- (1) Funding Requirement. At least 180 days prior to any periodic review by the ACC pursuant to A.A.C. Rule R-14-2-1608, or immediately upon any request from the ACC of its intent to review the Funding Requirement, APS shall notify PWEC of such anticipated submission. PWEC provide to APS the amount of and the basis for the anticipated Funding Requirement for the period to be covered by the ACC review.
- (2) APS, in cooperation with PWEC, shall determine the method, manner and means of presentation and determination of the Funding Requirement in proceedings before the ACC. APS, shall be obligated to take all reasonable steps and make all reasonable efforts to recover the Funding Requirement as submitted by PWEC.

c. Appeal of ACC Proceedings.

- (1) Decision to Appeal. PWEC may request APS to appeal any decision of the ACC relating to the determination of the Funding Requirement and may also decide to appeal such determination in its own right as a party. Further, PWEC, in its sole discretion, shall decide whether to appeal a determination in subsequent appeals to any state or federal district, appellate or supreme court, as the case may be. In the event PWEC is unable to pursue such an appeal in its own right as a party, PWEC shall notify APS, in writing, of its desire to appeal any such decision, and APS shall

file such appeal, and make such exceptions, as may be requested by PWEC.

- (2) Appellate Costs. PWEC shall reimburse APS for all costs associated with an appeal of a decision relating to a determination of the Funding Requirement, Decommissioning Charge and the cost of decommissioning the PVNGS Interest.

6. APS's Covenants.

- a. Compliance with Laws, Etc. APS will comply in all material respects with all applicable laws, rules, regulations and orders and shall preserve and maintain its existence, rights, franchises and qualifications, except to the extent that the failure to do so would not materially adversely affect the collectibility of the Decommissioning Funds or the ability of APS to perform its obligations under this Agreement.
- b. Records and Books of Account. APS will implement and maintain appropriate administrative and operating procedures to perform its duties hereunder, including procedures that allow it to identify all Decommissioning Funds received and remitted pursuant to this Agreement.
- c. Performance and Compliance with Collection Policy. APS will timely and fully comply in all material respects with its collection policies as are in effect from time to time during the term of this Agreement, subject to subsection e. of this Section 7.
- d. Sales, Liens, Setoff, Etc. APS will not sell, assign (by operation of law or otherwise) or otherwise dispose of, or create or suffer to exist any lien upon or with respect to, Decommissioning Funds in its possession or PWEC's interest in the Decommissioning Funds, or assign any right to receive income in respect thereof. Under no circumstances will APS have any right of setoff regarding the Decommissioning Funds.
- e. Change in Business or Collection Policy. APS will not make any change in the character of its business or in its collection policies that would, in either case, have a material adverse effect upon the collectibility of the Decommissioning Funds or the ability of APS to perform its obligations under this Agreement, without the prior written approval of PWEC.
- f. Audits. APS will, from time to time during regular business hours as may be reasonably requested by PWEC, permit PWEC or its agents or representatives to (i) examine and make copies of and abstracts from all books, records and documents (including, without limitation, computer tapes and disks) in APS's possession or under its control relating to the collection and remitting of the Decommissioning Funds, and (ii) visit APS's offices for the purpose of examining such materials described in

clause (i) of this subsection f., and to discuss matters relating to the Decommissioning Funds or APS's performance hereunder with any of the officers, employees, agents or representatives of APS having knowledge of such matters.

- g. Marking of Records. Upon the reasonable request of PWEC, APS will mark its records evidencing the Decommissioning Funds with a legend indicating that the Decommissioning Funds have been collected in accordance with this Agreement. APS will retain all decommissioning related books and records in its possession in accordance with applicable regulations of the NRC in effect from time to time during the term of this Agreement, and any extensions thereof.
- h. Confidential Information. Unless otherwise required by law, regulation or legal process, including disclosure mandated by the ACC, APS covenants and agrees to keep confidential any confidential, privileged or proprietary information of PWEC in its possession and will not disclose such information to any third party without the prior written consent of PWEC. APS further covenants and agrees that when requested or directed to do so by PWEC, it shall take all reasonable steps to obtain a protective order to prevent disclosure of information deemed by PWEC to be confidential, privileged and/or proprietary.
- i. Further Assurances. APS agrees from time to time to execute and deliver all further instruments and documents, and to take all further actions that may be necessary or desirable, or that PWEC may reasonably request, to perfect, protect or more fully evidence PWEC's interest in the Decommissioning Funds. Without limiting the foregoing, APS will, upon PWEC's request, execute and file such financing statements, or amendments thereto, and such other instruments and documents that may be necessary or desirable, or that PWEC, in its discretion, may request, to perfect, protect or evidence its interest in the Decommissioning Funds.

7. PWEC Covenants.

- a. Records and Books of Account. PWEC will implement and maintain appropriate administrative and operating procedures to perform its duties hereunder; including procedures to identify all Decommissioning Funds received by the Decommissioning Trusts from APS.
- b. Audits. PWEC will, from time to time during regular business hours as may be reasonably requested by APS, permit APS or its employees, agents or representatives to (i) examine and make copies of and abstracts from all books, records and documents (including, without limitation, computer tapes and disks) in the possession or under the control of PWEC relating to the receipt by the Decommissioning Trusts and application of the Decommissioning Funds, and (ii) visit the offices of PWEC for the purpose of examining such materials described in clause (i) hereof, and to

discuss matters relating to the Decommissioning Funds or PWEC's performance hereunder with any of the officers or employees of PWEC having knowledge of such matters.

- c. Confidential Information. PWEC covenants and agrees, subject to disclosure mandated by the ACC, (i) to keep confidential any confidential and proprietary information of APS in its possession and not to disclose such information to any third party, (ii) to utilize any such confidential, proprietary information only for purposes of preparation for proceedings before the ACC relating to nuclear decommissioning costs and the application thereof, and (iii) to limit disclosure of any such confidential, proprietary information to authorized employees, agents or representatives of PWEC requiring such information in order to prepare and present cases before the ACC relating to the establishment of the Funding Requirement and PVNGS' decommissioning costs.
8. Counterparts. This Agreement may be executed in any number of counterparts, each of which, when so executed and delivered, shall be an original, but all such counterparts shall together constitute one and the same instrument.
9. Governing Law. This Agreement shall be governed by the laws of the State of Arizona.
10. Term. The term of this Agreement begins on the Effective Date and continues until (i) the funds necessary to pay for decommissioning of the PVNGS Interest in PVNGS Units 1, 2 and 3 as authorized by the ACC have been collected and remitted as set forth herein.
11. Amendment. This Agreement may be amended only in writing signed by the parties hereto. Each of the parties consents and agrees to execute amendments to this Agreement in order to conform the Agreement to changes to, or clarifications of, law, rules, regulations or ACC order.
12. Assignment. This Agreement may be assigned in whole, or in part, by either party, to a successor of PWEC's interest in PVNGS, in the case of PWEC, or to the successor of APS's interest in its electric distribution assets, in the case of APS, so that the obligations hereunder will follow the asset either in whole or in part; provided that, the assignor obtains the consent of the non-assigning party hereto, which consent shall not be unreasonably withheld or delayed. The assignee shall be substituted for the assignor, and the assignor shall be released from its obligations under this Agreement to the extent of the assignment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the Effective Date.

ARIZONA PUBLIC SERVICE COMPANY PINNACLE WEST ENERGY CORPORATION

BY: _____
NAME: _____
TITLE: _____

BY: _____
NAME: _____
TITLE: _____

ENCLOSURE 3

**Request to Amend the Application for Order and Conforming
Administrative Amendments for License Transfers**

**Request to Amend the Application for Order
and Conforming Administrative Amendments for License Transfers**

In Reference 1 of the cover letter, Pinnacle West Energy Corporation (PWE) and Arizona Public Service Company (APS), collectively the "Applicants", submitted their Application for Order and Conforming Administrative Amendments for License Transfer ("Application") requesting NRC's consent to the transfer of APS' existing operating licenses for Palo Verde Nuclear Generating Station (PVNGS) Units 1, 2 and 3 to PWE, and approval of certain conforming administrative amendments to the PVNGS operating licenses to reflect the proposed transfer to PWE.

As explained in the Application, APS is required to separate its electric generating supply business from its transmission and distribution business, and to phase in retail competition. Accordingly, APS plans to transfer its fossil-fired and nuclear generating facilities to PWE, including its interests in PVNGS, in accordance with the terms of a restructuring settlement agreement approved by the Arizona Corporation Commission (ACC) on October 6, 1999.

As more fully described in the Application, upon completion of the proposed transfer APS will have no continuing involvement with the ownership or operations of PVNGS or be responsible for any licensed activities under the PVNGS licenses. Conversely, PWE will have no involvement in the ownership or operation of APS' transmission and distribution facilities.

Appendix C, Antitrust Conditions, to each of the three PVNGS licenses contains antitrust conditions that require APS to provide open access to bulk power transmission services over its transmission system. The Applicants propose that the NRC substitute "Pinnacle West Energy Corporation" for "Arizona Public Service Company" as a conforming administrative amendment in accordance with 10 CFR 2.1315(b), to better reflect the separate functional, legal, and regulatory responsibilities of APS and PWE following the license transfers.

This proposed conforming amendment to the antitrust license conditions for each operating license would have no practical impact on the requirement for APS to offer non-discriminatory open access to its transmission system. As the Commission noted in *Wolf Creek*, the Energy Policy Act of 1992 and FERC Order No. 888 impose generic industry requirements that include and substantially exceed the conditions imposed in the PVNGS antitrust license conditions (Kansas Gas & Electric Co. (Wolf Creek Generating Station, Unit 1), CLI-99-19, 49 NRC 441 (1999)). Consistent with Order No. 888, APS has an open-access-transmission tariff on file with FERC offering comparable and nondiscriminatory transmission service to all eligible customers. Moreover, APS is subject to Sections 211 and 212 of the Federal Power Act authorizing FERC to order utilities to provide transmission service to customers requesting such service.

To comply with the antitrust license conditions PWE will: (1) take no action to direct or otherwise control APS' transmission and distribution system or facilities; and (2) provide the NRC with prompt notice of any action proposed by APS (for so long as APS remains affiliated with PWE) or FERC that would materially reduce the open-access transmission requirements currently imposed on APS by FERC.

The attachments to this enclosure provide revised proposed annotated and re-typed conforming administrative license amendments to Appendix C, "Antitrust Conditions", for each PVNGS operating license.

ATTACHMENT 1

Annotated Changes to:

- Appendix C – Antitrust Conditions, Unit 1**
- Appendix C – Antitrust Conditions, Unit 2**
- Appendix C – Antitrust Conditions, Unit 3**

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-41

Pinnacle West Energy Corporation~~Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the Pinnacle West Energy Corporation~~Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such applicant has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-51

Pinnacle West Energy Corporation~~Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the Pinnacle West Energy Corporation~~Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such applicant has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-74

~~Pinnacle West Energy Corporation Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the ~~Pinnacle West Energy Corporation Arizona Public Service Company~~ and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such ~~Applicant-applicant~~ has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.

ATTACHMENT 2

Re-typed Pages of:

Appendix C – Antitrust Conditions, Unit 1

Appendix C – Antitrust Conditions, Unit 2

Appendix C – Antitrust Conditions, Unit 3

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-41

Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such applicant has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-51

Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such applicant has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.

APPENDIX C

ANTITRUST CONDITIONS
LICENSE NO. NPF-74

Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District shall comply with the following antitrust conditions:

1. In connection with the antitrust conditions, the following definitions are used herein:
 - A. "Bulk Power" means the electric power, and any attendant energy, supplied or made available at transmission or subtransmission voltage by one entity to another.
 - B. "Entity" means a person, private or public corporation, a municipality, a cooperative, an association or business trust owning, operating or proposing in good faith to own or operate equipment or facilities for the generation, transmission or distribution of electricity to or for the public as a utility.
 - C. "Joint Applicant(s)" means the Pinnacle West Energy Corporation and the Salt River Project Agricultural Improvement and Power District.
2.
 - A. Each Joint Applicant will transmit Bulk Power over its transmission system, between or among two or more Entities with which it is interconnected, or will be interconnected in the future, without restrictions on use or resale of the power so transmitted, provided that such services can reasonably be accommodated from a technical standpoint without impairing each Joint Applicant's reliability or its own use of its facilities.
 - B. Each Joint Applicant is obligated under this condition to transmit Bulk Power on the terms stated above, and in connection with each Joint Applicant's plan to construct new transmission facilities for its own use, to include in its planning and construction program sufficient transmission capacity for such Bulk Power transactions, provided that such applicant has received sufficient advance notice as may be necessary from a technical standpoint to accommodate the requirements of any requesting entity, and further provided that such entity(ies) are obligated as may be agreed (i) to share the capital, operating and maintenance costs of such new transmission facilities to the extent that additional cost burdens would be imposed on such Joint Applicant or (ii) to compensate the Joint Applicant fully for the use of its system.
3. The foregoing shall be implemented in a manner consistent with the provisions of the Federal Power Act as applicable and all rates, charges or practices in connection herewith are to be subject to the approval of regulatory agencies having jurisdiction over them.