

PINNACLE WEST CAPITAL CORP

FORM 10-Q (Quarterly Report)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from _____ to _____

Commission File Number	Exact Name of Each Registrant as specified in its charter; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-8962	PINNACLE WEST CAPITAL CORPORATION (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0512431
1-4473	ARIZONA PUBLIC SERVICE COMPANY (an Arizona corporation) 400 North Fifth Street, P.O. Box 53999 Phoenix, Arizona 85072-3999 (602) 250-1000	86-0011170

Indicate by check mark whether each registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

PINNACLE WEST CAPITAL CORPORATION	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
ARIZONA PUBLIC SERVICE COMPANY	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

PINNACLE WEST CAPITAL CORPORATION	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
ARIZONA PUBLIC SERVICE COMPANY	Yes <input type="checkbox"/>	No <input type="checkbox"/>

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

PINNACLE WEST CAPITAL CORPORATION	Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
ARIZONA PUBLIC SERVICE COMPANY	Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input checked="" type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether each registrant is a shell company (as defined in Exchange Act Rule 12b-2).

PINNACLE WEST CAPITAL CORPORATION	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
ARIZONA PUBLIC SERVICE COMPANY	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

PINNACLE WEST CAPITAL CORPORATION

Number of shares of common stock, no par value,
outstanding as of April 25, 2011: 109,016,655

ARIZONA PUBLIC SERVICE COMPANY

Number of shares of common stock, \$2.50 par value,
outstanding as of April 25, 2011: 71,264,947

Arizona Public Service Company meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format allowed under that General Instruction.

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This combined Form 10-Q is separately provided by Pinnacle West Capital Corporation (“Pinnacle West”) and Arizona Public Service Company (“APS”). Any use of the words “Company,” “we,” and “our” refer to Pinnacle West. Each registrant is providing on its own behalf all of the information contained in this Form 10-Q that relates to such registrant and, where required, its subsidiaries. Except as stated in the preceding sentence, neither registrant is providing any information that does not relate to such registrant, and therefore makes no representation as to any such information. The information required with respect to each company is set forth within the applicable items. Item 1 of this report includes Condensed Consolidated Financial Statements of Pinnacle West and Condensed Consolidated Financial Statements of APS. Item 1 also includes Notes to Pinnacle West’s Condensed Consolidated Financial Statements, the majority of which also relate to APS, and Supplemental Notes, which only relate to APS’s Condensed Consolidated Financial Statements.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements based on current expectations. These forward-looking statements are often identified by words such as “estimate,” “predict,” “may,” “believe,” “plan,” “expect,” “require,” “intend,” “assume” and similar words. Because actual results may differ materially from expectations, we caution readers not to place undue reliance on these statements. A number of factors could cause future results to differ materially from historical results, or from outcomes currently expected or sought by Pinnacle West or APS. In addition to the Risk Factors described in Item 1A of the Pinnacle West/APS Annual Report on Form 10-K for the fiscal year ended December 31, 2010 (“2010 Form 10-K”) and in Item 2 — “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” these factors include, but are not limited to:

- our ability to achieve timely and adequate rate recovery of our costs, including returns on debt and equity capital;
- our ability to manage capital expenditures and other costs while maintaining reliability and customer service levels;
- variations in demand for electricity, including those due to weather, the general economy, customer and sales growth (or decline), and the effects of energy conservation measures and distributed generation;
- power plant performance and outages;
- volatile fuel and purchased power costs;
- fuel and water supply availability;
- regulatory and judicial decisions, developments and proceedings;
- new legislation or regulation, including those relating to greenhouse gas emissions, renewable energy mandates, nuclear plant operation and energy efficiency standards;
- our ability to meet renewable energy requirements and recover related costs;
- risks inherent in the operation of nuclear facilities, including spent fuel disposal uncertainty;
- competition in retail and wholesale power markets;
- the duration and severity of the economic decline in Arizona and current real estate market conditions;
- the cost of debt and equity capital and the ability to access capital markets when required;
- changes to our credit ratings;
- the investment performance of the assets of our nuclear decommissioning trust, pension, and other postretirement benefit plans and the resulting impact on future funding requirements;
- the liquidity of wholesale power markets and the use of derivative contracts in our business;
- potential shortfalls in insurance coverage;
- new accounting requirements or new interpretations of existing requirements;
- generation, transmission and distribution facility and system conditions and operating costs;
- the ability to meet the anticipated future need for additional baseload generation and associated transmission facilities in our region;
- the willingness or ability of our counterparties, power plant participants and power plant land owners to meet contractual or other obligations or extend the rights for continued power plant operations;
- technological developments affecting the electric industry; and
- restrictions on dividends or other burdensome provisions in our credit agreements and Arizona Corporation Commission (“ACC”) orders.

These and other factors are discussed in Risk Factors described in Item 1A of our 2010 Form 10-K, which readers should review carefully before placing any reliance on our financial statements or disclosures. Neither Pinnacle West nor APS assumes any obligation to update these statements, even if our internal estimates change, except as required by law.

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

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

	Three Months Ended March 31,	
	2011	2010
OPERATING REVENUES		
Regulated electricity segment	\$ 647,974	\$ 611,425
Other revenues	11,601	8,930
Total	<u>659,575</u>	<u>620,355</u>
OPERATING EXPENSES		
Regulated electricity segment fuel and purchased power	212,007	215,540
Operations and maintenance	256,486	207,842
Depreciation and amortization	106,601	100,653
Taxes other than income taxes	37,624	31,724
Other expenses	9,716	6,928
Total	<u>622,434</u>	<u>562,687</u>
OPERATING INCOME	<u>37,141</u>	<u>57,668</u>
OTHER INCOME (DEDUCTIONS)		
Allowance for equity funds used during construction	5,395	5,389
Other income (Note 11)	1,690	2,108
Other expense (Note 11)	(1,699)	(2,696)
Total	<u>5,386</u>	<u>4,801</u>
INTEREST EXPENSE		
Interest charges	61,077	60,705
Allowance for borrowed funds used during construction	(3,576)	(3,047)
Total	<u>57,501</u>	<u>57,658</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(14,974)	4,811
INCOME TAXES	(5,649)	(7,172)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(9,325)	11,983
LOSS FROM DISCONTINUED OPERATIONS		
Net of income tax benefit of \$222 and \$8,389 (Note 14)	(349)	(12,880)
NET LOSS	(9,674)	(897)
Less: Net income attributable to noncontrolling interests (Note 7)	5,461	5,117
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	<u>\$ (15,135)</u>	<u>\$ (6,014)</u>
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — BASIC	108,832	101,474
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING — DILUTED	108,832	101,474
EARNINGS PER WEIGHTED-AVERAGE COMMON SHARE OUTSTANDING		
Income (loss) from continuing operations attributable to common shareholders — basic	\$ (0.14)	\$ 0.07
Net loss attributable to common shareholders — basic	(0.14)	(0.06)
Income (loss) from continuing operations attributable to common shareholders — diluted	(0.14)	0.07
Net loss attributable to common shareholders — diluted	(0.14)	(0.06)
DIVIDENDS DECLARED PER SHARE	\$ 0.525	\$ 0.525
AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS:		
Income (loss) from continuing operations, net of tax	\$ (14,795)	\$ 6,855
Discontinued operations, net of tax	(340)	(12,869)
Net loss attributable to common shareholders	<u>\$ (15,135)</u>	<u>\$ (6,014)</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.



PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	March 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 114,193	\$ 110,188
Customer and other receivables	309,854	324,207
Accrued unbilled revenues	93,659	103,292
Allowance for doubtful accounts	(7,691)	(7,981)
Materials and supplies (at average cost)	161,063	181,414
Fossil fuel (at average cost)	20,505	21,575
Deferred income taxes	124,244	124,897
Income tax receivable (Note 6)	—	2,483
Assets from risk management activities (Note 8)	54,579	73,788
Regulatory assets (Note 3)	55,743	62,286
Other current assets	31,868	28,362
Total current assets	<u>958,017</u>	<u>1,024,511</u>
INVESTMENTS AND OTHER ASSETS		
Assets from risk management activities (Note 8)	38,520	39,032
Nuclear decommissioning trust (Note 15)	486,737	469,886
Other assets	64,429	116,216
Total investments and other assets	<u>589,686</u>	<u>625,134</u>
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	13,270,775	13,201,960
Accumulated depreciation and amortization	(4,580,344)	(4,514,204)
Net	8,690,431	8,687,756
Construction work in progress	441,683	459,361
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	135,766	137,956
Intangible assets, net of accumulated amortization	182,855	184,952
Nuclear fuel, net of accumulated amortization	129,554	108,794
Total property, plant and equipment	<u>9,580,289</u>	<u>9,578,819</u>
DEFERRED DEBITS		
Regulatory assets (Note 3)	979,854	986,370
Income tax receivable (Note 6)	67,738	65,103
Other	127,306	113,061
Total deferred debits	<u>1,174,898</u>	<u>1,164,534</u>
TOTAL ASSETS	<u>\$ 12,302,890</u>	<u>\$ 12,392,998</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.

PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	March 31, 2011	December 31, 2010
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 215,968	\$ 236,354
Accrued taxes (Note 6)	155,172	104,711
Accrued interest	54,948	54,831
Short-term borrowings	17,300	16,600
Current maturities of long-term debt (Note 2)	832,275	631,879
Customer deposits	68,821	68,322
Liabilities from risk management activities (Note 8)	71,047	58,976
Deferred fuel and purchased power regulatory liability (Note 3)	77,151	58,442
Other regulatory liabilities (Note 3)	78,167	80,526
Other current liabilities	103,363	139,063
Total current liabilities	<u>1,674,212</u>	<u>1,449,704</u>
LONG-TERM DEBT LESS CURRENT MATURITIES (Note 2)		
Long-term debt less current maturities	2,748,676	2,948,991
Palo Verde sale leaseback lessor notes less current maturities (Note 7)	96,803	96,803
Total long-term debt less current maturities	<u>2,845,479</u>	<u>3,045,794</u>
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,775,368	1,863,861
Regulatory liabilities (Note 3)	689,942	614,063
Liability for asset retirements (Note 16)	244,483	328,571
Liabilities for pension and other postretirement benefits (Note 4)	824,502	813,121
Liabilities from risk management activities (Note 8)	56,517	65,390
Customer advances	118,778	121,645
Coal mine reclamation	117,455	117,243
Unrecognized tax benefits (Note 6)	82,613	66,349
Other	144,770	132,031
Total deferred credits and other	<u>4,054,428</u>	<u>4,122,274</u>
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
EQUITY (Note 9)		
Common stock, no par value	2,434,784	2,421,372
Treasury stock	(5,768)	(2,239)
Total common stock	<u>2,429,016</u>	<u>2,419,133</u>
Retained earnings	1,351,716	1,423,961
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(58,554)	(59,420)
Derivative instruments	(90,767)	(100,347)
Total accumulated other comprehensive loss	<u>(149,321)</u>	<u>(159,767)</u>
Total shareholders' equity	3,631,411	3,683,327
Noncontrolling interests (Note 7)	97,360	91,899
Total equity	<u>3,728,771</u>	<u>3,775,226</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 12,302,890</u>	<u>\$ 12,392,998</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements.



PINNACLE WEST CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (9,674)	\$ (897)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	123,298	114,122
Deferred fuel and purchased power	49,947	44,040
Deferred fuel and purchased power amortization	(31,238)	(25,953)
Allowance for equity funds used during construction	(5,395)	(5,389)
Real estate impairment charges	—	15,112
Deferred income taxes	(41,005)	50,845
Change in mark-to-market valuations	(284)	1,842
Changes in current assets and liabilities:		
Customer and other receivables	75,528	60,244
Accrued unbilled revenues	9,633	24,505
Materials, supplies and fossil fuel	21,421	6,240
Other current assets	(636)	(8,148)
Accounts payable	(24,543)	(23,334)
Accrued taxes and income tax receivable-net	52,944	30,004
Other current liabilities	(37,406)	(39,572)
Expenditures for real estate investments	(40)	(443)
Gains and other changes in real estate assets	(3)	4,095
Change in margin and collateral accounts — assets	4,220	(11,280)
Change in margin and collateral accounts — liabilities	35,478	(124,495)
Change in unrecognized tax benefits	18,959	(62,062)
Change in other long-term assets	(33,129)	(26,593)
Change in other long-term liabilities	35,421	(36,558)
Net cash flow provided by (used for) operating activities	<u>243,496</u>	<u>(13,675)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(191,553)	(202,554)
Contributions in aid of construction	9,136	2,949
Allowance for borrowed funds used during construction	(3,576)	(3,080)
Proceeds from nuclear decommissioning trust sales	189,318	158,448
Investment in nuclear decommissioning trust	(194,241)	(164,552)
Other	(1,879)	(1,639)
Net cash flow used for investing activities	<u>(192,795)</u>	<u>(210,428)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of long-term debt	175,000	—
Repayment of long-term debt	(175,170)	(4,150)
Short-term borrowings and payments — net	700	135,901
Dividends paid on common stock	(55,300)	(51,421)
Common stock equity issuance	11,727	844
Other	(3,653)	1,079
Net cash flow provided by (used for) financing activities	<u>(46,696)</u>	<u>82,253</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,005	(141,850)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>110,188</u>	<u>145,378</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 114,193</u>	<u>\$ 3,528</u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes, net of (refunds)	\$ —	\$ (5,547)
Interest, net of amounts capitalized	\$ 55,997	\$ 58,679

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Consolidation and Nature of Operations

The unaudited condensed consolidated financial statements include the accounts of Pinnacle West and our subsidiaries: APS, SunCor Development Company (“SunCor”), APS Energy Services Company, Inc. (“APSES”), and El Dorado Investment Company (“El Dorado”). Intercompany accounts and transactions between the consolidated companies have been eliminated. The unaudited condensed consolidated financial statements for APS include the accounts of APS and the Palo Verde sale leaseback variable interest entities (“VIEs”) (see Note 7 for further discussion). Our accounting records are maintained in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Weather conditions cause significant seasonal fluctuations in our revenues; therefore, results for interim periods do not necessarily represent results expected for the year.

In preparing the condensed consolidated financial statements, we have evaluated the events that have occurred after March 31, 2011 through the date the financial statements were issued.

Our condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments except as otherwise disclosed in the notes) that we believe are necessary for the fair presentation of our financial position, results of operations and cash flows for the periods presented. These condensed consolidated financial statements and notes have been prepared consistently with the 2010 Form 10-K with the exception of the reclassification of certain prior year amounts on our Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows in accordance with accounting requirements for reporting discontinued operations (see Note 14), and the impacts related to the reclassification of regulatory assets and liabilities for the current portion (see Note 3).

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following tables show the impact of the reclassifications to prior year (previously reported) amounts (dollars in thousands):

Statement of Income for the Three Months Ended March 31, 2010	As previously reported	Reclassifications for discontinued operations	Amount reported after reclassification for discontinued operations
Operating Revenues			
Real estate segment	\$ 9,416	\$ (9,416)	\$ —
Other revenues	12,750	(3,820)	8,930
Operating Expenses			
Real estate segment operations	13,890	(13,890)	—
Real estate impairment charge	15,112	(15,112)	—
Operations and maintenance	209,991	(2,149)	207,842
Depreciation and amortization	101,536	(883)	100,653
Taxes other than income taxes	31,827	(103)	31,724
Other expenses	8,061	(1,133)	6,928
Other			
Other income	2,395	(287)	2,108
Interest Expense			
Interest charges	62,054	(1,349)	60,705
Allowance for borrowed funds used during construction	(3,080)	33	(3,047)
Income Taxes	(15,480)	8,308	(7,172)
Income (Loss) From Continuing Operations	(772)	12,755	11,983
Loss From Discontinued Operations	(125)	(12,755)	(12,880)

Balance Sheets — December 31, 2010	As previously reported	Reclassifications for regulatory assets and liabilities	Amount reported after reclassification for regulatory assets and liabilities
Current Assets — Regulatory assets	\$ —	\$ 62,286	\$ 62,286
Current Assets — Deferred income taxes	94,602	30,295	124,897
Deferred Debits — Regulatory assets	1,048,656	(62,286)	986,370
Current Liabilities — Deferred fuel and purchased power regulatory liability	—	58,442	58,442
Current Liabilities — Other regulatory liabilities	—	80,526	80,526
Deferred Credits and Other — Deferred income taxes	1,833,566	30,295	1,863,861
Deferred Credits and Other — Deferred fuel and purchased power regulatory liability	58,442	(58,442)	—
Deferred Credits and Other — Regulatory liabilities	694,589	(80,526)	614,063

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Statement of Cash Flows for the Three Months Ended March 31, 2010	As previously reported	Reclassifications for regulatory assets and liabilities	Amount reported after reclassification for regulatory assets and liabilities
Cash Flows from Operating Activities			
Other current assets	\$ (8,836)	\$ 688	\$ (8,148)
Other current liabilities	(36,582)	(2,990)	(39,572)
Change in other long-term assets	(25,903)	(690)	(26,593)
Change in other long-term liabilities	(39,550)	2,992	(36,558)

2. Long-term Debt and Liquidity Matters

The following table shows principal payments due on Pinnacle West's and APS's total long-term debt and capitalized lease requirements as of March 31, 2011 (dollars in millions):

Year	Consolidated Pinnacle West	Consolidated APS
2011	\$ 457	\$ 457
2012	477	477
2013	140	140
2014	502	502
2015	488	313
Thereafter	1,620	1,620
Total	<u>\$ 3,684</u>	<u>\$ 3,509</u>

Credit Facilities and Debt Issuances

Pinnacle West and APS maintain committed revolving credit facilities in order to enhance liquidity and provide credit support for their commercial paper programs. During the first quarter of 2011, APS refinanced an existing revolving credit facility (as discussed below) that would have otherwise matured in September 2011.

Pinnacle West

On February 23, 2011, Pinnacle West entered into a \$175 million term loan facility that matures February 20, 2015. Pinnacle West used the proceeds of the loan to repay its 5.91% \$175 million Senior Notes. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings, or if unavailable, its long-term issuer ratings.

At March 31, 2011, Pinnacle West's \$200 million credit facility, which matures in 2013, was available for general corporate purposes, support of its \$200 million commercial paper program, or for issuances of letters of credit. Pinnacle West has the option to increase the amount of the facility up to a maximum of \$300 million upon the satisfaction of certain conditions and with the consent of the lenders. At March 31, 2011, Pinnacle West had no outstanding borrowings under this credit facility, no outstanding letters of credit and commercial paper borrowings of \$17 million.

**PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

APS

On February 14, 2011, APS refinanced its \$489 million revolving credit facility that would have matured in September 2011, with a new \$500 million facility. The new revolving credit facility terminates in February 2015. APS may increase the amount of the facility up to a maximum of \$700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use the facility for general corporate purposes, commercial paper program support and for the issuance of letters of credit. Interest rates are based on APS's senior unsecured debt credit ratings.

At March 31, 2011, APS had two credit facilities totaling \$1 billion, including the \$500 million credit facility described above and a \$500 million facility that matures in February 2013. These facilities are available to support its \$250 million commercial paper program, for bank borrowings or for issuances of letters of credit. See Note 12 for discussion of APS's letters of credit. At March 31, 2011, APS had no borrowings outstanding under any of its credit facilities and no outstanding commercial paper. A \$20 million letter of credit was outstanding under APS's 2011 \$500 million credit facility described above.

Debt Provisions

An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At March 31, 2011, APS was in compliance with the common equity ratio requirements established by the ACC. Its total shareholder equity was approximately \$3.8 billion, and total capitalization was approximately \$7.1 billion. APS would be prohibited from paying dividends if the payment would reduce its total shareholder equity below approximately \$2.9 billion, assuming APS's total capitalization remains the same. This restriction does not materially affect Pinnacle West's ability to meet its ongoing capital requirements.

3. Regulatory Matters

2008 General Retail Rate Case Impacts

On December 30, 2009, the ACC issued an order approving a settlement agreement entered into by APS and twenty-one other parties to its general retail rate case, which was originally filed in March 2008. The settlement agreement included a net retail rate increase of \$207.5 million, which represented a base rate increase of \$344.7 million less a reclassification of \$137.2 million of fuel and purchased power revenues from the then-existing PSA to base rates. The new rates were effective January 1, 2010. The settlement agreement also contained on-going requirements, commitments and authorizations, including the following:

- Revenue accounting treatment for line extension payments received for new or upgraded service from January 1, 2010 through year end 2012 (or until new rates are established in APS's next general rate case, if that is before the end of 2012);
- An authorized return on common equity of 11%;
- A capital structure comprised of 46.2% debt and 53.8% common equity;

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- A commitment from APS to reduce average annual operational expenses by at least \$30 million from 2010 through 2014;
- Authorization and requirements of equity infusions into APS of at least \$700 million during the period beginning June 1, 2009 through December 31, 2014 (\$253 million of which was infused into APS from proceeds of a Pinnacle West equity issuance in the second quarter of 2010); and
- Various modifications to the existing energy efficiency, demand-side management and renewable energy programs that require APS to, among other things, expand its conservation and demand-side management programs and its use of renewable energy, as well as allow for concurrent recovery of renewable energy expenses and provide for more concurrent recovery of demand-side management costs and incentives.

The parties also agreed to a rate case filing plan in which APS is prohibited from filing its next two general rate cases until on or after June 1, 2011 and June 1, 2013, respectively, unless certain extraordinary events occur. Subject to the foregoing, APS may not request its next general retail rate increase to be effective prior to July 1, 2012. On February 1, 2011, APS filed a 120-day advanced notice of its intent to file its next rate case on June 1, 2011. The parties agreed to use good faith efforts to process these subsequent rate cases within twelve months of sufficiency findings from the ACC staff, which generally occur within 30 days after the filing of a rate case.

Cost Recovery Mechanisms

APS has received regulatory decisions that allow for more timely recovery of certain costs through the following recovery mechanisms.

Renewable Energy Standard. In 2006, the ACC approved the Arizona Renewable Energy Standard and Tariff (“RES”). Under the RES, electric utilities that are regulated by the ACC must supply an increasing percentage of their retail electric energy sales from eligible renewable resources, including solar, wind, biomass, biogas and geothermal technologies. In order to achieve these requirements, the ACC allows APS to include a RES surcharge as part of customer bills to recover the approved amounts for use on renewable energy projects. Each year APS is required to file a five-year implementation plan with the ACC and seek approval for funding the upcoming year’s RES budget.

During 2009, APS filed its annual RES implementation plan, covering the 2010-2014 timeframe and requesting 2010 RES funding approval. The plan provided for the acquisition of renewable generation in compliance with requirements through 2014, and requested RES funding of \$87 million for 2010, which was later approved by the ACC. APS also sought various other determinations in its plan, including approval of the AZ Sun Program and the Community Power Project in Flagstaff, Arizona described below.

On March 3, 2010, the ACC approved the AZ Sun Program, which contemplates the addition of 100 megawatts (“MW”) of APS-owned solar resources through 2014. Through this program, APS plans to invest up to \$500 million in solar photovoltaic projects across Arizona, which APS will acquire through competitive procurement processes. The costs associated with the first 50 MW under this program will be recovered initially through the RES until such time as the costs are recovered in base rates or other mechanisms. The costs of the second 50 MW will be recovered through a mechanism to be determined in APS’s next retail rate case.

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On April 1, 2010, the ACC approved the Community Power Project, a pilot program in which APS will own, operate and receive energy from approximately 1.5 MW of solar panels on the rooftops of up to 200 residential and business customers located within a certain test area in Flagstaff, Arizona. The capital carrying costs of the program will be recovered through the RES until such time as these costs are recovered in base rates.

On July 1, 2010, APS filed its annual RES implementation plan, covering the 2011-2015 timeframe and requesting 2011 RES funding of \$96 million. The 2011 Plan addressed enhancements to the residential distributed energy incentive program based on high customer participation, among other things. On October 13, 2010, APS filed an adjusted RES implementation plan to reflect the following items, among others: 1) increased clarity relating to customer project in-service dates and related budget revisions; 2) AZ Sun Program updates; and 3) the addition of 10 MW of biomass capacity. On December 10, 2010, the ACC approved the 2011 Plan and associated funding request. In January 2011, the ACC voted to reconsider four aspects of the approved 2011 Plan, including: (a) approval to proceed with a feed-in tariff filing; (b) approval for APS to participate in the ownership of distributed energy facilities in the Schools and Government program; (c) denial of a Rapid Reservation program that allows customers to receive priority in the incentive reservation process in exchange for receipt of a reduced incentive amount; and (d) allocation of the budget among various programs and studies. Hearings were held on January 24, 2011 and January 28, 2011. The ACC amended its original decision that approved the 2011 Plan as follows: the ACC (a) reversed its approval of a feed-in tariff program; (b) restricted APS's ownership of facilities to only economically challenged, rural schools and only after a school has received a bid from a third-party solar installer; (c) approved the Rapid Reservation program; and (d) maintained the original approved budget with some timing modifications.

Demand-Side Management Adjustor Charge ("DSMAC"). The settlement agreement related to the 2008 retail rate case requires APS to submit an annual Energy Efficiency Implementation Plan for review by and approval of the ACC. On July 15, 2009, APS filed its initial Energy Efficiency Implementation Plan, requesting approval by the ACC of programs and program elements for which APS had estimated a budget in the amount of \$50 million for 2010. APS received ACC approval of all of its proposed programs and implemented the new DSMAC on March 1, 2010. A surcharge was added to customer bills in order to recover these estimated amounts for use on certain demand-side management programs. The surcharge allows for the recovery of energy efficiency expenses and any earned incentives.

The ACC approved recovery of all 2009 program costs plus incentives. The change from program cost recovery on a historical basis to recovery on a concurrent basis, as authorized in the settlement agreement, resulted in this one-time need to address two years (2009 and 2010) of cost recovery. As requested by APS, 2009 program cost recovery is to be spread over a three-year period.

On June 1, 2010, APS filed its 2011 Energy Efficiency Implementation Plan. In order to meet the energy efficiency goal for 2011 established by the settlement agreement of annual energy savings of 1.25%, expressed as a percent of total energy resources to meet retail load, APS proposed a total budget for 2011 of \$79 million. On February 17, 2011, a total budget for 2011 of \$80 million was approved and when added to the amortization of 2009 costs discussed above less the \$10 million already being recovered in general rates, the DSMAC would recover approximately \$75 million over a twelve month period beginning March 1, 2011. These amounts do not include approximately \$1 million for an electric vehicle charging station program submitted to the ACC for approval on September 30, 2010.

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PSA Mechanism and Balance. The power supply adjustor (“PSA”) provides for the adjustment of retail rates to reflect variations in retail fuel and purchased power costs.

The following table shows the changes in the deferred fuel and purchased power regulatory liability for 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Beginning balance	\$ (58)	\$ (87)
Deferred fuel and purchased power costs-current period	(50)	(44)
Amounts refunded through revenues	31	26
Ending balance	<u>\$ (77)</u>	<u>\$ (105)</u>

The PSA rate for the PSA year beginning February 1, 2011 is (\$0.0057) per kWh as compared to (\$0.0045) per kWh for the prior year. The regulatory liability at March 31, 2011 reflects lower average prices, primarily for natural gas and gas-based generation. Any uncollected (overcollected) deferrals during the 2011 PSA year will be included in the calculation of the PSA rate for the PSA year beginning February 1, 2012.

Transmission Rates and Transmission Cost Adjustor . In July 2008, the United States Federal Energy Regulatory Commission (“FERC”) approved an Open Access Transmission Tariff for APS to move from fixed rates to a formula rate-setting methodology in order to more accurately reflect and recover the costs that APS incurs in providing transmission services. A large portion of the rate represents charges for transmission services to serve APS’s retail customers (“Retail Transmission Charges”). In order to recover the Retail Transmission Charges, APS must file an application with, and obtain approval from, the ACC to reflect changes in Retail Transmission Charges through the transmission cost adjustor (“TCA”).

The formula rate is updated each year effective June 1 on the basis of APS’s actual cost of service, as disclosed in APS’s FERC Form 1 report for the previous fiscal year. Items to be updated include actual capital expenditures made as compared with previous projections, transmission revenue credits and other items. The resolution of proposed adjustments can result in significant volatility in the revenues to be collected. APS reviews the proposed formula rate filing amounts with the ACC staff. Any items or adjustments which are not agreed to by APS and the ACC staff can remain in dispute until settled or litigated at FERC. Settlement or litigated resolution of disputed issues could require an extended period of time and could have a significant effect on the Retail Transmission Charge because any adjustment, though applied prospectively, may be calculated to account for previously over-collected amounts.

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Effective June 1, 2011, APS's annual wholesale transmission rates for all users of its transmission system will increase by approximately \$44.3 million for the twelve-month period beginning June 1, 2011 in accordance with the FERC-approved formula as a result of higher costs and lower revenues reflected in the formula. Approximately \$38.2 million of this revenue increase relates to transmission services used for APS's retail customers. On April 22, 2011, APS filed with the ACC an application for the related increase of its TCA rate.

Regulatory Assets and Liabilities

As discussed in Note 1, as of March 31, 2011, the Company revised its presentation of regulatory assets and liabilities to separately reflect current and non-current amounts on the Condensed Consolidated Balance Sheets. This presentation is reflected in the tables below.

The detail of regulatory assets is as follows (dollars in millions):

	March 31, 2011		December 31, 2010	
	Current	Non-Current	Current	Non-Current
Pension and other postretirement benefits	\$ —	\$ 663	\$ —	\$ 669
Deferred fuel and purchased power — mark-to-market (Note 8)	38	38	42	35
Deferred income taxes	3	68	3	69
Transmission vegetation management	—	45	—	46
Coal reclamation	2	36	2	36
Palo Verde VIE (Note 7)	—	33	—	33
Deferred compensation	—	33	—	32
Tax expense of Medicare subsidy	2	22	2	21
Loss on reacquired debt	1	20	1	21
Demand side management (a)	9	5	12	6
Other	1	17	—	18
Total regulatory assets (b)	<u>\$ 56</u>	<u>\$ 980</u>	<u>\$ 62</u>	<u>\$ 986</u>

- (a) See Cost Recovery Mechanisms discussion above.
- (b) There are no regulatory assets for which the ACC has allowed recovery of costs but not allowed a return by exclusion from rate base. FERC rates are set using a formula rate as described in "Transmission Rates and Transmission Cost Adjustor."

Included in the balance of regulatory assets at March 31, 2011 and December 31, 2010 is a regulatory asset for pension and other postretirement benefits. This regulatory asset represents the future recovery of these costs through retail rates as these amounts are charged to earnings. If these costs are disallowed by the ACC, this regulatory asset would be charged to OCI and result in lower future earnings.

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The detail of regulatory liabilities is as follows (dollars in millions):

	March 31, 2011		December 31, 2010	
	Current	Non-Current	Current	Non-Current
Removal costs (a)	\$ 20	\$ 359	\$ 22	\$ 357
Asset retirement obligations (Note 16)	—	206	—	184
Deferred fuel and purchased power (b)(c)	77	—	58	—
Renewable energy standard (b)	50	—	50	—
Income taxes — change in rates	—	50	—	—
Spent nuclear fuel	5	41	4	41
Deferred gains on utility property	2	16	2	16
Other	1	18	3	16
Total regulatory liabilities	\$ 155	\$ 690	\$ 139	\$ 614

- (a) In accordance with regulatory accounting guidance, APS accrues for removal costs for its regulated assets, even if there is no legal obligation for removal.
- (b) See Cost Recovery Mechanisms discussion above.
- (c) Subject to a carrying charge.

4. Retirement Plans and Other Benefits

Pinnacle West sponsors a qualified defined benefit and account balance pension plan, a non-qualified supplemental excess benefit retirement plan, and other postretirement benefit plans for the employees of Pinnacle West and our subsidiaries. Pinnacle West uses a December 31 measurement date for its pension and other postretirement benefit plans. The market-related value of our plan assets is their fair value at the measurement date.

The following table provides details of the plans' net periodic benefit costs and the portion of these costs charged to expense (including administrative costs and excluding amounts capitalized as overhead construction, billed to electric plant participants or charged to a regulatory asset) (dollars in millions):

	Pension Benefits		Other Benefits	
	Three Months Ended		Three Months Ended	
	March 31,		March 31,	
	2011	2010	2011	2010
Service cost — benefits earned during the period	\$ 16	\$ 15	\$ 6	\$ 5
Interest cost on benefit obligation	31	31	12	11
Expected return on plan assets	(33)	(31)	(10)	(10)
Amortization of:				
Transition obligation	—	—	—	1
Prior service cost	—	1	—	—
Net actuarial loss	6	6	3	3
Net periodic benefit cost	<u>\$ 20</u>	<u>\$ 22</u>	<u>\$ 11</u>	<u>\$ 10</u>
Portion of cost charged to expense	<u>\$ 8</u>	<u>\$ 11</u>	<u>\$ 4</u>	<u>\$ 5</u>
APS's share of cost charged to expense	<u>\$ 8</u>	<u>\$ 10</u>	<u>\$ 4</u>	<u>\$ 5</u>

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Contributions

The required minimum contribution to our pension plan is zero in 2011 and approximately \$85 million in 2012. The contributions to our other postretirement benefit plans for 2011 and 2012 are expected to be approximately \$20 million each year. APS and other subsidiaries fund their share of the contributions. APS's share is approximately 99% of both plans.

5. Business Segments

Pinnacle West's reportable business segment is our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily retail and wholesale sales supplied to traditional cost-based rate regulation ("Native Load") customers) and related activities and includes electricity generation, transmission and distribution.

Financial data for the three months ended March 31, 2011 and 2010 and at March 31, 2011 and December 31, 2010 is provided as follows (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Operating revenues:		
Regulated electricity segment	\$ 648	\$ 611
All other (a)	12	9
Total	<u>\$ 660</u>	<u>\$ 620</u>
Net income (loss) attributable to common shareholders:		
Regulated electricity segment	\$ (15)	\$ 7
All other (b)	—	(13)
Total	<u>\$ (15)</u>	<u>\$ (6)</u>
	As of	As of
	March 31, 2011	December 31, 2010
Assets:		
Regulated electricity segment	\$ 12,237	\$ 12,285
All other (b)	66	108
Total	<u>\$ 12,303</u>	<u>\$ 12,393</u>

- (a) All other activities relate to APSES and El Dorado.
(b) All other activities relate to SunCor, APSES and El Dorado.

6. Income Taxes

The \$68 million income tax receivable on the Condensed Consolidated Balance Sheets represents the anticipated refunds related to an APS tax accounting method change approved by the IRS in the third quarter of 2009. This amount is classified as long-term, as cash refunds are not expected to be received in the next twelve months.

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On February 17, 2011, Arizona enacted legislation (H.B. 2001) that included a four year phase-in of corporate income tax rate reductions beginning in 2014. As a result of these tax rate reductions, Pinnacle West has revised the tax rate applicable to reversing temporary items in Arizona. In accordance with accounting for regulated companies, the benefit of this rate reduction is substantially offset by a regulatory liability. In the first quarter of 2011, Pinnacle West increased regulatory liabilities by a total of \$53 million, with a corresponding decrease in accumulated deferred income tax liabilities to reflect the impact of this change in tax law.

As of the balance sheet date, the tax year ended December 31, 2008 and all subsequent tax years remain subject to examination by the IRS. With few exceptions, we are no longer subject to state income tax examinations by tax authorities for years before 2006. We do not anticipate that there will be any significant increases or decreases in our unrecognized tax benefits within the next twelve months.

7. Variable-Interest Entities

Palo Verde Sale Leaseback Trusts

In 1986, APS entered into agreements with three separate variable-interest entity (“VIE”) lessor trusts in order to sell and lease back interests in Palo Verde Nuclear Generating Station (“Palo Verde”) Unit 2 and related common facilities. The VIE lessor trusts are single-asset leasing entities. APS will pay approximately \$49 million per year for the years 2011 to 2015 related to these leases. The leases do not contain fixed price purchase options or residual value guarantees. However, the lease agreements include fixed rate renewal periods which may have a significant impact on the VIEs’ economic performance. We have concluded that these fixed rate renewal periods may give APS the ability to utilize the asset for a significant portion of the asset’s economic life, and therefore provide APS with the power to direct activities of the VIEs that most significantly impact the VIEs’ economic performance. In addition to the fixed rate renewal periods, our primary beneficiary analysis also considered that APS is the operating agent for Palo Verde, is obligated to decommission the leased assets and has fair value purchase options.

For the reasons discussed above, APS consolidates these VIEs. Consolidation of these VIEs eliminates the lease accounting and results in changes in our consolidated assets, debt, equity, and net income. Assets of the VIEs are restricted and may only be used to settle the VIEs’ debt obligations and for payment to the noncontrolling interest holders. Other than the VIEs’ assets reported on our consolidated financial statements, the creditors of the VIEs have no other recourse to the assets of APS or Pinnacle West, except in certain circumstances such as a default by APS under the lease. As a result of consolidation we eliminate rent expense and recognize depreciation and interest expense, resulting in an increase in net income for the three months ended March 31, 2011 of \$5 million entirely attributable to the noncontrolling interests. Income attributable to Pinnacle West shareholders remains the same. Consolidation of these VIEs also results in changes to our Condensed Consolidated Statements of Cash Flows, but does not impact net cash flows.

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Our Condensed Consolidated Balance Sheets at March 31, 2011 and December 31, 2010 include the following amounts relating to the VIEs (in millions):

	<u>March 31, 2011</u>	<u>December 31, 2010</u>
Property plant and equipment, net of accumulated depreciation	\$ 136	\$ 138
Long-term debt including current maturities	126	126
Equity- Noncontrolling interests	97	91

For regulatory ratemaking purposes the agreements continue to be treated as operating leases and, as a result, we have recorded a regulatory asset of \$33 million as of March 31, 2011 and December 31, 2010.

APS is exposed to losses relating to these lessor trust VIEs upon the occurrence of certain events that APS does not consider to be reasonably likely to occur. Under certain circumstances (for example, the United States Nuclear Regulatory Commission (“NRC”) issuing specified violation orders with respect to Palo Verde or the occurrence of specified nuclear events), APS would be required to make specified payments to the VIEs’ noncontrolling equity participants, assume the VIEs’ debt, and take title to the leased Unit 2 interests, which, if appropriate, may be required to be written down in value. If such an event had occurred as of March 31, 2011, APS would have been required to pay the noncontrolling equity participants approximately \$146 million and assume \$126 million of debt. Since APS consolidates the VIEs, the debt APS would be required to assume is already reflected in our Condensed Consolidated Balance Sheets.

8. Derivative Accounting

We are exposed to the impact of market fluctuations in the commodity price and transportation costs of electricity, natural gas, coal, emissions allowances, and in interest rates. We manage risks associated with these market fluctuations by utilizing various derivative instruments, including futures, forwards, options and swaps. As part of our overall risk management program, we may use such instruments to hedge purchases and sales of electricity, fuels, and emissions allowances and credits. Derivative instruments that are designated as cash flow hedges are used to limit our exposure to cash flow variability on forecasted transactions. The changes in market value of such contracts have a high correlation to price changes in the hedged transactions. We may also invest in derivative instruments for trading purposes; however, for the period ended March 31, 2011, there was no material trading activity.

Our derivative instruments are accounted for at fair value; see Note 15 for a discussion of fair value measurements. Derivative instruments for the physical delivery of purchase and sale quantities transacted in the normal course of business qualify for the normal purchase and sales scope exception and are accounted for under the accrual method of accounting. Due to the scope exception, these derivative instruments are excluded from our derivative instrument discussion and disclosures below.

We also enter into derivative instruments for economic hedging purposes. While we believe the economic hedges mitigate exposure to fluctuations in commodity prices, some of these instruments may not meet the specific hedge accounting requirements and are not designated as accounting hedges. Economic hedges not designated as accounting hedges are recorded at fair value on our balance sheet with changes in fair value recognized in the statement of income as incurred. These instruments are included in the “non-designated hedges” discussion and disclosure below.

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Hedge effectiveness is the degree to which the derivative instrument contract and the hedged item are correlated and is measured based on the relative changes in fair value of the derivative instrument contract and the hedged item over time. We assess hedge effectiveness both at inception and on a continuing basis. These assessments exclude the time value of certain options. For accounting hedges that are deemed an effective hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income (“AOCI”) and reclassified into earnings in the same period during which the hedged transaction affects earnings. We recognize in current earnings, subject to the PSA, the gains and losses representing hedge ineffectiveness, and the gains and losses on any hedge components which are excluded from our effectiveness assessment. As of March 31, 2011, we hedged the majority of certain exposures to the price variability of commodities for a maximum of 39 months.

In the electricity business, some contracts to purchase energy are netted against other contracts to sell energy. This is called “book-out” and usually occurs in contracts that have the same terms (quantities and delivery points) and for which power does not flow. We net these book-outs, which reduces both revenues and fuel and purchased power costs in our Condensed Consolidated Statements of Income, but this does not impact our financial condition, net income or cash flows.

For its regulated operations, APS defers for future rate treatment approximately 90% of unrealized gains and losses on certain derivatives pursuant to the PSA mechanism that would otherwise be recognized in income. Realized gains and losses on derivatives are deferred in accordance with the PSA to the extent the amounts are above or below the portion of APS’s base rates attributable to fuel and purchased power costs (see Note 3). Gains and losses from derivatives in the following tables represent the amounts reflected in income before the effect of PSA deferrals.

As of March 31, 2011, we had the following outstanding gross notional amount of derivatives, which represent both purchases and sales (does not reflect net position):

Commodity	Quantity	
Power	13,715,268	megawatt hours
Gas	138,357,611	MMBTU (a)

(a) “MMBTU” is one million British thermal units.

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Derivative Instruments in Designated Accounting Hedging Relationships

The following table provides information about gains and losses from derivative instruments in designated accounting hedging relationships and their impact on our Condensed Consolidated Statements of Income during the three months ended March 31, 2011 and 2010 (dollars in thousands):

Commodity Contracts	Financial Statement Location	Three Months Ended March 31,	
		2011	2010
Amount of Gain (Loss) Recognized in AOCI on Derivative Instruments (Effective Portion)	Accumulated other comprehensive loss-derivative instruments	\$ 988	\$ (91,667)
Amount of Loss Reclassified from AOCI into Income (Effective Portion Realized)	Regulated electricity segment fuel and purchased power	(14,846)	(13,185)
Amount of Gain (Loss) Recognized in Income from Derivative Instruments (Ineffective Portion and Amount Excluded from Effectiveness Testing) (a)	Regulated electricity segment fuel and purchased power	12	(10,467)

(a) During the three months ended March 31, 2011 and 2010, we had no amounts reclassified from AOCI to earnings related to discontinued cash flow hedges.

During the next twelve months, we estimate that a net loss of \$102 million before income taxes will be reclassified from AOCI as an offset to the effect of market price changes for the related hedged transactions. Approximately 90% of the amounts related to derivatives subject to the PSA will be recorded as either a regulatory asset or liability and have no effect on earnings.

Derivative Instruments Not Designated as Accounting Hedges

The following table provides information about gains and losses from derivative instruments not designated as accounting hedging instruments and their impact on our Condensed Consolidated Statements of Income during the three months ended March 31, 2011 and 2010 (dollars in thousands):

Commodity Contracts	Financial Statement Location	Three Months Ended March 31,	
		2011	2010
Amount of Net Gain Recognized in Income from Derivative Instruments	Regulated electricity segment revenue	\$ 1,507	\$ 170
Amount of Net Loss Recognized in Income from Derivative Instruments	Regulated electricity segment fuel and purchased power expense	(9,026)	(34,969)
Total		\$ (7,519)	\$ (34,799)

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Fair Values of Derivative Instruments in the Condensed Consolidated Balance Sheets

The following table provides information about the fair value of our derivative instruments, margin account and cash collateral reported on a gross basis. Transactions with counterparties that have master netting arrangements are reported net on the Condensed Consolidated Balance Sheets. These amounts are located in the assets and liabilities from risk management activities lines of our Condensed Consolidated Balance Sheets. Amounts are as of March 31, 2011 (dollars in thousands):

Commodity Contracts	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Derivatives designated as accounting hedging instruments:					
Assets	\$ —	\$ 663	\$ 9,583	\$ 4,234	\$ 14,480
Liabilities	—	(245)	(98,821)	(54,802)	(153,868)
Total hedging instruments	—	418	(89,238)	(50,568)	(139,388)
Derivatives not designated as accounting hedging instruments:					
Assets	22,278	38,188	35,863	18,394	114,723
Liabilities	(44)	(86)	(107,359)	(90,530)	(198,019)
Total non-hedging instruments	22,234	38,102	(71,496)	(72,136)	(83,296)
Total derivatives	22,234	38,520	(160,734)	(122,704)	(222,684)
Margin account	20,076	—	359	—	20,435
Collateral provided to counterparties	11,985	—	101,123	66,187	179,295
Collateral provided from counterparties	—	—	(11,795)	—	(11,795)
Prepaid option premiums and other	284	—	—	—	284
Balance Sheet Total	<u>\$ 54,579</u>	<u>\$ 38,520</u>	<u>\$ (71,047)</u>	<u>\$ (56,517)</u>	<u>\$ (34,465)</u>

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The following table provides information about the fair value of our derivative instruments, margin account and cash collateral reported on a gross basis at December 31, 2010 (dollars in thousands):

Commodity Contracts	Current Assets	Investments and Other Assets	Current Liabilities	Deferred Credits and Other	Total Assets (Liabilities)
Derivatives designated as accounting hedging instruments:					
Assets	\$ 1,234	\$ 142	\$ 9,062	\$ 4,913	\$ 15,351
Liabilities	(602)	(1,933)	(107,784)	(71,109)	(181,428)
Total hedging instruments	<u>632</u>	<u>(1,791)</u>	<u>(98,722)</u>	<u>(66,196)</u>	<u>(166,077)</u>
Derivatives not designated as accounting hedging instruments:					
Assets	36,831	40,927	27,322	19,886	124,966
Liabilities	(312)	(33)	(112,535)	(85,473)	(198,353)
Total non-hedging instruments	<u>36,519</u>	<u>40,894</u>	<u>(85,213)</u>	<u>(65,587)</u>	<u>(73,387)</u>
Total derivatives	37,151	39,103	(183,935)	(131,783)	(239,464)
Margin account	24,579	—	997	—	25,576
Collateral provided to counterparties	11,556	—	125,367	66,393	203,316
Collateral provided from counterparties	(1,750)	—	(1,250)	—	(3,000)
Prepaid option premiums and other	2,252	(71)	(155)	—	2,026
Balance Sheet Total	<u>\$ 73,788</u>	<u>\$ 39,032</u>	<u>\$ (58,976)</u>	<u>\$ (65,390)</u>	<u>\$ (11,546)</u>

Credit Risk and Credit-Related Contingent Features

We are exposed to losses in the event of nonperformance or nonpayment by counterparties. We have risk management contracts with many counterparties, including two counterparties for which our exposure represents approximately 53% of Pinnacle West's \$93 million of risk management assets as of March 31, 2011. This exposure relates to long-term traditional wholesale contracts with counterparties that have very high credit quality. Our risk management process assesses and monitors the financial exposure of all counterparties. Despite the fact that the great majority of trading counterparties' debt is rated as investment grade by the credit rating agencies, there is still a possibility that one or more of these companies could default, resulting in a material impact on consolidated earnings for a given period. Counterparties in the portfolio consist principally of financial institutions, major energy companies, municipalities and local distribution companies. We maintain credit policies that we believe minimize overall credit risk to within acceptable limits. Determination of the credit quality of our counterparties is based upon a number of factors, including credit ratings and our evaluation of their financial condition. To manage credit risk, we employ collateral requirements and standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. Valuation adjustments are established representing our estimated credit losses on our overall exposure to counterparties.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Certain of our derivative instrument contracts contain credit-risk-related contingent features including, among other things, investment grade credit rating provisions, credit-related cross default provisions, and adequate assurance provisions. Adequate assurance provisions allow a counterparty with reasonable grounds for uncertainty to demand additional collateral based on subjective events and/or conditions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position on March 31, 2011 was \$328 million, for which we had posted collateral of \$167 million in the normal course of business.

For those derivative instruments in a net liability position, with investment grade credit contingencies, the counterparties could demand additional collateral if our debt credit ratings were to fall below investment grade (below BBB- for Standard & Poor's or Fitch or Baa3 for Moody's), which would be a violation of the credit rating provisions. If the investment grade contingent features underlying these agreements had been fully triggered on March 31, 2011, after off-setting asset positions under master netting arrangements we would have been required to post approximately an additional \$122 million of collateral to our counterparties; this amount includes those contracts which qualify for scope exceptions, which are excluded from the derivative details in the above footnote. We also have energy related non-derivative instrument contracts with investment grade credit-related contingent features which could also require us to post additional collateral of approximately \$196 million if our debt credit ratings were to fall below investment grade.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

9. Changes in Equity

The following tables show Pinnacle West's changes in shareholders' equity and changes in equity of noncontrolling interests for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Common Shareholders	Noncontrolling Interests	Total	Common Shareholders	Noncontrolling Interests	Total
Beginning balance, January 1	\$ 3,683,327	\$ 91,899	\$3,775,226	\$ 3,316,109	\$ 111,895	\$3,428,004
Net income (loss)	(15,135)	5,461	(9,674)	(6,014)	5,117	(897)
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	988	—	988	(91,667)	—	(91,667)
Net reclassification of realized losses to income (b)	14,846	—	14,846	13,185	—	13,185
Reclassification of pension and other postretirement benefits to income	1,433	—	1,433	1,393	—	1,393
Net income tax benefit (expense) related to items of other comprehensive income (loss)	(6,821)	—	(6,821)	30,426	—	30,426
Total other comprehensive income (loss)	10,446	—	10,446	(46,663)	—	(46,663)
Total comprehensive income (loss)	(4,689)	5,461	772	(52,677)	5,117	(47,560)
Issuance of capital stock	13,560	—	13,560	2,680	—	2,680
Purchase of treasury stock, net of reissuances	(3,530)	—	(3,530)	1,078	—	1,078
Other (primarily stock compensation)	(148)	—	(148)	2	(22)	(20)
Dividends on common stock	(57,109)	—	(57,109)	(53,259)	—	(53,259)
Net capital activities by noncontrolling interests	—	—	—	—	(923)	(923)
Ending balance, March 31	<u>\$ 3,631,411</u>	<u>\$ 97,360</u>	<u>\$3,728,771</u>	<u>\$ 3,213,933</u>	<u>\$ 116,067</u>	<u>\$3,330,000</u>

- (a) These amounts primarily include unrealized gains and losses on contracts used to hedge our forecasted electricity and natural gas requirements to serve Native Load. These changes are primarily due to changes in forward natural gas prices and wholesale electricity prices.
- (b) These amounts primarily include the reclassification of unrealized gains and losses to realized gains and losses for contracted commodities delivered during the period.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

10. Commitments and Contingencies

Palo Verde Nuclear Generating Station

Spent Nuclear Fuel and Waste Disposal

APS currently estimates it will incur \$122 million (in 2011 dollars) over the current life of Palo Verde for its share of the costs related to the on-site interim storage of spent nuclear fuel. At March 31, 2011, APS had a regulatory liability of \$46 million that represents amounts recovered in retail rates in excess of amounts spent for on-site interim spent fuel storage.

Nuclear Insurance

The Palo Verde participants are insured against public liability for a nuclear incident up to \$12.6 billion per occurrence. As required by the Price Anderson Nuclear Industries Indemnity Act, Palo Verde maintains the maximum available nuclear liability insurance in the amount of \$375 million, which is provided by commercial insurance carriers. The remaining balance of \$12.2 billion is provided through a mandatory industry wide retrospective assessment program. If losses at any nuclear power plant covered by the program exceed the accumulated funds, APS could be assessed retrospective premium adjustments. The maximum assessment per reactor under the program for each nuclear incident is approximately \$118 million, subject to an annual limit of \$18 million per incident, to be periodically adjusted for inflation. Based on APS's interest in the three Palo Verde units, APS's maximum potential assessment per incident for all three units is approximately \$103 million, with an annual payment limitation of approximately \$15 million.

The Palo Verde participants maintain "all risk" (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of \$2.75 billion, a substantial portion of which must first be applied to stabilization and decontamination. APS has also secured insurance against portions of any increased cost of generation or purchased power and business interruption resulting from a sudden and unforeseen accidental outage of any of the three units. The property damage, decontamination, and replacement power coverages are provided by Nuclear Electric Insurance Limited ("NEIL"). APS is subject to retrospective assessments under all NEIL policies if NEIL's losses in any policy year exceed accumulated funds. The maximum amount APS could incur under the current NEIL policies totals approximately \$18 million for each retrospective assessment declared by NEIL's Board of Directors due to losses. In addition, NEIL policies contain rating triggers that would result in APS providing approximately \$46 million of collateral assurance within 20 business days of a rating downgrade to non-investment grade. The insurance coverage discussed in this and the previous paragraph is subject to certain policy conditions and exclusions.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Contractual Obligations

Our future contractual purchase obligations have increased from approximately \$456 million at December 31, 2010 as disclosed in the 2010 Form 10-K to \$699 million at March 31, 2011. This increase is primarily related to an amended agreement for certain transmission rights-of-way and a new contract for the construction of a solar facility. Total contractual purchase obligations are as follows (dollars in millions):

2011	2012	2013	2014	2015	Thereafter	Total
\$ 232	\$ 116	\$ 69	\$ 6	\$ 6	\$ 270	\$ 699

Payments for the transmission rights-of-way are subject to change based on changes in the Consumer Price Index.

FERC Market Issues

On July 25, 2001, the FERC ordered an evidentiary proceeding to discuss and evaluate possible refunds for wholesale sales in the Pacific Northwest. The FERC affirmed the administrative law judge's conclusion that the prices in the Pacific Northwest were not unreasonable or unjust and refunds should not be ordered in this proceeding. This decision was appealed to the U.S. Court of Appeals for the Ninth Circuit. On August 24, 2007, the Ninth Circuit issued an opinion that remanded the proceeding to the FERC for further consideration. Although the FERC has not yet determined whether any refunds will ultimately be required, we do not expect that the resolution of these issues will have a material adverse impact on our financial position, results of operations or cash flows.

Superfund

The Comprehensive Environmental Response, Compensation and Liability Act ("Superfund") establishes liability for the cleanup of hazardous substances found contaminating the soil, water or air. Those who generated, transported or disposed of hazardous substances at a contaminated site are among those who are potentially responsible parties ("PRPs"). PRPs may be strictly, and often are jointly and severally, liable for clean-up. On September 3, 2003, the United States Environmental Protection Agency ("EPA") advised APS that the EPA considers APS to be a PRP in the Motorola 52nd Street Superfund Site, Operable Unit 3 (OU3) in Phoenix, Arizona. APS has facilities that are within this Superfund site. APS and Pinnacle West have agreed with the EPA to perform certain investigative activities of the APS facilities within OU3. In addition, on September 23, 2009, APS agreed with the EPA and one other PRP to voluntarily assist with the funding and management of the site-wide groundwater remedial investigation and feasibility study work plan. We estimate that our costs related to this investigation and study will be approximately \$1 million, which is reserved as a liability on our financial statements. We anticipate incurring additional expenditures in the future, but because the overall investigation is not complete and ultimate remediation requirements are not yet finalized, at the present time we cannot accurately estimate our total expenditures.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

11. Other Income and Other Expense

The following table provides detail of other income and other expense for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	<u>Three Months Ended March 31,</u>	
	<u>2011</u>	<u>2010</u>
Other income:		
Interest income	\$ 391	\$ 874
Investment gains — net	1,293	1,222
Miscellaneous	6	12
Total other income	<u>\$ 1,690</u>	<u>\$ 2,108</u>
Other expense:		
Non-operating costs	\$ (1,444)	\$ (1,794)
Miscellaneous	(255)	(902)
Total other expense	<u>\$ (1,699)</u>	<u>\$ (2,696)</u>

12. Guarantees and Surety Bonds

We have issued parental guarantees and obtained surety bonds on behalf of our subsidiaries, including credit support instruments enabling APSES to offer energy-related products and surety bonds at APS, principally related to self-insured workers' compensation. Non-performance or non-payment under the underlying contract by our subsidiaries would result in a payment liability on our part under the guarantee or surety bond. No liability is currently recorded on the Condensed Consolidated Balance Sheets related to such instruments. At March 31, 2011, we had no outstanding claims for payment under any of these instruments. Our guarantees and surety bonds have no recourse or collateral provisions to allow us to recover amounts paid under these instruments. The amounts and approximate terms of our guarantees and surety bonds for each subsidiary at March 31, 2011 are as follows (dollars in millions):

	<u>Guarantees</u>		<u>Surety Bonds</u>	
	<u>Amount</u>	<u>Term (in years)</u>	<u>Amount</u>	<u>Term (in years)</u>
APSES	\$ 5	1	\$ 60	1
APS	4	1	9	1
Total	<u>\$ 9</u>		<u>\$ 69</u>	

APS has entered into various agreements that require letters of credit for financial assurance purposes. At March 31, 2011, approximately \$44 million of letters of credit were outstanding to support existing pollution control bonds of similar amount. The letters of credit are available to fund the payment of principal and interest of such debt obligations. These letters of credit expire in 2011 and 2013. APS has also entered into approximately \$54 million of letters of credit to support certain equity participants in the Palo Verde sale leaseback transactions (see Note 7 for further details on the Palo Verde sale leaseback transactions). These letters of credit were amended and extended in April 2010, and will expire in 2013.

We enter into agreements that include indemnification provisions relating to liabilities arising from or related to certain of our agreements; most significantly, APS has agreed to indemnify the equity participants and other parties in the Palo Verde sale leaseback transactions with respect to certain tax matters. Generally, a maximum obligation is not explicitly stated in the indemnification provisions and, therefore, the overall maximum amount of the obligation under such indemnification provisions cannot be reasonably estimated. Based on historical experience and evaluation of the specific indemnities, we do not believe that any material loss related to such indemnification provisions is likely.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

13. Earnings Per Share

The following table presents earnings per weighted average common share outstanding for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
Basic earnings per share:		
Income (loss) from continuing operations attributable to common shareholders	\$ (0.14)	\$ 0.07
Loss from discontinued operations	—	(0.13)
Earnings per share — basic	<u>\$ (0.14)</u>	<u>\$ (0.06)</u>
Diluted earnings per share:		
Income (loss) from continuing operations attributable to common shareholders	\$ (0.14)	\$ 0.07
Loss from discontinued operations	—	(0.13)
Earnings per share — diluted	<u>\$ (0.14)</u>	<u>\$ (0.06)</u>

For the three months ended March 31, 2011 and 2010, the weighted average common shares outstanding were the same for both basic and diluted shares. Options to purchase 45,500 shares of common stock for the three-month period ended March 31, 2011, and 387,800 shares for the three-month period ended March 31, 2010 were outstanding but were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

14. Discontinued Operations

SunCor (real estate segment) — In 2009, our real estate subsidiary, SunCor, began disposing of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce its outstanding debt. All activity for the income statement and prior comparative period income statement amounts are included in discontinued operations. In 2010, SunCor recorded real estate impairment charges of \$15 million in the first quarter. SunCor's asset sales resulted in no gain for 2010. SunCor has approximately \$3 million of assets on its balance sheet classified as assets held for sale which are included in other current assets at March 31, 2011.

APSES (other) — In 2010, our subsidiary, APSES, sold its district cooling business consisting of operations in downtown Phoenix, Tucson, and on certain Arizona State University campuses. As a result of the sale, we recorded an after-tax gain from discontinued operations of approximately \$25 million in June 2010. Prior period income statement amounts related to this sale and the associated revenues and costs are reflected in discontinued operations in 2010.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table provides revenue, income (loss) before income taxes and income (loss) after taxes classified as discontinued operations in Pinnacle West's Condensed Consolidated Statements of Income for the three months ended March 31, 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Revenue:		
SunCor	\$ 1	\$ 9
APSES	—	4
Total revenue	<u>\$ 1</u>	<u>\$ 13</u>
Loss before taxes:	\$ (1)	\$ (21)
Loss after taxes (a):	\$ —	(13)

- (a) Includes a tax benefit recognized by the parent company in accordance with an intercompany tax sharing agreement of \$8 million for the three months ended March 31, 2010.

15. Fair Value Measurements

We disclose the fair value of certain assets and liabilities according to a fair value hierarchy. This hierarchy ranks the quality and reliability of the inputs used to determine fair values, which are then classified and disclosed in one of three categories. The three levels of the fair value hierarchy are:

Level 1 — Quoted prices in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide information on an ongoing basis. This category includes derivative instruments that are exchange-traded such as futures, cash equivalents invested in exchange-traded money market funds, exchange-traded equities, and nuclear decommissioning trust investments in Treasury securities.

Level 2 — Quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; and model-derived valuations whose inputs are observable. This category includes nonexchange-traded contracts such as forwards, options, and swaps. This category also includes investments in common and commingled funds that are redeemable and valued based on the funds' net asset values.

Level 3 — Model-derived valuations with significant unobservable inputs that are supported by little or no market activity. Instruments in this category include long-dated derivative transactions where models are required due to the length of the transaction, options, transactions in locations where observable market data does not exist, and common and collective trusts with significant restrictions on our ability to transact in the fund. The valuation models we employ utilize spot prices, forward prices, historical market data and other factors to forecast future prices. The primary valuation technique we use to calculate the fair value of contracts where price quotes are not available is based on the extrapolation of forward pricing curves using observable market data for more liquid delivery points in the same region and actual transactions at the more illiquid delivery points.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. We maximize the use of observable inputs and minimize the use of unobservable inputs. If market data is not readily available, inputs may reflect our own assumptions about the inputs market participants would use. Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities as well as their placement within the fair value hierarchy levels. Thus, a valuation may be classified in Level 3 even though the valuation may include significant inputs that are readily observable. We assess whether a market is active by obtaining observable broker quotes, reviewing actual market transactions, and assessing the volume of transactions. We consider broker quotes observable inputs when the quote is binding on the broker, we can validate the quote with market transactions, or we can determine that the inputs the broker used to arrive at the quoted price are observable.

Recurring Fair Value Measurements

We apply recurring fair value measurements to derivative instruments, nuclear decommissioning trusts, certain cash equivalents and plan assets held in our retirement and other benefit plans (see Note 8).

Cash Equivalents

Cash equivalents represent short-term investments in exchange-traded money market funds that are valued using quoted prices in active markets.

Risk Management Activities

Exchange-traded contracts are valued using quoted prices in active markets. For non-exchange traded contracts, we calculate fair market value based on the average of the bid and offer price, discounted to reflect net present value. We maintain certain valuation adjustments for a number of risks associated with the valuation of future commitments. These include valuation adjustments for liquidity and credit risks based on the financial condition of counterparties. The liquidity valuation adjustment represents the cost that would be incurred if all unmatched positions were closed-out or hedged.

The credit valuation adjustment represents estimated credit losses on our overall exposure to counterparties, taking into account netting arrangements, expected default experience for the credit rating of the counterparties and the overall diversification of the portfolio. Counterparties in the portfolio consist principally of major energy companies, municipalities, local distribution companies and financial institutions. We maintain credit policies that management believes minimize overall credit risk. Determination of the credit quality of counterparties is based upon a number of factors, including credit ratings, financial condition, project economics and collateral requirements. When applicable, we employ standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Some of our derivative instrument transactions are valued based on unobservable inputs due to the long-term nature of contracts or the unique location of the transactions. Our long-dated energy transactions consist of observable valuations for the near term portion and unobservable valuations for the long-term portions of the transaction. When the unobservable portion is significant to the overall valuation of the transaction, the entire transaction is classified as Level 3. Our classification of instruments as Level 3 is primarily reflective of the long-term nature of our energy transactions, and is not reflective of material inactive markets.

Nuclear Decommissioning Trust

The nuclear decommissioning trust invests in fixed income securities directly and equity securities indirectly through commingled funds. The commingled funds are valued based on the fund's net asset value and are classified within Level 2. We may transact in the equity commingled fund on a semi-monthly basis and the cash-equivalent commingled fund on a daily basis. Our trustee provides valuation of our nuclear decommissioning trust assets by using pricing services to determine fair market value. We assess these valuations and verify that pricing can be supported by actual recent market transactions. The trust fund investments have been established to satisfy APS's nuclear decommissioning obligations.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Tables

The following table presents the fair value at March 31, 2011 of our assets and liabilities that are measured at fair value on a recurring basis (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (a) (Level 3)	Counterparty Netting & Other (b)	Balance at March 31, 2011
Assets					
Risk management activities:					
Commodity contracts	\$ —	\$ 65	\$ 64	\$ (36)	\$ 93
Nuclear decommissioning trust:					
Equity securities:					
U.S. commingled funds	—	178	—	—	178
Fixed income securities:					
U.S. Treasury	69	—	—	—	69
Cash and cash equivalent funds (c)	—	21	—	—	21
Corporate	—	59	—	—	59
Mortgage-backed	—	81	—	—	81
Municipality	—	70	—	—	70
Other	—	20	—	(11)	9
Total	<u>\$ 69</u>	<u>\$ 494</u>	<u>\$ 64</u>	<u>\$ (47)</u>	<u>\$ 580</u>
Liabilities					
Risk management activities:					
Commodity contracts	<u>\$ —</u>	<u>\$ (240)</u>	<u>\$ (112)</u>	<u>\$ 224</u>	<u>\$ (128)</u>

- (a) Primarily consists of long-dated electricity contracts.
- (b) Risk management activities represent netting under master netting agreements, including margin and collateral (see Note 8). Nuclear decommissioning trust represents net pending securities sales and purchases.
- (c) These cash equivalents are held in a commingled short-term investment fund that invests in short-term, highly liquid, fixed income instruments.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the fair value at December 31, 2010 of our assets and liabilities that are measured at fair value on a recurring basis (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (a) (Level 3)	Counterparty Netting & Other (b)	Balance at December 31, 2010
Assets					
Cash equivalents	\$ 35	\$ —	\$ —	\$ —	\$ 35
Risk management activities:					
Commodity contracts	—	80	61	(28)	113
Nuclear decommissioning trust:					
Equity securities:					
U.S. commingled funds	—	168	—	—	168
Fixed income securities:					
U.S. Treasury	50	—	—	—	50
Cash and cash equivalent funds (c)					
Corporate	—	22	—	—	22
Mortgage-backed	—	60	—	—	60
Municipality	—	81	—	—	81
Municipality	—	79	—	—	79
Other	—	20	—	(10)	10
Total	<u>\$ 85</u>	<u>\$ 510</u>	<u>\$ 61</u>	<u>\$ (38)</u>	<u>\$ 618</u>
Liabilities					
Risk management activities:					
Commodity contracts	\$ (1)	\$ (280)	\$ (99)	\$ 256	\$ (124)

(a) Primarily consists of long-dated electricity contracts.

(b) Risk management activities represent netting under master netting arrangements, including margin and collateral. See Note 8. Nuclear decommissioning trust represents net pending securities sales and purchases.

(c) These cash equivalents are held in a commingled short-term investment fund that invests in short-term, highly liquid, fixed income instruments.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table shows the changes in fair value for assets and liabilities that are measured at fair value on a recurring basis using Level 3 inputs for the three months ended March 31, 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Commodity Contracts		
Net derivative balance at beginning of period	\$ (38)	\$ (10)
Total net gains (losses) realized/unrealized:		
Included in earnings	1	(1)
Included in OCI	2	(6)
Deferred as a regulatory asset or liability	(7)	(12)
Transfers into Level 3 from Level 2	(5)	—
Transfers from Level 3 into Level 2	(1)	(2)
Net derivative balance at end of period	<u>\$ (48)</u>	<u>\$ (31)</u>
Net unrealized gains (losses) included in earnings related to instruments still held at end of period	\$ 1	\$ (1)

Amounts included in earnings are recorded in either regulated electricity segment revenue or regulated electricity segment fuel and purchased power depending on the nature of the underlying contract.

Transfers reflect the fair market value at the beginning of the period and are triggered by a change in the lowest significant input as of the end of the period. We had no significant Level 1 transfers to or from any other hierarchy level. Transfers in or out of Level 3 are typically related to our long-dated energy transactions that extend beyond available quoted periods.

Nonrecurring Fair Value Measurements

We may be required to record other assets at fair value on a nonrecurring basis. These nonrecurring fair value measurements typically involve write-downs of individual assets due to impairment.

Financial Instruments Not Carried at Fair Value

The carrying value of our net accounts receivable, accounts payable and short-term borrowings approximate fair value. Our long-term debt fair value estimates are based on quoted market prices of the same or similar issues. Certain of our debt instruments contain third-party credit enhancements and, in accordance with GAAP, we do not consider the effect of these credit enhancements when determining fair value.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table represents the carrying amount and estimated fair value of our long-term debt, including current maturities (dollars in millions):

	As of March 31, 2011		As of December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Pinnacle West	\$ 175	\$ 174	\$ 175	\$ 176
APS	3,503	3,735	3,503	3,737
Total	<u>\$ 3,678</u>	<u>\$ 3,909</u>	<u>\$ 3,678</u>	<u>\$ 3,913</u>

Nuclear Decommissioning Trust

To fund the costs APS expects to incur to decommission Palo Verde, APS established external decommissioning trusts in accordance with NRC regulations. Third-party investment managers are authorized to buy and sell securities per their stated investment guidelines. The trust funds are invested in fixed income securities and domestic equity securities. APS classifies investments in decommissioning trust funds as available for sale. As a result, we record the decommissioning trust funds at their fair value on our Condensed Consolidated Balance Sheets. Because of the ability of APS to recover decommissioning costs in rates and in accordance with the regulatory treatment for decommissioning trust funds, we have recorded the offsetting amount of gains or losses on investment securities in other regulatory liabilities or assets. The following table summarizes the fair value of APS's nuclear decommissioning trust fund assets at March 31, 2011 and December 31, 2010 (dollars in millions):

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
March 31, 2011			
Equity securities	\$ 178	\$ 52	\$ —
Fixed income securities	320	12	(1)
Net payables (a)	(11)	—	—
Total	<u>\$ 487</u>	<u>\$ 64</u>	<u>\$ (1)</u>

(a) Net payables relate to pending securities sales and purchases.

	Fair Value	Total Unrealized Gains	Total Unrealized Losses
December 31, 2010			
Equity securities	\$ 168	\$ 43	\$ (1)
Fixed income securities	312	12	(2)
Net receivables (a)	(10)	—	—
Total	<u>\$ 470</u>	<u>\$ 55</u>	<u>\$ (3)</u>

(a) Net payables relate to pending securities sales and purchases.

PINNACLE WEST CAPITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The costs of securities sold are determined on the basis of specific identification. The following table sets forth approximate realized gains and losses and proceeds from the sale of securities by the nuclear decommissioning trust funds (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Realized gains	\$ 1	\$ 12
Realized losses	(2)	(2)
Proceeds from the sale of securities (a)	189	158

(a) Proceeds are reinvested in the trust.

The fair value of fixed income securities, summarized by contractual maturities, at March 31, 2011 is as follows (dollars in millions):

	Fair Value
Less than one year	\$ 24
1 year - 5 years	68
5 years - 10 years	98
Greater than 10 years	130
Total	<u>\$ 320</u>

16. Asset Retirement Obligations

APS has asset retirement obligations for its Palo Verde nuclear facilities and certain other generation, transmission and distribution assets. During the period ending March 31, 2011, a new decommissioning study with updated cash flow estimates was completed for Palo Verde. This study reflects the twenty-year license extension approved by the NRC on April 21, 2011, which extends the commencement of decommissioning to 2045. The new study resulted in a \$90 million decrease to the liability for asset retirements, a \$78 million decrease to electric plant in service, and a \$12 million increase to regulatory liabilities.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2011	2010
ELECTRIC OPERATING REVENUES	\$ 647,994	\$ 611,476
OPERATING EXPENSES		
Fuel and purchased power	212,007	215,540
Operations and maintenance	252,607	203,881
Depreciation and amortization	106,559	100,609
Income taxes	(6,003)	(5,440)
Taxes other than income taxes	37,250	31,451
Total	602,420	546,041
OPERATING INCOME	45,574	65,435
OTHER INCOME (DEDUCTIONS)		
Income taxes	(1,340)	843
Allowance for equity funds used during construction	5,395	5,389
Other income (Note S-2)	1,978	1,783
Other expense (Note S-2)	(3,592)	(3,626)
Total	2,441	4,389
INTEREST EXPENSE		
Interest on long-term debt	54,737	54,752
Interest on short-term borrowings	2,308	842
Debt discount, premium and expense	1,157	1,137
Allowance for borrowed funds used during construction	(3,576)	(3,019)
Total	54,626	53,712
NET INCOME (LOSS)	(6,611)	16,112
Less: Net income attributable to noncontrolling interests (Note 7)	5,470	5,128
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDER	\$ (12,081)	\$ 10,984

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	March 31, 2011	December 31, 2010
ASSETS		
PROPERTY, PLANT AND EQUIPMENT		
Plant in service and held for future use	\$ 13,266,069	\$ 13,197,254
Accumulated depreciation and amortization	(4,576,692)	(4,510,591)
Net	8,689,377	8,686,663
Construction work in progress	441,683	459,316
Palo Verde sale leaseback, net of accumulated depreciation (Note 7)	135,766	137,956
Intangible assets, net of accumulated amortization	182,673	184,768
Nuclear fuel, net of accumulated amortization	129,554	108,794
Total property, plant and equipment	<u>9,579,053</u>	<u>9,577,497</u>
INVESTMENTS AND OTHER ASSETS		
Nuclear decommissioning trust (Note 15)	486,737	469,886
Assets from risk management activities (Note 8)	38,520	39,032
Other assets	29,124	71,428
Total investments and other assets	<u>554,381</u>	<u>580,346</u>
CURRENT ASSETS		
Cash and cash equivalents	104,386	99,937
Customer and other receivables	276,698	288,323
Accrued unbilled revenues	93,659	103,292
Allowance for doubtful accounts	(7,489)	(7,646)
Materials and supplies (at average cost)	161,063	181,414
Fossil fuel (at average cost)	20,505	21,575
Assets from risk management activities (Note 8)	54,579	73,788
Regulatory assets (Note 3)	55,743	62,286
Deferred income taxes	104,389	105,042
Other current assets	27,756	25,135
Total current assets	<u>891,289</u>	<u>953,146</u>
DEFERRED DEBITS		
Regulatory assets (Note 3)	979,854	986,370
Income tax receivable (Note 6)	68,133	65,498
Unamortized debt issue costs	19,938	20,530
Other	103,759	88,490
Total deferred debits	<u>1,171,684</u>	<u>1,160,888</u>
TOTAL ASSETS	<u>\$ 12,196,407</u>	<u>\$ 12,271,877</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(dollars in thousands)

	<u>March 31,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>
LIABILITIES AND EQUITY		
CAPITALIZATION		
Common stock	\$ 178,162	\$ 178,162
Additional paid-in capital	2,379,696	2,379,696
Retained earnings	1,334,210	1,403,390
Accumulated other comprehensive loss:		
Pension and other postretirement benefits	(35,182)	(35,961)
Derivative instruments	(90,755)	(100,334)
Total shareholder equity	<u>3,766,131</u>	<u>3,824,953</u>
Noncontrolling interests (Note 7)	96,554	91,084
Total equity	<u>3,862,685</u>	<u>3,916,037</u>
Long-term debt less current maturities (Note 2)	2,573,676	2,948,991
Palo Verde sale leaseback lessor notes less current maturities (Notes 2 and 7)	96,803	96,803
Total capitalization	<u>6,533,164</u>	<u>6,961,831</u>
CURRENT LIABILITIES		
Current maturities of long-term debt (Note 2)	832,275	456,879
Accounts payable	204,480	218,491
Accrued taxes	170,904	106,431
Accrued interest	54,471	54,638
Customer deposits	68,809	68,312
Liabilities from risk management activities (Note 8)	71,047	58,976
Deferred fuel and purchased power regulatory liability (Note 3)	77,151	58,442
Other regulatory liabilities (Note 3)	78,167	80,526
Other current liabilities	96,561	132,170
Total current liabilities	<u>1,653,865</u>	<u>1,234,865</u>
DEFERRED CREDITS AND OTHER		
Deferred income taxes	1,800,146	1,895,654
Regulatory liabilities (Note 3)	689,942	614,063
Liability for asset retirements (Note 16)	244,483	328,571
Liabilities for pension and other postretirement benefits (Note 4)	782,556	770,611
Liabilities from risk management activities (Note 8)	56,517	65,390
Customer advances	118,778	121,645
Coal mine reclamation	117,455	117,243
Unrecognized tax benefits (Note 6)	81,640	65,363
Other	117,861	96,641
Total deferred credits and other	<u>4,009,378</u>	<u>4,075,181</u>
COMMITMENTS AND CONTINGENCIES (SEE NOTES)		
TOTAL LIABILITIES AND EQUITY	<u>\$ 12,196,407</u>	<u>\$ 12,271,877</u>

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(dollars in thousands)

	Three Months Ended March 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (Loss)	\$ (6,611)	\$ 16,112
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization including nuclear fuel	123,256	113,195
Deferred fuel and purchased power	49,947	44,040
Deferred fuel and purchased power amortization	(31,238)	(25,953)
Allowance for equity funds used during construction	(5,395)	(5,389)
Deferred income taxes	(47,962)	47,754
Change in mark-to-market valuations	(284)	1,842
Changes in current assets and liabilities:		
Customer and other receivables	61,973	61,239
Accrued unbilled revenues	9,633	24,505
Materials, supplies and fossil fuel	21,421	6,240
Other current assets	248	(7,811)
Accounts payable	(18,168)	(22,275)
Other current liabilities	26,872	(64,600)
Change in margin and collateral accounts — assets	4,220	(11,280)
Change in margin and collateral accounts — liabilities	35,478	(124,495)
Change in long-term income tax receivable	(2,635)	—
Change in unrecognized tax benefits	18,972	(61,683)
Change in other long-term assets	(29,494)	(23,723)
Change in other long-term liabilities	44,324	(31,926)
Net cash flow provided by (used for) operating activities	<u>254,557</u>	<u>(64,208)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(191,596)	(199,276)
Contributions in aid of construction	9,136	2,949
Allowance for borrowed funds used during construction	(3,576)	(3,019)
Proceeds from nuclear decommissioning trust sales	189,318	158,448
Investment in nuclear decommissioning trust	(194,241)	(164,552)
Other	(1,879)	(1,639)
Net cash flow used for investing activities	<u>(192,838)</u>	<u>(207,089)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	(170)	(357)
Short-term borrowings and payments-net	—	195,000
Dividends paid on common stock	(57,100)	(42,500)
Net cash flow provided by (used for) financing activities	<u>(57,270)</u>	<u>152,143</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,449	(119,154)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	99,937	120,798
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 104,386</u>	<u>\$ 1,644</u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Income taxes, net of (refunds)	\$ —	\$ 65,498
Interest, net of amounts capitalized	\$ 53,636	\$ 54,174

See Notes to Pinnacle West's Condensed Consolidated Financial Statements and Supplemental Notes to Arizona Public Service Company's Condensed Consolidated Financial Statements.



Table of Contents

Certain notes to APS's Condensed Consolidated Financial Statements are combined with the Notes to Pinnacle West's Condensed Consolidated Financial Statements. Listed below are the Condensed Consolidated Notes to Pinnacle West's Condensed Consolidated Financial Statements, the majority of which also relate to APS's Condensed Consolidated Financial Statements. In addition, listed below are the Supplemental Notes that are required disclosures for APS and should be read in conjunction with Pinnacle West's Condensed Consolidated Notes.

	Condensed Consolidated Note Reference	APS's Supplemental Note Reference
Consolidation and Nature of Operations	Note 1	—
Long-term Debt and Liquidity Matters	Note 2	—
Regulatory Matters	Note 3	—
Retirement Plans and Other Benefits	Note 4	—
Business Segments	Note 5	—
Income Taxes	Note 6	—
Variable-Interest Entities	Note 7	—
Derivative Accounting	Note 8	—
Changes in Equity	Note 9	Note S-1
Commitments and Contingencies	Note 10	—
Other Income and Other Expense	Note 11	Note S-2
Guarantees and Surety Bonds	Note 12	—
Earnings Per Share	Note 13	—
Discontinued Operations	Note 14	—
Fair Value Measurements	Note 15	—
Asset Retirement Obligations	Note 16	—

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

S-1. Changes in Equity

The following tables show APS's changes in shareholder equity and changes in equity of noncontrolling interests for the three and nine months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Shareholder Equity	Noncontrolling Interests	Total	Shareholder Equity	Noncontrolling Interests	Total
Beginning balance, January 1	\$ 3,824,953	\$ 91,084	\$3,916,037	\$ 3,445,355	\$ 82,324	\$3,527,679
Net income (loss)	(12,081)	5,470	(6,611)	10,984	5,128	16,112
Other comprehensive income (loss):						
Net unrealized gains (losses) on derivative instruments (a)	988	—	988	(91,667)	—	(91,667)
Net reclassification of realized losses to income (b)	14,846	—	14,846	13,185	—	13,185
Reclassification of pension and other postretirement benefits to income	1,288	—	1,288	1,064	—	1,064
Net income tax benefit (expense) related to items of other comprehensive income (loss)	(6,764)	—	(6,764)	30,565	—	30,565
Total other comprehensive income (loss)	10,358	—	10,358	(46,853)	—	(46,853)
Total comprehensive income (loss)	(1,723)	5,470	3,747	(35,869)	5,128	(30,741)
Dividends on common stock	(57,100)	—	(57,100)	(42,500)	—	(42,500)
Other	1	—	1	—	—	—
Ending balance, March 31	<u>\$ 3,766,131</u>	<u>\$ 96,554</u>	<u>\$3,862,685</u>	<u>\$ 3,366,986</u>	<u>\$ 87,452</u>	<u>\$3,454,438</u>

(a) These amounts primarily include unrealized gains and losses on contracts used to hedge our forecasted electricity and natural gas requirements to serve Native Load. These changes are primarily due to changes in forward natural gas prices and wholesale electricity prices.

(b) These amounts primarily include the reclassification of unrealized gains and losses to realized gains and losses for contracted commodities delivered during the period.

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

S-2. Other Income and Other Expense

The following table provides detail of APS's other income and other expense for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31,	
	2011	2010
Other income:		
Interest income	\$ 130	\$ 462
Investment gains — net	1,150	1,165
Miscellaneous	698	156
Total other income	<u>\$ 1,978</u>	<u>\$ 1,783</u>
Other expense:		
Non-operating costs (a)	\$ (1,899)	\$ (1,958)
Asset dispositions	(728)	(39)
Miscellaneous	(965)	(1,629)
Total other expense	<u>\$ (3,592)</u>	<u>\$ (3,626)</u>

(a) As defined by the FERC, includes below-the-line non-operating utility income and expense (items excluded from utility rate recovery).

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The following discussion should be read in conjunction with Pinnacle West's Condensed Consolidated Financial Statements and APS's Condensed Consolidated Financial Statements and the related Notes that appear in Item 1 of this report. For information on the broad factors that may cause our actual future results to differ from those we currently seek or anticipate, see "Forward-Looking Statements" at the front of this report and "Risk Factors" in Item 1A of the 2010 Form 10-K.

OVERVIEW

Pinnacle West owns all of the outstanding common stock of APS. APS is a vertically-integrated electric utility that provides either retail or wholesale electric service to most of the state of Arizona, with the major exceptions of about one-half of the Phoenix metropolitan area, the Tucson metropolitan area and Mohave County in northwestern Arizona. APS accounts for substantially all of our revenues and earnings, and is expected to continue to do so.

Areas of Business Focus

Operational Performance, Reliability and Recent Developments.

Nuclear. APS operates and is a joint-owner of the Palo Verde Nuclear Generating Station. With a focus on safely and efficiently generating electricity for the long-term, APS applied for twenty-year extensions of its operating licenses for each of the three Palo Verde units in December 2008. On April 21, 2011, the NRC approved the twenty-year extensions of the Palo Verde licenses.

Coal and Related Environmental Matters. APS is a joint-owner of three coal-fired power plants and acts as operating agent for two of the plants. APS is focused on the impacts on its coal fleet that may result from potential legislation and increased regulation concerning greenhouse gas emissions. Recent concern over climate change and other emission-related issues could have a significant impact on our capital expenditures and operating costs in the form of taxes, emissions allowances or required equipment upgrades for these plants. APS is closely monitoring its long-range capital management plans, understanding that any resulting legislation and regulation could impact the economic viability of certain plants, as well as the willingness or ability of power plant participants to fund any such equipment upgrades.

Southern California Edison ("SCE"), a participant in the Four Corners Power Plant ("Four Corners"), has indicated that certain California legislation may prohibit it from making emission control expenditures at the coal-fired plant. On November 8, 2010, APS and SCE entered into an asset purchase agreement, providing for the purchase by APS of SCE's 48% interest in each of Units 4 and 5 of Four Corners. The purchase price is \$294 million, subject to certain adjustments. Completion of the purchase by APS, which is expected to occur in the second half of 2012, is subject to the receipt of approvals by the ACC, the California Public Utilities Commission and the FERC. APS and SCE filed applications with their respective commissions seeking requisite authority or approvals to complete the transaction. Hearings with the ACC are scheduled to commence on July 14, 2011. Closing is also conditioned on the execution of a new coal supply contract for the lease renewal period described below, expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act and other typical closing conditions.

APS, on behalf of the Four Corners participants, negotiated amendments to an existing facility lease with the Navajo Nation which would extend the Four Corners leasehold interest to 2041. Execution by the Navajo Nation of the lease amendments is a condition to closing of the purchase by APS of SCE's interests in Four Corners. The amendments were approved by the Navajo Nation Council on February 15, 2011 and signed by the Nation's President on March 7, 2011. The effectiveness of the amendments also requires the approval of the U.S. Department of the Interior ("DOI"), as does a related Federal rights-of-way grant which the Four Corners participants will pursue. A Federal environmental review will be conducted as part of the DOI review process.

Pursuant to a Co-Tenancy Agreement among the Four Corners participants, the other participants have a right of first refusal to purchase shares of SCE's interests proportional to their current ownership percentages. The exercise of this purchase right by any of the other participants expired on March 8, 2011 and none of the other participants exercised this right.

APS has announced that, if APS's purchase of SCE's interests in Units 4 and 5 at Four Corners is consummated, it will close Units 1, 2 and 3 at the plant. These events will change the plant's overall generating capacity from 2,100 MW to 1,540 MW and APS's entitlement from the plant from 791 MW to 970 MW. When applying for approval to purchase Units 4 and 5, APS also requested from the ACC recovery of any unrecovered costs associated with the closure of Units 1, 2 and 3.

APS cannot predict whether all of the conditions necessary to consummate the purchase of SCE's interest will be met such that closing can occur, including whether the parties will receive satisfactory regulatory approvals.

Transmission and Delivery. APS's 2011 transmission plan projects that it will invest approximately \$450 million in new transmission over the next ten years, which includes 258 miles of new lines. The first three years of these additional line miles are included in the capital expenditures table presented in the "Liquidity" section below along with other transmission costs for upgrades and replacements. APS is working closely with regulators to identify and plan for transmission needs resulting from the current focus on renewable energy. APS is also working to establish and expand smart grid technology throughout its service territory designed to provide long-term benefits both to APS and its customers. APS is piloting and deploying a variety of technologies that are intended to allow customers to better monitor their energy use and needs, minimize system outage durations and the number of customers that experience outages, and facilitate cost savings to APS through improved reliability and the automation of certain distribution functions, including remote meter reading and remote connects and disconnects.

Renewable Energy . The ACC approved the RES in 2006, recognizing the importance of renewable energy to our state. The renewable energy requirement is 3% of retail electric sales in 2011 and increases annually until it reaches 15% in 2025. In the settlement agreement related to the 2008 retail rate case, APS agreed to exceed the RES standards, committing to 1,700 GWh of new renewable resources to be in service by year-end 2015 in addition to its 2008 renewable resource commitments. Taken together, APS's commitment is estimated to be 3,400 GWh or approximately 10% of APS's retail energy sales by year-end 2015, which is double the existing RES target of 5% for that year. See Note 3. A component of the RES is focused on stimulating development of distributed energy systems (generally speaking, small-scale renewable technologies that are located on customers' properties).

During the first quarter 2011, APS's third-party owned distributed energy resources in operation and planned or under development grew by 16 MW and 10 MW, respectively. At March 31, 2011, APS's renewable resources totaled 901 MW, including solar, wind, geothermal, biomass and biogas. Of this portfolio, 304 MW are currently in operation and 597 MW are under contract for development or are under construction. Renewable resources in operation include 5 MW of utility-scale facilities owned by APS, 223 MW of long-term purchased power agreements, and an estimated 76 MW of distributed energy resources. Resources under contract or under development include 83 MW of utility-scale facilities to be owned by APS, 382 MW of long-term purchased power agreements and an estimated 132 MW of distributed energy resources.

On April 5, 2011, APS issued its 2011 Small Generation request for proposal to solicit for a broad base of renewable technology projects between 2 MW and 15 MW. APS continues to actively consider opportunities to enhance its renewable energy portfolio, both to ensure its compliance with the Renewable Energy Standard and to meet the needs of its customer base .

Demand Side Management. Arizona regulators are placing an increased focus on energy efficiency and other demand side management programs to encourage customers to conserve energy, while incentivizing utilities to aid in these efforts that ultimately reduce the demand for energy. In December 2009, the ACC initiated Energy Efficiency rulemaking, with a proposed Energy Efficiency Standard of 22% cumulative annual energy savings by 2020. The 22% figure represents the cumulative reduction in future energy usage through 2020 attributable to energy efficiency initiatives. On July 27, 2010, the proposed Energy Efficiency Standard was adopted by the ACC, approved by the Arizona Attorney General and became effective on January 1, 2011. This ambitious standard will likely impact Arizona's future energy resource needs.

Rate Matters. APS needs timely recovery through rates of its capital and operating expenditures to maintain adequate financial health. APS's retail rates are regulated by the ACC and its wholesale electric rates (primarily for transmission) are regulated by the FERC. At the end of 2009, the ACC approved a settlement agreement entered into by APS and twenty-one of the twenty-three other parties to APS's general retail rate case, with modifications that did not materially affect the overall economic terms of the agreement. The rate case settlement authorizes and requires equity infusions into APS of at least \$700 million prior to the end of 2014. The settlement demonstrated cooperation among APS, the ACC staff, the Residential Utility Consumer Office and other intervenors to the rate case, and establishes a future rate case filing plan that allows APS the opportunity to help shape Arizona's energy future outside of continual rate cases. See Note 3 for a detailed discussion of the settlement agreement terms and information on APS's FERC rates.

APS has several recovery mechanisms in place that provide more timely recovery to APS of its fuel and transmission costs, and costs associated with the promotion and implementation of its demand-side management and renewable energy efforts and customer programs. These mechanisms are described more fully in Note 3.

On October 18, 2010, the Chairman of the ACC issued a draft decoupling policy statement for consideration by the commission. On December 15, 2010, the ACC unanimously approved a slightly modified decoupling policy statement supportive of using a revenue-per-customer methodology, which is the mechanism APS and a number of other parties support. Decoupling refers to a ratemaking design which reduces or removes the linkage between sales and utility revenues and/or profits, reducing utility disincentives to the adoption of programs that benefit customers by saving energy. Mechanically, decoupling compares actual versus authorized revenues or revenue per customer over a period and either credits or collects any differences from customers in a subsequent period. The policy permits regulated utilities to file a decoupling proposal in their next general rate case. In its 120-day notice of intent to file a rate case, APS indicated it would be filing a decoupling model consistent with the policy statement and other mechanisms to more timely recover capital and operating costs for consideration in its upcoming general rate case, currently expected to be filed in June 2011.

Financial Strength and Flexibility. Pinnacle West and APS currently have ample borrowing capacity under their respective credit facilities and have been able to access these facilities and the commercial paper markets, ensuring adequate liquidity for each company. In early February 2011, APS entered into a \$500 million revolving credit facility, replacing its \$489 million revolving credit facility that would have otherwise terminated in September 2011.

Subsidiaries. The operations of APSES and El Dorado are not expected to have any material impact on our financial results, or to require any material amounts of capital, over the next three years. In addition, as a result of the continuing distressed conditions in the real estate markets, during 2009 our other first-tier subsidiary, SunCor, undertook a program to dispose of its homebuilding operations, master-planned communities, land parcels, commercial assets and golf courses in order to reduce its outstanding debt. At March 31, 2011, SunCor had total remaining assets of about \$16 million, which includes approximately \$3 million of assets held for sale.

Key Financial Drivers

In addition to the continuing impact of the matters described above, many factors influence our financial results and our future financial outlook, including those listed below. We closely monitor these factors to plan for the Company's current needs, and to adjust our expectations, financial budgets and forecasts appropriately.

Electric Operating Revenues. For the years 2008 through 2010, retail electric revenues comprised approximately 93% of our total electric operating revenues. Our electric operating revenues are affected by customer growth or decline, variations in weather from period to period, customer mix, average usage per customer and the impacts of energy efficiency programs, electricity rates and tariffs, the recovery of PSA deferrals and the operation of other recovery mechanisms. Off-system sales of excess generation output, purchased power and natural gas are included in regulated electricity segment revenues and related fuel and purchased power because they are credited to APS's retail customers through the PSA. These revenue transactions are affected by the availability of excess generation or other energy resources and wholesale market conditions, including competition, demand and prices.

Customer and Sales Growth. Customer growth in APS's service territory for the three-month period ended March 31, 2011 was 0.4% compared with the prior year period. For the three years 2008 through 2010, APS's customer growth averaged 0.9% per year. We currently expect customer growth to average about 1.7% per year for 2011 through 2013 due to anticipated improving economic conditions, both nationally and in Arizona. Retail sales in kilowatt-hours, adjusted to exclude the effects of weather variations, for the three-month period ended March 31, 2011 increased 1.2% compared to the same period in the prior year, reflecting the improving economic conditions, partially offset by the effects of our energy efficiency programs. For the three years 2008 through 2010, APS's actual retail electricity sales in kilowatt-hours, adjusted to exclude the effects of weather variations, declined at an average annual rate of 0.9%. We currently estimate that total retail electricity sales in kilowatt-hours will remain flat on average per year during 2011 through 2013, including the effects of APS's energy efficiency programs, but excluding the effects of weather variations. A continuation of the economic downturn, or the failure of the Arizona economy to rebound in the near future, could further impact these estimates. The customer and sales growth referred to in this paragraph apply to Native Load customers.

Actual sales growth, excluding weather-related variations, may differ from our projections as a result of numerous factors, such as economic conditions, customer growth, usage patterns, impacts of energy efficiency programs and responses to retail price changes. Our experience indicates that a reasonable range of variation in our kilowatt-hour sales projection attributable to such economic factors under normal business conditions can result in increases or decreases in annual net income of up to \$10 million.

Weather. In forecasting the retail sales growth numbers provided above, we assume normal weather patterns based on historical data. Historical extreme weather variations have resulted in annual variations in net income in excess of \$20 million. However, our experience indicates that the more typical variations from normal weather can result in increases or decreases in annual net income of up to \$10 million.

Fuel and Purchased Power Costs. Fuel and purchased power costs included on our Condensed Consolidated Statements of Income are impacted by our electricity sales volumes, existing contracts for purchased power and generation fuel, our power plant performance, transmission availability or constraints, prevailing market prices, new generating plants being placed in service in our market areas, our hedging program for managing such costs and PSA deferrals and the related amortization.

Operations and Maintenance Expenses . Operations and maintenance expenses are impacted by growth, power plant operations, maintenance of utility plant (including generation, transmission, and distribution facilities), inflation, outages, higher-trending pension and other postretirement benefit costs, renewable energy and demand side management related expenses (which are offset by the same amount of regulated electricity segment operating revenues) and other factors. In the settlement agreement related to the 2008 retail rate case, APS committed to operational expense reductions from 2010 through 2014 and received approval to defer certain pension and other postretirement benefit cost increases to be incurred in 2011 and 2012.

Depreciation and Amortization Expenses. Depreciation and amortization expenses are impacted by net additions to utility plant and other property (such as new generation, transmission, and distribution facilities), and changes in depreciation and amortization rates. See “Capital Expenditures” below for information regarding the planned additions to our facilities. With the twenty-year extensions of the operating licenses for each of the Palo Verde units recently granted by the NRC, we estimate that our annual pretax depreciation expense will decrease by approximately \$34 million at January 1, 2012.

Property Taxes. Taxes other than income taxes consist primarily of property taxes, which are affected by the value of property in-service and under construction, assessment ratios, and tax rates. The average property tax rate for APS, which currently owns substantially all of our property, was 8.0% of the assessed value in 2010 and 7.5% of the assessed value in 2009. We expect property taxes to increase as we add new utility plants (including new generation, transmission and distribution facilities) and as we improve our existing facilities.

Income Taxes . Income taxes are affected by the amount of pre-tax book income, income tax rates, and certain non-taxable items, such as the allowance for equity funds used during construction. In addition, income taxes may also be affected by the settlement of issues with taxing authorities.

Interest Expense. Interest expense is affected by the amount of debt outstanding and the interest rates on that debt (see Note 2.) The primary factors affecting borrowing levels are expected to be our capital expenditures, long-term debt maturities, equity issuances and internally generated cash flow. An allowance for borrowed funds offsets a portion of interest expense while capital projects are under construction. We stop accruing allowance for borrowed funds on a project when it is placed in commercial operation.

RESULTS OF OPERATIONS

Pinnacle West's reportable business segment is our regulated electricity segment, which consists of traditional regulated retail and wholesale electricity businesses (primarily electricity service to Native Load customers) and related activities and includes electricity generation, transmission and distribution.

Operating Results — Three-month period ended March 31, 2011 compared with three-month period ended March 31, 2010

Our consolidated net loss attributable to common shareholders for the three months ended March 31, 2011 was \$15 million, compared with a net loss of \$6 million for the comparable prior-year period. The \$9 million variance consists of a \$22 million decrease in income (loss) from continuing operations, partially offset by a \$13 million improvement in our loss from discontinued operations (primarily due to real estate impairment charges in the prior-year period). The reduction in results from continuing operations reflects a decrease of approximately \$22 million in regulated electricity segment net income primarily due to increased operations and maintenance expenses related to planned timing and level of maintenance at two of our gas-fired, combined-cycle generation plants.

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The following table presents net income (loss) attributable to common shareholders by business segment compared with the prior-year period:

	Three Months Ended March 31,		<u>Net Change</u>
	<u>2011</u>	<u>2010</u>	
(dollars in millions)			
Income (Loss) from Continuing Operations Attributable to Common Shareholders:			
Regulated Electricity Segment:			
Operating revenues less fuel and purchased power expenses (a)	\$ 436	\$ 396	\$ 40
Operations and maintenance (a)	(255)	(207)	(48)
Depreciation and amortization	(107)	(101)	(6)
Taxes other than income taxes	(38)	(32)	(6)
Interest charges, net of allowance for funds used during construction	(52)	(52)	—
Income taxes	6	8	(2)
Less income related to noncontrolling interests (Note 7)	(5)	(5)	—
Regulated electricity segment net income (loss)	<u>(15)</u>	<u>7</u>	<u>(22)</u>
Loss from Discontinued Operations Attributable to Common Shareholders (primarily real estate impairment charges)	<u>—</u>	<u>(13)</u>	<u>13</u>
Net Loss Attributable to Common Shareholders	<u>\$ (15)</u>	<u>\$ (6)</u>	<u>\$ (9)</u>

- (a) Includes effects of settlement of certain prior-period transmission rights-of-way related to Four Corners, which did not affect net income, but increased both electric operating revenues and operations and maintenance expenses by \$28 million. Costs related to the settlement were offset by related revenues to be received from SCE, which leases the related transmission line from APS.

Regulated electricity segment

This section includes a discussion of major variances in income and expense amounts for the regulated electricity segment.

Operating revenues less fuel and purchased power expenses Regulated electricity segment operating revenues less fuel and purchased power expenses were \$40 million higher for the three months ended March 31, 2011 compared with the prior-year period. The following table describes the major components of this change:

	Increase (Decrease)		
	Operating revenues	Fuel and purchased power expenses	Net change
	(dollars in millions)		
Settlement of certain prior-period transmission rights-of-way (offset in operations and maintenance expense)	\$ 28	\$ —	\$ 28
Effects of weather on retail sales	10	4	6
Higher retail sales primarily due to higher usage per customer, excluding the effects of weather, but including the effects of APS's energy efficiency programs	7	2	5
Higher demand-side management, renewable energy and similar regulatory surcharges (substantially offset in operations and maintenance expense)	4		4
Lower retail revenues related to refund of PSA deferrals, substantially offset by lower amortization of fuel and purchased power expense	(5)	(6)	1
Miscellaneous items, net	(7)	(3)	(4)
Total	\$ 37	\$ (3)	\$ 40

Operations and maintenance Operations and maintenance expenses increased \$48 million for the three months ended March 31, 2011 compared with the prior-year period primarily because of:

- An increase of \$28 million for settlement of certain transmission rights-of-way, which is offset in operating revenues;
- An increase of \$19 million in generation costs, primarily due to planned timing and level of maintenance at two of our gas-fired combined-cycle generation plants;
- An increase of \$4 million related to costs for demand-side management, renewable energy, and similar regulatory programs, which are offset in operating revenues; and
- A decrease of \$3 million due to other miscellaneous factors.

Depreciation and Amortization Depreciation and amortization expenses were \$6 million higher for the three months ended March 31, 2011 compared with the prior-year period primarily because of increased plant in service.

Taxes other than income taxes Taxes other than income taxes increased \$6 million for the three months ended March 31, 2011 compared with the prior-year period primarily because of higher property tax rates in the current period.

Income taxes Income tax benefits were \$2 million lower for the three months ended March 31, 2011 compared to 2010. The prior-year period includes \$8 million of income tax benefits related to a reduction in the Company’s 2010 effective income tax rate.

Discontinued Operations

Real estate activities SunCor’s operations have been reclassified to discontinued operations. The loss from discontinued operations related to real estate activities improved by \$13 million for the three months ended March 31, 2011 compared with the prior-year period primarily because of real estate impairment charges recorded in the prior-year period.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows — Pinnacle West Consolidated

The following table presents net cash provided by (used for) operating, investing and financing activities for the three months ended March 31, 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Net cash flow provided by (used for) operating activities	\$ 243	\$ (14)
Net cash flow used for investing activities	(193)	(210)
Net cash flow provided by (used for) financing activities	(47)	82

The increase of approximately \$257 million in net cash provided by operating activities is primarily due to return of collateral and margin cash as a result of changes in commodity prices and expiration of prior hedge contracts; a voluntary pension contribution in 2010 of approximately \$100 million; and other changes in working capital.

The decrease of approximately \$17 million in net cash used for investing activities is primarily due to lower capital expenditures.

The decrease of approximately \$129 million in net cash provided by financing activities is primarily due to lower levels of short-term borrowings.

Cash Flows — Arizona Public Service Company Consolidated

The following table presents net cash provided by (used for) operating, investing and financing activities for the three months ended March 31, 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Net cash flow provided by (used for) operating activities	\$ 255	\$ (64)
Net cash flow used for investing activities	(193)	(207)
Net cash flow provided by (used for) financing activities	(57)	152

The increase of approximately \$319 million in net cash provided by operating activities is primarily due to return of collateral and margin cash as a result of changes in commodity prices and expiration of prior hedge contracts; a voluntary pension contribution in 2010 of approximately \$100 million; income tax payments in 2010; and other changes in working capital.

The decrease of approximately \$14 million in net cash used for investing activities is primarily due to lower capital expenditures.

The decrease of approximately \$209 million in net cash provided by financing activities is primarily due to lower levels of short-term borrowings.

Liquidity

Capital Expenditure Requirements

The following table summarizes the actual capital expenditures on an accrual basis for the three months ended March 31, 2011 and 2010 and the estimated capital expenditures for the next three years:

CAPITAL EXPENDITURES
(dollars in millions)

	Three Months Ended March 31,		Estimated for the Year Ended December 31,		
	2010	2011	2011	2012	2013
APS					
Generation:					
Nuclear Fuel	\$ 29	\$ 26	\$ 69	\$ 68	\$ 69
Renewables	—	25	236	185	90
Environmental	1	1	11	22	122
Four Corners Units 4 and 5	—	—	—	294	—
Other Generation	47	58	142	152	107
Distribution	59	48	273	350	285
Transmission	36	26	143	220	248
Other (a)	11	7	78	49	41
Total APS	<u>183</u>	<u>191</u>	<u>952</u>	<u>1,340</u>	<u>962</u>
Other	1	—	—	—	—
Total	<u>\$ 184</u>	<u>\$ 191</u>	<u>\$ 952</u>	<u>\$ 1,340</u>	<u>\$ 962</u>

(a) Primarily information systems and facilities projects.

Generation capital expenditures are comprised of various improvements to APS's existing fossil and nuclear plants. Examples of the types of projects included in this category are additions, upgrades and capital replacements of various power plant equipment, such as turbines, boilers and environmental equipment. Included under Renewables is the AZ Sun Program, which is a significant component of the increase in capital expenditures from 2010 to 2011. For purposes of this table, we have assumed the consummation of APS's purchase of SCE's interest in Four Corners Units 4 and 5 and the subsequent shut down of Units 1-3, as discussed in the "Overview" section above. As a result, we included the \$294 million purchase price under Generation and have not included environmental expenditures for Units 1-3. We are also monitoring the status of certain environmental matters, which, depending on their final outcome, could require modification to our environmental expenditures. (See "Business of Arizona Public Service Company — Environmental Matters — EPA Environmental Regulation — Regional Haze Rules and Coal Combustion Waste" in Item 1 of the 2010 Form 10-K and "Mercury and other Hazardous Air Pollutants" in Part II, Item 5 below.)

Distribution and transmission capital expenditures are comprised of infrastructure additions and upgrades, capital replacements, new customer construction, related information systems and facility costs. Examples of the types of projects included in the forecast include power lines, substations, line extensions to new residential and commercial developments and upgrades to customer information systems.

Capital expenditures will be funded with internally generated cash and external financings, which may include issuances of long-term debt and Pinnacle West common stock.

Pinnacle West (Parent Company)

Our primary cash needs are for dividends to our shareholders and principal and interest payments on our short-term and long-term debt. The level of our common stock dividends and future dividend growth will be dependent on a number of factors including, but not limited to, payout ratio trends, free cash flow and financial market conditions.

On April 20, 2011, the Pinnacle West Board of Directors declared a quarterly dividend of \$0.525 per share of common stock, payable on June 1, 2011, to shareholders of record on May 2, 2011.

Our primary sources of cash are dividends from APS, external debt and equity financings. An existing ACC order requires APS to maintain a common equity ratio of at least 40%. As defined in the ACC order, the common equity ratio is total shareholder equity divided by the sum of total shareholder equity and long-term debt, including current maturities of long-term debt. At March 31, 2011, APS's common equity ratio, as defined, was 53%. Its total shareholder equity was approximately \$3.8 billion, and total capitalization was approximately \$7.1 billion. APS would be prohibited from paying dividends if the payment would reduce its total shareholder equity below approximately \$2.9 billion, assuming APS's total capitalization remains the same. This restriction does not materially affect Pinnacle West's ability to meet its ongoing capital requirements.

Pinnacle West maintains committed revolving credit facilities in order to enhance liquidity and provide credit support for its commercial paper program.

On February 23, 2011, Pinnacle West entered into a \$175 million term loan facility that matures February 20, 2015. Pinnacle West used the proceeds of the loan to repay its 5.91% \$175 million Senior Notes. Interest rates are based on Pinnacle West's senior unsecured debt credit ratings, or, if unavailable, its long-term issuer ratings.

At March 31, 2011, Pinnacle West's \$200 million credit facility, which matures in 2013, was available for general corporate purposes, support of its \$200 million commercial paper program, or for issuances of letters of credit. Pinnacle West has the option to increase the amount of the facility up to a maximum of \$300 million upon the satisfaction of certain conditions and with the consent of the lenders. At March 31, 2011, Pinnacle West had no outstanding borrowings under this credit facility, no outstanding letters of credit and commercial paper borrowings of \$17 million.

The \$68 million income tax receivable on the Condensed Consolidated Balance Sheets represents the anticipated refunds related to an APS tax accounting method change approved by the IRS in the third quarter of 2009. This amount is classified as long-term, as cash refunds are not expected to be received in the next twelve months.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 includes provisions making qualified property placed into service after September 8, 2010 and before January 1, 2012 eligible for 100% bonus depreciation for federal income tax purposes. In addition, qualified property placed into service in 2012 is eligible for 50% bonus depreciation for federal income tax purposes. These provisions of the recent tax legislation are expected to generate approximately \$425-475 million of cash tax benefits for APS through accelerated depreciation. It is anticipated that these cash benefits will be fully realized by APS by the end of 2013, with a majority of the benefit realized in 2012 and 2013. The cash generated is an acceleration of tax benefits that APS would have otherwise received over 20 years.

Pinnacle West sponsors a qualified defined benefit and account balance pension plan and a non-qualified supplemental excess benefit retirement plan for the employees of Pinnacle West and our subsidiaries. IRS regulations require us to contribute a minimum amount to the qualified plan. We contribute at least the minimum amount required under IRS regulations, but no more than the maximum tax-deductible amount. The minimum required funding takes into consideration the value of plan assets and our pension obligation. The assets in the plan are comprised of fixed-income, equity, real estate, and short-term investments. Future year contribution amounts are dependent on plan asset performance and plan actuarial assumptions. The required minimum contribution to our pension plan is zero in 2011 and approximately \$85 million in 2012. The contributions to our other postretirement benefit plans for 2011 and 2012 are expected to be approximately \$20 million each year. APS and other subsidiaries fund their share of the contributions. APS's share is approximately 99% of both plans.

APS

APS's capital requirements consist primarily of capital expenditures and maturities of long-term debt. APS funds its capital requirements with cash from operations and, to the extent necessary, external debt financing and equity infusions from Pinnacle West. See "Pinnacle West (Parent Company)" above for a discussion of the common equity ratio that APS must maintain in order to pay dividends to Pinnacle West.

On February 14, 2011, APS refinanced its \$489 million credit facility that would have matured in September 2011 with a new \$500 million facility. The new credit facility terminates in February 2015. APS may increase the amount of the facility up to a maximum of \$700 million upon the satisfaction of certain conditions and with the consent of the lenders. APS will use the facility for general corporate purposes, commercial paper program support and for the issuance of letters of credit. Interest rates are based on APS's senior unsecured debt credit ratings.

At March 31, 2011, APS had two credit facilities totaling \$1 billion, including the \$500 million credit facility described above and a \$500 million facility that matures in February 2013. These facilities are available to support its \$250 million commercial paper program, for bank borrowings, or for issuances of letters of credit. See Note 12 for a discussion of APS's letters of credit. At March 31, 2011, APS had no borrowings outstanding under any of its credit facilities and no outstanding commercial paper. A \$20 million letter of credit was outstanding under APS's 2011 \$500 million credit facility described above.

Other Financing Matters — See Note 3 for information regarding the PSA approved by the ACC. Although APS defers actual retail fuel and purchased power costs to the extent those costs vary from the base fuel rate on a current basis, APS's recovery or refund of the deferrals from or to its ratepayers, as appropriate, is subject to annual and, if necessary, periodic PSA adjustments.

See Note 3 for information regarding the retail rate case settlement, which includes ACC authorization and requirements of equity infusions into APS of at least \$700 million by December 31, 2014.

See Note 8 for information related to the change in our margin accounts.

Other Subsidiaries

SunCor — At March 31, 2011, SunCor had total remaining assets of approximately \$16 million, which includes approximately \$3 million of assets held for sale. At March 31, 2011, SunCor had no debt outstanding.

As of March 31, 2011, SunCor could not transfer any cash dividends to Pinnacle West. This restriction does not affect Pinnacle West's ability to meet its ongoing capital requirements.

El Dorado — El Dorado expects minimal capital requirements over the next three years and intends to focus on prudently realizing the value of its existing investments.

APSES —APSES expects minimal capital expenditures over the next three years.

Debt Provisions

Pinnacle West's and APS's debt covenants related to their respective bank financing arrangements include maximum debt to capitalization ratios. Pinnacle West and APS comply with this covenant and each anticipates it will continue to meet this and other significant covenant requirements. For both Pinnacle West and APS, this covenant requires that the ratio of consolidated debt to total consolidated capitalization not exceed 65%. At March 31, 2011, the ratio was approximately 50% for Pinnacle West and 47% for APS. Failure to comply with such covenant levels would result in an event of default which, generally speaking, would require the immediate repayment of the debt subject to the covenants and could cross-default other debt. See further discussion of "cross-default" provisions below.

Neither Pinnacle West's nor APS's financing agreements contain "rating triggers" that would result in an acceleration of the required interest and principal payments in the event of a rating downgrade. However, our bank credit agreements contain a pricing grid in which the interest rates we pay for borrowings and letters of credit issued thereunder are determined by our current credit ratings.

All of Pinnacle West’s loan agreements contain “cross-default” provisions that would result in defaults and the potential acceleration of payment under these loan agreements if Pinnacle West or APS were to default under certain other material agreements. All of APS’s bank agreements contain cross-default provisions that would result in defaults and the potential acceleration of payment under these bank agreements if APS were to default under certain other material agreements. Pinnacle West and APS do not have a material adverse change restriction for credit facilities borrowings.

See Note 2 for further discussions of liquidity matters.

Credit Ratings

The ratings of securities of Pinnacle West and APS as of April 27, 2011 are shown below. We are disclosing these credit ratings to enhance understanding of our cost of short-term and long-term capital and our ability to access the markets for liquidity and long-term debt. The ratings reflect the respective views of the rating agencies, from which an explanation of the significance of their ratings may be obtained. There is no assurance that these ratings will continue for any given period of time. The ratings may be revised or withdrawn entirely by the rating agencies if, in their respective judgments, circumstances so warrant. Any downward revision or withdrawal may adversely affect the market price of Pinnacle West’s or APS’s securities and/or result in an increase in the cost of, or limit access to, capital. Such revisions may also result in substantial additional cash or other collateral requirements related to certain derivative instruments, insurance policies, natural gas transportation, fuel supply, and other energy-related contracts. At this time, we believe we have sufficient liquidity to cover a downward revision to our credit ratings.

	Moody’s	Standard & Poor’s	Fitch
Pinnacle West			
Senior unsecured (a)	Baa3 (P)	BB+ (prelim)	N/A
Commercial paper	P-3	A-3	F3
Outlook	Stable	Positive	Stable
APS			
Senior unsecured	Baa2	BBB-	BBB
Secured lease obligation bonds	Baa2	BBB-	BBB
Commercial paper	P-2	A-3	F3
Outlook	Stable	Positive	Stable

- (a) Pinnacle West has a shelf registration under SEC Rule 415. Pinnacle West currently has no outstanding, rated senior unsecured securities. However, Moody’s assigned a provisional (P) rating and Standard & Poor’s assigned a preliminary (prelim) rating to the senior unsecured securities that can be issued under such shelf registration.

Off-Balance Sheet Arrangements

See Note 7 for a discussion of VIEs and the impacts on our financial statements of consolidating certain VIEs.

Guarantees and Surety Bonds

We have issued parental guarantees and obtained surety bonds on behalf of our subsidiaries, including credit support instruments enabling APSES to offer energy-related products and surety bonds at APS, principally related to self-insured workers' compensation. Non-performance or non-payment under the underlying contract by our subsidiaries would result in a payment liability on our part under the guarantee or surety bond. No liability is currently recorded on the Condensed Consolidated Balance Sheets related to such instruments. At March 31, 2011, we had no outstanding claims for payment under any of these instruments. Our guarantees and surety bonds have no recourse or collateral provisions to allow us to recover amounts paid under these instruments or surety bonds from our subsidiaries. We generally agree to indemnification provisions related to liabilities arising from or related to certain of our agreements, with limited exceptions depending on the particular agreement. See Note 12 for additional information regarding guarantees and letters of credit.

Contractual Obligations

Our future contractual purchase obligations have increased from approximately \$0.5 billion at December 31, 2010 as discussed in the 2010 Form 10-K to \$0.7 billion at March 31, 2011. This increase is primarily related to an amended agreement for certain transmission rights-of-way and a new contract for the construction of a solar facility. Total contractual purchase obligations are as follows (dollars in billions):

2011	2012-2013	2014-2015	Thereafter	Total
\$ 0.2	\$ 0.2	\$ 0.0	\$ 0.3	\$ 0.7

Payments for the transmission rights-of-way are subject to change based on changes in the Consumer Price Index.

See Note 2 for a list of payments due on total long-term debt and capitalized lease requirements.

CRITICAL ACCOUNTING POLICIES

In preparing the financial statements in accordance with GAAP, management must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex, and actual results could differ from those estimates. There have been no changes to our critical accounting policies since our 2010 Form 10-K. See "Critical Accounting Policies" in Item 7 of the 2010 Form 10-K for further details about our critical accounting policies.

MARKET AND CREDIT RISKS

Market Risks

Our operations include managing market risks related to changes in interest rates, commodity prices and investments held by our nuclear decommissioning trust fund.

Interest Rate and Equity Risk

We have exposure to changing interest rates. Changing interest rates will affect interest paid on variable-rate debt and the market value of fixed income securities held by our nuclear decommissioning trust fund (see Note 15). The nuclear decommissioning trust fund also has risks associated with the changing market value of its investments. Nuclear decommissioning costs are recovered in regulated electricity prices.

Commodity Price Risk

We are exposed to the impact of market fluctuations in the commodity price and transportation costs of electricity and natural gas. Our risk management committee, consisting of officers and key management personnel, oversees company-wide energy risk management activities to ensure compliance with our stated energy risk management policies. We manage risks associated with these market fluctuations by utilizing various commodity instruments that qualify as derivatives, including exchange-traded futures and options and over-the-counter forwards, options and swaps. As part of our risk management program, we use such instruments to hedge purchases and sales of electricity and fuels. The changes in market value of such contracts have a high correlation to price changes in the hedged commodities.

The following table shows the net pretax changes in mark-to-market of our derivative positions for the three months ended March 31, 2011 and 2010 (dollars in millions):

	Three Months Ended March 31,	
	2011	2010
Mark-to-market of net positions at beginning of period	\$ (239)	\$ (169)
Recognized in earnings:		
Change in mark-to-market losses for future period deliveries	—	(3)
Mark-to-market losses realized including ineffectiveness during the period	—	1
Increase in regulatory asset	—	(31)
Recognized in other comprehensive income (OCI):		
Change in mark-to-market gains (losses) for future period deliveries (a)	1	(92)
Mark-to-market losses realized during the period	15	13
Change in valuation techniques	—	—
Mark-to-market of net positions at end of period	<u>\$ (223)</u>	<u>\$ (281)</u>

(a) The changes in mark-to-market recorded in OCI are due primarily to changes in forward natural gas prices.

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The table below shows the fair value of maturities of our derivative contracts (dollars in millions and excluding margin and collateral) at March 31, 2011 by maturities and by the type of valuation that is performed to calculate the fair values. See Note 1, “Derivative Accounting” and “Fair Value Measurements,” in Item 8 of our 2010 Form 10-K and Note 15 for more discussion of our valuation methods.

Source of Fair Value	2011	2012	2013	2014	2015	Years thereafter	Total fair value
Prices actively quoted	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Prices provided by other external sources	(118)	(45)	(13)	1	—	—	(175)
Prices based on models and other valuation methods	(10)	(8)	(10)	(7)	(7)	(6)	(48)
Total by maturity	<u>\$ (128)</u>	<u>\$ (53)</u>	<u>\$ (23)</u>	<u>\$ (6)</u>	<u>\$ (7)</u>	<u>\$ (6)</u>	<u>\$ (223)</u>

The table below shows the impact that hypothetical price movements of 10% would have on the market value of our risk management assets and liabilities included on Pinnacle West’s Condensed Consolidated Balance Sheets at March 31, 2011 and December 31, 2010 (dollars in millions):

	March 31, 2011		December 31, 2010	
	Price Up 10%	Price Down 10%	Price Up 10%	Price Down 10%
Mark-to-market changes reported in:				
Earnings				
Electricity	\$ —	\$ —	\$ —	\$ —
Natural gas	1	(1)	1	(1)
Regulatory asset, (liability) or OCI (a)				
Electricity	12	(12)	13	(13)
Natural gas	42	(42)	42	(42)
Total	<u>\$ 55</u>	<u>\$ (55)</u>	<u>\$ 56</u>	<u>\$ (56)</u>

- (a) These contracts are hedges of our forecasted purchases of natural gas and electricity. The impact of these hypothetical price movements would substantially offset the impact that these same price movements would have on the physical exposures being hedged. To the extent the amounts are eligible for inclusion in the PSA, the amounts are recorded as either a regulatory asset or liability.

Credit Risk

We are exposed to losses in the event of non-performance or non-payment by counterparties. See Note 15 — “Fair Value Measurements” for a discussion of our credit valuation adjustment policy. See Note 8 for a further discussion of credit risk.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Key Financial Drivers” and “Market and Credit Risks” in Item 2 above for a discussion of quantitative and qualitative disclosures about market risks.

Item 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

The term “disclosure controls and procedures” means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) (15 U.S.C. 78a *et seq.*), is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Pinnacle West’s management, with the participation of Pinnacle West’s Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of Pinnacle West’s disclosure controls and procedures as of March 31, 2011. Based on that evaluation, Pinnacle West’s Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, Pinnacle West’s disclosure controls and procedures were effective.

APS’s management, with the participation of APS’s Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of APS’s disclosure controls and procedures as of March 31, 2011. Based on that evaluation, APS’s Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, APS’s disclosure controls and procedures were effective.

(b) Changes in Internal Control Over Financial Reporting

The term “internal control over financial reporting” (defined in SEC Rule 13a-15(f)) refers to the process of a company that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

No change in Pinnacle West’s or APS’s internal control over financial reporting occurred during the fiscal quarter ended March 31, 2011 that materially affected, or is reasonably likely to materially affect, Pinnacle West’s or APS’s internal control over financial reporting.

Part II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

See “Environmental Matters” in Item 5 below and “Business of Arizona Public Service Company — Environmental Matters” in Item 1 of the 2010 Form 10-K in regard to pending or threatened litigation or other disputes.

See Note 10 for information relating to FERC proceedings on Pacific Northwest energy market issues.

Item 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. — Risk Factors in the 2010 Form 10-K, which could materially affect the business, financial condition, cash flows or future results of Pinnacle West and APS. The risks described in the 2010 Form 10-K are not the only risks facing Pinnacle West and APS. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect the business, financial condition, cash flows and/or operating results of Pinnacle West and APS.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The following table contains information about our purchases of our common stock during the first quarter of 2011.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 — January 31, 2011			—	—
February 1 — February 28, 2011	25,128	\$ 41.88	—	—
March 1 — March 31, 2011	60,879	41.91	—	—
Total	86,007	\$ 41.90	—	—

- (1) Represents shares of common stock withheld by Pinnacle West to satisfy tax withholding obligations upon the vesting of restricted stock units and performance shares.

Item 5. OTHER INFORMATION

Environmental Matters

Superfund

See “Superfund” in Note 10 for a discussion of the OU3 Superfund site.

By letter dated April 25, 2008, the EPA informed APS that it may be a PRP in the Gila River Indian Reservation Superfund Site in Maricopa County, Arizona. APS, along with three other electric utility companies, owns a parcel of property on which a transmission pole and a portion of a transmission line are located. The property abuts the Gila River Indian Community boundary and, at one time, may have been part of an airfield where crop dusting took place. The EPA has settled the matter with APS and four other PRPs for past cleanup-related costs involving contamination from the crop dusting. APS's share of the settlement had no material adverse impact on APS's financial position, results of operations, or cash flows.

Climate Change

Climate Change Lawsuits. In February 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in federal court in the Northern District of California against nine oil companies, fourteen power companies (including Pinnacle West), and a coal company, alleging that the defendants' emissions of carbon dioxide contribute to global warming and constitute a public and private nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village, and they are seeking an unspecified amount of monetary damages. In June 2008, the defendants filed motions to dismiss the action, which were granted. The plaintiffs filed an appeal with the Ninth Circuit Court of Appeals in November 2009, and Pinnacle West filed its reply on June 30, 2010. The court has not yet scheduled oral arguments on the plaintiffs' appeal. On January 24, 2011, the defendants filed a motion to defer calendaring of oral argument until after the United States Supreme Court rules in a similar nuisance lawsuit, *American Electric Power Co., Inc. v. Connecticut*. The *Kivalina* court granted that motion on February 23, 2011. We believe the action in *Kivalina* is without merit and intend to continue to defend against the claims.

EPA Environmental Regulation

Mercury and other Hazardous Air Pollutants. In early 2008, the U.S. Court of Appeals for the D.C. Circuit vacated the Clean Air Mercury Rule ("CAMR"), which was adopted by the EPA to regulate mercury emissions from coal-fired power plants. As a result, the law in effect prior to the adoption of the CAMR became the applicable law, and the EPA is now required to adopt final maximum achievable control technology emissions ("MACT") standards. Under a consent decree that was finalized on April 15, 2010, the EPA has agreed to issue final MACT standards for mercury and other hazardous air pollutants by November 2011. APS will have three years after the EPA's final rule becomes effective to achieve compliance. EPA released its proposed MACT standards on March 16, 2011. The proposed rule would require APS to install additional pollution control equipment, which is consistent with APS's expectations. The proposed rule is subject to a sixty-day public comment period from the date published in the federal register.

APS has installed, and continues to install, certain of the equipment necessary to meet the anticipated standards. APS estimates that the cost for equipment necessary to meet these anticipated standards is approximately \$220 million for Four Corners Units 1-3 and \$89 million for Cholla Units 1-3. The estimated costs for Four Corners Units 1-3 are not included in our current environmental expenditure estimates since our estimates assume the consummation of APS's purchase of SCE's interest in Four Corners Units 4 and 5 and the subsequent shut down of Units 1-3. Cholla's estimated costs for the next three years are included in our environmental expenditure estimates. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Expenditures" in Item 2 for details of our capital expenditure estimates).

Cooling Water Intake Structures. The EPA issued its proposed cooling water intake structures rule on April 20, 2011, which provides national standards applicable to certain cooling water intake structures at existing power plants and other facilities pursuant to Section 316(b) of the Clean Water Act. The proposed standards are intended to protect fish and other aquatic organisms by minimizing impingement mortality (the capture of aquatic wildlife on intake structures or against screens) and entrainment mortality (the capture of fish or shellfish in water flow entering and passing through intake structures). To minimize impingement mortality, the proposed rule would require facilities such as Four Corners and the Navajo Generating Station to either demonstrate that impingement mortality at its cooling water intakes does not exceed a specified rate or reduce the flow at those structures to less than a specified velocity, and to take certain protective measures with respect to impinged fish. To minimize entrainment mortality, the proposed rule would also require these facilities to conduct a “structured site-specific analysis” to determine what site-specific controls, if any, should be required. Additional studies and a peer review process will also be required at these facilities.

The proposed rule is subject to a ninety-day public comment period, which ends on July 19, 2011, and the EPA is expected to issue a final rule by July 2012. As proposed, existing facilities subject to the rule would have to comply with the impingement mortality requirements as soon as possible, but in no event later than eight years after the effective date of the rule, and would have to comply with the entrainment requirements as soon as possible under a schedule of compliance established by the permitting authority. APS is performing analyses to determine the costs of compliance with the proposed rule.

Impact of Earthquake and Tsunami in Japan on Nuclear Energy Industry

On March 11, 2011, a 9.0 magnitude earthquake occurred off the north-eastern coast of Japan. The earthquake produced a tsunami that caused significant damage to the Fukushima Daiichi Nuclear Power Station in Japan. Preliminary data available from the Fukushima Daiichi plant operator and Japanese government have each indicated that the earthquake and tsunami were beyond the plant’s required licensing and design parameters. Validation of that data will continue as more information becomes available.

The Nuclear Energy Institute (“NEI”) and the Institute of Nuclear Power Operations (“INPO”) are working closely to analyze the situation in Japan and develop action plans for U.S. nuclear power plants. APS is actively engaged with NEI and INPO in these efforts. Additionally, the NRC is performing its own independent review of the events at Fukushima Daiichi. On March 23, 2011, the NRC Commissioners voted to launch a two-pronged review of U.S. nuclear power plant safety. The NRC announced that it supports the establishment of an agency task force that will conduct both a short- and long-term analysis of the lessons that can be learned from the situation in Japan. The NRC expects the task force to begin its long-term evaluations within 90 days and anticipates that a report with any recommended actions will be available within six months after the evaluations begin. Until formal action, if any, is taken by the NRC as a result of its review, we cannot predict whether there will be any financial or operational impacts on Palo Verde or APS.

Item 6. EXHIBITS

(a) Exhibits

<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>
10.1	APS	Amendment and Supplement No. 2 to Supplemental and Additional Indenture of Lease with the Navajo Nation dated March 7, 2011
10.2	APS	Amendment and Supplement No. 3 to Supplemental and Additional Indenture of Lease with the Navajo Nation dated March 7, 2011
10.3	Pinnacle West	Credit Agreement dated as of February 23, 2011 among Pinnacle West Capital Corporation, as Borrower, Union Bank, N.A., as Agent, and the lenders and other parties thereto
10.4	Pinnacle West	Form of Performance Share Agreement under the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan
10.5	Pinnacle West	Form of Restricted Stock Unit Agreement under the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan
10.6	Pinnacle West	Form of Restricted Stock Unit Agreement under the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (Supplemental 2010 Award)
12.1	Pinnacle West	Ratio of Earnings to Fixed Charges
12.2	APS	Ratio of Earnings to Fixed Charges
12.3	Pinnacle West	Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividend Requirements
31.1	Pinnacle West	Certificate of Donald E. Brandt, Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.2	Pinnacle West	Certificate of James R. Hatfield, Senior Vice President and Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended

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<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>
31.3	APS	Certificate of Donald E. Brandt, Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.4	APS	Certificate of James R. Hatfield, Senior Vice President and Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
32.1*	Pinnacle West	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	APS	Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	Pinnacle West APS**	XBRL Instance Document
101.SCH*	Pinnacle West APS**	XBRL Taxonomy Extension Schema Document
101.CAL*	Pinnacle West APS**	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	Pinnacle West APS**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	Pinnacle West APS**	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	Pinnacle West APS**	XBRL Taxonomy Definition Linkbase Document

* Furnished herewith as an Exhibit.

** Furnished voluntarily.

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In addition, Pinnacle West hereby incorporates the following Exhibits pursuant to Exchange Act Rule 12b-32 and Regulation §229.10(d) by reference to the filings set forth below:

<i>Exhibit No.</i>	<i>Registrant(s)</i>	<i>Description</i>	<i>Previously Filed as Exhibit</i> ¹	<i>Date Filed</i>
3.1	Pinnacle West	Pinnacle West Capital Corporation Bylaws, amended as of May 19, 2010	3.1 to Pinnacle West/APS June 30, 2010 Form 10-Q Report, File Nos. 1-8962 and 1-4473	8-3-10
3.2	Pinnacle West	Articles of Incorporation, restated as of May 21, 2008	3.1 to Pinnacle West/APS June 30, 2008 Form 10-Q Report, File Nos. 1-8962 and 1-4473	8-7-08
3.3	APS	Articles of Incorporation, restated as of May 25, 1988	4.2 to APS's Form S-3 Registration Nos. 33-33910 and 33-55248 by means of September 24, 1993 Form 8-K Report, File No. 1-4473	9-29-93
3.4	APS	Arizona Public Service Company Bylaws, amended as of December 16, 2008	3.4 to Pinnacle West/APS December 31, 2008 Form 10-K, File Nos. 1-8962 and 1-4473	2-20-09

¹ Reports filed under File Nos. 1-4473 and 1-8962 were filed in the office of the Securities and Exchange Commission located in Washington, D.C.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PINNACLE WEST CAPITAL CORPORATION
(Registrant)

Dated: April 29, 2011

By: /s/ James R. Hatfield
James R. Hatfield
Sr. Vice President and Chief Financial Officer
(Principal Financial Officer and
Officer Duly Authorized to sign this Report)

ARIZONA PUBLIC SERVICE COMPANY
(Registrant)

Dated: April 29, 2011

By: /s/ James R. Hatfield
James R. Hatfield
Sr. Vice President and Chief Financial Officer
(Principal Financial Officer and
Officer Duly Authorized to sign this Report)

AMENDMENT AND SUPPLEMENT NO. 2
TO
SUPPLEMENTAL AND ADDITIONAL INDENTURE OF LEASE
BETWEEN
THE NAVAJO NATION
AND
ARIZONA PUBLIC SERVICE COMPANY,
EL PASO ELECTRIC COMPANY,
PUBLIC SERVICE COMPANY OF NEW MEXICO,
SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT,
SOUTHERN CALIFORNIA EDISON COMPANY
AND
TUCSON ELECTRIC POWER COMPANY
Dated: March 7, 2011

**AMENDMENT AND SUPPLEMENT NO. 2 TO
SUPPLEMENTAL AND ADDITIONAL INDENTURE OF LEASE**

This Amendment and Supplement No. 2 to the Supplemental and Additional Indenture of Lease dated March 7, 2011 (this “Amendment”) is by and between the Navajo Nation (formerly known as The Navajo Tribe of Indians), acting through the Navajo Nation Council, for and on behalf of the Navajo Nation (hereinafter referred to as the “Nation”), as lessor, and Arizona Public Service Company (“APS”), El Paso Electric Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, Southern California Edison Company (“Edison”), and Tucson Electric Power Company (formerly known as Tucson Gas & Electric Company) (hereinafter, collectively, together with their successors and assigns, referred to as the “Lessees,” and each individually referred to as a “Lessee”). The Nation and the Lessees are hereinafter collectively referred to as the “Parties.”

The Parties agree as follows:

1 BACKGROUND.

- 1.1 APS has leased certain premises from the Nation under that certain Indenture of Lease dated December 1, 1960 between APS and the Nation, as supplemented and amended by that certain Supplemental and Additional Indenture of Lease dated July 6, 1966, between the Nation, APS and the other Lessees, as further supplemented and amended by that certain Amendment and Supplement No. 1 to Supplemental and Additional Indenture of Lease dated April 25, 1985, between the Nation, APS and the other Lessees (the “1985 Lease Supplement”; and such Indenture of Lease, as supplemented and amended, the “1960 Lease”).
- 1.2 Lessees have leased certain premises from the Nation under that certain Supplemental and Additional Indenture of Lease dated July 6, 1966, between the Nation and the Lessees, as supplemented and amended by the 1985 Lease Supplement (such Supplemental and Additional Indenture of Lease, as supplemented and amended, the “1966 Lease”).

- 1.3 The Parties desire to amend the 1960 Lease and the 1966 Lease to reflect certain new terms and conditions.
- 1.4 Edison does not intend to remain a participant in the Four Corners Project after July 2016. Accordingly, Edison intends to end its tenancy under the Lease upon the earlier of the sale of its interest in the Four Corners Project or July 6, 2016. The date on which Edison ends its tenancy, as set forth in the preceding sentence, is referred to as the “ Amendment 2 Termination Date .”
- 1.5 Upon the Amendment 2 Termination Date, this Amendment shall terminate.
- 1.6 The 1960 Lease and the 1966 Lease are amended only as set forth in this Amendment. To the extent, however, that there is any conflict between the 1960 Lease and this Amendment or the 1966 Lease and this Amendment, this Amendment shall govern.
- 1.7 This Amendment is not intended to and does not merge the leasehold estates of the 1960 Lease and the 1966 Lease, or the rights, liabilities, or obligations (collectively, “ Rights .”) of the Parties set forth in the 1960 Lease and the 1966 Lease. Further, in no event shall the Lessees (except for APS) have any Rights under the 1960 Lease or with respect to the leasehold estate demised to APS under the 1960 Lease. Rather, except for APS, all the Lessees’ Rights are limited only to the Four Corners Project, as set forth in the 1966 Lease.

2 **DEFINITIONS** .

- 2.1 “ § 323 Grant” or “§ 323 Grants ” — One or more grants of rights-of-way and easements under the Act of February 5, 1948 (62 Stat. 17, 18, 25 U.S.C. § 323-328), the Act of March 3, 1879 (20 Stat. 394, 5 U.S.C. § 485), as amended, and the Acts of July 9, 1832, and July 27, 1868 (4 Stat. 564, 15 Stat. 228. 25 U.S.C. § 2) and such regulations promulgated thereunder, as are applicable, including 25 C.F.R. § 1.2 and 25 C.F.R. Part 169.

- 2.2 “§ 323 Grant Land” — Has the meaning set forth in Section 5.2.
- 2.3 “Annual Payment” — Except for (i) payments owed to the Nation under the existing Settlement and Closing Agreements that the Nation has executed with each individual Lessee, (ii) payments that will be owed to the Nation under the Settlement and Closing Agreements set forth in Section 14, and (iii) the payment set forth in Section 4.5, the total and sole payment that shall be made by (X) APS to the Nation, in consideration for the rights set forth in the 1960 Lease, including, but not limited to, (a) all leasehold rights, (b) the Existing § 323 Grants, and (c) the Renewed § 323 Grants; and by (Y) the Lessees to the Nation, in consideration for the rights set forth in the 1966 Lease, including, but not limited to, (a) all leasehold rights, (b) the Existing § 323 Grants, and (c) the Renewed § 323 Grants.
- 2.4 “Communication Sites” — The communication sites and related facilities identified within item 5 of Exhibit B.
- 2.5 “Existing § 323 Grants” — The § 323 Grants set forth on Exhibit B.
- 2.6 “Four Corners Project” — Has the meaning set forth in the 1966 Lease.
- 2.7 “Initial Four Corners Plant” — Has the meaning set forth in the 1966 Lease.
- 2.8 “Plan” — Has the meaning set forth in Section 7.1.
- 2.9 “Plant” — For convenience only, and not to merge the leasehold estates under the 1960 Lease and the 1966 Lease, a reference to the Initial Four Corners Plant and the Four Corners Project, respectively.
- 2.10 “Renewed § 323 Grants” — Has the meaning set forth in Section 4.2.

2.11 “Navajo Nation Lands” — Has the meaning set forth in the 1966 Lease for the term “Reservation Lands.”

2.12 “Secretary” — The Secretary of the United States Department of the Interior or his or her duly authorized designee, representative, or successor.

2.13 “Transmission Lines” — The electrical transmission lines and related facilities identified within items 3 and 4 of Exhibit B.

3 **TERM.**

3.1 This Amendment shall become effective when it has been signed by the Lessees and subsequently signed by the Nation’s duly authorized representative, pursuant to a Navajo Nation Council Resolution approving this Amendment.

3.2 The Navajo Nation Council Resolution approving this Amendment, and signature by the Nation’s duly authorized representative, shall be deemed to be sufficient legal approval by the Nation of this Amendment.

3.3 This Amendment shall terminate on the Amendment 2 Termination Date.

3.4 In the event this Amendment terminates as a result of the arrival of July 6, 2016, Edison shall not be relieved of any of its continuing or accrued and unfulfilled or unperformed obligations to the Nation under the 1966 Lease, and Edison shall retain all of its rights under the 1966 Lease with respect to such continuing obligations.

4 **NATION’S CONSENT TO § 323 GRANTS BY SECRETARY FOR THE PLANT, TRANSMISSION LINES, AND COMMUNICATION SITES.**

4.1 The Nation has previously consented to, and the Secretary has granted, the Existing § 323 Grants, and the renewal, extension or reissuance of each Existing § 323 Grant will be necessary.

- 4.2 The Nation consents and covenants to consent now, and for the terms of each of the 1960 Lease and the 1966 Lease (collectively, “Consents”), that the Lessees shall have the right to obtain, by grant from the Secretary, and the Nation Consents to the grant by the Secretary, of renewed, extended, or reissued § 323 Grants for the rights-of-way covered in the Existing § 323 Grants. (Such renewed, extended, or reissued § 323 Grants are referred to as the “Renewed § 323 Grants”).
- 4.3 The Nation and Lessees will cooperate fully with each other and the Secretary to obtain the Renewed § 323 Grants.
- 4.4 The Navajo Nation Council Resolution approving this Amendment shall be deemed to be sufficient legal approval by the Nation for the Renewed § 323 Grants. No further consideration shall be required by the Nation in order for the Secretary to issue the Renewed § 323 Grants.
- 4.5 The Lessees shall provide the Nation a copy of applications for the Renewed § 323 Grants, and each application shall be accompanied by a payment of no more than \$800 per application.
- 4.6 The Existing § 323 Grants and the Renewed § 323 Grants shall be additional and supplementary to, separate and independent from, and not conditioned upon the leasehold rights leased to APS under the 1960 Lease and to the Lessees under the 1966 Lease; and a termination of either the 1960 Lease or the 1966 Lease for any reason shall not terminate any §323 Grant, and a termination of any § 323 Grant for any reason, shall not terminate the 1960 Lease or the 1966 Lease.

- 4.7 The Nation agrees to support the renewal, extension, or reissuance of the Existing § 323 Grants as categorically excluded under section 3.2A of the Bureau of Indian Affairs' 2005 National Environmental Policy Act Handbook. If the Secretary determines that additional environmental impact analysis is required, the Nation hereby grants Lessees access to all Navajo Nation Lands necessary to complete such additional analysis. Lessees will work with the appropriate Navajo Nation agencies to effectuate any necessary access to any Navajo Nation Lands. The Nation also agrees to assist the Lessees in completing such analysis and to take reasonable actions to reduce the time and cost required to complete such analysis.
- 4.8 Except as set forth in the 1960 Lease, APS shall not change the voltages of the Transmission Lines without the Nation's prior approval.
- 4.9 Under no circumstances shall any § 323 Grant be interpreted as granting a fee simple interest to the Lessees or any other property interest, except as set forth in the § 323 Grant.

5 **ADDITIONAL TERMS REGARDING § 323 GRANTS FOR TRANSMISSION LINES.**

- 5.1 The provisions of Section 5.2 through Section 5.7, Section 11, and Section 13 below constitute a separate agreement between the Nation and APS. In no event shall any default, action or omission by APS under Section 5.2 through Section 5.7, Section 11, or Section 13 below have any effect on any other Parties' rights, privileges, duties, obligations and liabilities under the remainder of this Amendment.
- 5.2 The Navajo Nation Lands subject to an Existing § 323 Grant or a Renewed § 323 Grant and pertaining only to the Transmission Lines shall hereinafter be referred to as "§ 323 Grant Land."
- 5.3 The use of the § 323 Grant Land shall be strictly limited to constructing, reconstructing, replacing, repairing, operating and maintaining the Transmission Lines. Any other use of the § 323 Grant Land shall require the consent of the Nation. The consent of the Nation may be given, given upon conditions, or denied at the sole discretion of the Nation.

- 5.4 The Nation shall be under no obligation to forego the use of the § 323 Grant Land or any portion or lands burdened by the § 323 Grant Land, or to refrain from authorizing any use of said lands by any third party, including but not limited to, the exploration for and development and transportation of coal, oil, gas, or other natural resources located within or beneath said lands, except to the extent that such use physically interferes with the operation and maintenance of the Transmission Lines or interferes with the purposes of the § 323 Grants.
- 5.5 Upon the Nation's proposed authorization of the use of the § 323 Grant Lands by any third party, which new use may occupy the § 323 Grant Lands or otherwise burden the § 323 Grant Lands, the Nation agrees to notify APS and commence good faith consultation with APS prior to the Nation's final approval of said third party use. Prior to the Nation's final approval, the Nation shall require the third party to enter into an agreement with APS, which agreement must be acceptable to APS, to indemnify, defend, and hold APS harmless from any and all liability arising from the third party's use, interest, and activities within the § 323 Grant Land.
- 5.6 Five years prior to the expiration of a Renewed § 323 Grant, or as soon as practicable after any earlier termination of a Renewed § 323 Grant, APS and the Nation shall meet to discuss whether APS will leave in place all, some, or none of the Transmission Lines. If APS and the Nation cannot agree to terms regarding the disposition of one or more of the Transmission Lines, APS shall remove the Transmission Line(s) for which no agreement is reached, in accordance with the

Lease and applicable laws and requirements, and shall leave the § 323 Grant Land in good condition. On the expiration date of a Renewed § 323 Grant, APS shall have ninety (90) days to peaceably and without legal process deliver the possession of the § 323 Grant Land, with or without the Transmission Lines, as the case may be. In the event a Renewed § 323 Grant is terminated early, APS shall have six months to peaceably and without legal process deliver the possession of the § 323 Grant Land for such terminated § 323 Grant, with or without the Transmission Lines, as the case may be. If delivery cannot be performed on or before such 90-day period or six month period, as the case may be, APS and the Nation shall commence good faith negotiations for compensation, fees or damages to be paid to the Nation for prospective periods of occupation, use, or burden of the § 323 Grant Lands.

5.7 Holding over by APS after the expiration or early termination of a Renewed § 323 Grant shall not constitute an extension/renewal thereof, or give APS any rights in or to the § 323 Grant Lands. Holding over after expiration or early termination of a Renewed § 323 Grant shall not give APS any rights via a Renewed § 323 Grant. Following expiration or early termination of a § 323 Grant, the act of applying for a § 323 Grant from the Secretary shall not give APS any rights to the § 323 Grant land.

6 NATION’S SUPPORT OF ENVIRONMENTAL REVIEWS AND § 323 GRANTS.

The Nation shall work with the Lessees to obtain the necessary regulatory approvals and to advocate on behalf of the Lessees in support of any National Environmental Policy Act, Endangered Species Act, or National Historic Preservation Act analyses; § 323 renewals or extensions; or any other requirements of the Department of the Interior (“ DOI ”) or the Nation that are prerequisites necessary to conduct the operations of the Plant, Transmission Lines, and Communication Sites. In its interactions with the DOI, the Nation shall support the interests of the Lessees and advocate positions that support the continued operations of the Plant, Transmission Lines, and Communication Sites.

7 **EMPLOYMENT AT THE FOUR CORNERS GENERATING STATION.**

Section 19 of the 1960 Lease, Section 24 of the 1966 Lease and Section 25 of the 1966 Lease (as amended by Section 12 of the 1985 Lease Supplement) are deleted in their entirety and replaced as follows:

- 7.1 Without limiting the scope or effectiveness of the provisions of Section 17 of the 1960 Lease (Operation of Power Plant) or Section 22 of the 1966 Lease (Operation of Enlarged Four Corners Generating Station), APS and the Lessees shall comply with the terms of the Four Corners Generating Station Preference Plan (the "Plan"), attached as Exhibit C.
- 7.2 In the event that, in the opinion of their counsel, federal law develops in the future to permit APS and the Lessees, respectively, to grant a preference in employment based on tribal affiliation, as distinguished from a "Native American Indian" preference in employment, APS and the Lessees shall practice a Navajo preference in employment at the Plant in accordance with the requirements of this Section 7 and the Plan.
- 7.3 If, at any time, APS's then current Collective Bargaining Agreement (which governs labor at the Plant), as negotiated by APS in its sole discretion, conflicts with this Section 7 or the Plan, then APS's Collective Bargaining Agreement shall take precedence.

8 **ADVISORY COMMITTEE** .

APS, the Lessees, and the Nation shall establish a Four Corners Advisory Committee for the purpose of promoting open dialogue between them regarding operations of the Plant.

- 8.1 The Committee shall consist of two members of the Navajo Nation Government with experience in energy-related matters, one from the executive and one from the legislative branch, and two senior officials representing APS and the Lessees, who shall be tasked to work together and in consultation with their respective leaderships to resolve concerns raised by APS and the Lessees or the Nation in a mutually beneficial manner. The Committee shall meet regularly, but no less than two times a year. Discussion topics and updates may include voluntary compliance agreements, the impact of plant operations on the Nation's members and surrounding communities and emerging issues.
- 8.2 APS and the Lessees or the Nation may submit disagreements and disputes to the Committee for discussion and possible resolution. Decisions of the Committee shall be in the nature of recommendations and shall not be binding on APS and the Lessees or the Nation.

9 **ANNUAL PAYMENT** .

- 9.1 The Annual Payment shall replace all compensation for rents, rights of way, or otherwise, set forth in the § 323 Grants (as to the § 323 Grant Land), the 1960 Lease and the 1966 Lease, as applicable. All sections of the aforementioned documents imposing a payment obligation on APS and the Lessees are hereby deleted.

- 9.2 The Annual Payment, which shall be \$7,000,000 (in 2011 dollars), shall begin on July 6, 2011. All subsequent Annual Payments shall be subject to annual adjustments, based upon changes in the April Consumer Price Index U.S. City Average for All Urban Consumers, published by the U.S. Bureau of Labor Statistics (“CPI”). The annual CPI adjustment for the Annual Payment shall be as set forth in Exhibit D.
- 9.3 On or before July 6 of each year, APS and the Lessees shall submit one check for the Annual Payment to the Nation and indicate the adjustment required by the CPI.
- 9.4 No Lessee shall be responsible or liable to the Nation for the payment of any portion of such Annual Payment of any other Lessee. In the event that one or more Lessees fails to pay the Nation its portion of such Annual Payment at the time such Annual Payment is submitted to the Nation, APS (or the then operator of the Plant) shall inform the Nation of the name of the Lessee(s) failing to make the Annual Payment and the specific amount of each such Lessee’s shortfall. In the event the Nation incurs costs associated with obtaining the required Annual Payment owed, the Nation shall be entitled to recover from the defaulting Lessee(s) its associated costs, including, but not limited to, attorney’s fees, filing fees and interest accrued. A list of each Lessee’s portion of the Annual Payment shall be provided to the Nation.
- 9.5 The Nation agrees that the Annual Payment payable by APS and the Lessees constitutes fair and adequate consideration for the rights granted in the 1960 Lease, the 1966 Lease, the Existing § 323 Grants and the Renewed § 323 Grants.

- 9.6 Upon agreement between the Lessees, the percentage of the Annual Payment owed by each of APS and the Lessees, respectively, may be changed without the consent of the Nation. But in no event shall the amount due be less than 100% of the Annual Payment, as calculated in accordance with Section 9.2. In the event of a change in payment percentages, an updated list of each Lessee's portion of the Annual Payment shall be provided to the Nation.
- 9.7 In consideration of the Annual Payment made by APS and the Lessees, respectively, the Nation releases APS and the Lessees from all and any kind of claims, suits, actions, causes of action, rights, liabilities, and obligations (the aforementioned, collectively referred to as "Claims"), whether past, present, or future, known or unknown, for or related to compensation due under the 1960 Lease or 1966 Lease, or compensation for the Existing § 323 Grants and the Renewed § 323 Grants. In consideration of the Annual Payment made by APS and the Lessees, respectively, the Nation releases APS and the Lessees from and settles all outstanding issues and potential Claims, under the 1960 Lease or 1966 Lease, or under the Existing § 323 Grants. Notwithstanding the foregoing, the release set forth in this Section 9.7 shall not apply to any claims arising under Section 11 of this Amendment.
- 9.8 APS and the Lessees release the Nation from and settle all outstanding issues and potential Claims under the 1960 Lease or the 1966 Lease, or under the Existing § 323 Grants. Notwithstanding the foregoing, the release set forth in this Section 9.8 shall not apply to any claims arising under Section 11 of this Amendment.

10 **SURVEY OF PLANT.**

- 10.1 APS and the Lessees and the Nation agree that part of the Annual Payment is based on their understanding that the Plant Site and the Ancillary Facilities, as identified within items 1 and 2 of Exhibit B (the "Plant Property"), comprise a total of 3,663 acres (3,600 acres, with an upper margin of error of 63 acres) (the "Expected Plant Property Acreage").

- 10.2 APS and the Nation agree that part of APS's share of the Annual Payment is based on their understanding that the § 323 Grant Land comprises 10,000 acres (9839.40 acres, with an upper margin of error of 172 acres) (the "Expected § 323 Grant Land Acreage").
- 10.3 APS, for the § 323 Grant Land, and APS and the Lessees, for the Plant Property, shall conduct surveys of the § 323 Grant Land and the Plant Property, respectively, within twelve months for the § 323 Grant Land, and six months for the Plant Property, after the effective date of this Amendment. The Nation hereby grants APS and the Lessees access to all Navajo Nation Lands necessary to complete such surveys, and APS and the Lessees will work with the appropriate Nation agencies to effectuate any necessary access to any Navajo Nation Lands. The actual acres for the Plant Property and the § 323 Grant Land, as determined in such surveys, shall each be referred to as the "Actual Acreage." If the Actual Acreage for the Plant Property exceeds the Expected Plant Property Acreage, or if the Actual Acreage for the § 323 Grant Land exceeds the Expected § 323 Grant Land Acreage, then Section 10.4 and, if necessary, Section 10.5 shall apply. If Section 10.4 does not apply, there shall be no adjustment to the Annual Payment and no other compensation shall be due to the Nation.
- 10.4 If the Actual Acreage for the Plant Property exceeds the Expected Plant Property Acreage, or if the Actual § 323 Grant Land Acreage exceeds the Expected § 323 Grant Land Acreage, APS (individually) or APS and the Lessees, as the case may be, shall have 90 days to cure and reduce the respective Actual Acreages to at or below the Expected Plant Property Acreage or Expected § 323 Grant Land Acreage, as the case may be. If the Actual Acreages are reduced accordingly, there shall be no adjustment to the Annual Payment and no other compensation shall be due to the Nation.

- 10.5 For any Actual Acreage in excess of the Expected Plant Property Acreage or Expected § 323 Grant Land Acreage that APS (individually) or APS and the Lessees fail or choose not to cure, the Annual Payment shall be adjusted in the next Annual Payment as follows: (a) for each one acre the Actual Acreage of the Plant Property exceeds the Expected Plant Property Acreage, the Annual Payment shall increase by \$269, adjusted annually by the CPI (in 2011 dollars); and (b) for each one acre the Actual Acreage of the § 323 Grant Land exceeds the Expected § 323 Grant Land Acreage, the Annual Payment payable by APS shall increase by \$612, adjusted annually by the CPI (in 2011 dollars).
- 10.6 Any adjusted Annual Payment shall be prospective only, and there shall be no true-up required for previous Annual Payments, and the Nation shall have no claims against the Lessees for additional liabilities or compensation for historic use of the Plant Property or the § 323 Grant Land related to property survey inaccuracies.
- 10.7 The respective surveys will not be used to acquire additional or different lands beyond what the surveys demonstrate comprise the current boundaries of the Plant Property or the § 323 Grant Lands.
- 11 **APS'S 230kV LINES**.

APS and the Nation disagree as to whether the provisions of Section 17 of the 1960 Lease (Operation of Power Plant) or Section 22 of the 1966 Lease (Operation of Enlarged Four Corners Generating Station) apply to the Existing §323 Grants listed on Exhibit B for the 230kV lines identified as (a) Flagstaff to Leupp and (b) Cholla to Leupp (collectively, the "Leupp Lines"). APS and the Nation each reserve the right to assert that the aforementioned sections apply or do not apply to the Leupp Lines, as the case may be.

12 **DECOMMISSIONING**.

Upon the decommissioning of the Initial Four Corners Plant, the Four Corners Project or any part of either facility, the final decommissioning obligations of APS as to the Initial Four Corners Plant and of the Lessees as to the Four Corners Project shall be limited to the requirements under the applicable federal environmental laws existing at the time of such decommissioning. All or any part of any such decommissioning may occur at any time during the term of either the 1960 Lease or the 1966 Lease, as applicable.

13 **MOENKOPI SUBSTATION**.

In the event that there is a future expansion of the Moenkopi Substation, it shall be subject to an increase in APS's portion of the Annual Payment by \$1500 per acre (in April 2009 dollars) for up to 100 acres. The \$1500 per acre payment shall be adjusted annually by the CPI (in April 2009 dollars). The expansion shall be subject to all applicable regulatory requirements.

14 **SETTLEMENT AND CLOSING AGREEMENTS**.

Except for Edison, each Party shall execute a new Settlement and Closing Agreement in form and substance substantially similar to the proposed sample Settlement and Closing Agreement attached as Exhibit F.

15 **NO CROSS DEFAULT**.

Notwithstanding anything to the contrary in this Amendment, the 1960 Lease or the 1966 Lease, a default by APS under the 1960 Lease, as amended by this Amendment, shall not constitute a default by Lessees under the 1966 Lease, and a default by Lessees under the 1966 Lease, as amended by this Amendment, shall not constitute a default by APS under the 1960 Lease.

16 **PRIMARY FUEL**. The primary fuel used at the Plant shall be coal.

17 **NO THIRD PARTY BENEFICIARIES**.

The 1960 Lease and the 1966 Lease are not intended to confer upon any third person any rights, privileges, waivers, obligations, or remedies granted hereunder.

18 **EXECUTION IN COUNTERPARTS**.

This Amendment may be executed in any number of counterparts, and each executed counterpart shall have the same force and effect as an original instrument and as if all of the Parties to the aggregate counterparts had signed the same instrument. Any signature page of this Amendment may be detached from any counterpart thereof without impairing the legal effect of any signatures thereon, and may be attached to other counterparts of this Amendment identical in form hereto but having attached to it one or more additional signature pages.

This Amendment has been executed by the duly authorized representatives of the Parties, effective as set forth in Section 3.1.

THE NAVAJO NATION

By: /s/ Ben Shelly
Printed Name: Ben Shelly
Its: President

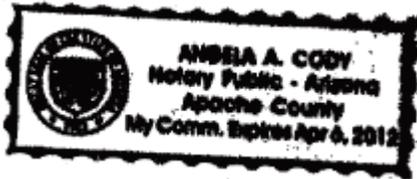
State of Arizona

County of Apache

The foregoing instrument was acknowledge before me this 7th day of March, 2011 by Ben Shelly the PRESIDENT of
(Name) (Title)
THE NAVAJO NATION , on behalf of The Navajo Nation.

/s/ Angela Cody
Notary Public

My Commission Expires:



ARIZONA PUBLIC SERVICE COMPANY , an Arizona corporation, in its individual capacity and as a Lessee

By: /s/ Mark A. Schiavoni
Printed Name: Mark A. Schiavoni
Its: Senior Vice President, Fossil

State of Arizona

County of Maricopa

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Mark A. Schiavoni the Senior Vice
(Name) (Title)
President, Fossil of **ARIZONA PUBLIC SERVICE COMPANY**, an Arizona corporation, on behalf of the corporation.

/s/ Norann Ascitutto
Notary Public

My Commission Expires:
2-27-14



**Reviewed and Approved
Legal Department**

EL PASO ELECTRIC COMPANY ,
a Texas corporation

/s/ [ILLEGIBLE]

By: /s/ David W. Stevens
Printed Name: David W. Stevens
Its: CEO

State of Texas

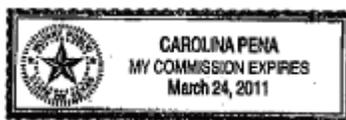
County of EL Paso

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by David W. Stevens the CEO of **EL PASO ELECTRIC COMPANY** , a Texas corporation, on behalf of the corporation.
(Name) *(Title)*

/s/ Carolina Pena

Notary Public

My Commission Expires:
3-24-2011



PUBLIC SERVICE COMPANY OF NEW MEXICO , a
New Mexico corporation

By: /s/ Patricia K. Collawn
Printed Name: Patricia K. Collawn
Its: President & CEO

State of New Mexico

County of Bernalillo

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Patricia K. Collawn the President & CEO of **PUBLIC SERVICE COMPANY OF NEW MEXICO** , a New Mexico corporation, on behalf of the corporation.
(Name) *(Title)*

/s/ [ILLEGIBLE]

Notary Public

My Commission Expires:

September 12, 2012

SOUTHERN CALIFORNIA EDISON COMPANY , a California Corporation

By: /s/ RW Krieger
Printed Name: RW Krieger
Its: Vice President

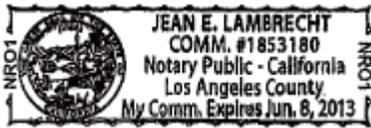
State of California

County of Los Angeles

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Jean E. Lambrecht the Notary of
SOUTHERN CALIFORNIA EDISON COMPANY , a California corporation, on behalf of the corporation.
(Name) (Title)

/s/ Jean E. Lambrecht
Notary Public

My Commission Expires:
June 8, 2013



TUCSON ELECTRIC POWER COMPANY , an Arizona Corporation

By: /s/ Michael J. DeConcini
Printed Name: Michael J. DeConcini
Its: Senior Vice President and
Chief Operating Officer

State of Arizona

County of Pima

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Michael J. DeConcini the Sr. Vice
President & Chief Operating Officer of **TUCSON ELECTRIC POWER COMPANY** , an Arizona corporation, on behalf of the
corporation.
(Name) (Title)

/s/ Janice Spencer
Notary Public

My Commission Expires:
8/8/11



SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT, an agricultural improvement district organized under the laws of the State of Arizona.

By: /s/ David Rousseau
David Rousseau, President or
John R. Hoopes, Vice President

Date: 11/23/2010

Reviewed by SRP Legal Services

By: /s/ Kanlee Ramaley
Signature

Kanlee Ramaley
Printed Name

Date: 11/23/2010

Attest and Countersign:

By: /s/ Terrill A. Lonon
Terrill A. Lonon, Secretary or
Stephanie K. Reed, Assistant Secretary

Date: 11/23/2010

State of Arizona

County of Maricopa

The foregoing instrument was acknowledge before me this 23rd day of November, 2010 by David Rousseau the President
(Name) *(Title)*
of **SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT** , an agricultural improvement district organized under the laws of the State of Arizona.

/s/ Stephanie K. Reed
Notary Public

My Commission Expires:
August 5, 2011



EXHIBIT A

This exhibit intentionally not used.

Exhibit B

<i>Item</i>	<i>Existing § 323 Grants</i>	<i>Property or Facility</i>	<i>APS File #</i>	<i>Grant Date</i>	<i>Expiration Date</i>	<i>Acres</i>
1	Plant Site	Amended Original Lease (Units 1-3)		12/01/60	07/06/16	
		New Lease (Units 4-5)		07/06/66	07/06/16	
						3,466.42
2	Ancillary Facilities	Utah Mine Haul Road (Communication Lines and Access Road)	IN-13	07/2861	07/28/11	19.25
		Plant — Coal Lease Area — 69 kV	IN-15	12/15/61	12/15/11	3.75
		Pumping Station to Plant Access Road & Pipeline	IN-12	04/02/62	04/02/12	40.91
		River Pumping Station to Plant — 69 kV	IN-11	04/02/62	04/02/12	21.74
		Plant — EPNG Bridge / Access Rd	IN-16	07/03/63	07/03/13	37.57
		Pumping Station to Plant Access Road & Pipeline Addition	IN-92	04/21/69	04/21/19	10.36
						133.58
3	500 kV ROW	El Dorado 500 kV (Navajo portion only)	IN78 INH-79,			
			INH-80	03/22/67	03/22/17	3,959.29
	345 kV ROW	Four Corners to Cholla	IN-17	05/26/61	05/26/11	5,658.91
	230 kV ROW	Flagstaff to Leupp	IN-4	09/12/57	09/12/07	102.82
Cholla to Leupp		IN-7	09/21/60	09/21/10	249.16	
4	Substation Sites	12 kV line and Roadway to Moenkopi Switchyard	INH-88	04/24/70	04/27/95	1.12
		Leupp Substation	IN-5	05/06/59	05/06/09	.43
		Moenkopi Switchyard	INH-83	04/09/68	04/09/18	211.09
5	Communication Sites	Preston Mesa Communication Site	IN-1182	12/30/96	12/30/14	0.23
		Jacks Peak Communication Site	IN-1181	04/16/02	04/15/17	1.75
		Dezza Bluff Communication Site	IN-1357	12/15/97	12/14/17	0.08
		Zilnez Mesa Microwave Site, Navajo Reservation	IN-113	01/03/73	01/03/23	2.40
		Roof Butte Communication Site	IN-85	07/07/70	07/07/20	0.02
		Marsh Pass Communication Site	IN-116	01/03/73	01/03/23	3.90

* *Certain of the terms used to describe the listed property or facilities have the meanings given to them in the 1960 Lease and 1966 Lease.*

Exhibit C

FOUR CORNERS GENERATING STATION

PREFERENCE PLAN

March 7, 2011

Table of Contents

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I. INTRODUCTION

The purpose of this Preference Plan is to clarify and delineate Arizona Public Service Company's ("APS") Indian Preference Plan for the Four Corners Generating Station ("Four Corners") and specifically, the procedures for giving preference in employment to Indians.

II. PREFERENCE POLICY STATEMENT

Employment at Four Corners is based on qualifications without regard to race, color, creed, religion, national origin, sex, or age, except that preference will be given to qualified Indians, provided, however, that to the extent allowed by law (as set forth in Section 7.2 of the Amendment, to which this Preference Plan is attached), APS will give preference to qualified Navajos rather than to Indians. Each member of APS's management is responsible for implementing this policy in his/her areas and is held accountable for it in the same way each manager is held accountable for other company policies. In particular, the Plant Manager for Four Corners has overall accountability and responsibility for implementation of this Preference Plan.

III. SELECTION

In order to conduct operations at Four Corners in a safe and effective manner, all positions must be filled by persons qualified to perform the work required. APS has procedures to evaluate the qualifications (knowledge, skills and abilities) required for each job position. In general, these job qualifications are documented in "job descriptions" maintained by APS's Human Resource Department. Employees may also obtain a copy of their job descriptions by contacting their supervisors.

Job requirements consist of standards which identify the skills, education, and experience necessary to perform a particular job. These job requirements are the basis for hiring decisions and are also used to formulate employee training programs for job classifications with few incumbent-Indian employees. Hence, it is important that the job descriptions describe the true requirements of the job. For this reason, APS will review its job descriptions to assure that the job qualifications are relevant to the job requirements.

Qualifications are assessed on the basis of performance reviews, skills evaluations, experience and education, as appropriate for the position under consideration. Supervisors (and previous employers, in the case of external applicants) may be contacted. Skills may be evaluated by written tests, skill demonstrations, or by supervisory interview. Tests will be validated for job relevancy.

APS is committed to Indian preference in employment. Preference will be given to Indians who possess the skills and abilities to fulfill the job requirements established above.

IV. GOALS

The purpose of this Preference Plan is to provide a means to increase the employment of Indians at Four Corners, in both regular full-time and temporary positions. In particular, APS intends to focus on increasing the overall employment of Indians at Four Corners and promoting Indians into management positions.

Analysis of Indian employment levels by job classification will lead to establishing goals for job placement and training. These goals will be reviewed annually to evaluate the progress made toward the objective, and revised as necessary.

The commitment of APS is to offer available job opportunities to Indians who satisfy job requirements, whether the person is a current employee or a non-employee identified through recruitment and advertising. Through the adoption and implementation of training programs at Four Corners, the long-range goal is to develop a pool of Indian candidates qualified for all positions.

Openings created through resignation, discharge, transfer, promotion, or a newly created position cause the posting of an internal "bid" and create opportunities for internal movement through the bid process. Bidding is the established process by which job vacancies are announced, advertised and filled. When vacancies occur, employees, who feel they have the qualifications for a particular job, may submit their internal applications (bids) for consideration.

The bid process frequently creates a cascading effect, as employees vacate existing jobs to fill positions that result from another employee accepting a bid to fill the original vacancy. When an Indian bidder accepts a position vacated by another Indian, the net effect on the overall percentage of Indian employment is zero. While Indian bidders will be given preference in accordance with this Preference Plan, an increase in the total percentage of Indian employees at Four Corners can be expected only when the cascading effect of the bid system results in the employment of external Indian candidates.

Nevertheless, the potential for increasing the number of Indian employees is greater in certain job classifications than in others. Some of these job classifications are:

- First and second level supervision
- Operations (Operator Trainee through Control Operator)
- Machinist
- Plant Mechanic
- Electrician
- Equipment Operator
- Plant Chemist
- Scheduler

Four Corners management will give these job classifications particular attention to increase employment of Indians. Additionally, technical and professional recruiting will be increased to locate, identify, and employ suitable Indian candidates for engineers, technicians, and professional positions.

V. TRAINING

When there are too few qualified Indian bidders, internal training programs to increase the availability of Indian bidders may be appropriate. Training programs should focus on raising the level of skills, knowledge and abilities of Indians in “feeder jobs.” These are jobs which typically provide employees for higher level jobs, particularly when the lower level job has skill, knowledge and ability requirements that are prerequisites for a higher level job. Training should continue until the goal has been met. Other “in-place” training programs, such as apprenticeships and operations training, are on-going and continue to provide trained replacements for journeymen.

Indians will be encouraged to enhance their careers at APS by taking advantage of on-the-job training, apprenticeships, and in-house and off-the-job educational courses. As a specific part of this Preference Plan, the following actions will be taken to provide opportunities for Indians to advance to journeyman-level and supervisory positions.

1. New apprenticeships will be awarded only to qualified Indians.
2. Currently employed Indian journeymen will be selected for supervisory training to make them better qualified for future opportunities in foreman positions.

Because of the magnitude of the work and its accompanying time constraints, virtually everyone at Four Corners is affected by an overhaul. Four Corners has chosen to supplement the knowledge, skills and experience of its regular full-time employees with those of temporary workers with job specific skills. During an overhaul, where possible, regular full time employees are upgraded to higher level skill positions including supervisory positions. In this manner, employees may further expand the practical application of their technical and supervisory skills.

VI. RECRUITMENT/ADVERTISING FOR REGULAR EMPLOYEES

Recruitment is any activity that causes individuals to apply for employment. Advertising is one method of recruitment. Examples of other methods include meetings with graduating college seniors, participation in trade fairs, and day programs.

Since most regular full-time jobs at Four Corners are filled internally, a large recruitment effort is not needed. Thus, recruitment of regular full-time employees should be limited to those positions which are not filled by Indians internally. For purposes of this Preference Plan, recruitment will concentrate on jobs in which Indians are underutilized.

In an effort to attract qualified Indian applicants, contacts with key organizations throughout the Navajo Reservation will be maintained, although contacts within the Western Navajo Agency will be emphasized. In addition, Four Corners will work with appropriate tribal agencies to develop other potential recruitment sources.

Universities, vocational schools, Joint Training and Partnership Act classroom training programs, the Navajo Division of Education, the ONLR, and employment service offices located in the vicinity of Four Corners will be included in the recruitment and advertising efforts of Four Corners. Technical and professional jobs will be emphasized in recruitment efforts at colleges, universities, and in periodic advertisements to attempt to locate and identify suitable Indian candidates for employment opportunities.

Advertising and recruiting efforts will include a statement that APS at Four Corners recognizes Indian preference in employment. The following statement will be included in all advertisements for employment opportunities at Four Corners and on bid sheets posting jobs at Four Corners:

APS follows a policy of giving preferential treatment to Indians in connection with employment at the Four Corners Generating Station.

VII. ADVERTISING/RECRUITING FOR TEMPORARY EMPLOYEES

Each year, temporary employees are hired for certain specific assignments at Four Corners. Only when no qualified Indian applicant is found, after a thorough review of returning Indian applicants, existing files on temporary Indian employees, and new applications from Indians (generated by advertising), will a temporary position be filled by a non-Indian.

VIII. CONTRACT LABOR/SERVICES

APS will select qualified Indian-owned businesses, when available, to provide contract labor or services at Four Corners. APS will notify its vendors (a) of the employment and contracting preference policy at Four Corners; and (b) that they are expected to comply with applicable laws and regulations.

IX. CROSS CULTURAL COMMUNICATIONS PROGRAM

APS will develop and implement a cross-cultural program designed to provide a forum for Indian and non-Indian employees to openly examine and discuss the culturally significant customs, beliefs, values, and social mores that all individuals bring with them to the workplace.

X. DISPUTE RESOLUTION FOR EMPLOYEES

APS acknowledges the value of maintaining a work environment free of prejudice and discrimination. Nevertheless, despite even the best of intentions, complaints do arise, and the parties have determined that complaints of whatever nature are best handled internally, without the involvement of external agencies. Therefore, employees are encouraged to take advantage of APS's existing internal processes. Through this approach, a wide variety of employment related complaints may be addressed and resolved.

If Navajo Nation officials become aware of an employment concern at Four Corners, the Navajo Nation must bring the issue to the Advisory Committee, formed pursuant to the Lease (to which this Preference Plan is attached), for resolution.

XI. ENTIRE AGREEMENT; NO THIRD PARTY BENEFICIARIES

This Preference Plan is the entire agreement between the Parties concerning its subject matter and supersedes all prior agreements and understandings, whether or not written, including without limitation the letter agreement dated March 8, 1985 between APS and the Navajo Nation and signed by G. Mark De Michele and Peterson Zah. This Preference Plan also is not intended to confer upon any person other than the Parties any rights, privileges, waivers, obligations or remedies granted hereunder.

Exhibit D

Annual Payment for 2012

$$\$7,000,000.00x \frac{\text{CPI for April 2012}}{\text{April 2011 CPI}}$$

Annual Payment for all subsequent years

$$7,000,000.00x \frac{\text{CPI for April in year which Annual Payment is due}}{\text{April 2011 CPI}}$$

Exhibit E

This exhibit intentionally not used.

Exhibit F
(Includes Exhibits A-D of the Restated and Amended Settlement and Closing Agreement)

DRAFT
11/4/2010 3:30 PM

Restated and Amended Settlement and Closing Agreement

This Restated and Amended Settlement and Closing Agreement (the “**Restated Agreement**”) amends the Settlement and Closing Agreement dated August 15, 2002 (“**Original Agreement**”) and is entered into as of the Effective Date (as defined in Section 18) by Arizona Public Service Company (“**APS**”) and the Office of the Navajo Tax Commission (“**ONTC**”), acting on its own behalf and, pursuant to Section 103 of the Navajo Nation Uniform Tax Administration Statute (“**UTAS**”), on behalf of the Navajo Nation. APS and the ONTC may be referred to herein individually as a “Party” or collectively as the “Parties.”

Recitals

A. Pursuant to Section 105 of UTAS, the ONTC, on behalf of the Navajo Nation, issued an assessment to APS on [Date] seeking to assess the Possessory Interest Tax (“**PIT**”) on APS in connection with its ownership and operation of the Four Corners Power Plant (the “**Plant**”), switchyards, and transmission and distribution facilities within the Navajo Nation (hereinafter, the Plant, switchyards, and transmission and distribution facilities within the Navajo Nation are collectively referred to as the “**Facilities**”). Pursuant to Regulation 1.125 of the ONTC Tax Administration Regulations, the ONTC also issued on [Date] a private ruling asserting that it has jurisdictional authority to impose the Business Activity Tax (“**BAT**”) upon APS’ activities related to the Facilities. Pursuant to Section 133 of UTAS, the ONTC is entering into this Restated Agreement.

B. APS and the other participants in the Plant (collectively, the “Participants”) assert that neither the Navajo Nation nor the ONTC has jurisdictional authority to impose any tax on APS, the Participants or the Facilities based on (i) certain agreements between the Navajo Nation, APS and Participants, including without limitation, certain covenants in leases entered into by APS, the Participants and the Navajo Nation and approved by the United States (“**Leases**”) and in federal grants of rights-of-way issued to APS and the Participants by the United States (“**Grants**”), (ii) the location of the Facilities on federally granted rights-of-way, (iii) the non-Indian character of APS and the Participants, and (iv) relevant case law.

C. The ONTC asserts that it possesses jurisdictional authority to administer taxes enacted by the Navajo Nation with respect to the Participants, including APS, and the Facilities based on (i) certain agreements between the Navajo Nation, APS and the Participants, including without limitation, certain covenants in the Leases and Grants, (ii) the location of the Facilities on lands held in trust by the United States for the benefit of the Navajo Tribe, and (iii) relevant case law.

D. The Parties entered into the Original Agreement for purposes of settling the dispute and to avoid litigation over the question of the jurisdictional authority of the Navajo Nation and ONTC to tax the Facilities and APS, based on its ownership interest in and operation of the Facilities.

E. The Parties desire to restate, amend and extend the Original Agreement and are thus entering into this Restated Agreement in accordance with the express terms set forth below.

WHEREFORE, THE PARTIES AGREE AS FOLLOWS:

1. Settlement Payments. Subject to the terms and conditions contained in this Restated Agreement, APS will make settlement payments as specified below (“**Settlement Payments**”):

a. PIT Settlement Payments.

(i) Beginning with calendar year 2001 and continuing through July 7, 2041 (the “**Amended Term**”), APS will pay to ONTC the following amount as a PIT Settlement Payment for the APS-owned Facilities, subject to adjustment as provided in subsection a(ii) of this Section 1:

Calendar Year	PIT Settlement Payment
2001	\$2,993,515.00
2002 – 2003	\$5,987,030.00 per year
2004 – 2040	\$6,342,600 per year
2041	\$3,171,300.00

(ii) Beginning July 8, 2016 and continuing through July 7, 2041, the PIT Settlement Payment is subject to reduction in the event APS and/or the Participants permanently shut down any of the Facilities and/or unit(s) of the Plant in which APS has an ownership interest, including but not limited to the permanent shut down of the entire Plant (the "Permanently Shut Down Facilities"). For any Permanently Shut Down Facilities salvage value will be determinative of value, and salvage value will be based on 5% of original or acquisition cost of the Permanently Shut Down Facilities in question. In the event of any permanent shut down under this Section 1a(ii), the PIT Settlement Payment will be recalculated in two steps:

- a. Step One : PIT Settlement Payment will be proportionally reduced by multiplying the PIT Settlement Payment by a factor that represents the ratio of the original or acquisition cost of the APS-owned Facilities within the Navajo Nation that are not Permanently Shut Down Facilities divided by the total original or acquisition cost of the APS-owned Facilities.
- b. Step Two : The proportionately reduced PIT Settlement Payment derived under Step One will then be increased by adding the product of a 3% in-lieu-of tax rate and the salvage value (i.e., 5% of original or acquisition cost) of the Permanently Shut Down Facilities. A sample calculation is included as Exhibit D to this Restated Agreement.

(iii) In the event APS constructs a new unit or units at the Plant during the Amended Term, the PIT Settlement Payment will be proportionally increased by an amount that represents the product obtained by multiplying the original or acquisition cost of the new APS-owned unit or units by the following factor:

- a. The PIT Settlement Payment of \$6,342,600 divided by the original or acquisition cost of the APS- owned Facilities within the Navajo Nation as of the Effective Date of this Restated Agreement. A sample calculation is included as Exhibit 1 to this Restated Agreement

(iv) APS will pay the PIT Settlement Payment specified above (as may be adjusted pursuant to Section 1a(ii) or Section 1a(iii), above) for calendar years 2002-2040 on a semi-annual basis, with the first half for each calendar year due November 1 and the second half due May 1 of the following year. APS will pay the PIT Settlement Payment specified above for calendar year 2041 on or before November 1, 2041. On or before June 1 of each calendar year during the term of this Restated Agreement, APS will provide to the ONTC, for informational purposes only, the form attached as Exhibit A.

(v) Interest on any late payment of the PIT Settlement Payment will be computed from the date the PIT Settlement Payment was first due to the date such payment is received by the ONTC. The rate of interest on any late payment will be equal to the rate then being used by the Internal Revenue Service for an underpayment of taxes by an individual. If APS fails to timely pay the PIT Settlement Payment, APS also will pay an additional amount equal to 5% of its PIT Settlement Payment. For each full month the payment is overdue, APS will pay an additional amount equal to 0.5% of its PIT Settlement Payment; provided, however, that the maximum additional amount APS must pay for the failure to timely pay shall not exceed 10% of the PIT Settlement Payment amount due. If APS fails to timely provide the Report for PIT Settlement Payment, attached as Exhibit A, as required by Section 1(a)(iv) of this Restated Agreement, APS will pay an additional 5% of its PIT Settlement Payment due for the period for each month or fraction thereof that the Report for PIT Settlement Payment is not provided; provided, however, that the minimum additional amount to be paid for failure to timely provide such Report for PIT Settlement Payment shall be \$50 and the maximum additional amount shall not exceed 25% of APS' PIT Settlement Payment for that period. For good cause shown, the ONTC may in its discretion relieve APS from all or part of the requirements imposed under this Section 1.a(v).

(vi) APS will provide, within six (6) months of the Effective Date of this Restated Agreement, a schedule of original or acquisition cost for the Facilities in which APS has an ownership interest (including the Permanently Shut Down Facilities) for use in connection with the calculations provided for in Section 1.a(ii). In addition, if APS constructs a new unit or units at the Plant for purposes of Section 1.a(iii), APS will provide a schedule of original or acquisition cost for such new unit or units within six (6) months after its/their completion, for use in connection with the calculations provided for in Section 1.a(iii).

(vii) The ONTC expressly agrees that APS is hereby released from any obligation and will not be required or requested to make any other payment with respect to any other amounts that the ONTC asserted or could have asserted were payable prior to execution of this Restated Agreement.

b. BAT Settlement Payment.

(i) Effective as of July 6, 2001 and continuing through the Amended Term, APS will calculate its BAT Settlement Payment amount using the following formula:

BAT Settlement Payment =

[(R * AI * Net KWhrs) less (Deductions) less (10% Standard Deduction)] * 5%

Where R = \$.0256 / KWhr.

Where Net KWhrs = APS' share of actual net kilowatt hours generated from the Plant during the quarterly period.

Where Deductions = (1) Salaries and/or other compensation paid to members of the Navajo Nation; (2) Purchases of Navajo goods and services; and (3) Any payment made to the government of the Navajo Nation, except for the BAT Settlement Payment paid pursuant to this Restated Agreement and any penalties or fines.

Where Standard Deduction = an amount equal to the greater of ten percent of (R * AI * Net KWhrs) or \$125,000.00.

As set forth on Exhibit C, APS will include in its Operating Report provided to the ONTC a statement of actual net generation for each quarter.

Where AI = an adjustment calculated in the 3rd Quarter of each year based upon a 5-year rolling average of Producer Price Index data published by the Bureau of Labor Statistics. Annual adjustments shall be cumulative, i.e., the total current year adjustment shall be equal to the incremental current year adjustment multiplied by the previous year's adjustment. The incremental adjustment shall be calculated utilizing the following methodology:

AI = (75% * Cost Index) plus (25% * Revenue Index).

Where Cost Index =

42.3% * Bituminous Coal and Lignite: West (BLS Series PCU1211#214)

plus 0.9% * Natural Gas(BLS Series PCU1331#A2)

plus 7.6% * Other Heavy Construction (BLS Series PCUBHVY#)

plus 49.2% * Unit Labor Costs: Non-Farm Business (BLS Series PRS85006112)

Where Revenue Index =

65.2% * Electric Power and Natural Gas Utilities, Other, Mountain (BLS Series PCU4981#148)

plus 34.8% * Electric Power and Natural Gas Utilities, Other, Pacific (BLS Series PCU4981#149)

If any of the BLS indices used in this calculation are discontinued, the Parties shall mutually agree upon an equivalent substitute BLS index. The Parties agree that, beginning January 1, 2002, the Bituminous Coal and Lignite: Surface Mining (BLS Series PCU1211#1) will be substituted into the calculation in place of Bituminous Coal and Lignite: West (BLS Series PCU1211#214).

A calculation of AI for the 3rd Quarter 2001 through the 2nd Quarter 2002 BAT Settlement Payments is attached as Exhibit B. The 5-year average of index data for 1996 through 2000 is used to develop this initial adjustment.

Each subsequent annual adjustment will be made for the 3rd Quarter BAT Settlement Payment using the 5-year rolling average of index data through the end of the previous year.

A sample calculation of AI for the 3rd Quarter 2002 through 2nd Quarter 2003 BAT Settlement Payments using estimated data is included in Exhibit B. Calculations in subsequent years will follow this same formula.

(ii) APS will make its BAT Settlement Payments on a quarterly basis, with payments due 45 days after the end of each calendar quarter. APS will, at the time of making such payments, provide to the ONTC an Operating Report containing the following information used to calculate APS' BAT Settlement Payment:

- (a) APS revenue requirement, as adjusted by AI;
- (b) Net KWhrs for the quarter;
- (c) Deductions as defined above; and
- (d) Standard Deduction.

The format for the Operating Report is set forth in Exhibit C.

(iii) Interest on any late payment of a BAT Settlement Payment will be computed from the date the BAT Settlement Payment was first due to the date such payment is received by the ONTC. The rate of interest on any late payments will be equal to the rate then being used by the Internal Revenue Service for an underpayment of taxes by an individual. If APS fails to timely pay the BAT Settlement Payment, APS will pay an additional amount equal to 5% of the BAT Settlement Payment due. For each full month the payment is overdue, APS will pay an additional amount equal to 0.5% of the amount of its BAT Settlement Payment; provided, however, that the maximum additional amount that APS will be required to pay for the failure to timely pay shall not exceed 10% of the BAT Settlement Payment amount due. If APS fails to timely provide to the ONTC an Operating Report required by this Restated Agreement, APS will pay an additional 5% of its BAT Settlement Payment for each month or fraction thereof that the Operating Report has not been provided to the ONTC; provided, however, that the minimum additional amount to be paid for APS' failure to timely provide such Operating Report will be \$50 and the maximum additional amount will not exceed twenty-five percent (25%) of APS' BAT Settlement Payment for that period. For good cause shown, the ONTC may in its discretion relieve APS from all or part of the requirements imposed under this Section 2.b(iii).

(iv) The ONTC expressly agrees that APS is hereby released from any obligation and will not be required or requested to make any other payment with respect to any other amounts that the ONTC asserted or could have asserted were payable prior to execution of this Restated Agreement.

2. Releases.

a. APS hereby releases and forever discharges the ONTC, its predecessors, successors, affiliates, and assigns, of and from any and all claims, demands, damages, actions, causes of action, or suits of whatsoever kind and nature, existing as of the Effective Date of this Restated Agreement, whether now known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, allegedly owed by the ONTC, its predecessors, successors, affiliates, and assigns, to APS arising from APS' ownership interests or operation of the Facilities.

b. The ONTC hereby releases and forever discharges APS, its predecessors, successors, affiliates, and assigns, of and from any and all claims, demands, damages, actions, causes of action, or suits of whatsoever kind and nature, existing as of the Effective Date of this Restated Agreement, whether now known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, allegedly owed by APS, its predecessors, successors, affiliates, and assigns to the ONTC or Navajo Nation arising from APS' ownership interests or operation of the Facilities.

c. The ONTC expressly covenants that it will not seek to apply or assess the Navajo Sales Tax, approved by the Navajo Nation Council pursuant to Resolution No. CO-84-01 on October 18, 2001 (as amended), with respect to any electricity generated at, from or by the Plant except for retail sales of electricity to persons who purchase electricity for that person's own use, including use in that person's trade or business and not for resale, redistribution or retransmission, within the Navajo Nation.

3. Case Closure.

The Parties agree that the following cases shall be closed:

Possessory Interest Tax: Case No. 01-042

Business Activity Tax: Case No. 01-056

4. Preservation of Rights .

It is understood and agreed that this is a settlement of disputed claims, whether asserted or unasserted, and that nothing contained herein shall be construed as an admission of liability, guilt, or wrongdoing by or on behalf of any of the undersigned Parties, all such liability, guilt, or wrongdoing being expressly denied. The Parties acknowledge and agree that this Restated Agreement shall not prejudice or limit in any way the rights or contentions of any Party. The Parties further agree that this Restated Agreement shall not in any way be deemed a waiver or amendment of any provisions of any other agreement between the Navajo Nation, APS and/or any of the Participants, including but not limited to the Leases and Grants. This Restated Agreement, and the actions of the Parties contemplated hereunder, are not intended, nor shall they be deemed, to constitute any waiver, consent or admission with respect to the existence or lack of regulatory, taxing, or adjudicatory authority or jurisdiction of the Navajo Nation or the ONTC over the Facilities or any Party hereto.

5. Enforcement and Judicial Review .

a. Neither Party shall commence any judicial or administrative action challenging the validity of this Restated Agreement or any Party's authority to enter into it. Any commencement of such an action by a Party shall constitute a material breach of this Restated Agreement by that Party.

b. Challenge to Validity of the Restated Agreement .

(i) If the ONTC, or any of its representatives, officers, employees, departments or agents (a) commences any judicial or administrative action challenging this Agreement or the ONTC's authority to enter into it, or (b) otherwise in any manner invalidates or breaches this Restated Agreement or takes any action contrary to this Restated Agreement, APS may, in its sole discretion, elect to seek specific performance of or terminate this Restated Agreement. If the ONTC, or any of its representatives, officers, employees, departments or agents, repeals the PIT or BAT and enacts a replacement tax that the ONTC seeks to assert against APS or the Facilities, APS may terminate this Restated Agreement. The ONTC agrees and recognizes that if APS terminates this Restated Agreement, APS shall have no further obligation or liability to make any Settlement Payments from the date of termination forward. The ONTC further agrees and recognizes that in such circumstance, APS has preserved its rights to contest the jurisdiction of the ONTC or the Navajo Nation to assert or assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

(ii) If APS, or any of its representatives, officers, employees, departments, or agents (a) commences any judicial or administrative action challenging this Restated Agreement or APS' authority to enter into it, or (b) otherwise in any manner invalidates or breaches this Restated Agreement or takes any action contrary to this Restated Agreement, the ONTC may, in its sole discretion, elect to seek specific performance of or terminate this Restated Agreement. APS agrees and recognizes that, if the ONTC elects to terminate this Restated Agreement, the ONTC has preserved its rights to assert jurisdiction to assess taxes against APS from and after the date of termination with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities of APS within the Navajo Nation. If the ONTC elects to terminate this Restated Agreement, the ONTC shall be under no further obligation to accept Settlement Payments in satisfaction of APS' obligations.

(iii) If any person or entity not a Party to this Restated Agreement or the Navajo Nation, or any of their representatives, officers, employees, agencies, departments or agents, commences any judicial, administrative or other action challenging in any way the Restated Agreement's validity, the Parties shall jointly request that the court, tribunal, agency, or official before which the action is pending dismiss the action. If the action is not dismissed, either Party may file an appropriate responsive pleading, or otherwise act as reasonably necessary to respond to the action or to otherwise protect such Party. If any person, including the Navajo Nation or ONTC, brings an action or proceeding to assert or challenge the jurisdictional authority of the Nation or ONTC to tax the Facilities or activities at the Facilities with respect to such other person other than APS, each Party agrees not to rely on any ruling in such action or proceeding for purposes of challenging the validity of this Restated Agreement as long as the other Party is not in material breach hereof.

(iv) If any court, tribunal, agency or official determines that this Restated Agreement is non-binding on the ONTC or the Navajo Nation, APS may elect to terminate this Restated Agreement, and if so terminated, APS shall have no further obligation or liability to make any Settlement Payments from the date of termination forward. The ONTC agrees and recognizes that in such circumstance APS has preserved its rights to contest the jurisdiction of the Navajo Nation and ONTC to assert or assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

(v) If any court, tribunal, agency or official determines that this Restated Agreement is non-binding on APS, the ONTC may elect to terminate this Restated Agreement, and if so terminated, APS agrees and recognizes that in such circumstance, the ONTC has preserved its rights to assert jurisdiction to assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

c. Other Taxes. Nothing in this Restated Agreement affects the rights, if any, of (i) the Navajo Nation or ONTC to seek to enforce taxes other than the Sales Tax (except as otherwise provided in Section 2(c) above), PIT or BAT on APS or the Facilities or (ii) APS to challenge any such action by the Navajo Nation or ONTC, including when permitted by federal law, bringing such an action in federal court.

d. Enforcement of the Restated Agreement. Enforcement of this Restated Agreement by either Party shall be pursuant to this Restated Agreement and not pursuant to any Navajo Nation or other law independent of this Restated Agreement. Nothing in this Restated Agreement shall or may be deemed to limit a Party's right to seek enforcement of this Restated Agreement or defend any claim in federal or tribal court where otherwise permitted by law. Nothing in this Restated Agreement shall or may be deemed as a consent to federal or tribal court jurisdiction by either Party.

6. Assignment.

APS may transfer or assign, without the consent of the Navajo Nation or ONTC, all or any portion of its interests and obligations under this Restated Agreement to any parent, subsidiary, affiliate or successor in interest of APS by merger, acquisition, or consolidation or to any other current or future owner of the Facilities, provided that the assignee assumes in writing all of APS' obligations under this Restated Agreement.

7. Representations.

Each Party represents and warrants as of the Effective Date of this Restated Agreement as follows:

- a. It has full legal right, power and authority to execute, deliver and perform this Restated Agreement;
- b. It has taken all appropriate and necessary action to authorize the execution, delivery and performance of this Restated Agreement;

c. It has obtained all consents, approvals and authorizations necessary for the valid execution and delivery of this Restated Agreement;

d. This Restated Agreement constitutes its legal, valid and binding obligation, enforceable against it in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy or insolvency laws or by limitation upon the availability of equitable remedies;

e. It is not in violation of any applicable law promulgated or judgment entered by any federal, state, local or other governmental body, which violations, individually or in the aggregate, would adversely affect the performance of its obligations under this Restated Agreement; and

f. The execution, delivery and performance by it of this Restated Agreement, the compliance with the terms and provisions hereof and the carrying out of the transactions contemplated hereby, (i) do not conflict with and will not conflict with or result in a breach or violation of any of the terms and provisions of its organizational documents, and (ii) to the best of its knowledge, do not conflict with and will not conflict with or result in a breach or violation of any of the terms and provisions of any law, rule or regulation, or any order, writ, injunction, judgment or decree by any court or other governmental body against it or by which it or any of its properties is bound, or any loan agreement, indenture, mortgage, note, resolution, bond or contract or other agreement or instrument to which it is a party or by which it or any of its properties is bound, or constitute or will constitute a default thereunder or will result in the imposition of any lien upon any of its properties.

8. Successors and Assigns.

This Restated Agreement shall be binding on and inure to the benefit of the Parties hereto and their successors and assigns.

9. Entire Agreement.

Except for any separate agreement of the Parties settling disputed claims related to applicability of the BAT to certain transmission and distribution facilities within the Navajo Nation, this Restated Agreement reflects the entire agreement of the Parties relating to taxation of the Facilities and no other agreement written or oral shall be used to effect any changes of the provisions retained herein. No amendment of this Restated Agreement shall be valid unless in writing and signed by all Parties.

10. Counterparts.

This Restated Agreement may be signed in counterparts, each of which shall be deemed an original. Facsimile signatures shall be as valid as original signatures until each Party receives a fully signed counterpart with original signatures. Each Party shall provide the other Party with original signatures so that each Party shall have a fully signed counterpart within five business days after the date of the last signature.

11. Relationship of Parties .

Nothing herein may be construed to create an association, joint venture, trust, or partnership, or to impose a trust or partnership covenant, obligation or liability on or with regard to any one or more of the Parties.

12. Severability .

Subject to the provisions of and except as otherwise provided in Section 5, Enforcement and Judicial Review, of this Restated Agreement, if any term or condition of this Restated Agreement is held to be invalid, void, or unenforceable by any court or tribunal of competent jurisdiction, that holding shall not affect the validity or enforceability of any other term or condition of this Restated Agreement, unless either Party determines in its sole discretion that enforcing the balance of the Restated Agreement would deprive that Party of a fundamental benefit of its bargain.

13. Adjustment of PIT and BAT Settlement Payment Amounts; Termination .

a. One year prior to the expiration of the Amended Term, the Parties shall commence good faith negotiations to establish PIT and BAT Settlement Payment amounts for APS to run concurrently with any extension of the Leases and Grants. If the Parties are not able to reach agreement upon new PIT and BAT Settlement Payment amounts before expiration of the Amended Term, the Parties will either continue this Restated Agreement in effect with the PIT and BAT Settlement Payment amounts set forth in Section 1 above, or either Party may elect to terminate this Restated Agreement.

b. The Parties recognize and agree that, upon termination or expiration of this Restated Agreement for any reason, (i) each Party has preserved all of its rights and arguments regarding the question of the jurisdictional authority of the Navajo Nation and ONTC to tax the Facilities and/or APS and its successors and assigns based on ownership interests in and operation of the Facilities; (ii) this Restated Agreement shall not in any way be deemed a waiver or amendment of any provisions of any agreement between the Navajo Nation, APS and/or any of the Participants, including but not limited to the Leases and Grants; and (iii) neither Party may assert any claim, demand, damages, action, cause of action, or suit of whatsoever kind and nature, whether known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, that arose or may have arisen while this Restated Agreement was in effect.

14. No Third Party Beneficiaries .

Nothing herein, either express or implied is intended or may be construed to confer upon or to give to any person or entity other than the Parties any rights or remedies under or by reason of this Restated Agreement.

15. Limited Responsibility .

The Parties acknowledge and agree that it is their mutual intent that the obligations, representations, warranties and undertakings under this Restated Agreement or as a result of the transactions contemplated by this Restated Agreement are limited to only those expressly set forth herein, and not enlarged by implication, creation of law, or otherwise.

16. Survival .

The provisions of Sections 2(a) and (b), 4, 7 and 13.b of this Restated Agreement survive expiration or termination of this Restated Agreement. Provided that the Restated Agreement remains in effect through the Amended Term, APS' obligation to make the calendar year 2041 PIT Settlement Payment specified in this Restated Agreement and APS' obligation to make BAT Settlement Payments for any periods prior to expiration or termination of this Restated Agreement also shall survive expiration or termination of this Restated Agreement.

17. Notices .

Notices shall be deemed to have been given if in writing and (a) hand delivered, (b) delivered by a reputable overnight courier service (such as but not limited to FedEx and UPS), (c) mailed by certified or registered mail, return receipts requested, first class postage prepaid, or (d) transmitted by telecopy or electronic mail, followed within 24 hours by transmittal under option (a), (b) or (c) above addressed as follows:

If to ONTC:

President
The Navajo Nation
P.O. Box 9000
Window Rock, Arizona 86515

With a copy to:

Attorney General
Navajo Nation Department of Justice
P.O. Drawer 2010

Window Rock, Arizona 86515

Executive Director
Office of the Navajo Tax Commission
P.O. Box 1903
Window Rock, Arizona 86515

If to APS:

Arizona Public Service Corporation
400 North 5th Street
Phoenix, Arizona 85004
Attn: Corporate Secretary

With a copy to:

Pinnacle West Capital Corporation
400 North 5th Street
Phoenix, Arizona 85004
Attn: Executive Vice President and General Counsel

or at such other address as the Parties may, from time to time, designate in writing. Service by overnight courier or mail shall be deemed made on the first business day delivery is attempted or upon receipt, whichever is earlier. Service by telecopy or electronic mail shall be deemed made upon confirmed transmission.

18. Effective Date; Effect of this Restated Agreement .

This Restated Agreement is effective upon the date when duly executed by both Parties (the “**Effective Date**”). It is the Parties’ intention that through the Effective Date of this Restated Agreement, the terms and conditions of the Original Agreement in effect at the date of execution of this Restated Agreement shall continue to govern the Parties’ rights and obligations thereunder. Upon and after the Effective Date of this Restated Agreement, the Parties’ right and obligations shall be governed by the terms and conditions of this Restated Agreement.

By signing, the undersigned certify that they have read and agreed to the terms of this Restated Agreement.

ARIZONA PUBLIC SERVICE COMPANY

By: _____
Donald G. Robinson
President

Date _____

NAVAJO NATION

By: _____
Martin Ashley, Executive Director
Office of the Navajo Tax Commission

Date _____

APPROVED:

By: _____
Louis Denetsosie, Attorney General
Navajo Nation Department of Justice

_____ Date

Transmission & Distribution Property Information

1. Transmission Lines

<u>KV Rating</u>	<u>Year Built</u>	<u>Miles</u>	<u>Width of Right-of-Way</u>	<u>Acres</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Distribution System

<u>Chapter</u>	<u>Urban Meters</u>	<u>Rural Miles</u>	<u>KV Rating</u>	<u>Width of Right-of-Way</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

3. Substations & Switching Stations

<u>Name</u>	<u>Voltage Rating</u>	<u>Transformer KVA</u>	<u>Year Built</u>	<u>Acres</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Additional Information for Operating Report

1. Copy of the previous calendar year annual report or the 10-K filed with the Securities and Exchange Commission
 2. Copy of the previous calendar year FERC Form No. 1 (*Only for those companies that are required to file this report with FERC*)
 3. Copy of the New Mexico Property Tax Report
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Exhibit B
Calculation of AI (BAT Index) for 2001 and 2002

Price Indexes: Year-to-Year Change

	Electric Power - Other - Mountain	Electric Power - Other - Pacific	Bituminous Coal and Lignite: West	Natural Gas	Heavy Construction	Unit Labor Cost: Non-Farm Business
1996	105.1%	99.3%	102.8%	136.9%	101.9%	100.5%
1997	101.8%	102.4%	99.3%	111.5%	101.8%	100.9%
1998	100.0%	100.4%	96.4%	82.5%	99.0%	102.7%
1999	99.6%	100.1%	98.4%	108.8%	101.1%	102.0%
2000	99.9%	104.9%	97.9%	170.4%	103.7%	103.1%
2001 (estimated)	105.2%	111.1%	103.0%	110.7%	99.9%	103.8%
2002 (estimated)	99.2%	97.9%	99.1%	52.1%	97.7%	100.4%

Note: Each entry is calculated as the annual average of the appropriate index for the current year divided by the annual average of the same index for the previous year.

BAT Index Calculation

	<u>Revenue Index</u>	<u>Cost Index</u>	<u>Total BAT Index</u>	<u>5-Year Average</u>
1996	103.1%	101.9%	102.2%	—
1997	102.0%	100.4%	100.8%	—
1998	100.1%	99.6%	99.7%	—
1999	99.8%	100.5%	100.3%	—
2000	101.7%	101.5%	101.5%	100.9%
2001 (estimated*)	107.3%	103.2%	104.2%	101.3%
2002 (estimated*)	98.7%	99.2%	99.1%	101.0%

Note:

Revenue Index =

65.24% * (BLS Index: Electric Power — Other — Mountain)
plus 34.76% * (BLS Index: Electric Power — Other — Pacific)

Cost Index =

42.29% * (BLS Index: Bituminous Coal and Lignite: West)
plus 0.86% * (BLS Index: Natural Gas)
plus 7.58% * (BLS Index: Heavy Construction)
plus 49.27% * (BLS Index: Unit Labor Costs: Non-Farm Business)

Total BAT Index = (75% * Cost Index) plus (25% * Revenue Index)

AI Calculation

AI for BAT Settlement Payments 2001 Q3 through 2002 Q2 =

Average of BAT Index for 1996-2000 = 100.9%

AI (estimated*) for BAT Settlement Payments 2002 Q3 through 2003 Q2 =

AI for 2001 multiplied by average of BAT Index for 1997-2001 =

[100.9% * 101.3%] = 102.2% estimated*

AI for BAT Settlement Payments 2003 Q3 through 2004 Q2 =

AI for 2002 multiplied by average of BAT Index for 1998-2002 =

[100.9% * 101.3% * 101.0%] = 103.2% estimated*

AI for subsequent year BAT Settlement Payments will follow the same formula.

Note:

* The AI for the 2002 BAT Settlement Payments is estimated using actual BLS data through November 2001 and estimated data for December 2001. This calculation should be updated when complete 2001 BLS data is made available. The AI for the 2003 BAT Settlement Payments is a sample calculation using only data available through March 2002.



Exhibit B(continued)
BLS Price Index Data for AI Calculation

Series Id: PCU4981#148

Industry: Electric power and natural gas utilities

Product: Other — Mountain

Base Date: 9012

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ann Avg
1995	112.0	111.9	110.4	110.4	110.5	114.9	115.1	115.1	115.2	115.2	112.0	111.8	112.9
1996	111.7	111.8	110.3	111.5	120.0	123.6	123.7	123.7	123.6	122.9	120.2	120.2	118.6
1997	119.9	118.9	118.6	118.6	121.5	122.9	122.8	122.8	122.8	122.8	118.4	118.2	120.7
1998	118.4	119.1	119.1	119.1	122.0	123.3	122.5	122.2	122.2	122.2	118.9	118.9	120.7
1999	118.3	118.2	118.0	118.0	120.7	122.1	122.0	122.4	122.4	122.1	119.3	119.3	120.2
2000	119.2	119.1	118.2	118.2	118.2	121.9	121.6	121.9	122.1	122.2	119.3	119.8	120.1
2001	119.9	120.0	124.4	124.7	127.6	129.2	129.0	130.0	130.1	129.7	126.3	[ILLEGIBLE]	[ILLEGIBLE]
2002	[ILLEGIBLE]	[ILLEGIBLE]	[ILLEGIBLE]										[ILLEGIBLE]

Series Id: PCU4981#149

Industry: Electric power and natural gas utilities

Product: Other — Pacific

Base Date: 9012

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ann Avg
1995	103.6	103.6	102.2	101.5	103.4	113.4	113.5	113.5	113.2	101.5	103.0	103.0	106.3
1996	102.6	102.7	100.3	101.2	103.1	111.2	111.6	111.6	111.5	102.6	104.1	104.1	105.6
1997	104.6	104.7	102.6	104.1	105.5	113.3	114.2	114.2	116.0	105.8	105.9	106.0	108.1
1998	105.8	105.4	103.5	103.5	106.2	114.5	114.6	114.5	115.5	106.0	106.1	106.1	108.5
1999	106.1	105.9	102.5	102.6	104.4	113.8	114.2	114.0	116.1	107.9	107.9	107.0	108.5
2000	106.9	106.9	105.8	106.1	106.9	117.5	121.2	123.4	123.3	115.8	114.9	117.5	113.9
2001	126.0	120.9	122.4	114.0	114.8	134.6	136.0	136.2	136.1	126.5	126.2	[ILLEGIBLE]	[ILLEGIBLE]
2002	[ILLEGIBLE]	[ILLEGIBLE]	[ILLEGIBLE]										[ILLEGIBLE]

Series Id: PRS85006113

Duration: index, 1992 = 100

Measure: Unit Labor Costs

Sector: Nonfarm Business

Year	Qtr1	Qtr2	Qtr3	Qtr4	Ann Avg
1995	103.1	103.6	104.0	104.0	103.7
1996	103.6	103.7	104.5	104.9	104.2
1997	105.2	104.5	104.7	106.1	105.1
1998	106.7	108.0	108.7	108.6	108.0
1999	109.0	110.5	111.1	110.2	110.2
2000	112.1	112.5	114.0	115.8	113.6
2001	117.2	118.0	118.7	117.9	118.0
2002	[ILLEGIBLE]				[ILLEGIBLE]

Notes:

The PCU1211 series was discontinued at the end of 2001. The new series, PCU 1221#1 (which started at 100.0 in Dec. 2001), will be substituted in the AI calculation beginning Jan. 2002. Monthly values for the coal index will be calculated by taking the value of the old coal index on Dec. 2001, 118.4, and multiplying it by the value of the new coal index in each month, then dividing by 100. For example, in Jan. 2002, the value for the coal index used in the AI calculation will be $118.4 * 96.7 / 100 = 114.5$.

The PPI data is updated monthly and made available at the BLS website:

<http://data.bls.gov/labjava/outside.isp?survey=pc>

The labor cost data is updated quarterly and is also available at the BLS website:

<http://www.bls.gov/lpc/home./htm>

Shaded entries denote preliminary BLS data.

Settlement and Closing Agreement

**Exhibit C
Operating Report**

Line No.		
1.	Revenue Requirement	\$X.XXXX /KWhr
2.		x AI
3.	Subtotal	\$ X.XXXX
4.		x Net KWhrs
5.	Subtotal	\$ XXXXX
Less Deductions		
6.	Salaries and/or other compensation paid to members of the Navajo Nation (See Supplemental Schedule I)	\$ XXXXX
7.	Purchases of Navajo goods and Services (See Supplemental Schedule II)	\$ XXXXX
8.	Payments made to the Navajo Nation government (See Supplemental Schedule III)	\$ XXXXX
9.	Standard Deduction (The greater of \$125,000 or 10% of line 5.)	\$ XXXXX
10.	Total Deductions	\$ XXXXX
11.	BAT Settlement Payment Base (Line 5 less Line 10)	\$ XXXXX
12.	BAT Settlement Payment Rate	x 5%
13.	BAT Settlement Payment	\$ XXXXX

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE I

SALARIES, WAGES, AND OTHER COMPENSATION PAID TO NAVAJOS

Page ____ of ____

Company Name (Employer)

Quarter Ended

<u>I.</u>	<u>1. Employee Name</u>	<u>Navajo Census Number</u>	<u>2. Salaries or Wages Paid</u>	<u>3. Other Compensation (e.g. fringe benefits)</u>	<u>4. Total of Column 2 and Column 3</u>
II.	Total from any additional pages				
	Total Salaries and Wages Paid, total column 2				
	Total Other Compensation (e.g. fringe benefits), total column 3				
III.	Total Salaries, Wages, and Other Compensation, total Col. 4				

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE II

Purchases of Navajo Goods & Services

Page ____ of ____

Company Name (Employer)

Quarter Ended

Part A — Detail Purchases of Navajo Goods

<u>Type of Goods Purchased</u>	<u>Vendor Name and Address</u>	<u>Amount</u>
		Total amount

Part B — Detail of Purchases of Navajo Services

<u>Type of Services Purchased</u>	<u>Vendor Name and Address</u>	<u>Amount</u>
		Total amount

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE III

Detail of Payments Made to the Navajo Nation Government

Page ____ of ____

Company Name (Employer)

Quarter Ended

Detail of Payments Made to the Navajo Nation Government

<u>Type of Payment</u>	<u>Payee</u>	<u>Date of Payment</u>	<u>Amount</u>
			Total amount



Restated and Amended Settlement and Closing Agreement
Exhibit D — Sample PIT Calculations

Assumptions:

Original Cost of Facilities on Navajo Nation:

<i>Property Group</i>	<i>Original Cost*</i>
Units 1 - 3	400,000,000
Units 4 - 5	200,000,000
Common	100,000,000
T & D	100,000,000
TOTAL	800,000,000

Current PIT Settlement Payment: \$ 6,342,600

Salvage Value = Original Cost x 5%

In-lieu-of-Tax Rate for Salvage = 3%

Sample Calculation for Shut Down of Units:

Assume Permanent Shut Down of Units 1 - 3

Salvage Value of Units 1 - 3 = Original Cost x 5%

$\$400M \times 5\% = 20,000,000$

In-lieu-of tax on Units 1 - 3 = Salvage Value x In-lieu-of Tax Rate

$\$20M \times 3\% = 600,000$

Calc. of PIT for Remaining Property in Service:

Original Cost of Remaining Property In Service/Total Original Cost

$\$400M/800M = 50.00\%$

PIT on Remaining Property

$0.50 \times \$6,342,600 = \$ 3,171,300$

New PIT After Permanent Shut Down of Units 1 - 3:

In-lieu-of tax + PIT on Remaining Property = \$ 3,771,300

Sample Calculation if APS Adds a Unit:

Assume APS Adds \$1B Unit

Calculation of Increase Factor = Current PIT Settlement Payment/Total Original Cost

$\$6,342,600/\$800M = 0.7928\%$

Calculation of PIT on New Unit = Original Cost of New Unit x Factor

$\$1B \times 0.007928 = \$ 7,928,250$

Existing PIT = \$ 6,342,600

New PIT After Addition of Unit

\$ 14,270,850

* Original Costs are not actual original costs, these costs are for illustration purposes only.

AMENDMENT AND SUPPLEMENT NO. 3
TO
SUPPLEMENTAL AND ADDITIONAL INDENTURE OF LEASE
BETWEEN
THE NAVAJO NATION
AND
ARIZONA PUBLIC SERVICE COMPANY,
EL PASO ELECTRIC COMPANY,
PUBLIC SERVICE COMPANY OF NEW MEXICO,
SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT,
AND
TUCSON ELECTRIC POWER COMPANY
Dated: March 7, 2011

**AMENDMENT AND SUPPLEMENT NO. 3 TO
SUPPLEMENTAL AND ADDITIONAL INDENTURE OF LEASE**

This Amendment and Supplement No. 3 to the Supplemental and Additional Indenture of Lease dated March 7, 2011 (this “Amendment”) is by and between the Navajo Nation (formerly known as The Navajo Tribe of Indians), acting through the Navajo Nation Council for and on behalf of the Navajo Nation (hereinafter referred to as the “Nation”), as lessor, and Arizona Public Service Company (“APS”), El Paso Electric Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, and Tucson Electric Power Company (formerly known as Tucson Gas & Electric Company) (hereinafter, collectively, together with their successors and assigns, referred to as the “Lessees,” and each individually referred to as a “Lessee”). The Nation and the Lessees are hereinafter collectively referred to as the “Parties.”

The Parties agree as follows:

1 **BACKGROUND.**

- 1.1 APS has leased certain premises from the Nation under that certain Indenture of Lease dated December 1, 1960 between APS and the Nation, as supplemented and amended by that certain Supplemental and Additional Indenture of Lease dated July 6, 1966, between the Nation, APS, and the other Lessees, as further supplemented and amended by that certain Amendment and Supplement No. 1 to Supplemental and Additional Indenture of Lease dated April 25, 1985, between the Nation, APS and the other Lessees (the “1985 Lease Supplement”; and such Indenture of Lease, as supplemented and amended, the “1960 Lease”).
- 1.2 Lessees have leased certain premises from the Nation under that certain Supplemental and Additional Indenture of Lease dated July 6, 1966, between the Nation, Southern California Edison Company (“SCE”), and the Lessees, as supplemented and amended by the 1985 Lease Supplement (such Supplemental and Additional Indenture of Lease, as supplemented and amended, the “1966 Lease”).

- 1.3 The Parties desire to extend the respective terms of and otherwise amend the 1960 Lease and the 1966 Lease to reflect certain new terms and conditions.
- 1.4 The 1960 Lease and the 1966 Lease are amended only as set forth in this Amendment. To the extent, however, that there is any conflict between the 1960 Lease and this Amendment or the 1966 Lease and this Amendment, this Amendment shall govern .
- 1.5 This Amendment is not intended to and does not merge the leasehold estates of the 1960 Lease and the 1966 Lease, or the rights, liabilities, or obligations (collectively, “ Rights ”) of the Parties set forth in the 1960 Lease and the 1966 Lease. Further, in no event shall the Lessees (except for APS) have any Rights under the 1960 Lease or with respect to the leasehold estate demised to APS under the 1960 Lease. Rather, except for APS, all the Lessees’ Rights are limited only to the Four Corners Project, as set forth in the 1966 Lease.

2 **DEFINITIONS.**

- 2.1 “ § 323 Grant ” or “ § 323 Grants ” — One or more grants of rights-of-way and easements under the Act of February 5, 1948 (62 Stat. 17, 18, 25 U.S.C. §323-328), the Act of March 3, 1879 (20 Stat. 394, 5 U.S.C. § 485), as amended, and the Acts of July 9, 1832, and July 27, 1868 (4 Stat. 564, 15 Stat. 228, 25 U.S.C. §2) and such regulations promulgated thereunder, as are applicable, including 25 C.F.R. §1.2 and 25 C.F.R. Part 169.
- 2.2 “ § 323 Grant Land ” — Has the meaning set forth in Section 5.2.

- 2.3 “Affiliate” — With respect to any Lessee hereto, any entity, including but not limited to a corporation, company, partnership, LLC/LLP or joint venture that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with such Lessee. For purposes of this definition, the term “control” (including “controlled by” and “under common control with”) shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity, whether through the ownership of voting securities, regardless of percentage by written contract, or otherwise.
- 2.4 “Annual Payment” — Except for (i) payments owed to the Nation under the existing Settlement and Closing Agreements that the Nation has executed with each individual Lessee (ii) the payments that will be owed to the Nation under the Settlement and Closing Agreements set forth in Section 14; (iii) the negotiation premium set forth in Section 3.4; and (iv) the payment set forth in Section 4.5, the total and sole payment that shall be made by (X) APS to the Nation, in consideration for the rights set forth in the 1960 Lease, including, but not limited to, (a) all leasehold rights, (b) the Existing § 323 Grants, and (c) the Renewed § 323 Grants; and by (Y) the Lessees to the Nation, in consideration for the rights set forth in the 1966 Lease, including, but not limited to, (a) all leasehold rights, (b) the Existing § 323 Grants, and (c) the Renewed § 323 Grants.
- 2.5 “Communication Sites” — The communication sites and related facilities identified within item 5 of Exhibit B.
- 2.6 “Existing § 323 Grants” — The § 323 Grants set forth on Exhibit B.
- 2.7 “Four Corners Project” — Has the meaning set forth in the 1966 Lease.
- 2.8 “Initial Four Corners Plant” — Has the meaning set forth in the 1966 Lease.

- 2.9 “Plan” — Has the meaning set forth in Section 7.1.
- 2.10 “Plant” — For convenience only, and not to merge the leasehold estates under the 1960 Lease and the 1966 Lease, a reference to the Initial Four Corners Plant and the Four Corners Project, respectively.
- 2.11 “Renewed § 323 Grants” — Has the meaning set forth in Section 4.2.
- 2.12 “Navajo Nation Lands” — Has the meaning set forth in the 1966 Lease for the term “Reservation Lands.”
- 2.13 “Secretary” — The Secretary of the United States Department of the Interior or his or her duly authorized designee, representative, or successor.
- 2.14 “Transmission Lines” — The electrical transmission lines and related facilities identified within items 3 and 4 of Exhibit B.

3 **TERM.**

- 3.1 This Amendment shall become effective (the “Amendment Effective Date”) upon the earlier of SCE’s sale of its interest in the Four Corners Project or July 6, 2016 (the “Amendment 2 Termination Date,” as defined in the Amendment and Supplement No. 2 to the Supplemental and Additional Indenture of Lease, attached as Exhibit A).
- 3.2 The Navajo Nation Council Resolution approving this Amendment, and signature by the Nation’s duly authorized representative, shall be deemed to be sufficient legal approval by the Nation of this Amendment.
- 3.3 The 1960 Lease and the 1966 Lease (and the Annual Payments payable thereunder) are extended to July 6, 2041, whether or not the Initial Four Corners Plant or the Four Corners Project are operating or the Renewed § 323 Grants are terminated.

3.4 The Nation will engage in good-faith negotiations for an additional extension of both the 1960 Lease and the 1966 Lease beyond 2041, provided that such negotiations begin no later than July 2029 and conclude by July 2031. Any mutual agreement to continue the negotiations beyond July 2031, which such negotiations are not successfully completed, will extend the term of both the 1960 Lease and the 1966 Lease equally beyond July 2041, provided that (i) the negotiation extension period shall not exceed three years; and (ii) APS with respect to the 1960 Lease and the Lessees with respect to the 1966 Lease shall pay the Nation a pre-negotiated premium (above the Annual Payment) for the period the negotiations are extended.

4 **NATION'S CONSENT TO § 323 GRANTS BY SECRETARY FOR THE PLANT, TRANSMISSION LINES, AND COMMUNICATION SITES.**

4.1 The Nation has previously consented to, and the Secretary has granted, the Existing § 323 Grants, and the renewal, extension or reissuance of each Existing § 323 Grant will be necessary.

4.2 The Nation consents and covenants to consent now, and for the terms of each of the 1960 Lease and the 1966 Lease (collectively, "Consents"), that the Lessees shall have the right to obtain, by grant from the Secretary, and the Nation Consents to the grant by the Secretary, of renewed, extended, or reissued § 323 Grants for the rights-of-way covered in the Existing § 323 Grants. (Such renewed, extended, or reissued § 323 Grants are referred to as the "Renewed § 323 Grants").

4.3 The Nation and Lessees will cooperate fully with each other and the Secretary to obtain the Renewed § 323 Grants.

- 4.4 The Navajo Nation Council Resolution approving this Amendment shall be deemed to be sufficient legal approval by the Nation for the Renewed § 323 Grants. No further consideration shall be required by the Nation in order for the Secretary to issue the Renewed § 323 Grants.
- 4.5 The Lessees shall provide the Nation a copy of applications for the Renewed § 323 Grants, and each application shall be accompanied by a payment of no more than \$800 per application.
- 4.6 The Existing § 323 Grants and the Renewed § 323 Grants shall be additional and supplementary to, separate and independent from, and not conditioned upon the leasehold rights leased to APS under the 1960 Lease and to the Lessees under the 1966 Lease; and a termination of either the 1960 Lease or the 1966 Lease for any reason shall not terminate any §323 Grant, and a termination of any § 323 Grant for any reason, shall not terminate the 1960 Lease or the 1966 Lease.
- 4.7 The Nation agrees to support the renewal, extension, or reissuance of the Existing § 323 Grants as categorically excluded under section 3.2A of the Bureau of Indian Affairs' 2005 National Environmental Policy Act Handbook. If the Secretary determines that additional environmental impact analysis is required, the Nation hereby grants Lessees access to all Navajo Nation Lands necessary to complete such additional analysis. Lessees will work with the appropriate Navajo Nation agencies to effectuate any necessary access to any Navajo Nation Lands. The Nation also agrees to assist the Lessees in completing such analysis and to take reasonable actions to reduce the time and cost required to complete such analysis.
- 4.8 Except as set forth in the 1960 Lease, APS shall not change the voltages of the Transmission Lines without the Nation's prior approval.
- 4.9 Under no circumstances shall any § 323 Grant be interpreted as granting a fee simple interest to the Lessees or any other property interest, except as set forth in the § 323 Grant.

5 **ADDITIONAL TERMS REGARDING § 323 GRANTS FOR TRANSMISSION LINES .**

- 5.1 The provisions of Section 5.2 through Section 5.7 and Section 10 and Section 12 below constitute a separate agreement between the Nation and APS. In no event shall any default, action or omission by APS under Section 5.2 through Section 5.7, Section 10, or Section 12 below have any effect on any other Parties' rights, privileges, duties, obligations and liabilities under the remainder of this Amendment.
- 5.2 The Navajo Nation Lands subject to an Existing § 323 Grant or a Renewed § 323 Grant and pertaining only to the Transmission Lines shall hereinafter be referred to as "§ 323 Grant Land."
- 5.3 The use of the § 323 Grant Land shall be strictly limited to constructing, reconstructing, replacing, repairing, operating and maintaining the Transmission Lines. Any other use of the § 323 Grant Land shall require the consent of the Nation. The consent of the Nation may be given, given upon conditions, or denied at the sole discretion of the Nation.
- 5.4 The Nation shall be under no obligation to forego the use of the § 323 Grant Land or any portion or lands burdened by the § 323 Grant Land, or to refrain from authorizing any use of said lands by any third party, including but not limited to, the exploration for and development and transportation of coal, oil, gas, or other natural resources located within or beneath said lands, except to the extent that such use physically interferes with the operation and maintenance of the Transmission Lines or interferes with the purposes of the § 323 Grants.

- 5.5 Upon the Nation's proposed authorization of the use of the § 323 Grant Lands by any third party, which new use may occupy the § 323 Grant Lands or otherwise burden the § 323 Grant Lands, the Nation agrees to notify APS and commence good faith consultation with APS prior to the Nation's final approval of said third party use. Prior to the Nation's final approval, the Nation shall require the third party to enter into an agreement with APS, which agreement must be acceptable to APS, to indemnify, defend, and hold APS harmless from any and all liability arising from the third party's use, interest, and activities within the § 323 Grant Land.
- 5.6 Five years prior to the expiration of a Renewed § 323 Grant, or as soon as practicable after any earlier termination of a Renewed § 323 Grant, APS and the Nation shall meet to discuss whether APS will leave in place all, some, or none of the Transmission Lines. If APS and the Nation cannot agree to terms regarding the disposition of one or more of the Transmission Lines, APS shall remove the Transmission Line(s) for which no agreement is reached, in accordance with the Lease and applicable laws and requirements, and shall leave the § 323 Grant Land in good condition. On the expiration date of a Renewed § 323 Grant, APS shall have ninety (90) days to peaceably and without legal process deliver the possession of the § 323 Grant Land, with or without the Transmission Lines, as the case may be. In the event a Renewed § 323 Grant is terminated early, APS shall have six months to peaceably and without legal process deliver the possession of the § 323 Grant Land for such terminated § 323 Grant, with or without the Transmission Lines, as the case may be. If delivery cannot be performed on or before such 90-day period or six month period, as the case may be, APS and the Nation shall commence good faith negotiations for compensation, fees or damages to be paid to the Nation for prospective periods of occupation, use, or burden of the § 323 Grant Lands.

5.7 Holding over by APS after the expiration or early termination of a Renewed § 323 Grant shall not constitute an extension/renewal thereof, or give APS any rights in or to the § 323 Grant Lands. Holding over after expiration or early termination of a Renewed § 323 Grant shall not give APS any rights via a Renewed § 323 Grant. Following expiration or early termination of a § 323 Grant, the act of applying for a § 323 Grant from the Secretary shall not give APS any rights to the § 323 Grant land.

6 **NATION'S SUPPORT OF ENVIRONMENTAL REVIEWS AND § 323 GRANTS .**

The Nation shall work with the Lessees to obtain the necessary regulatory approvals and to advocate on behalf of the Lessees in support of any National Environmental Policy Act, Endangered Species Act, or National Historic Preservation Act analyses; § 323 renewals or extensions; or any other requirements of the Department of the Interior (“DOI”) or the Nation that are prerequisites necessary to conduct the operations of the Plant, Transmission Lines, and Communication Sites. In its interactions with the DOI, the Nation shall support the interests of the Lessees and advocate positions that support the continued operations of the Plant, Transmission Lines, and Communication Sites.

7 **EMPLOYMENT AT THE FOUR CORNERS GENERATING STATION.**

Section 19 of the 1960 Lease, Section 24 of the 1966 Lease and Section 25 of the 1966 Lease (as amended by Section 12 of the 1985 Lease Supplement) are deleted in their entirety and replaced as follows:

- 7.1 Without limiting the scope or effectiveness of the provisions of Section 17 of the 1960 Lease (Operation of Power Plant) or Section 22 of the 1966 Lease (Operation of Enlarged Four Corners Generating Station), APS and the Lessees shall comply with the terms of the Four Corners Generating Station Preference Plan (the "Plan"), attached as Exhibit C.
 - 7.2 In the event that, in the opinion of their counsel, federal law develops in the future, to permit APS and the Lessees, respectively, to grant a preference in employment based on tribal affiliation, as distinguished from a "Native American Indian" preference in employment, APS and the Lessees shall practice a Navajo preference in employment at the Plant in accordance with the requirements of this Section 7 and the Plan.
 - 7.3 If, at any time, APS's then current Collective Bargaining Agreement (which governs labor at the Plant), as negotiated by APS, in its sole discretion, conflicts with this Section 7 or the Plan, then APS's Collective Bargaining Agreement shall take precedence.
-

8 **ADVISORY COMMITTEE** .

APS, the Lessees, and the Nation shall establish a Four Corners Advisory Committee for the purpose of promoting open dialogue between them regarding operations of the Plant.

- 8.1 The Committee shall consist of two members of the Navajo Nation Government with experience in energy-related matters, one from the executive and one from the legislative branch, and two senior officials representing APS and the Lessees, who shall be tasked to work together and in consultation with their respective leaderships to resolve concerns raised by APS and the Lessees or the Nation in a mutually beneficial manner. The Committee shall meet regularly, but no less than two times a year. Discussion topics and updates may include voluntary compliance agreements, the impact of plant operations on the Nation's members and surrounding communities and emerging issues.
- 8.2 APS and the Lessees or the Nation may submit disagreements and disputes to the Committee for discussion and possible resolution. Decisions of the Committee shall be in the nature of recommendations and shall not be binding on APS and the Lessees or the Nation.

9 **ANNUAL PAYMENT** .

- 9.1 The Annual Payment shall replace all compensation for rents, rights of way, or otherwise, set forth in the § 323 Grants (as to the § 323 Grant Land), the 1960 Lease and the 1966 Lease, as applicable. All sections of the aforementioned documents imposing a payment obligation on APS and the Lessees are hereby deleted.
- 9.2 The Annual Payment shall be \$7,000,000, as adjusted from the April 2011 CPI (defined below), and shall begin on the Amendment Effective Date. All subsequent Annual Payments shall be subject to annual adjustments, based upon changes in the April Consumer Price Index U.S. City Average for All Urban Consumers, published by the U.S. Bureau of Labor Statistics (“CPI”). The annual CPI adjustment for the Annual Payment shall be as set forth in Exhibit D.

- 9.3 On or before July 6 of each year, APS and the Lessees shall submit one check for the Annual Payment to the Nation and indicate the adjustment required by the CPI.
- 9.4 No Lessee shall be responsible or liable to the Nation for the payment of any portion of such Annual Payment of any other Lessee. In the event that one or more Lessees fails to pay the Nation its portion of such Annual Payment at the time such Annual Payment is submitted to the Nation, APS (or the then operator of the Plant) shall inform the Nation of the name of the Lessee(s) failing to make the Annual Payment and the specific amount of each such Lessee's shortfall. In the event the Nation incurs costs associated with obtaining the required Annual Payment owed, the Nation shall be entitled to recover from the defaulting Lessee(s) its associated costs, including, but not limited to, attorney's fees, filing fees and interest accrued. A list of each Lessee's portion of the Annual Payment shall be provided to the Nation.
- 9.5 The Nation agrees that the Annual Payment payable by APS and the Lessees constitutes fair and adequate consideration for the rights granted in the 1960 Lease, the 1966 Lease, the Existing § 323 Grants and the Renewed § 323 Grants.
- 9.6 Upon agreement between the Lessees, the percentage of the Annual Payment owed by each of APS and the Lessees, respectively, may be changed without the consent of the Nation. But in no event shall the amount due be less than 100% of the Annual Payment, as calculated in accordance with Section 9.2. In the event of a change in payment percentages, an updated list of each Lessee's portion of the Annual Payment shall be provided to the Nation. In consideration of the Annual Payment made by APS and the Lessees, respectively, the Nation releases APS and the Lessees from all and any kind of claims, suits, actions, causes of action, rights, liabilities, and obligations (the aforementioned, collectively referred to as "Claims"), whether past, present, or future, known or unknown, for or related to compensation due under the 1960 Lease or 1966 Lease, or compensation for the Existing § 323 Grants and the Renewed § 323 Grants.

9.7 In consideration of the Annual Payment made by APS and the Lessees, respectively, the Nation releases APS and the Lessees from and settles all outstanding issues and potential Claims, under the 1960 Lease or 1966 Lease, or under the Existing § 323 Grants. Notwithstanding the foregoing, the release set forth in this Section 9.7 shall not apply to any claims arising under Section 10 of this Amendment.

9.8 APS and the Lessees release the Nation from and settle all outstanding issues and potential Claims under the 1960 Lease or the 1966 Lease, or under the Existing § 323 Grants. Notwithstanding the foregoing, the release set forth in this Section 9.8 shall not apply to any claims arising under Section 10 of this Amendment.

10 **APS'S 230kV LINES.**

APS and the Nation disagree as to whether the provisions of Section 17 of the 1960 Lease (Operation of Power Plant) or Section 22 of the 1966 Lease (Operation of Enlarged Four Corners Generating Station) apply to the Existing §323 Grants listed on Exhibit B for the 230kV lines identified as (a) Flagstaff to Leupp and (b) Cholla to Leupp (collectively, the "Leupp Lines"). APS and the Nation each reserve the right to assert that the aforementioned sections apply or do not apply to the Leupp Lines, as the case may be.

11 **DECOMMISSIONING.**

Upon the decommissioning of the Initial Four Corners Plant, the Four Corners Project or any part of either facility, the final decommissioning obligations of APS as to the Initial Four Corners Plant and of the Lessees as to the Four Corners Project shall be limited to the requirements under the applicable federal environmental laws existing at the time of such decommissioning. All or any part of any such decommissioning may occur at any time during the term of either the 1960 Lease or the 1966 Lease, as applicable.

12 **MOENKOPI SUBSTATION.**

In the event that there is a future expansion of the Moenkopi Substation, it shall be subject to an increase in APS's portion of the Annual Payment by \$1500 per acre (in April 2009 dollars) for up to 100 acres. The \$1500 per acre payment shall be adjusted annually by the CPI (in April 2009 dollars). The expansion shall be subject to all applicable regulatory requirements.

13 **ASSIGNMENTS.**

The second paragraph of Section 19 of the 1966 Lease is deleted and replaced as follows: Except as set forth in the first paragraph of Section 19 of the 1966 Lease and in Section 9.6 of this Amendment, and except for any assignment, sublease or other transfer by a Lessee to its Affiliate, all other assignments, subleases, or other transfers of rights (including operating rights) of APS related to the 1960 Lease or the Lessees related to the 1966 Lease shall be subject to the prior written consent of the Nation, which consent shall not be unreasonably withheld, nor conditioned on any payments or changes to the terms and conditions of the respective leases, other than nominal administration fees.

14 **SETTLEMENT AND CLOSING AGREEMENTS.**

Each Party shall execute a new Settlement and Closing Agreement in form and substance substantially similar to the proposed sample Settlement and Closing Agreement attached as Exhibit F. Once executed, the Settlement and Closing Agreement will be effective as of July 6, 2016.

15 **NO CROSS DEFAULT** .

Notwithstanding anything to the contrary in this Amendment, the 1960 Lease or the 1966 Lease, a default by APS under the 1960 Lease, as amended by this Amendment, shall not constitute a default by Lessees under the 1966 Lease, and a default by Lessees under the 1966 Lease, as amended by this Amendment, shall not constitute a default by APS under the 1960 Lease.

16 **PRIMARY FUEL** .

The primary fuel used at the Plant shall be coal.

17 **THIRD PARTY BENEFICIARIES** .

The 1960 Lease and the 1966 Lease are not intended to confer upon any third person any rights, privileges, waivers, obligations, or remedies granted hereunder. If, on or before July 6, 2018, SCE has sold its share of the Four Corners Project (“SCE’s Share”), the Nation agrees that, without any additional consent or compensation, such buyer(s) of SCE’s Share (“Buyers”) shall (a) automatically, upon the closing of such a sale, become a Lessee(s) under the 1966 Lease and (2) assume the portion of the Annual Payment attributable to SCE’s Share. Upon the closing of such transaction, all such Buyers shall be express third party beneficiaries under this Section 17, and such Buyers and the Nation shall have first party rights to enforce full performance of this Section 17 against each other.

18 **EXECUTION IN COUNTERPARTS** .

This Amendment may be executed in any number of counterparts, and each executed counterpart shall have the same force and effect as an original instrument and as if all of the Parties to the aggregate counterparts had signed the same instrument. Any signature page of this Amendment may be detached from any counterpart thereof without impairing the legal effect of any signatures thereon, and may be attached to other counterparts of this Amendment identical in form hereto but having attached to it one or more additional signature pages.

This Amendment has been executed by the duly authorized representatives of the Parties, effective as of the Amendment Effective Date.

THE NAVAJO NATION

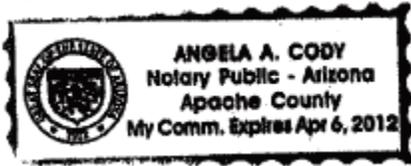
By: /s/ Ben Shelly
Printed Name: Ben Shelly
Its: President

State of Arizona
County of Apache

The foregoing instrument was acknowledge before me this 7th day of March, 2011 by Ben Shelly the President of
(Name) (Title)
THE NAVAJO NATION , on behalf of The Navajo Nation.

/s/ Angela Cody
Notary Public

My Commission Expires:



ARIZONA PUBLIC SERVICE COMPANY , an Arizona corporation, in its individual capacity and as a Lessee

By: /s/ Mark A. Schiavnoi
Printed Name: Mark A. Schiavnoi
Its: Senior Vice President, Fossil

State of Arizona
County of Maricopa

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Mark A. Schiavnoi the
(Name)
Senior Vice President, Fossil of **ARIZONA PUBLIC SERVICE COMPANY**, an Arizona corporation, on behalf of the corporation.
(Title)

/s/ Norann Ascitutto
Notary Public

My Commission Expires:
2-27-14



My Commission Expires:

Notary Public

**Reviewed and Approved
Legal Department**

EL PASO ELECTRIC COMPANY , a
Texas corporation

/s/ [ILLEGIBLE]

By: /s/ David W. Stevens
Printed Name: David W. Stevens
Its: CEO

State of Texas

County of EL PASO

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by David W. Stevens the CEO of
(Name) *(Title)*
EL PASO ELECTRIC COMPANY , a Texas corporation, on behalf of the corporation.

/s/ Carolina Pena
Notary Public

My Commission Expires:
3-24-2011



PUBLIC SERVICE COMPANY OF NEW MEXICO ,
a New Mexico corporation

By: /s/ Patricia K. Collawn
Printed Name: Patricia K. Collawn
Its: President & CEO

State of New Mexico

County of Bernalillo

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Patricia K. Collawn the President &
(Name) *(Title)*
CEO of **PUBLIC SERVICE COMPANY OF NEW MEXICO** , a New Mexico corporation, on behalf of the corporation.

/s/ [ILLEGIBLE]
Notary Public

My Commission Expires:
September 12, 2012

TUCSON ELECTRIC POWER COMPANY ,
an Arizona Corporation

By: /s/ Michael J. Deconcini _____

Printed Name: Michael J. Deconcini

Its: Chief Operating Officer

State of Arizona

County of Pima

The foregoing instrument was acknowledge before me this 8th day of November, 2010 by Michael J. Deconcini the
(Name)
Sr. Vice President & Chief Operating Officer of **TUCSON ELECTRIC POWER COMPANY** , an Arizona corporation, on behalf of
(Title)
the corporation.

/s/ Janice Spencer _____

Notary Public

My Commission Expires:
8/8/11



SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT, an agricultural improvement district organized under the laws of the State of Arizona.

Reviewed by SRP Legal Services

By: /s/ David Rousseau
David Rousseau, President or
John R. Hoopes, Vice President

Date: 11/23/2010

By: /s/ Kanlee Ramaley
Signature

/s/ Kanlee Ramaley
Printed Name

Date: 11/23/2010

Attest and Countersign:

By: /s/ Terrill A. Lonon
Terrill A. Lonon, Secretary or
Stephanie K. Reed, Assistant Secretary

Date: 11/23/2010

State of Arizona

County of Maricopa

The foregoing instrument was acknowledge before me this 23rd day of November, 2010 by David Rousseau the President of
(Name) (Title)

SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT , an agricultural improvement district organized under the laws of the State of Arizona.

/s/ Stephanie K. Reed
Notary Public

My Commission Expires:
August 5, 2011



EXHIBIT A

See Amendment 2

Exhibit B

<i>Item</i>	<i>Existing § 323 Grants</i>	<i>Property or Facility</i>	<i>APS File #</i>	<i>Grant Date</i>	<i>Expiration Date</i>	<i>Acres</i>
1	Plant Site	Amended Original Lease (Units 1-3)		12/01/60	07/06/16	
		New Lease (Units 4-5)		07/06/66	07/06/16	
						3,466.42
2	Ancillary Facilities	Utah Mine Haul Road (Communication Lines and Access Road)	IN-13	07/2861	07/28/11	19.25
		Plant — Coal Lease Area — 69 kV	IN-15	12/15/61	12/15/11	3.75
		Pumping Station to Plant Access Road & Pipeline	IN-12	04/02/62	04/02/12	40.91
		River Pumping Station to Plant — 69 kV	IN-11	04/02/62	04/02/12	21.74
		Plant — EPNG Bridge / Access Rd	IN-16	07/03/63	07/03/13	37.57
		Pumping Station to Plant Access Road & Pipeline Addition	IN-92	04/21/69	04/21/19	10.36
						133.58
3	500 kV ROW	El Dorado 500 kV (Navajo portion only)	IN78 INH-79, INH-80	03/22/67	03/22/17	3,959.29
	345 kV ROW	Four Corners to Cholla	IN-17	05/26/61	05/26/11	5,658.91
	230 kV ROW	Flagstaff to Leupp	IN-4	09/12/57	09/12/07	102.82
		Cholla to Leupp	IN-7	09/21/60	09/21/10	249.16
4	Substation Sites	12 kV line and Roadway to Moenkopi Switchyard	INH-88	04/24/70	04/27/95	1.12
		Leupp Substation	IN-5	05/06/59	05/06/09	.43
		Moenkopi Switchyard	INH-83	04/09/68	04/09/18	211.09
5	Communication Sites	Preston Mesa Communication Site	IN-1182	12/30/96	12/30/14	0.23
		Jacks Peak Communication Site	IN-1181	04/16/02	04/15/17	1.75
		Dezza Bluff Communication Site	IN-1357	12/15/97	12/14/17	0.08
		Zilnez Mesa Microwave Site, Navajo Reservation	IN-113	01/03/73	01/03/23	2.40
		Roof Butte Communication Site	IN-85	07/07/70	07/07/20	0.02
		Marsh Pass Communication Site	IN-116	01/03/73	01/03/23	3.90

* *Certain of the terms used to describe the listed property or facilities have the meanings given to them in the 1960 Lease and 1966 Lease.*

Exhibit C

FOUR CORNERS GENERATING STATION

PREFERENCE PLAN

March 7, 2011

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I. INTRODUCTION

The purpose of this Preference Plan is to clarify and delineate Arizona Public Service Company's ("APS") Indian Preference Plan for the Four Corners Generating Station ("Four Corners") and specifically, the procedures for giving preference in employment to Indians.

II. PREFERENCE POLICY STATEMENT

Employment at Four Corners is based on qualifications without regard to race, color, creed, religion, national origin, sex, or age, except that preference will be given to qualified Indians, provided, however, that to the extent allowed by law (as set forth in Section 7.2 of the Amendment, to which this Preference Plan is attached), APS will give preference to qualified Navajos rather than to Indians. Each member of APS's management is responsible for implementing this policy in his/her areas and is held accountable for it in the same way each manager is held accountable for other company policies. In particular, the Plant Manager for Four Corners has overall accountability and responsibility for implementation of this Preference Plan.

III. SELECTION

In order to conduct operations at Four Corners in a safe and effective manner, all positions must be filled by persons qualified to perform the work required. APS has procedures to evaluate the qualifications (knowledge, skills and abilities) required for each job position. In general, these job qualifications are documented in "job descriptions" maintained by APS's Human Resource Department. Employees may also obtain a copy of their job descriptions by contacting their supervisors.

Job requirements consist of standards which identify the skills, education, and experience necessary to perform a particular job. These job requirements are the basis for hiring decisions and are also used to formulate employee training programs for job classifications with few incumbent-Indian employees. Hence, it is important that the job descriptions describe the true requirements of the job. For this reason, APS will review its job descriptions to assure that the job qualifications are relevant to the job requirements.

Qualifications are assessed on the basis of performance reviews, skills evaluations, experience and education, as appropriate for the position under consideration. Supervisors (and previous employers, in the case of external applicants) may be contacted. Skills may be evaluated by written tests, skill demonstrations, or by supervisory interview. Tests will be validated for job relevancy.

APS is committed to Indian preference in employment. Preference will be given to Indians who possess the skills and abilities to fulfill the job requirements established above.

IV. GOALS

The purpose of this Preference Plan is to provide a means to increase the employment of Indians at Four Corners, in both regular full-time and temporary positions. In particular, APS intends to focus on increasing the overall employment of Indians at Four Corners and promoting Indians into management positions.

Analysis of Indian employment levels by job classification will lead to establishing goals for job placement and training. These goals will be reviewed annually to evaluate the progress made toward the objective, and revised as necessary.

The commitment of APS is to offer available job opportunities to Indians who satisfy job requirements, whether the person is a current employee or a non-employee identified through recruitment and advertising. Through the adoption and implementation of training programs at Four Corners, the long-range goal is to develop a pool of Indian candidates qualified for all positions.

Openings created through resignation, discharge, transfer, promotion, or a newly created position cause the posting of an internal "bid" and create opportunities for internal movement through the bid process. Bidding is the established process by which job vacancies are announced, advertised and filled. When vacancies occur, employees, who feel they have the qualifications for a particular job, may submit their internal applications (bids) for consideration.

The bid process frequently creates a cascading effect, as employees vacate existing jobs to fill positions that result from another employee accepting a bid to fill the original vacancy. When an Indian bidder accepts a position vacated by another Indian, the net effect on the overall percentage of Indian employment is zero. While Indian bidders will be given preference in accordance with this Preference Plan, an increase in the total percentage of Indian employees at Four Corners can be expected only when the cascading effect of the bid system results in the employment of external Indian candidates.

Nevertheless, the potential for increasing the number of Indian employees is greater in certain job classifications than in others. Some of these job classifications are:

- First and second level supervision
- Operations (Operator Trainee through Control Operator)
- Machinist
- Plant Mechanic
- Electrician
- Equipment Operator
- Plant Chemist
- Scheduler

Four Corners management will give these job classifications particular attention to increase employment of Indians. Additionally, technical and professional recruiting will be increased to locate, identify, and employ suitable Indian candidates for engineers, technicians, and professional positions.

V. TRAINING

When there are too few qualified Indian bidders, internal training programs to increase the availability of Indian bidders may be appropriate. Training programs should focus on raising the level of skills, knowledge and abilities of Indians in “feeder jobs.” These are jobs which typically provide employees for higher level jobs, particularly when the lower level job has skill, knowledge and ability requirements that are prerequisites for a higher level job. Training should continue until the goal has been met. Other “in-place” training programs, such as apprenticeships and operations training, are on-going and continue to provide trained replacements for journeymen.

Indians will be encouraged to enhance their careers at APS by taking advantage of on-the-job training, apprenticeships, and in-house and off-the-job educational courses. As a specific part of this Preference Plan, the following actions will be taken to provide opportunities for Indians to advance to journeyman-level and supervisory positions.

1. New apprenticeships will be awarded only to qualified Indians.
2. Currently employed Indian journeymen will be selected for supervisory training to make them better qualified for future opportunities in foreman positions.

Because of the magnitude of the work and its accompanying time constraints, virtually everyone at Four Corners is affected by an overhaul. Four Corners has chosen to supplement the knowledge, skills and experience of its regular full-time employees with those of temporary workers with job specific skills. During an overhaul, where possible, regular full time employees are upgraded to higher level skill positions including supervisory positions. In this manner, employees may further expand the practical application of their technical and supervisory skills.

VI. RECRUITMENT/ADVERTISING FOR REGULAR EMPLOYEES

Recruitment is any activity that causes individuals to apply for employment. Advertising is one method of recruitment. Examples of other methods include meetings with graduating college seniors, participation in trade fairs, and day programs.

Since most regular full-time jobs at Four Corners are filled internally, a large recruitment effort is not needed. Thus, recruitment of regular full-time employees should be limited to those positions which are not filled by Indians internally. For purposes of this Preference Plan, recruitment will concentrate on jobs in which Indians are underutilized.

In an effort to attract qualified Indian applicants, contacts with key organizations throughout the Navajo Reservation will be maintained, although contacts within the Western Navajo Agency will be emphasized. In addition, Four Corners will work with appropriate tribal agencies to develop other potential recruitment sources.

Universities, vocational schools, Joint Training and Partnership Act classroom training programs, the Navajo Division of Education, the ONLR, and employment service offices located in the vicinity of Four Corners will be included in the recruitment and advertising efforts of Four Corners. Technical and professional jobs will be emphasized in recruitment efforts at colleges, universities, and in periodic advertisements to attempt to locate and identify suitable Indian candidates for employment opportunities.

Advertising and recruiting efforts will include a statement that APS at Four Corners recognizes Indian preference in employment. The following statement will be included in all advertisements for employment opportunities at Four Corners and on bid sheets posting jobs at Four Corners:

APS follows a policy of giving preferential treatment to Indians in connection with employment at the Four Corners Generating Station.

VII. ADVERTISING/RECRUITING FOR TEMPORARY EMPLOYEES

Each year, temporary employees are hired for certain specific assignments at Four Corners. Only when no qualified Indian applicant is found, after a thorough review of returning Indian applicants, existing files on temporary Indian employees, and new applications from Indians (generated by advertising), will a temporary position be filled by a non-Indian.

VIII. CONTRACT LABOR/SERVICES

APS will select qualified Indian-owned businesses, when available, to provide contract labor or services at Four Corners. APS will notify its vendors (a) of the employment and contracting preference policy at Four Corners; and (b) that they are expected to comply with applicable laws and regulations.

IX. CROSS CULTURAL COMMUNICATIONS PROGRAM

APS will develop and implement a cross-cultural program designed to provide a forum for Indian and non-Indian employees to openly examine and discuss the culturally significant customs, beliefs, values, and social mores that all individuals bring with them to the workplace.

X. DISPUTE RESOLUTION FOR EMPLOYEES

APS acknowledges the value of maintaining a work environment free of prejudice and discrimination. Nevertheless, despite even the best of intentions, complaints do arise, and the parties have determined that complaints of whatever nature are best handled internally, without the involvement of external agencies. Therefore, employees are encouraged to take advantage of APS's existing internal processes. Through this approach, a wide variety of employment related complaints may be addressed and resolved.

If Navajo Nation officials become aware of an employment concern at Four Corners, the Navajo Nation must bring the issue to the Advisory Committee, formed pursuant to the Lease (to which this Preference Plan is attached), for resolution.

XI. ENTIRE AGREEMENT; NO THIRD PARTY BENEFICIARIES

This Preference Plan is the entire agreement between the Parties concerning its subject matter and supersedes all prior agreements and understandings, whether or not written, including without limitation the letter agreement dated March 8, 1985 between APS and the Navajo Nation and signed by G. Mark De Michele and Peterson Zah. This Preference Plan also is not intended to confer upon any person other than the Parties any rights, privileges, waivers, obligations or remedies granted hereunder.

Exhibit D

Annual Payment for 2016 and all subsequent years:

$$7,000,000.00 \times \frac{\text{CPI for April in year which Annual Payment is due}}{\text{CPI for April 2011}}$$

Exhibit E

This exhibit intentionally not used.

Exhibit F
(Includes Exhibits A-D of the Restated and Amended Settlement and Closing Agreement)

DRAFT
11/4/2010 3:30 PM

Restated and Amended Settlement and Closing Agreement

This Restated and Amended Settlement and Closing Agreement (the “**Restated Agreement**”) amends the Settlement and Closing Agreement dated August 15, 2002 (“**Original Agreement**”) and is entered into as of the Effective Date (as defined in Section 18) by Arizona Public Service Company (“**APS**”) and the Office of the Navajo Tax Commission (“**ONTC**”), acting on its own behalf and, pursuant to Section 103 of the Navajo Nation Uniform Tax Administration Statute (“**UTAS**”), on behalf of the Navajo Nation. APS and the ONTC may be referred to herein individually as a “Party” or collectively as the “Parties.”

Recitals

A. Pursuant to Section 105 of UTAS, the ONTC, on behalf of the Navajo Nation, issued an assessment to APS on [Date] seeking to assess the Possessory Interest Tax (“**PIT**”) on APS in connection with its ownership and operation of the Four Corners Power Plant (the “**Plant**”), switchyards, and transmission and distribution facilities within the Navajo Nation (hereinafter, the Plant, switchyards, and transmission and distribution facilities within the Navajo Nation are collectively referred to as the “**Facilities**”). Pursuant to Regulation 1.125 of the ONTC Tax Administration Regulations, the ONTC also issued on [Date] a private ruling asserting that it has jurisdictional authority to impose the Business Activity Tax (“**BAT**”) upon APS’ activities related to the Facilities. Pursuant to Section 133 of UTAS, the ONTC is entering into this Restated Agreement.

B. APS and the other participants in the Plant (collectively, the “Participants”) assert that neither the Navajo Nation nor the ONTC has jurisdictional authority to impose any tax on APS, the Participants or the Facilities based on (i) certain agreements between the Navajo Nation, APS and Participants, including without limitation, certain covenants in leases entered into by APS, the Participants and the Navajo Nation and approved by the United States (“**Leases**”) and in federal grants of rights-of-way issued to APS and the Participants by the United States (“**Grants**”), (ii) the location of the Facilities on federally granted rights-of-way, (iii) the non-Indian character of APS and the Participants, and (iv) relevant case law.

C. The ONTC asserts that it possesses jurisdictional authority to administer taxes enacted by the Navajo Nation with respect to the Participants, including APS, and the Facilities based on (i) certain agreements between the Navajo Nation, APS and the Participants, including without limitation, certain covenants in the Leases and Grants, (ii) the location of the Facilities on lands held in trust by the United States for the benefit of the Navajo Tribe, and (iii) relevant case law.

D. The Parties entered into the Original Agreement for purposes of settling the dispute and to avoid litigation over the question of the jurisdictional authority of the Navajo Nation and ONTC to tax the Facilities and APS, based on its ownership interest in and operation of the Facilities.

E. The Parties desire to restate, amend and extend the Original Agreement and are thus entering into this Restated Agreement in accordance with the express terms set forth below.

WHEREFORE, THE PARTIES AGREE AS FOLLOWS:

1. Settlement Payments. Subject to the terms and conditions contained in this Restated Agreement, APS will make settlement payments as specified below (“**Settlement Payments**”):

a. PIT Settlement Payments.

(i) Beginning with calendar year 2001 and continuing through July 7, 2041 (the “**Amended Term**”), APS will pay to ONTC the following amount as a PIT Settlement Payment for the APS-owned Facilities, subject to adjustment as provided in subsection a(ii) of this Section 1:

Calendar Year	PIT Settlement Payment
2001	\$2,993,515.00
2002 – 2003	\$5,987,030.00 per year
2004 – 2040	\$6,342,600 per year
2041	\$3,171,300.00

(ii) Beginning July 8, 2016 and continuing through July 7, 2041, the PIT Settlement Payment is subject to reduction in the event APS and/or the Participants permanently shut down any of the Facilities and/or unit(s) of the Plant in which APS has an ownership interest, including but not limited to the permanent shut down of the entire Plant (the "Permanently Shut Down Facilities"). For any Permanently Shut Down Facilities salvage value will be determinative of value, and salvage value will be based on 5% of original or acquisition cost of the Permanently Shut Down Facilities in question. In the event of any permanent shut down under this Section 1a(ii), the PIT Settlement Payment will be recalculated in two steps:

- a. Step One : PIT Settlement Payment will be proportionally reduced by multiplying the PIT Settlement Payment by a factor that represents the ratio of the original or acquisition cost of the APS-owned Facilities within the Navajo Nation that are not Permanently Shut Down Facilities divided by the total original or acquisition cost of the APS-owned Facilities.
- b. Step Two : The proportionately reduced PIT Settlement Payment derived under Step One will then be increased by adding the product of a 3% in-lieu-of tax rate and the salvage value (i.e., 5% of original or acquisition cost) of the Permanently Shut Down Facilities. A sample calculation is included as Exhibit D to this Restated Agreement.

(iii) In the event APS constructs a new unit or units at the Plant during the Amended Term, the PIT Settlement Payment will be proportionally increased by an amount that represents the product obtained by multiplying the original or acquisition cost of the new APS-owned unit or units by the following factor:

- a. The PIT Settlement Payment of \$6,342,600 divided by the original or acquisition cost of the APS- owned Facilities within the Navajo Nation as of the Effective Date of this Restated Agreement. A sample calculation is included as Exhibit 1 to this Restated Agreement

(iv) APS will pay the PIT Settlement Payment specified above (as may be adjusted pursuant to Section 1a(ii) or Section 1a(iii), above) for calendar years 2002-2040 on a semi-annual basis, with the first half for each calendar year due November 1 and the second half due May 1 of the following year. APS will pay the PIT Settlement Payment specified above for calendar year 2041 on or before November 1, 2041. On or before June 1 of each calendar year during the term of this Restated Agreement, APS will provide to the ONTC, for informational purposes only, the form attached as Exhibit A.

(v) Interest on any late payment of the PIT Settlement Payment will be computed from the date the PIT Settlement Payment was first due to the date such payment is received by the ONTC. The rate of interest on any late payment will be equal to the rate then being used by the Internal Revenue Service for an underpayment of taxes by an individual. If APS fails to timely pay the PIT Settlement Payment, APS also will pay an additional amount equal to 5% of its PIT Settlement Payment. For each full month the payment is overdue, APS will pay an additional amount equal to 0.5% of its PIT Settlement Payment; provided, however, that the maximum additional amount APS must pay for the failure to timely pay shall not exceed 10% of the PIT Settlement Payment amount due. If APS fails to timely provide the Report for PIT Settlement Payment, attached as Exhibit A, as required by Section 1(a)(iv) of this Restated Agreement, APS will pay an additional 5% of its PIT Settlement Payment due for the period for each month or fraction thereof that the Report for PIT Settlement Payment is not provided; provided, however, that the minimum additional amount to be paid for failure to timely provide such Report for PIT Settlement Payment shall be \$50 and the maximum additional amount shall not exceed 25% of APS' PIT Settlement Payment for that period. For good cause shown, the ONTC may in its discretion relieve APS from all or part of the requirements imposed under this Section 1.a(v).

(vi) APS will provide, within six (6) months of the Effective Date of this Restated Agreement, a schedule of original or acquisition cost for the Facilities in which APS has an ownership interest (including the Permanently Shut Down Facilities) for use in connection with the calculations provided for in Section 1.a(ii). In addition, if APS constructs a new unit or units at the Plant for purposes of Section 1.a(iii), APS will provide a schedule of original or acquisition cost for such new unit or units within six (6) months after its/their completion, for use in connection with the calculations provided for in Section 1.a(iii).

(vii) The ONTC expressly agrees that APS is hereby released from any obligation and will not be required or requested to make any other payment with respect to any other amounts that the ONTC asserted or could have asserted were payable prior to execution of this Restated Agreement.

b. BAT Settlement Payment.

(i) Effective as of July 6, 2001 and continuing through the Amended Term, APS will calculate its BAT Settlement Payment amount using the following formula:

BAT Settlement Payment =

[(R * AI * Net KWhrs) less (Deductions) less (10% Standard Deduction)] * 5%

Where $R = \$.0256 / \text{KWhr}$.

Where Net KWhrs = APS' share of actual net kilowatt hours generated from the Plant during the quarterly period.

Where Deductions = (1) Salaries and/or other compensation paid to members of the Navajo Nation; (2) Purchases of Navajo goods and services; and (3) Any payment made to the government of the Navajo Nation, except for the BAT Settlement Payment paid pursuant to this Restated Agreement and any penalties or fines.

Where Standard Deduction = an amount equal to the greater of ten percent of $(R * AI * \text{Net KWhrs})$ or \$125,000.00.

As set forth on Exhibit C, APS will include in its Operating Report provided to the ONTC a statement of actual net generation for each quarter.

Where AI = an adjustment calculated in the 3rd Quarter of each year based upon a 5-year rolling average of Producer Price Index data published by the Bureau of Labor Statistics. Annual adjustments shall be cumulative, i.e., the total current year adjustment shall be equal to the incremental current year adjustment multiplied by the previous year's adjustment. The incremental adjustment shall be calculated utilizing the following methodology:

$AI = (75\% * \text{Cost Index}) \text{ plus } (25\% * \text{Revenue Index})$.

Where Cost Index =

42.3% * Bituminous Coal and Lignite: West (BLS Series PCU1211#214)
plus 0.9% * Natural Gas (BLS Series PCU1331#A2)
plus 7.6% * Other Heavy Construction (BLS Series PCUBHVY#)
plus 49.2% * Unit Labor Costs: Non-Farm Business (BLS Series PRS85006112)

Where Revenue Index =

65.2% * Electric Power and Natural Gas Utilities, Other, Mountain (BLS Series PCU4981#148)
plus 34.8% * Electric Power and Natural Gas Utilities, Other, Pacific (BLS Series PCU4981#149)

If any of the BLS indices used in this calculation are discontinued, the Parties shall mutually agree upon an equivalent substitute BLS index. The Parties agree that, beginning January 1, 2002, the Bituminous Coal and Lignite: Surface Mining (BLS Series PCU1211#1) will be substituted into the calculation in place of Bituminous Coal and Lignite: West (BLS Series PCU1211#214).

A calculation of AI for the 3rd Quarter 2001 through the 2nd Quarter 2002 BAT Settlement Payments is attached as Exhibit B. The 5-year average of index data for 1996 through 2000 is used to develop this initial adjustment.

Each subsequent annual adjustment will be made for the 3rd Quarter BAT Settlement Payment using the 5-year rolling average of index data through the end of the previous year.

A sample calculation of AI for the 3rd Quarter 2002 through 2nd Quarter 2003 BAT Settlement Payments using estimated data is included in Exhibit B. Calculations in subsequent years will follow this same formula.

(ii) APS will make its BAT Settlement Payments on a quarterly basis, with payments due 45 days after the end of each calendar quarter. APS will, at the time of making such payments, provide to the ONTC an Operating Report containing the following information used to calculate APS' BAT Settlement Payment:

- (a) APS revenue requirement, as adjusted by AI;
- (b) Net KWhrs for the quarter;
- (c) Deductions as defined above; and
- (d) Standard Deduction.

The format for the Operating Report is set forth in Exhibit C.

(iii) Interest on any late payment of a BAT Settlement Payment will be computed from the date the BAT Settlement Payment was first due to the date such payment is received by the ONTC. The rate of interest on any late payments will be equal to the rate then being used by the Internal Revenue Service for an underpayment of taxes by an individual. If APS fails to timely pay the BAT Settlement Payment, APS will pay an additional amount equal to 5% of the BAT Settlement Payment due. For each full month the payment is overdue, APS will pay an additional amount equal to 0.5% of the amount of its BAT Settlement Payment; provided, however, that the maximum additional amount that APS will be required to pay for the failure to timely pay shall not exceed 10% of the BAT Settlement Payment amount due. If APS fails to timely provide to the ONTC an Operating Report required by this Restated Agreement, APS will pay an additional 5% of its BAT Settlement Payment for each month or fraction thereof that the Operating Report has not been provided to the ONTC; provided, however, that the minimum additional amount to be paid for APS' failure to timely provide such Operating Report will be \$50 and the maximum additional amount will not exceed twenty-five percent (25%) of APS' BAT Settlement Payment for that period. For good cause shown, the ONTC may in its discretion relieve APS from all or part of the requirements imposed under this Section 2.b(iii).

(iv) The ONTC expressly agrees that APS is hereby released from any obligation and will not be required or requested to make any other payment with respect to any other amounts that the ONTC asserted or could have asserted were payable prior to execution of this Restated Agreement.

2. Releases.

a. APS hereby releases and forever discharges the ONTC, its predecessors, successors, affiliates, and assigns, of and from any and all claims, demands, damages, actions, causes of action, or suits of whatsoever kind and nature, existing as of the Effective Date of this Restated Agreement, whether now known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, allegedly owed by the ONTC, its predecessors, successors, affiliates, and assigns, to APS arising from APS' ownership interests or operation of the Facilities.

b. The ONTC hereby releases and forever discharges APS, its predecessors, successors, affiliates, and assigns, of and from any and all claims, demands, damages, actions, causes of action, or suits of whatsoever kind and nature, existing as of the Effective Date of this Restated Agreement, whether now known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, allegedly owed by APS, its predecessors, successors, affiliates, and assigns to the ONTC or Navajo Nation arising from APS' ownership interests or operation of the Facilities.

c. The ONTC expressly covenants that it will not seek to apply or assess the Navajo Sales Tax, approved by the Navajo Nation Council pursuant to Resolution No. CO-84-01 on October 18, 2001 (as amended), with respect to any electricity generated at, from or by the Plant except for retail sales of electricity to persons who purchase electricity for that person's own use, including use in that person's trade or business and not for resale, redistribution or retransmission, within the Navajo Nation.

3. Case Closure.

The Parties agree that the following cases shall be closed:

Possessory Interest Tax: Case No. 01-042

Business Activity Tax: Case No. 01-056

4. Preservation of Rights.

It is understood and agreed that this is a settlement of disputed claims, whether asserted or unasserted, and that nothing contained herein shall be construed as an admission of liability, guilt, or wrongdoing by or on behalf of any of the undersigned Parties, all such liability, guilt, or wrongdoing being expressly denied. The Parties acknowledge and agree that this Restated Agreement shall not prejudice or limit in any way the rights or contentions of any Party. The Parties further agree that this Restated Agreement shall not in any way be deemed a waiver or amendment of any provisions of any other agreement between the Navajo Nation, APS and/or any of the Participants, including but not limited to the Leases and Grants. This Restated Agreement, and the actions of the Parties contemplated hereunder, are not intended, nor shall they be deemed, to constitute any waiver, consent or admission with respect to the existence or lack of regulatory, taxing, or adjudicatory authority or jurisdiction of the Navajo Nation or the ONTC over the Facilities or any Party hereto.

5. Enforcement and Judicial Review.

a. Neither Party shall commence any judicial or administrative action challenging the validity of this Restated Agreement or any Party's authority to enter into it. Any commencement of such an action by a Party shall constitute a material breach of this Restated Agreement by that Party.

b. Challenge to Validity of the Restated Agreement.

(i) If the ONTC, or any of its representatives, officers, employees, departments or agents (a) commences any judicial or administrative action challenging this Agreement or the ONTC's authority to enter into it, or (b) otherwise in any manner invalidates or breaches this Restated Agreement or takes any action contrary to this Restated Agreement, APS may, in its sole discretion, elect to seek specific performance of or terminate this Restated Agreement. If the ONTC, or any of its representatives, officers, employees, departments or agents, repeals the PIT or BAT and enacts a replacement tax that the ONTC seeks to assert against APS or the Facilities, APS may terminate this Restated Agreement. The ONTC agrees and recognizes that if APS terminates this Restated Agreement, APS shall have no further obligation or liability to make any Settlement Payments from the date of termination forward. The ONTC further agrees and recognizes that in such circumstance, APS has preserved its rights to contest the jurisdiction of the ONTC or the Navajo Nation to assert or assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

(ii) If APS, or any of its representatives, officers, employees, departments, or agents (a) commences any judicial or administrative action challenging this Restated Agreement or APS' authority to enter into it, or (b) otherwise in any manner invalidates or breaches this Restated Agreement or takes any action contrary to this Restated Agreement, the ONTC may, in its sole discretion, elect to seek specific performance of or terminate this Restated Agreement. APS agrees and recognizes that, if the ONTC elects to terminate this Restated Agreement, the ONTC has preserved its rights to assert jurisdiction to assess taxes against APS from and after the date of termination with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities of APS within the Navajo Nation. If the ONTC elects to terminate this Restated Agreement, the ONTC shall be under no further obligation to accept Settlement Payments in satisfaction of APS' obligations.

(iii) If any person or entity not a Party to this Restated Agreement or the Navajo Nation, or any of their representatives, officers, employees, agencies, departments or agents, commences any judicial, administrative or other action challenging in any way the Restated Agreement's validity, the Parties shall jointly request that the court, tribunal, agency, or official before which the action is pending dismiss the action. If the action is not dismissed, either Party may file an appropriate responsive pleading, or otherwise act as reasonably necessary to respond to the action or to otherwise protect such Party. If any person, including the Navajo Nation or ONTC, brings an action or proceeding to assert or challenge the jurisdictional authority of the Nation or ONTC to tax the Facilities or activities at the Facilities with respect to such other person other than APS, each Party agrees not to rely on any ruling in such action or proceeding for purposes of challenging the validity of this Restated Agreement as long as the other Party is not in material breach hereof.

(iv) If any court, tribunal, agency or official determines that this Restated Agreement is non-binding on the ONTC or the Navajo Nation, APS may elect to terminate this Restated Agreement, and if so terminated, APS shall have no further obligation or liability to make any Settlement Payments from the date of termination forward. The ONTC agrees and recognizes that in such circumstance APS has preserved its rights to contest the jurisdiction of the Navajo Nation and ONTC to assert or assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

(v) If any court, tribunal, agency or official determines that this Restated Agreement is non-binding on APS, the ONTC may elect to terminate this Restated Agreement, and if so terminated, APS agrees and recognizes that in such circumstance, the ONTC has preserved its rights to assert jurisdiction to assess any taxes against APS with respect to the Facilities, APS' activities at the Facilities, or with respect to any other properties or activities within the Navajo Nation.

c. Other Taxes. Nothing in this Restated Agreement affects the rights, if any, of (i) the Navajo Nation or ONTC to seek to enforce taxes other than the Sales Tax (except as otherwise provided in Section 2(c) above), PIT or BAT on APS or the Facilities or (ii) APS to challenge any such action by the Navajo Nation or ONTC, including when permitted by federal law, bringing such an action in federal court.

d. Enforcement of the Restated Agreement. Enforcement of this Restated Agreement by either Party shall be pursuant to this Restated Agreement and not pursuant to any Navajo Nation or other law independent of this Restated Agreement. Nothing in this Restated Agreement shall or may be deemed to limit a Party's right to seek enforcement of this Restated Agreement or defend any claim in federal or tribal court where otherwise permitted by law. Nothing in this Restated Agreement shall or may be deemed as a consent to federal or tribal court jurisdiction by either Party.

6. Assignment.

APS may transfer or assign, without the consent of the Navajo Nation or ONTC, all or any portion of its interests and obligations under this Restated Agreement to any parent, subsidiary, affiliate or successor in interest of APS by merger, acquisition, or consolidation or to any other current or future owner of the Facilities, provided that the assignee assumes in writing all of APS' obligations under this Restated Agreement.

7. Representations.

Each Party represents and warrants as of the Effective Date of this Restated Agreement as follows:

- a. It has full legal right, power and authority to execute, deliver and perform this Restated Agreement;
- b. It has taken all appropriate and necessary action to authorize the execution, delivery and performance of this Restated Agreement;

c. It has obtained all consents, approvals and authorizations necessary for the valid execution and delivery of this Restated Agreement;

d. This Restated Agreement constitutes its legal, valid and binding obligation, enforceable against it in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy or insolvency laws or by limitation upon the availability of equitable remedies;

e. It is not in violation of any applicable law promulgated or judgment entered by any federal, state, local or other governmental body, which violations, individually or in the aggregate, would adversely affect the performance of its obligations under this Restated Agreement; and

f. The execution, delivery and performance by it of this Restated Agreement, the compliance with the terms and provisions hereof and the carrying out of the transactions contemplated hereby, (i) do not conflict with and will not conflict with or result in a breach or violation of any of the terms and provisions of its organizational documents, and (ii) to the best of its knowledge, do not conflict with and will not conflict with or result in a breach or violation of any of the terms and provisions of any law, rule or regulation, or any order, writ, injunction, judgment or decree by any court or other governmental body against it or by which it or any of its properties is bound, or any loan agreement, indenture, mortgage, note, resolution, bond or contract or other agreement or instrument to which it is a party or by which it or any of its properties is bound, or constitute or will constitute a default thereunder or will result in the imposition of any lien upon any of its properties.

8. Successors and Assigns.

This Restated Agreement shall be binding on and inure to the benefit of the Parties hereto and their successors and assigns.

9. Entire Agreement.

Except for any separate agreement of the Parties settling disputed claims related to applicability of the BAT to certain transmission and distribution facilities within the Navajo Nation, this Restated Agreement reflects the entire agreement of the Parties relating to taxation of the Facilities and no other agreement written or oral shall be used to effect any changes of the provisions retained herein. No amendment of this Restated Agreement shall be valid unless in writing and signed by all Parties.

10. Counterparts.

This Restated Agreement may be signed in counterparts, each of which shall be deemed an original. Facsimile signatures shall be as valid as original signatures until each Party receives a fully signed counterpart with original signatures. Each Party shall provide the other Party with original signatures so that each Party shall have a fully signed counterpart within five business days after the date of the last signature.

11. Relationship of Parties .

Nothing herein may be construed to create an association, joint venture, trust, or partnership, or to impose a trust or partnership covenant, obligation or liability on or with regard to any one or more of the Parties.

12. Severability .

Subject to the provisions of and except as otherwise provided in Section 5, Enforcement and Judicial Review, of this Restated Agreement, if any term or condition of this Restated Agreement is held to be invalid, void, or unenforceable by any court or tribunal of competent jurisdiction, that holding shall not affect the validity or enforceability of any other term or condition of this Restated Agreement, unless either Party determines in its sole discretion that enforcing the balance of the Restated Agreement would deprive that Party of a fundamental benefit of its bargain.

13. Adjustment of PIT and BAT Settlement Payment Amounts; Termination .

a. One year prior to the expiration of the Amended Term, the Parties shall commence good faith negotiations to establish PIT and BAT Settlement Payment amounts for APS to run concurrently with any extension of the Leases and Grants. If the Parties are not able to reach agreement upon new PIT and BAT Settlement Payment amounts before expiration of the Amended Term, the Parties will either continue this Restated Agreement in effect with the PIT and BAT Settlement Payment amounts set forth in Section 1 above, or either Party may elect to terminate this Restated Agreement.

b. The Parties recognize and agree that, upon termination or expiration of this Restated Agreement for any reason, (i) each Party has preserved all of its rights and arguments regarding the question of the jurisdictional authority of the Navajo Nation and ONTC to tax the Facilities and/or APS and its successors and assigns based on ownership interests in and operation of the Facilities; (ii) this Restated Agreement shall not in any way be deemed a waiver or amendment of any provisions of any agreement between the Navajo Nation, APS and/or any of the Participants, including but not limited to the Leases and Grants; and (iii) neither Party may assert any claim, demand, damages, action, cause of action, or suit of whatsoever kind and nature, whether known or unknown to the Parties, or whether asserted or unasserted, related, either directly or indirectly, to any and all PIT and BAT tax assessments and taxes, and interest and penalties thereon, that arose or may have arisen while this Restated Agreement was in effect.

14. No Third Party Beneficiaries .

Nothing herein, either express or implied is intended or may be construed to confer upon or to give to any person or entity other than the Parties any rights or remedies under or by reason of this Restated Agreement.

15. Limited Responsibility .

The Parties acknowledge and agree that it is their mutual intent that the obligations, representations, warranties and undertakings under this Restated Agreement or as a result of the transactions contemplated by this Restated Agreement are limited to only those expressly set forth herein, and not enlarged by implication, creation of law, or otherwise.

16. Survival .

The provisions of Sections 2(a) and (b), 4, 7 and 13.b of this Restated Agreement survive expiration or termination of this Restated Agreement. Provided that the Restated Agreement remains in effect through the Amended Term, APS' obligation to make the calendar year 2041 PIT Settlement Payment specified in this Restated Agreement and APS' obligation to make BAT Settlement Payments for any periods prior to expiration or termination of this Restated Agreement also shall survive expiration or termination of this Restated Agreement.

17. Notices .

Notices shall be deemed to have been given if in writing and (a) hand delivered, (b) delivered by a reputable overnight courier service (such as but not limited to FedEx and UPS), (c) mailed by certified or registered mail, return receipts requested, first class postage prepaid, or (d) transmitted by telecopy or electronic mail, followed within 24 hours by transmittal under option (a), (b) or (c) above addressed as follows:

If to ONTC:

President
The Navajo Nation
P.O. Box 9000
Window Rock, Arizona 86515

With a copy to:

Attorney General
Navajo Nation Department of Justice
P.O. Drawer 2010
Window Rock, Arizona 86515

Executive Director
Office of the Navajo Tax Commission
P.O. Box 1903
Window Rock, Arizona 86515

If to APS:

Arizona Public Service Corporation
400 North 5th Street
Phoenix, Arizona 85004
Attn: Corporate Secretary

With a copy to:

Pinnacle West Capital Corporation
400 North 5th Street
Phoenix, Arizona 85004
Attn: Executive Vice President and General Counsel

or at such other address as the Parties may, from time to time, designate in writing. Service by overnight courier or mail shall be deemed made on the first business day delivery is attempted or upon receipt, whichever is earlier. Service by telecopy or electronic mail shall be deemed made upon confirmed transmission.

18. Effective Date; Effect of this Restated Agreement.

This Restated Agreement is effective upon the date when duly executed by both Parties (the “**Effective Date**”). It is the Parties’ intention that through the Effective Date of this Restated Agreement, the terms and conditions of the Original Agreement in effect at the date of execution of this Restated Agreement shall continue to govern the Parties’ rights and obligations thereunder. Upon and after the Effective Date of this Restated Agreement, the Parties’ right and obligations shall be governed by the terms and conditions of this Restated Agreement.

By signing, the undersigned certify that they have read and agreed to the terms of this Restated Agreement.

ARIZONA PUBLIC SERVICE COMPANY

By: _____
Donald G. Robinson
President

Date

NAVAJO NATION

By: _____
Martin Ashley, Executive Director
Office of the Navajo Tax Commission

Date

APPROVED:

By: _____
Louis Denetsosie, Attorney General
Navajo Nation Department of Justice

Date



Transmission & Distribution Property Information

1. Transmission Lines

<u>KV Rating</u>	<u>Year Built</u>	<u>Miles</u>	<u>Width of Right-of-Way</u>	<u>Acres</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Distribution System

<u>Chapter</u>	<u>Urban Meters</u>	<u>Rural Miles</u>	<u>KV Rating</u>	<u>Width of Right-of-Way</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

3. Substations & Switching Stations

<u>Name</u>	<u>Voltage Rating</u>	<u>Transformer KVA</u>	<u>Year Built</u>	<u>Acres</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Additional Information for Operating Report

1. Copy of the previous calendar year annual report or the 10-K filed with the Securities and Exchange Commission
 2. Copy of the previous calendar year FERC Form No. 1 (*Only for those companies that are required to file this report with FERC*)
 3. Copy of the New Mexico Property Tax Report
-

Exhibit B
Calculation of AI (BAT Index) for 2001 and 2002

Price Indexes: Year-to-Year Change

	Electric Power- Other- Mountain	Electric Power- Other -. Pacific	Bituminous Coal and Lignite: West	Natural Gas	Heavy Construction	Unit Labor Cost: Non-Farm Business
1996	105.1%	99.3%	102.8%	136.9%	101.9%	100.5%
1997	101.8%	102.4%	99.3%	111.5%	101.8%	100.9%
1998	100.0%	100.4%	96.4%	82.5%	99.0%	102.7%
1999	99.6%	100.1%	98.4%	108.8%	101.1%	102.0%
2000	99.9%	104.9%	97.9%	170.4%	103.7%	103.1%
2001 (estimated)	105.2%	111.1%	103.0%	110.7%	99.9%	103.8%
2002 (estimated)	99.2%	97.9%	99.1%	52.1%	97.7%	100.4%

Note: Each entry is calculated as the annual average of the appropriate index for the current year divided by the annual average of the same index for the previous year.

BAT Index Calculation

	<u>Revenue Index</u>	<u>Cost Index</u>	<u>Total BAT Index</u>	<u>5-Year Average</u>
1996	103.1%	101.9%	102.2%	—
1997	102.0%	100.4%	100.8%	—
1998	100.1%	99.6%	99.7%	—
1999	99.8%	100.5%	100.3%	—
2000	101.7%	101.5%	101.5%	100.9%
2001 (estimated*)	107.3%	103.2%	104.2%	101.3%
2002 (estimated*)	98.7%	99.2%	99.1%	101.0%

Note:

Revenue Index =

65.24% * (BLS Index: Electric Power — Other — Mountain)
plus 34.76% * (BLS Index: Electric Power — Other — Pacific)

Cost Index =

42.29% * (BLS Index: Bituminous Coal and Lignite: West)
plus 0.86% * (BLS Index: Natural Gas)
plus 7.58% * (BLS Index: Heavy Construction)
plus 49.27% * (BLS Index: Unit Labor Costs: Non-Farm Business)

Total BAT Index = (75% * Cost Index) plus (25% * Revenue Index)

AI Calculation

AI for BAT Settlement Payments 2001 Q3 through 2002 Q2 =

Average of BAT Index for 1996-2000 = 100.9%

AI (estimated*) for BAT Settlement Payments 2002 Q3 through 2003 Q2 =

AI for 2001 multiplied by average of BAT Index for 1997-2001 =

[100.9% * 101.3%] = 102.2% estimated*

AI for BAT Settlement Payments 2003 Q3 through 2004 Q2 =

AI for 2002 multiplied by average of BAT Index for 1998-2002 =

[100.9% * 101.3% * 101.0%] = 103.2% estimated*

AI for subsequent year BAT Settlement Payments will follow the same formula.

Note:

* The AI for the 2002 BAT Settlement Payments is estimated using actual BLS data through November 2001 and estimated data for December 2001. This calculation should be updated when complete 2001 BLS data is made available. The AI for the 2003

BAT Settlement Payments is a sample calculation using only data available through March 2002.

Exhibit B(continued)
BLS Price Index Data for AI Calculation

Series Id: PCU4981#148

Industry: Electric power and natural gas utilities

Product: Other — Mountain

Base Date: 9012

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ann Avg
1995	112.0	111.9	110.4	110.4	110.5	114.9	115.1	115.1	115.2	115.2	112.0	111.8	112.9
1996	111.7	111.8	110.3	111.5	120.0	123.6	123.7	123.7	123.6	122.9	120.2	120.2	118.6
1997	119.9	118.9	118.6	118.6	121.5	122.9	122.8	122.8	122.8	122.8	118.4	118.2	120.7
1998	118.4	119.1	119.1	119.1	122.0	123.3	122.5	122.2	122.2	122.2	118.9	118.9	120.7
1999	118.3	118.2	118.0	118.0	120.7	122.1	122.0	122.4	122.4	122.1	119.3	119.3	120.2
2000	119.2	119.1	118.2	118.2	118.2	121.9	121.6	121.9	122.1	122.2	119.3	119.8	120.1
2001	119.9	120.0	124.4	124.7	127.6	129.2	129.0	130.0	130.1	129.7	126.3	[ILLEGIBLE]	[ILLEGIBLE]
2002	[ILLEGIBLE]	[ILLEGIBLE]	[ILLEGIBLE]										[ILLEGIBLE]

Series Id: PCU4981#149

Industry: Electric power and natural gas utilities

Product: Other — Pacific

Base Date: 9012

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ann Avg
1995	103.6	103.6	102.2	101.5	103.4	113.4	113.5	113.5	113.2	101.5	103.0	103.0	106.3
1996	102.6	102.7	100.3	101.2	103.1	111.2	111.6	111.6	111.5	102.6	104.1	104.1	105.6
1997	104.6	104.7	102.6	104.1	105.5	113.3	114.2	114.2	116.0	105.8	105.9	106.0	108.1
1998	105.8	105.4	103.5	103.5	106.2	114.5	114.6	114.5	115.5	106.0	106.1	106.1	108.5
1999	106.1	105.9	102.5	102.6	104.4	113.8	114.2	114.0	116.1	107.9	107.9	107.0	108.5
2000	106.9	106.9	105.8	106.1	106.9	117.5	121.2	123.4	123.3	115.8	114.9	117.5	113.9
2001	126.0	120.9	122.4	114.0	114.8	134.6	136.0	136.2	136.1	126.5	126.2	[ILLEGIBLE]	[ILLEGIBLE]
2002	[ILLEGIBLE]	[ILLEGIBLE]	[ILLEGIBLE]										[ILLEGIBLE]

Series Id: PRS85006113

Duration: index, 1992 = 100

Measure: Unit Labor Costs

Sector: Nonfarm Business

Year	Qtr1	Qtr2	Qtr3	Qtr4	Ann Avg
1995	103.1	103.6	104.0	104.0	103.7
1996	103.6	103.7	104.5	104.9	104.2
1997	105.2	104.5	104.7	106.1	105.1
1998	106.7	108.0	108.7	108.6	108.0
1999	109.0	110.5	111.1	110.2	110.2
2000	112.1	112.5	114.0	115.8	113.6
2001	117.2	118.0	118.7	117.9	118.0
2002	[ILLEGIBLE]				[ILLEGIBLE]

Notes:

The PCU1211 series was discontinued at the end of 2001. The new series, PCU 1221#1 (which started at 100.0 in Dec. 2001), will be substituted in the AI calculation beginning Jan. 2002. Monthly values for the coal index will be calculated by taking the value of the old coal index on Dec. 2001, 118.4, and multiplying it by the value of the new coal index in each month, then dividing by 100. For example, in Jan. 2002, the value for the coal index used in the AI calculation will be $118.4 * 96.7 / 100 = 114.5$.

The PPI data is updated monthly and made available at the BLS website:

<http://data.bls.gov/labjava/outside.jsp?survey-pc>

The labor cost data is updated quarterly and is also available at the BLS website:

<http://www.bls.gov/lpc/home.htm>

Shaded entries denote preliminary BLS data



Settlement and Closing Agreement

Exhibit C Operating Report

Line No.

1. Revenue Requirement		\$X.XXXX /KWhr
2.	x	AI
3. Subtotal		\$ X.XXXX
4.	x	Net KWhrs
5. Subtotal		\$ XXXXX
Less Deductions		
6. Salaries and/or other compensation paid to members of the Navajo Nation (See Supplemental Schedule I)		\$ XXXXX
7. Purchases of Navajo goods and Services (See Supplemental Schedule II)		\$ XXXXX
8. Payments made to the Navajo Nation government (See Supplemental Schedule III)		\$ XXXXX
9. Standard Deduction (The greater of \$125,000 or 10% of line 5.)		\$ XXXXX
10. Total Deductions		\$ XXXXX
11. BAT Settlement Payment Base (Line 5 less Line 10)		\$ XXXXX
12. BAT Settlement Payment Rate	x	5%
13. BAT Settlement Payment		\$ XXXXX

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE I

SALARIES, WAGES, AND OTHER COMPENSATION PAID TO NAVAJOS

Page ____ of ____

Company Name (Employer)

Quarter Ended

I.	1. Employee Name	Navajo Census Number	2. Salaries or Wages Paid	3. Other Compensation (e.g. fringe benefits)	4. Total of Column 2 and Column 3
II.	Total from any additional pages...				
	Total Salaries and Wages Paid, total column 2				
	Total Other Compensation (e.g. fringe benefits), total column 3				
III.	Total Salaries, Wages, and Other Compensation, total Col. 4				

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE II

Purchases of Navajo Goods & Services

Page ____ of ____

Company Name (Employer)

Quarter Ended

Part A — Detail Purchases of Navajo Goods

<u>Type of Goods Purchased</u>	<u>Vendor Name and Address</u>	<u>Amount</u>
--------------------------------	--------------------------------	---------------

Total amount

Part B — Detail of Purchases of Navajo Services

<u>Type of Services Purchased</u>	<u>Vendor Name and Address</u>	<u>Amount</u>
-----------------------------------	--------------------------------	---------------

Total amount

SETTLEMENT & CLOSING AGREEMENT
EXHIBIT C
SUPPLEMENTAL SCHEDULE III

Detail of Payments Made to the Navajo Nation Government

Page ____ of ____

Company Name (Employer)

Quarter Ended

Detail of Payments Made to the Navajo Nation Government

<u>Type of Payment</u>	<u>Payee</u>	<u>Date of Payment</u>	<u>Amount</u>
Total amount			



Restated and Amended Settlement and Closing Agreement
Exhibit D — Sample PIT Calculations

Assumptions:

Original Cost of Facilities on Navajo Nation:

<i>Property Group</i>	<i>Original Cost*</i>
Units 1 - 3	400,000,000
Units 4 - 5	200,000,000
Common	100,000,000
T & D	100,000,000
TOTAL	800,000,000

Current PIT Settlement Payment: \$ 6,342,600

Salvage Value = Original Cost x 5%

In-lieu-of-Tax Rate for Salvage = 3%

Sample Calculation for Shut Down of Units:

Assume Permanent Shut Down of Units 1 - 3

Salvage Value of Units 1 - 3 = Original Cost x 5%

$\$400M \times 5\% = 20,000,000$

In-lieu-of tax on Units 1 - 3 = Salvage Value x In-lieu-of Tax Rate

$\$20M \times 3\% = 600,000$

Calc. of PIT for Remaining Property in Service:

Original Cost of Remaining Property In Service/Total Original Cost

$\$400M/800M = 50.00\%$

PIT on Remaining Property

$0.50 \times \$6,342,600 = \$ 3,171,300$

New PIT After Permanent Shut Down of Units 1 - 3:

In-lieu-of tax + PIT on Remaining Property = \$ 3,771,300

Sample Calculation if APS Adds a Unit:

Assume APS Adds \$1B Unit

Calculation of Increase Factor = Current PIT Settlement Payment/Total Original Cost

$\$6,342,600/\$800M = 0.7928\%$

Calculation of PIT on New Unit = Original Cost of New Unit x Factor

$\$1B \times 0.007928 = \$ 7,928,250$

Existing PIT = \$ 6,342,600

New PIT After Addition of Unit

\$ 14,270,850

* Original Costs are not actual original costs, these costs are for illustration purposes only.

U.S. \$175,000,000

CREDIT AGREEMENT

Dated as of February 23, 2011

among

PINNACLE WEST CAPITAL CORPORATION,
as Borrower,

THE LENDERS PARTY HERETO,

UNION BANK, N.A.,
as Agent,

THE ROYAL BANK OF SCOTLAND FINANCE (IRELAND),
as Syndication Agent,

SUNTRUST BANK,
as Documentation Agent,

and

UNION BANK, N.A., SUNTRUST ROBINSON HUMPHREY, INC. and
THE ROYAL BANK OF SCOTLAND FINANCE (IRELAND),
as Joint Lead Arrangers,

UNION BANK, N.A. and THE ROYAL BANK OF SCOTLAND FINANCE (IRELAND),
as Joint Bookrunners

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CREDIT AGREEMENT

Dated as of February 23, 2011

PINNACLE WEST CAPITAL CORPORATION, an Arizona corporation (the “Borrower”), the banks, financial institutions and other institutional lenders (the “Initial Lenders”) listed on the signature pages hereof, Union Bank, N.A., SunTrust Robinson Humphrey, Inc. and The Royal Bank of Scotland Finance (Ireland), as Joint Lead Arrangers (the “Arrangers”), The Royal Bank of Scotland Finance (Ireland), as Syndication Agent, SunTrust Bank, as Documentation Agent, and UNION BANK, N.A., as Agent for the Lenders (as hereinafter defined), agree as follows:

The Borrower has requested that the Lenders provide a \$175,000,000 term loan facility for the purposes set forth herein, and the Lenders are willing to do so on the terms and conditions set forth herein.

In consideration of the mutual covenants and agreements herein contained, the parties hereto covenant and agree as follows:

ARTICLE I

DEFINITIONS AND ACCOUNTING TERMS

Section 1.01 Certain Defined Terms. As used in this Agreement, the following terms shall have the following meanings:

“Administrative Questionnaire” means an Administrative Questionnaire in a form supplied by the Agent.

“Affected Lender” means any Lender, as reasonably determined by the Agent or, if the Agent is the Affected Lender, by the Required Lenders, that (a) has defaulted in its obligation to fund a Loan or any of its other funding obligations under this Agreement, (b) has notified the Borrower, the Agent or any Lender in writing of its intention not to fund a Loan or any of its other funding obligations under this Agreement, (c) has otherwise failed to pay over to the Agent or any other Lender any other amount required to be paid by it hereunder within three Business Days of the date when due, unless the subject of a good faith dispute, (d) has failed, within three Business Days after written request by the Agent, or, if the Agent is the Affected Lender, by the Required Lenders, to confirm that it will comply with the terms of this Agreement relating to its obligations to fund a Loan or (e) shall (or whose parent company shall) generally not pay its debts as such debts become due, or shall admit in writing its inability to pay its debts generally, or shall make a general assignment for the benefit of creditors; or shall have had any proceeding instituted by or against such Lender (or its parent company) seeking to adjudicate it as bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief, or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors, or seeking the entry of an order for relief or the appointment of a receiver, trustee, administrator, assignee for the benefit of creditors or similar Person charged with reorganization or liquidation of its business or custodian for it or for any substantial part of its property and, in the case of any such proceeding instituted against it (but not instituted by it), either such proceeding shall remain undismissed or unstayed for a period of 30 days, or any of the actions sought in such proceeding (including, without limitation, the entry of an order for relief against, or the appointment of a receiver, trustee, administrator, assignee for the benefit of creditors or similar Person charged with reorganization or liquidation of its business or custodian for, it or for any substantial part of its property) shall occur, or shall take (or whose parent company shall take) any corporate action to authorize any of the actions set forth above in this subsection (e), provided that a Lender shall not be deemed to be an Affected Lender solely by virtue of the ownership or acquisition of any equity interest in such Lender or any Person that directly or indirectly controls such Lender by a Governmental Authority or an instrumentality thereof.

“Affiliate” means, as to any Person, any other Person that, directly or indirectly, controls, is controlled by or is under common control with such Person or is a director or officer of such Person. For purposes of this definition, the term “control” (including the terms “controlling”, “controlled by” and “under common control with”) of a Person means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of Voting Stock, by contract or otherwise.

“Agent” means Union Bank in its capacity as administrative agent under any of the Loan Documents, or any successor administrative agent.

“Agent’s Account” means the account of the Agent designated on Schedule 8.02 under the heading “Agent’s Account” or such other account as the Agent may designate to the Lenders and the Borrower from time to time.

“Agent’s Office” means the Agent’s address specified in Section 8.02(a) and, as appropriate, the Agent’s Account, or such other address or account as the Agent may from time to time notify to the Borrower and the Lenders.

“Agreement” means this Credit Agreement, dated as of February 23, 2011, among the Borrower, the Lenders named herein and from time to time party hereto, the Arrangers, the Syndication Agent, the Documentation Agent and the Agent, together with all schedules and exhibits hereto.

“Applicable Lending Office” means, with respect to each Lender, such Lender’s Domestic Lending Office in the case of a Base Rate Loan and such Lender’s Eurodollar Lending Office in the case of a Eurodollar Rate Loan.

“ Applicable Rate ” means, from time to time, the following percentages *per annum* determined by reference to the Public Debt Rating as set forth below:

Public Debt Rating S&P/Moody’s	Base Rate Loan	Eurodollar Rate Loan
Level 1		
≥ BBB+/Baa1	0.25%	1.25%
Level 2		
< Level 1 but ≥ BBB/Baa2	0.50%	1.50%
Level 3		
< Level 2 but ≥ BBB-/Baa3	0.75%	1.75%
Level 4		
< Level 3	1.00%	2.00%

“ Approved Fund ” means any Fund that is administered or managed by (a) a Lender, (b) an Affiliate of a Lender or (c) an entity or an Affiliate of any entity that administers or manages a Lender.

“ APS ” means Arizona Public Service Company, an Arizona corporation.

“ Arrangers ” has the meaning given to such term in the introductory paragraph hereof.

“ Assignment and Assumption ” means an assignment and assumption entered into by a Lender and an Eligible Assignee, and accepted by the Agent, in substantially the form of Exhibit C hereto.

“ Authorized Officer ” means the chairman of the board, chief executive officer, chief operating officer, chief financial officer, chief accounting officer, president, any vice president, treasurer, controller or any assistant treasurer of the Borrower.

“ Base Rate ” means for any day a fluctuating rate *per annum* equal to the highest of:

(a) the Reference Rate in effect for such day as publicly announced from time to time by Union Bank;

(b) the Federal Funds Rate plus 0.50%; and

(c) an amount equal to (i) the Eurodollar Rate for a one month Interest Period on such day (or if such day is not a Business Day, the immediately preceding Business Day) plus (ii) 1%.

Any change in the Base Rate due to a change in the Reference Rate, the Federal Funds Rate or the Eurodollar Rate shall be effective from and including the effective date of such change in the Reference Rate, the Federal Funds Rate or the Eurodollar Rate, respectively.

“ Base Rate Loan ” means a Loan that bears interest as provided in Section 2.05(a)(i).

“ Borrower ” has the meaning given to such term in the introductory paragraph hereof.

“ Borrower Information ” has the meaning specified in Section 8.08.

“Borrowing” means Loans of the same Type that are made, Converted or continued on the same date and, in the case of Eurodollar Rate Loans, as to which a single Interest Period is in effect.

“Business Day” means a day of the year on which banks are not required or authorized by Law to close in New York City, Phoenix, Arizona or Los Angeles, California and, if the applicable Business Day relates to any Loan in which interest is calculated by reference to the Eurodollar Rate, on which dealings are carried on in the London interbank market.

“Capital Lease” means, at any time, a lease with respect to which the lessee is required concurrently to recognize the acquisition of an asset and the incurrence of a liability in accordance with GAAP.

“Capital Lease Obligations” means as to any Person, the obligations of such Person to pay rent or other amounts under a lease of (or other agreement conveying the right to use) real and/or personal property, which obligations are required to be classified and accounted for as a Capital Lease on the balance sheet of such Person under GAAP and, for the purposes of this Agreement, the amount of such obligations shall be the capitalized amount thereof, determined in accordance with GAAP.

“Change in Law” means the occurrence, after the date of this Agreement, of any of the following: (a) the adoption of any Law, (b) any change in any Law or in the administration, interpretation or application thereof by any Governmental Authority or (c) the making or issuance of any request, guideline or directive (whether or not having the force of law) by any Governmental Authority. Notwithstanding anything to the contrary herein, it is understood and agreed that the Dodd—Frank Act, all requests, rules, regulations, guidelines and directives relating thereto, all interpretations and applications thereof and any compliance by a Lender with any request, guideline or directive relating thereto, shall, for the purposes of this Agreement, be deemed to be adopted and issued subsequent to the date hereof.

“Commitment” means, as to any Lender, its obligation to make a Loan to the Borrower pursuant to Section 2.01, in an aggregate principal amount not to exceed the amount set forth opposite such Lender’s name on Schedule 1.01 under the column “Commitment”. “Commitments” means the total of the Lenders’ Commitments hereunder. The Commitments shall in no event exceed \$175,000,000.

“Consolidated” refers to the consolidation of accounts in accordance with GAAP.

“Consolidated Indebtedness” means, at any date, the Indebtedness of the Borrower and its Consolidated Subsidiaries determined on a Consolidated basis as of such date; provided, however, that so long as the creditors of the VIE Lessor Trusts have no recourse to the assets of APS or the Borrower, Consolidated Indebtedness shall not include any Indebtedness or other obligations of the VIE Lessor Trusts.

“Consolidated Net Worth” means, at any date, the sum as of such date of (a) the par value (or value stated on the books of the Borrower) of all classes of capital stock of the Borrower and its Subsidiaries, excluding the Borrower’s capital stock owned by the Borrower and/or its Subsidiaries, *plus* (or *minus* in the case of a surplus deficit) (b) the amount of the Consolidated surplus, whether capital or earned, of the Borrower, determined in accordance with GAAP as of the end of the most recent calendar month (excluding the effect on the Borrower’s accumulated other comprehensive income/loss of the ongoing application of Accounting Standards Codification Topic 815).

“Consolidated Subsidiary” means, at any date, any Subsidiary or other entity the accounts of which would be Consolidated with those of the Borrower on its Consolidated financial statements if such financial statements were prepared as of such date.

“Convert”, “Conversion” and “Converted” each refers to a conversion of Loans of one Type into Loans of the other Type pursuant to Section 2.06, Section 2.07 or Section 2.10.

“Debtor Relief Laws” means the Bankruptcy Code of the United States of America, and all other liquidation, conservatorship, bankruptcy, assignment for the benefit of creditors, moratorium, rearrangement, receivership, insolvency, reorganization, or similar debtor relief Laws of the United States of America or other applicable jurisdictions from time to time in effect and affecting the rights of creditors generally.

“Default” means any Event of Default or any event that would constitute an Event of Default but for the requirement that notice be given or time elapse or both.

“Documentation Agent” means SunTrust Bank in its capacity as documentation agent for the Lenders.

“Dodd-Frank Act” means the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203), as amended.

“Dollars” or “\$” means dollars of the United States of America.

“Domestic Lending Office” means, with respect to any Lender, the office of such Lender described as such in such Lender’s Administrative Questionnaire, or such other office or offices as a Lender may from time to time notify the Borrower and the Agent.

“Effective Date” has the meaning specified in Section 3.01.

“Eligible Assignee” means any Person that meets the requirements to be an assignee under Section 8.07(b)(iii), (v) and (vi) (subject to such consents, if any, as may be required under Section 8.07(b)(iii)).

“Environmental Action” means any action, suit, demand, demand letter, claim, notice of non-compliance or violation, notice of liability or potential liability, investigation, proceeding, consent order or consent agreement relating in any way to any Environmental Law, Environmental Permit or Hazardous Materials or arising from alleged injury or threat of injury to health, safety or the environment and relating to any Environmental Law, including, without limitation, (a) by any Governmental Authority for enforcement, cleanup, removal, response, remedial or other actions or damages and (b) by any Governmental Authority or any third party for damages, contribution, indemnification, cost recovery, compensation or injunctive relief.

“Environmental Law” means any federal, state, local or foreign statute, law, ordinance, rule, regulation, code, order, judgment, decree or judicial or agency interpretation, policy or guidance relating to pollution or protection of the environment, natural resources or, to the extent relating to exposure to Hazardous Materials, human health or safety, including, without limitation, those relating to the use, handling, transportation, treatment, storage, disposal, release or discharge of Hazardous Materials.

“Environmental Permit” means any permit, approval, identification number, license or other authorization required under any Environmental Law.

“ERISA” means the Employee Retirement Income Security Act of 1974.

“ERISA Affiliate” means any trade or business (whether or not incorporated) under common control with the Borrower within the meaning of Section 414(b) or (c) of the Internal Revenue Code (and Sections 414(m) and (o) of the Internal Revenue Code for purposes of provisions relating to Section 412 or 430 of the Internal Revenue Code).

“ERISA Event” means (a) a Reportable Event with respect to a Pension Plan; (b) a withdrawal by the Borrower or any ERISA Affiliate from a Pension Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer (as defined in Section 4001(a)(2) of ERISA) or a cessation of operations that is treated as such a withdrawal under Section 4062(e) of ERISA; (c) a complete or partial withdrawal by the Borrower or any ERISA Affiliate from a Multiemployer Plan or notification that a Multiemployer Plan is in reorganization; (d) the filing of a notice of intent to terminate, the treatment of a Plan amendment as a termination under Section 4041 or 4041A of ERISA, or the commencement of proceedings by the PBGC to terminate a Pension Plan or Multiemployer Plan; (e) an event or condition which constitutes grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Pension Plan or Multiemployer Plan; or (f) the imposition of any liability under Title IV of ERISA, other than for PBGC premiums due but not delinquent under Section 4007 of ERISA, upon the Borrower or any ERISA Affiliate.

“Eurodollar Lending Office” means, with respect to any Lender, the office of such Lender described as such in such Lender’s Administrative Questionnaire, or such other office or offices as a Lender may from time to time notify the Borrower and the Agent.

“Eurodollar Rate” means:

(a) for any Interest Period with respect to a Eurodollar Rate Loan, the rate *per annum* equal to the British Bankers Association LIBOR Rate (“BBA LIBOR”), as published by Reuters (or other commercially available source providing quotations of BBA LIBOR as designated by the Agent from time to time) at approximately 11:00 a.m., London time, two Business Days prior to the commencement of such Interest Period, for Dollar deposits (for delivery on the first day of such Interest Period) with a term equivalent to such Interest Period. If such rate is not available at such time for any reason, then the “Eurodollar Rate” for such Interest Period shall be the rate *per annum* determined by the Agent to be the average (rounded upward, if necessary, to the nearest 1/100th of 1%) of the rates *per annum* at which deposits in Dollars for delivery on the first day of such Interest Period in same day funds in the approximate amount of the Eurodollar Rate Loan being made, continued or Converted by the Agent and with a term equivalent to such Interest Period would be offered to the Agent by major banks in the London interbank eurodollar market at the Agent’s request at approximately 11:00 a.m. (London time) two Business Days prior to the commencement of such Interest Period; and

(b) for any interest rate calculation with respect to a Base Rate Loan, the rate *per annum* equal to (i) BBA LIBOR, as published by Reuters (or other commercially available source providing quotations of BBA LIBOR as designated by the Agent from time to time) at approximately 11:00 a.m., London time, two Business Days prior to the date of determination (provided that if such day is not a Business Day in London, the next preceding Business Day in London), for Dollar deposits being delivered in the London interbank market for a term of one month commencing that day or (ii) if such published rate is not available at such time for any reason, the rate determined by the Agent to be the average (rounded upward, if necessary, to the nearest 1/100th of 1%) of the rates *per annum* at which deposits in Dollars for delivery on the date of determination in same day funds in the approximate amount of the Base Rate Loan being made, continued or Converted by the Agent and with a term equal to one month would be offered to the Agent by major banks in the London interbank eurodollar market at the Agent's request at approximately 11:00 a.m. (London time) two Business Days prior to the date of determination.

“ Eurodollar Rate Loan ” means a Loan that bears interest at a rate based on the Eurodollar Rate (other than a Base Rate Loan bearing interest at a rate based on the Eurodollar Rate).

“ Events of Default ” has the meaning specified in Section 6.01.

“ Excluded Taxes ” means, with respect to the Agent, any Lender or any other recipient of any payment to be made by or on account of any obligation of the Borrower hereunder, (a) taxes imposed on or measured by its overall net income (however denominated), and franchise taxes imposed on it (in lieu of net income taxes), by the United States of America or the jurisdiction (or any political subdivision thereof) under the Laws of which such recipient is organized or does business or in which its principal office is located or, in the case of any Lender, in which its Applicable Lending Office is located, (b) any branch profits taxes imposed by the United States of America or any similar tax imposed by any other jurisdiction in which the Borrower is located, (c) any backup withholding tax that is required by the Internal Revenue Code to be withheld from amounts payable to a Lender that has failed to comply with clause (A) of Section 2.12(e)(ii), and (d) in the case of a Foreign Lender (other than as agreed to between any assignee and the Borrower pursuant to a request by the Borrower under Section 2.17), any United States of America withholding tax that (i) is required to be imposed on amounts payable to such Foreign Lender pursuant to the Laws in force at the time such Foreign Lender becomes a party hereto (or designates a new Applicable Lending Office) or (ii) is attributable to such Foreign Lender's failure or inability (other than as a result of a Change in Law) to comply with clause (B) of Section 2.12(e)(ii), except to the extent that such Foreign Lender (or its assignor, if any) was entitled, at the time of designation of a new Applicable Lending Office (or assignment), to receive additional amounts from the Borrower with respect to such withholding tax pursuant to Section 2.12(a)(i) or (ii).

“Federal Funds Rate” means, for any day, the rate *per annum* equal to the weighted average of the rates on overnight federal funds transactions with members of the Federal Reserve System arranged by federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the Business Day next succeeding such day; provided that (a) if such day is not a Business Day, the Federal Funds Rate for such day shall be such rate on such transactions on the next preceding Business Day as so published on the next succeeding Business Day, and (b) if no such rate is so published on such next succeeding Business Day, the Federal Funds Rate for such day shall be the average rate (rounded upward, if necessary, to a whole multiple of 1/100 of 1%) charged to the Agent on such day on such transactions as determined by the Agent.

“Fee Letters” means each of the following letters to the Borrower dated February 23, 2011: (a) the fee letter from SunTrust Robinson Humphrey, Inc., (b) the fee letter from The Royal Bank of Scotland Finance (Ireland) and (c) the fee letter from Union Bank, each relating to certain fees payable by the Borrower to such parties in respect of the transactions contemplated by this Agreement, each as amended, modified, restated or supplemented from time to time.

“Foreign Lender” means any Lender that is organized under the Laws of a jurisdiction other than that in which the Borrower is resident for tax purposes. For purposes of this definition, the United States of America, each State thereof and the District of Columbia shall be deemed to constitute a single jurisdiction.

“Four Corners Acquisition” means the acquisition by APS from Southern California Edison Company (“SCE”) of SCE’s interests in Units 4 and 5 of the Four Corners Power Plant near Farmington, New Mexico, pursuant to the Purchase and Sale Agreement, dated as of November 8, 2010, by and between SCE and APS.

“Fund” means any Person (other than a natural person) that is (or will be) engaged in making, purchasing, holding or otherwise investing in commercial loans and similar extensions of credit in the ordinary course of its business.

“GAAP” has the meaning specified in Section 1.03.

“Governmental Authority” means the government of the United States of America or any other nation, or of any political subdivision thereof, whether state or local, and any agency, authority, instrumentality, regulatory body, court, central bank or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative powers or functions of or pertaining to government (including any supra-national bodies such as the European Union or the European Central Bank).

“Guarantee” means as to any Person, any obligation, contingent or otherwise, of such Person directly or indirectly guaranteeing any Indebtedness of any other Person or in any manner providing for the payment of any Indebtedness of any other Person or otherwise protecting the holder of such Indebtedness against loss (whether by virtue of partnership arrangements, agreements to keep well, to purchase assets, goods, securities or services, or to take-or-pay or otherwise), provided that the term “Guarantee” shall not include endorsements for collection or deposit in the ordinary course of business. The term “Guarantee” used as a verb has a corresponding meaning.

“Hazardous Materials” means (a) petroleum and petroleum products, byproducts or breakdown products, radioactive materials, asbestos-containing materials, polychlorinated biphenyls and radon gas and (b) any other chemicals, materials or substances designated, classified or regulated as hazardous or toxic or as a pollutant or contaminant under any Environmental Law.

“Hedge Agreement” means any interest rate swap, cap or collar agreement, interest rate future or option contract, currency swap agreement, currency future or option contract, commodity future or option contract, commodity forward contract or other similar agreement.

“Indebtedness” means as to any Person at any date (without duplication): (a) indebtedness created, issued, incurred or assumed by such Person for borrowed money or evidenced by bonds, debentures, notes or similar instruments; (b) all obligations of such Person to pay the deferred purchase price of property or services, excluding, however, trade accounts payable (other than for borrowed money) arising in, and accrued expenses incurred in, the ordinary course of business of such Person so long as such trade accounts payable are paid within 180 days of the date incurred (unless subject to a good faith dispute); (c) all Indebtedness secured by a Lien on any asset of such Person, to the extent such Indebtedness has been assumed by, or is a recourse obligation of, such Person; (d) all Guarantees by such Person; (e) all Capital Lease Obligations of such Person; and (f) the amount of all reimbursement obligations of such Person (whether contingent or otherwise) in respect of letters of credit, bankers’ acceptances, surety or other bonds and similar instruments in support of Indebtedness.

“Indemnified Taxes” means Taxes other than Excluded Taxes.

“Initial Borrowing” means the Loans made by the Initial Lenders on the Effective Date pursuant to Section 2.01 hereof.

“Initial Lenders” has the meaning given to such term in the introductory paragraph hereof.

“Interest Election Request” means a written request by the Borrower to Convert or continue a Borrowing in accordance with the definition of “*Interest Period*” contained in this Section 1.01 and/or Section 2.07, as applicable, in each case in substantially the form of Exhibit D hereto.

“Interest Period” means, for each Eurodollar Rate Loan comprising part of the same Borrowing, the period commencing on (i) the date such Eurodollar Rate Loan is disbursed, (ii) the date of the Conversion of any Base Rate Loan into such Eurodollar Rate Loan or (iii) the effective date of the most recent continuation of such Eurodollar Rate Loan, as the case may be, and ending on the last day of the period selected by the Borrower pursuant to the provisions below and, thereafter, each subsequent period commencing on the last day of the immediately preceding Interest Period and ending on the last day of the period selected by the Borrower pursuant to the provisions below. The duration of each such Interest Period shall be one, two, three or six months (or, if available to all Lenders, twelve months), as the Borrower may, upon notice (in the form of an Interest Election Request duly completed and executed by the Borrower) received by the Agent not later than 12:00 noon on the third Business Day prior to the first day of such Interest Period, select; provided, however, that:

- (a) the Borrower may not select any Interest Period that ends after the Termination Date;

(b) Interest Periods commencing on the same date for Eurodollar Rate Loans comprising part of the same Borrowing shall be of the same duration;

(c) whenever the last day of any Interest Period would otherwise occur on a day other than a Business Day, the last day of such Interest Period shall be extended to occur on the next succeeding Business Day, provided, however, that, if such extension would cause the last day of such Interest Period to occur in the next following calendar month, the last day of such Interest Period shall occur on the next preceding Business Day; and

(d) whenever the first day of any Interest Period occurs on a day of an initial calendar month for which there is no numerically corresponding day in the calendar month that succeeds such initial calendar month by the number of months equal to the number of months in such Interest Period, such Interest Period shall end on the last Business Day of such succeeding calendar month.

“ Internal Revenue Code ” means the Internal Revenue Code of 1986, as amended from time to time, and the regulations promulgated and rulings issued thereunder.

“ Joint Bookrunners ” means Union Bank and The Royal Bank of Scotland Finance (Ireland) in their capacity as joint bookrunners for the credit facility established by this Agreement.

“ Laws ” means, collectively, all international, foreign, Federal, state and local statutes, treaties, rules, guidelines, regulations, ordinances, codes and administrative or judicial precedents or authorities, including the interpretation or administration thereof by any Governmental Authority charged with the enforcement, interpretation or administration thereof, and all applicable administrative orders, directed duties, licenses, authorizations and permits of, and agreements with, any Governmental Authority.

“ Lenders ” means the Initial Lenders and each Person that shall become a party hereto pursuant to Section 8.07.

“ Lien ” means any mortgage, pledge, hypothecation, assignment, deposit arrangement, encumbrance, lien (statutory or otherwise), charge or other security interest or preferential arrangement that has the practical effect of creating a security interest, including, without limitation, the lien or retained security title of a conditional vendor and any easement, right of way or other encumbrance on title to real property, and any Capital Lease having substantially the same economic effect as any of the foregoing.

“ Loans ” has the meaning specified in Section 2.01.

“Loan Documents” mean this Agreement, each Note and the Fee Letters.

“Material Adverse Effect” means a material adverse effect on (a) the financial condition, operations, business or properties of the Borrower and its Subsidiaries (excluding SunCor Development Company and its Subsidiaries) taken as a whole, (b) the rights and remedies of the Agent or any Lender under this Agreement or any Note or (c) the ability of the Borrower to perform its obligations under this Agreement or any Note.

“Material Subsidiary” means APS and, at any time, each other Subsidiary of the Borrower (excluding SunCor Development Company and its Subsidiaries) which as of such time meets the definition of a “significant subsidiary” in Regulation S-X of the Securities and Exchange Commission or whose assets at such time exceed 10% of the assets of the Borrower and the Subsidiaries (on a Consolidated basis).

“Moody’s” means Moody’s Investors Service, Inc.

“Multiemployer Plan” means any employee benefit plan of the type described in Section 4001(a)(3) of ERISA, to which the Borrower or any ERISA Affiliate makes or is obligated to make contributions, or during the preceding five plan years, has made or been obligated to make contributions.

“Note” means a promissory note of the Borrower payable to the order of any Lender, delivered pursuant to a request made under Section 2.14, in substantially the form of Exhibit A hereto.

“Notice of Initial Borrowing” has the meaning specified in Section 2.02(a).

“Obligations” means all loans to, and debts, liabilities, obligations, covenants and duties of, the Borrower arising under any Loan Document or otherwise with respect to any Loan, whether direct or indirect (including those acquired by assumption), absolute or contingent, due or to become due, now existing or hereafter arising and including interest and fees that accrue under any Loan Document after the commencement by or against the Borrower of any proceeding under any Debtor Relief Laws naming such Person as the debtor in such proceeding, regardless of whether such interest and fees are allowed claims in such proceeding.

“Other Taxes” means all present or future stamp or documentary taxes or any other excise or property taxes, charges or similar levies arising from any payment made hereunder or under any other Loan Document or from the execution, delivery or enforcement of, or otherwise with respect to, this Agreement or any other Loan Document.

“PBGC” means the Pension Benefit Guaranty Corporation.

“Pension Plan” means any “employee pension benefit plan” (as such term is defined in Section 3(2) of ERISA), other than a Multiemployer Plan, that is subject to Title IV of ERISA and is sponsored or maintained by the Borrower or any ERISA Affiliate or to which the Borrower or any ERISA Affiliate contributes or has an obligation to contribute, or in the case of a multiple employer or other plan described in Section 4064(a) of ERISA, has made contributions at any time during the immediately preceding five plan years.

“ Percentage ” means, with respect to any Lender at any time, a fraction the numerator of which is the outstanding principal amount of such Lender’s Loans at such time and the denominator of which is the aggregate outstanding principal amount of all Loans at such time; provided, that (i) the initial Percentage of each Lender shall be the percentage set forth opposite such Lender’s name on Schedule 1.01 under the column “Ratable Share” and (ii) if the outstanding principal amount of all Loans has been repaid in full, the Percentage of each Lender shall be such Lender’s Percentage as in effect immediately prior to such repayment.

“ Person ” means an individual, partnership, corporation (including a business trust), joint stock company, trust, unincorporated association, joint venture, limited liability company or other entity, or a government or any political subdivision or agency thereof.

“ Plan ” means any “employee benefit plan” (as such term is defined in Section 3(3) of ERISA) established by the Borrower or, with respect to any such plan that is subject to Section 412 or 430 of the Internal Revenue Code or Title IV of ERISA, any ERISA Affiliate.

“ Public Debt Rating ” means, as of any date, (i) the rating that has been most recently announced by either S&P or Moody’s, as the case may be, for any class of non-credit enhanced long-term senior unsecured debt issued by the Borrower (or, if any such rating agency shall have issued more than one such rating, the lowest such rating issued by such rating agency) or (ii) if neither S&P nor Moody’s has in effect any rating for any class of non-credit enhanced long-term senior unsecured debt issued by the Borrower, the Borrower’s long-term issuer rating that has been most recently announced by either S&P or Moody’s, as the case may be. For purposes of the foregoing, (a) if only one of S&P and Moody’s shall have in effect a Public Debt Rating, the Applicable Rate shall be determined by reference to the available rating; (b) if neither S&P nor Moody’s shall have in effect a Public Debt Rating, the Applicable Rate will be set in accordance with Level 4 under the definition of “ Applicable Rate ”; (c) if the ratings established by S&P and Moody’s shall fall within different levels, the Applicable Rate shall be based upon the higher rating unless such ratings differ by two or more levels, in which case the applicable level will be deemed to be one level below the higher of such levels; (d) if any rating established by S&P or Moody’s shall be changed (other than as a result of a change in the basis on which ratings are established), such change shall be effective as of the date on which such change is first announced publicly by the rating agency making such change; and (e) if S&P or Moody’s shall change the basis on which ratings are established, each reference to the Public Debt Rating announced by S&P or Moody’s, as the case may be, shall refer to the then equivalent rating by S&P or Moody’s, as the case may be.

“ Ratable Share ” of any amount means, with respect to any Lender at any time, the product of such amount times such Lender’s Percentage.

“ Reference Rate ” means the variable rate of interest *per annum* established by Union Bank from time to time as its “reference rate”. Such “reference rate” is set by Union Bank as a general reference rate of interest, taking into account such factors as Union Bank may deem appropriate, it being understood that many of Union Bank’s commercial or other loans are priced in relation to such rate, that it is not necessarily the lowest or best rate actually charged to any customer and that Union Bank may make various commercial or other loans at rates of interest having no relationship to such rate. For purposes of this Agreement, each change in the Reference Rate shall be effective as of the opening of business on the date announced as the effective date of any change in such “reference rate”.

“Register” has the meaning specified in Section 8.07(c).

“Related Parties” means, with respect to any Person, such Person’s Affiliates and the partners, directors, officers, employees, agents, trustees and advisors of such Person and of such Person’s Affiliates.

“Reportable Event” means any of the events set forth in Section 4043(c) of ERISA, other than events for which the 30 day notice period has been waived under the final regulations issued under Section 4043, as in effect as of the date of this Agreement (the “Section 4043 Regulations”). Any changes made to the Section 4043 Regulations that become effective after the Effective Date shall have no impact on the definition of Reportable Event as used herein unless otherwise amended by the Borrower and the Required Lenders.

“Required Lenders” means, as of any date of determination, but subject to Section 2.16, Lenders holding in the aggregate more than 50% of the aggregate outstanding principal amount of all Loans (or, if all Loans have been repaid in full, more than 50% of the aggregate amount of all outstanding Obligations).

“S&P” means Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc.

“SEC Reports” means the Borrower’s Form 10-K Report for the fiscal year ended December 31, 2010 as filed with the Securities and Exchange Commission on February 18, 2011.

“Senior Notes” means the 5.91% Senior Notes, Series A, due February 28, 2011, issued by the Borrower pursuant to the Senior Notes Indenture.

“Senior Notes Indenture” means the Uncommitted Master Shelf Agreement, dated as of February 28, 2006, among the Borrower, Prudential Investment Management, Inc. and certain affiliates of Prudential Investment Management, Inc.

“Subsidiary” of any Person means any corporation, partnership, joint venture, limited liability company, trust or estate of which (or in which) more than 50% of (a) the issued and outstanding Voting Stock, (b) the interest in the capital or profits of such limited liability company, partnership or joint venture or (c) the beneficial interest in such trust or estate, is at the time directly or indirectly owned or controlled by such Person, by such Person and one or more of its other Subsidiaries or by one or more of such Person’s other Subsidiaries.

“Syndication Agent” means The Royal Bank of Scotland Finance (Ireland) in its capacity as syndication agent for the Lenders.

“Taxes” means all present or future taxes, levies, imposts, duties, deductions, withholdings (including backup withholding), assessments, fees or other charges imposed by any Governmental Authority, including any interest, additions to tax or penalties applicable thereto.

“Termination Date” means February 20, 2015.

“Type”, when used in reference to any Loan or Borrowing, refers to whether the rate of interest on such Loan, or on the Loans comprising such Borrowing, is determined by reference to the Eurodollar Rate or the Base Rate.

“Union Bank” means Union Bank, N.A., a national banking association.

“VIE Lessor Trusts” means the three (3) separate variable-interest entity lessor trusts that purchased from, and leased back to, APS certain interests in the Palo Verde Nuclear Generating Station Unit 2 and related common facilities, as described in Note 20 of the Notes to Consolidated Financial Statements set forth in the Borrower’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

“Voting Stock” means capital stock issued by a corporation, or equivalent interests in any other Person, the holders of which are ordinarily, in the absence of contingencies, entitled to vote for the election of directors (or persons performing similar functions) of such Person, even if the right so to vote has been suspended by the happening of such a contingency.

Section 1.02 Other Interpretive Provisions. With reference to this Agreement and each other Loan Document, unless otherwise specified herein or in such other Loan Document:

(a) The definitions of terms herein shall apply equally to the singular and plural forms of the terms defined. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms. The words “include,” “includes” and “including” shall be deemed to be followed by the phrase “without limitation.” The word “will” shall be construed to have the same meaning and effect as the word “shall.” Unless the context requires otherwise, (i) any definition of or reference to any agreement, instrument or other document shall be construed as referring to such agreement, instrument or other document as from time to time amended, restated, supplemented or otherwise modified (subject to any restrictions on such amendments, restatements, supplements or modifications set forth herein or in any other Loan Document), (ii) any reference herein to any Person shall be construed to include such Person’s permitted successors and permitted assigns, (iii) the words “herein,” “hereof” and “hereunder,” and words of similar import when used in any Loan Document, shall be construed to refer to such Loan Document in its entirety and not to any particular provision thereof, (iv) all references in a Loan Document to Articles, Sections, Exhibits and Schedules shall be construed to refer to Articles and Sections of, and Exhibits and Schedules to, the Loan Document in which such references appear, (v) any reference to any law shall include all statutory and regulatory provisions consolidating, amending, replacing or interpreting such law and any reference to any law or regulation shall, unless otherwise specified, refer to such law or regulation as amended, modified or supplemented from time to time, and (vi) the words “asset” and “property” shall be construed to have the same meaning and effect and to refer to any and all tangible and intangible assets and properties, including cash, securities, accounts and contract rights.

(b) In the computation of periods of time from a specified date to a later specified date, the word “from” means “from and including;” the words “to” and “until” each mean “to but excluding;” and the word “through” means “to and including.”

(c) Section headings herein and in the other Loan Documents are included for convenience of reference only and shall not affect the interpretation of this Agreement or any other Loan Document.

Section 1.03 Accounting Terms. Unless otherwise specified herein, all accounting terms used herein shall be interpreted, all accounting determinations hereunder shall be made, and all financial statements required to be delivered hereunder shall be prepared, in accordance with generally accepted accounting principles as in effect from time to time, applied on a basis consistent (except for changes concurred in by the Borrower’s independent public accountants) with the most recent audited Consolidated financial statements of the Borrower delivered to the Agent (“GAAP”). If at any time any change in GAAP or in the interpretation thereof would affect the computation of any financial ratio or requirement set forth in any Loan Document, and either the Borrower or the Required Lenders shall so request, the Agent, the Lenders and the Borrower shall negotiate in good faith to amend such ratio or requirement to preserve the original intent thereof in light of such change in GAAP or in the interpretation thereof (subject to the approval of the Required Lenders); provided that, unless and until so amended, such ratio or requirement shall continue to be computed in accordance with GAAP prior to such change therein.

Section 1.04 Rounding. Any financial ratios required to be maintained by the Borrower pursuant to this Agreement shall be calculated by dividing the appropriate component by the other component, carrying the result to one place more than the number of places by which such ratio is expressed herein and rounding the result up or down to the nearest number (with a rounding-up if there is no nearest number).

Section 1.05 Times of Day. Unless otherwise specified, all references herein to times of day shall be references to Eastern time (daylight or standard, as applicable).

ARTICLE II

AMOUNTS AND TERMS OF THE LOANS

Section 2.01 The Loans.

Subject to the terms and conditions hereof (including, without limitation, Section 3.01), each Lender, by its acceptance hereof, severally agrees to make a one-time loan (individually, a “Loan” and, collectively, the “Loans”) to the Borrower on the Effective Date in Dollars in an aggregate principal amount equal to such Lender’s Commitment. As provided in Section 2.05, the Borrower may elect that each Borrowing of Loans be either Base Rate Loans or Eurodollar Rate Loans. Amounts borrowed by the Borrower hereunder and prepaid or otherwise repaid may not be reborrowed. Unless an earlier maturity is provided for hereunder, all Loans shall mature and be due and payable on the Termination Date. Upon the making of the Loans pursuant to this Section 2.01, the Commitments shall immediately and automatically terminate.

Section 2.02 Making the Loans .

(a) The Initial Borrowing shall be made on notice, given not later than (x) 12:00 noon on the third Business Day prior to the Effective Date in the case of an Initial Borrowing consisting of Eurodollar Rate Loans or (y) 12:00 noon on the Business Day prior to the Effective Date in the case of an Initial Borrowing consisting of Base Rate Loans, by the Borrower to the Agent, which shall give to each Lender prompt notice thereof by facsimile. Such notice of the Initial Borrowing (the “ Notice of Initial Borrowing ”) shall be in writing or by facsimile in substantially the form of Exhibit B hereto, specifying therein the requested (i) date of the Initial Borrowing (which shall be the Effective Date and a Business Day), (ii) Type of Loans comprising the Initial Borrowing, (iii) aggregate amount of the Initial Borrowing, and (iv) in the case of an Initial Borrowing consisting of Eurodollar Rate Loans, initial Interest Period for each such Loan. Each Lender shall, before 2:00 p.m. on the date of the Initial Borrowing, make available for the account of its Applicable Lending Office to the Agent at the Agent’s Account, in same day funds, such Lender’s Ratable Share of the Initial Borrowing. After the Agent’s receipt of such funds and upon fulfillment of the applicable conditions set forth in Article III, the Agent will make such funds available to the Borrower at the Agent’s address referred to in Section 8.02 or as requested by the Borrower in the Notice of Initial Borrowing.

(b) Anything in subsection (a) above to the contrary notwithstanding, (i) the Borrower may not select Eurodollar Rate Loans for any Borrowing if the aggregate amount of such Borrowing is less than \$5,000,000 (or an integral multiple of \$1,000,000 in excess thereof) or if the obligation of the Lenders to make Eurodollar Rate Loans shall then be suspended pursuant to Section 2.06 or 2.10, and (ii) at no time shall there be more than fifteen (15) different Interest Periods outstanding for Eurodollar Rate Loans.

(c) The Notice of Initial Borrowing shall be irrevocable and binding on the Borrower. If the Notice of Initial Borrowing specifies that the Initial Borrowing is to be comprised of Eurodollar Rate Loans, the Borrower shall indemnify each Lender against any loss, cost or expense reasonably incurred by such Lender as a result of any failure (i) to fulfill on or before the date specified in the Notice of Initial Borrowing the applicable conditions set forth in Article III or (ii) to otherwise borrow the Eurodollar Rate Loans requested by the Borrower in the Notice of Initial Borrowing on such date (and shall set forth such indemnification obligation in the Notice of Initial Borrowing), including, without limitation, any loss (excluding loss of anticipated profits), cost or expense incurred by reason of the liquidation or reemployment of deposits or other funds acquired by such Lender to fund the Loan to be made by such Lender as part of the Initial Borrowing when such Loan, as a result of any such failure, is not made on such date.

(d) Unless the Agent shall have received notice from a Lender prior to the time of the Initial Borrowing that such Lender will not make available to the Agent such Lender’s Ratable Share of the Initial Borrowing, the Agent may assume that such Lender has made such portion available to the Agent on the date of the Initial Borrowing in accordance with subsection (a) of this Section 2.02 and the Agent may, in reliance upon such assumption, make available to the Borrower on such date a corresponding amount. If and to the extent that such Lender shall not have so made such Ratable Share available to the Agent, such Lender and the Borrower severally agree to repay to the Agent within one Business Day after demand for such Lender and within three Business Days after demand for the Borrower such corresponding amount together with interest thereon, for each day from the date such amount is made available to the Borrower until the date such amount is repaid to the Agent, at (i) in the case of the Borrower, the interest rate applicable at the time to Loans comprising the Initial Borrowing and (ii) in the case of such Lender, the Federal Funds Rate. If the Borrower and such Lender shall pay such interest to the Agent for the same or an overlapping period, the Agent shall promptly remit to the Borrower the amount of such interest paid by the Borrower for such period. If such Lender shall repay to the Agent such corresponding amount, such amount so repaid shall constitute such Lender’s Loan as part of the Initial Borrowing for purposes of this Agreement.

(e) The failure of any Lender to make the Loan to be made by it as part of the Initial Borrowing shall not relieve any other Lender of its obligation, if any, hereunder to make its Loan on the date of the Initial Borrowing, but no Lender shall be responsible for the failure of any other Lender to make the Loan to be made by such other Lender on the date of the Initial Borrowing.

Section 2.03 Agent's Fees . The Borrower shall pay to the Agent for its own account such fees as are agreed between the Borrower and the Agent pursuant to the Fee Letter between the Borrower and the Agent.

Section 2.04 Repayment of Loans . The Borrower hereby unconditionally agrees to pay to the Agent on the Termination Date, for the account of the Lenders and the Agent, the then unpaid principal amount of the Loans, together with all accrued and unpaid interest thereon, and all other outstanding Obligations.

Section 2.05 Interest on Loans .

(a) Scheduled Interest . The Borrower shall pay interest on the unpaid principal amount of each Loan owing to each Lender from the date of such Loan until such principal amount shall be paid in full, at the following rates *per annum* :

(i) Base Rate Loans . During such periods as such Loan is a Base Rate Loan, a rate *per annum* equal at all times to the sum of (x) the Base Rate in effect from time to time plus (y) the Applicable Rate for Base Rate Loans in effect from time to time, payable in arrears quarterly on the last day of each March, June, September and December during such periods and on the date such Base Rate Loan shall be Converted or paid in full.

(ii) Eurodollar Rate Loans . During such periods as such Loan is a Eurodollar Rate Loan, a rate *per annum* equal at all times during each Interest Period for such Loan to the sum of (x) the Eurodollar Rate for such Interest Period for such Loan plus (y) the Applicable Rate for Eurodollar Rate Loans in effect from time to time, payable in arrears on the last day of such Interest Period and, if such Interest Period has a duration of more than three months, on each day that occurs during such Interest Period every three months from the first day of such Interest Period and on the date such Eurodollar Rate Loan shall be Converted or paid in full.

(b) Default Interest. Upon the occurrence and during the continuance of an Event of Default under Section 6.01(a), the Agent may, and upon the request of the Required Lenders shall, require the Borrower to pay interest (“Default Interest”) on (i) the unpaid principal amount of each Loan owing to each Lender, payable in arrears on the dates referred to in clause (a)(i) or (a)(ii) above, at a rate *per annum* equal at all times to 2% *per annum* above the rate *per annum* required to be paid on such Loan pursuant to clause (a)(i) or (a)(ii) above and (ii) to the fullest extent permitted by Law, the amount of any interest, fee or other amount payable hereunder that is not paid when due, from the date such amount shall be due until such amount shall be paid in full, payable in arrears on the date such amount shall be paid in full and on demand, at a rate *per annum* equal at all times to 2% *per annum* above the rate *per annum* required to be paid on Base Rate Loans pursuant to clause (a)(i) above, provided, however, that following acceleration of the Loans pursuant to Section 6.01, Default Interest shall accrue and be payable hereunder whether or not previously required by the Agent.

(c) Interest Rate Limitation. Nothing contained in this Agreement or in any other Loan Document shall be deemed to establish or require the payment of interest to any Lender at a rate in excess of the maximum rate permitted by applicable Law. If the amount of interest payable for the account of any Lender on any interest payment date would exceed the maximum amount permitted by applicable Law to be charged by such Lender, the amount of interest payable for its account on such interest payment date shall be automatically reduced to such maximum permissible amount. In the event of any such reduction affecting any Lender, if from time to time thereafter the amount of interest payable for the account of such Lender on any interest payment date would be less than the maximum amount permitted by applicable Law to be charged by such Lender, then the amount of interest payable for its account on such subsequent interest payment date shall be automatically increased to such maximum permissible amount, provided that at no time shall the aggregate amount by which interest paid for the account of any Lender has been increased pursuant to this sentence exceed the aggregate amount by which interest paid for its account has theretofore been reduced pursuant to the previous sentence.

Section 2.06 Interest Rate Determination.

(a) The Agent shall give prompt notice to the Borrower and the Lenders of the applicable interest rate determined by the Agent for purposes of Section 2.05(a).

(b) If the Required Lenders determine that for any reason in connection with any request for a Eurodollar Rate Loan or a Conversion to or continuation thereof that (a) Dollar deposits are not being offered to banks in the London interbank eurodollar market for the applicable amount and Interest Period of such Eurodollar Rate Loan, (b) adequate and reasonable means do not exist for determining the Eurodollar Rate for any requested Interest Period with respect to a proposed Eurodollar Rate Loan, or (c) the Eurodollar Rate for any requested Interest Period with respect to a proposed Eurodollar Rate Loan does not adequately and fairly reflect the cost to such Lenders of funding such Loan, the Agent will promptly so notify the Borrower and each Lender, whereupon each Eurodollar Rate Loan will automatically on the last day of the then existing Interest Period therefor Convert into a Base Rate Loan. Thereafter, the obligation of the Lenders to make or maintain Eurodollar Rate Loans shall be suspended until the Agent (upon the instruction of the Required Lenders) revokes such notice. Upon receipt of such notice, the Borrower may revoke any pending request for a Borrowing of, Conversion to or continuation of Eurodollar Rate Loans or, failing that, will be deemed to have Converted such request into a request for a Base Rate Loan in the amount specified therein.

(c) If the Borrower shall fail to select the duration of any Interest Period for any Eurodollar Rate Loans in accordance with the provisions contained in the definition of "Interest Period" in Section 1.01, the Agent will forthwith so notify the Borrower and the Lenders and such Loans will automatically, on the last day of the then existing Interest Period therefor, Convert into Base Rate Loans.

(d) On the date on which the aggregate unpaid principal amount of Eurodollar Rate Loans comprising any Borrowing shall be reduced, by payment or prepayment or otherwise, to less than \$5,000,000, such Loans shall automatically Convert into Base Rate Loans.

(e) Upon the occurrence and during the continuance of any Event of Default,

(i) with respect to Eurodollar Rate Loans, each such Loan will automatically, on the last day of the then existing Interest Period therefor, Convert into a Base Rate Loan (or if such Loan is then a Base Rate Loan, will continue as a Base Rate Loan); and

(ii) the obligation of the Lenders to Convert Loans into Eurodollar Rate Loans shall be suspended until the Agent shall notify the Borrower and the Lenders that the circumstances causing such suspension no longer exist.

Section 2.07 Optional Conversion of Loans. The Borrower may on any Business Day, upon notice given to the Agent (in the form of an Interest Election Request duly completed and executed by the Borrower) not later than 12:00 noon on the third Business Day prior to the date of the proposed Conversion and subject to the provisions of Sections 2.06 and 2.10, Convert all or any portion of the Loans of one Type comprising the same Borrowing into Loans of the other Type; provided, however, that (a) any Conversion of Eurodollar Rate Loans into Base Rate Loans shall be made only on the last day of an Interest Period for such Eurodollar Rate Loans, (b) any Conversion of Base Rate Loans into Eurodollar Rate Loans shall be in an amount not less than the minimum amount specified in Section 2.02(b) and (c) no Conversion of any Loans shall result in more separate Borrowings than permitted under Section 2.02(b). Each such notice of a Conversion shall, within the restrictions specified above, specify (i) the date of such Conversion, (ii) the Loans to be Converted and (iii) if such Conversion is into Eurodollar Rate Loans, the duration of the initial Interest Period for each such Loan. Each Interest Election Request shall be irrevocable and binding on the Borrower.

Section 2.08 Prepayments of Loans.

(a) Optional. At any time and from time to time, the Borrower shall have the right to prepay the Loans, in whole or in part, without premium or penalty (except as provided in clause (z) below), upon notice at least two Business Days' prior to the date of such prepayment, in the case of Eurodollar Rate Loans, and not later than 11:00 a.m. on the date of such prepayment, in the case of Base Rate Loans, to the Agent specifying the proposed date of such prepayment and the aggregate principal amount and Type of the Loans to be prepaid (and, in the case of Eurodollar Rate Loans, the Interest Period of the Borrowing pursuant to which made); provided,

however, that (x) each partial prepayment shall be in an aggregate principal amount of \$5,000,000 or an integral multiple of \$1,000,000 in excess thereof, (y) accrued interest to the date of prepayment on the principal amount prepaid shall be payable by the Borrower on the date of such prepayment, and (z) in the event of any such prepayment of a Eurodollar Rate Loan, the Borrower shall be obligated to reimburse the Lenders in respect thereof pursuant to Section 8.04(e). Each prepayment of Loans shall be applied ratably to the outstanding principal amount of each Lender's Loan in accordance with such Lender's Ratable Share.

(b) Mandatory. The Borrower shall prepay the aggregate principal amount of the Loans, together with accrued interest to the date of prepayment on the principal amount prepaid, without requirement of demand therefor, or shall pay or prepay any other Indebtedness then outstanding at any time, when and to the extent required to comply with applicable Laws of any Governmental Authority or applicable resolutions of the Board of Directors of the Borrower.

Section 2.09 Increased Costs.

(a) Increased Costs Generally. If any Change in Law shall:

(i) impose, modify or deem applicable any reserve, special deposit, compulsory loan, insurance charge or similar requirement against assets of, deposits with or for the account of, or credit extended or participated in by, any Lender (except any reserve requirement contemplated by Section 2.09(e)); or

(ii) impose on any Lender or the London interbank market any other condition, cost or expense affecting this Agreement or Eurodollar Rate Loans made by such Lender;

and the result of any of the foregoing shall be to increase the cost to such Lender of making or maintaining any Eurodollar Rate Loan (or of maintaining its obligation to make any such Loan), or to reduce the amount of any sum received or receivable by such Lender hereunder (whether of principal, interest or any other amount) then, upon request of such Lender, the Borrower will pay to such Lender such additional amount or amounts as will compensate such Lender for such additional costs incurred or reduction suffered.

(b) Capital Requirements. If any Lender determines that any Change in Law affecting such Lender or any Applicable Lending Office of such Lender or such Lender's holding company, if any, regarding capital requirements has or would have the effect of reducing the rate of return on such Lender's capital or on the capital of such Lender's holding company, if any, as a consequence of this Agreement, the Commitments of such Lender or the Loans made by such Lender, to a level below that which such Lender or such Lender's holding company could have achieved but for such Change in Law (taking into consideration such Lender's policies and the policies of such Lender's holding company with respect to capital adequacy), then from time to time the Borrower will pay to such Lender such additional amount or amounts as will compensate such Lender or such Lender's holding company for any such reduction suffered. For the avoidance of doubt, this Section 2.09(b) shall apply to all requests, rules, regulations, guidelines or directives concerning capital adequacy issued in connection with the Dodd-Frank Act, regardless of the date adopted, issued, promulgated or implemented.

(c) Certificates for Reimbursement . A certificate of a Lender setting forth the amount or amounts necessary to compensate such Lender or its holding company, as the case may be, as specified in subsection (a) or (b) of this Section and delivered to the Borrower shall be conclusive and binding upon all parties absent manifest error. The Borrower shall pay such Lender the amount shown as due on any such certificate within 30 days after receipt thereof.

(d) Delay in Requests . Failure or delay on the part of any Lender to demand compensation pursuant to the foregoing provisions of this Section shall not constitute a waiver of such Lender's right to demand such compensation, provided that the Borrower shall not be required to compensate a Lender pursuant to the foregoing provisions of this Section for any increased costs incurred or reductions suffered more than three months prior to the date that such Lender notifies the Borrower of the Change in Law giving rise to such increased costs or reductions and of such Lender's intention to claim compensation therefor (except that, if the Change in Law giving rise to such increased costs or reductions is retroactive, then the three-month period referred to above shall be extended to include the period of retroactive effect thereof).

(e) Reserves on Eurodollar Rate Loans . The Borrower shall pay to each Lender, as long as such Lender shall be required to maintain reserves with respect to liabilities or assets consisting of or including Eurocurrency funds or deposits (currently known as "Eurocurrency liabilities"), additional interest on the unpaid principal amount of each Eurodollar Rate Loan equal to the actual costs of such reserves allocated to such Loan by such Lender (as determined by such Lender in good faith, which determination shall be conclusive absent manifest error), which shall be due and payable on each date on which interest is payable on such Loan, provided the Borrower shall have received at least 30 days' prior notice (with a copy to the Agent) of such additional interest from such Lender. If a Lender fails to give notice 30 days prior to the relevant interest payment date, such additional interest shall be due and payable 30 days from receipt of such notice.

Section 2.10 Illegality . If any Lender shall have determined in good faith that the introduction of or any change in any applicable Law or in the interpretation or administration thereof by any Governmental Authority charged with the interpretation or administration thereof, or compliance with any guideline or request from any such Governmental Authority (whether or not having the force of law), makes it unlawful for any Lender or its Applicable Lending Office to make, maintain or fund Eurodollar Rate Loans, or to determine or charge interest rates based upon the Eurodollar Rate, or any Governmental Authority has imposed material restrictions on the authority of such Lender to purchase or sell, or to take deposits of, Dollars in the London interbank market, then, on notice thereof by such Lender to the Borrower through the Agent, any obligation of such Lender to make or continue Eurodollar Rate Loans or to Convert Base Rate Loans to Eurodollar Rate Loans shall be suspended until such Lender notifies the Agent and the Borrower that the circumstances giving rise to such determination no longer exist. Upon receipt of such notice, the Borrower shall, upon demand from such Lender (with a copy to the Agent), prepay or, if applicable, Convert all Eurodollar Rate Loans of such Lender to Base Rate Loans, either on the last day of the Interest Period therefor, if such Lender may lawfully continue to maintain such Eurodollar Rate Loans to such day, or immediately, if such Lender may not lawfully continue to maintain such Eurodollar Rate Loans. Upon any such prepayment or Conversion, the Borrower shall also pay accrued interest on the amount so prepaid or Converted.

Section 2.11 Payments and Computations.

(a) All payments to be made by the Borrower shall be made without condition or deduction for any counterclaim, defense, recoupment or setoff. The Borrower shall make each payment hereunder not later than 1:00 p.m. on the day when due in Dollars to the Agent at the Agent's Account in same day funds. The Agent will promptly thereafter cause to be distributed like funds relating to the payment of principal, interest or fees ratably (other than amounts payable pursuant to Section 2.09, 2.10, 2.12, 2.17 or 8.04(e)) to the Lenders for the account of their respective Applicable Lending Offices, and like funds relating to the payment of any other amount payable to any Lender to such Lender for the account of its Applicable Lending Office, in each case to be applied in accordance with the terms of this Agreement. Upon its acceptance of an Assignment and Assumption and recording of the information contained therein in the Register pursuant to Section 8.07(c), from and after the effective date specified in such Assignment and Assumption, the Agent shall make all payments hereunder and under the Notes in respect of the interest assigned thereby to the Lender assignee thereunder, and the parties to such Assignment and Assumption shall make all appropriate adjustments in such payments for periods prior to such effective date directly between themselves.

(b) All computations of interest based on the Base Rate (when the Base Rate is based on the Reference Rate) shall be made by the Agent on the basis of a year of 365 or 366 days, as the case may be, and all other computations of interest and fees hereunder (including computations of interest based on the Eurodollar Rate and the Federal Funds Rate) shall be made by the Agent on the basis of a year of 360 days, in each case for the actual number of days (including the first day but excluding the last day) occurring in the period for which such interest or fees are payable. Each determination by the Agent of an interest rate hereunder shall be conclusive and binding for all purposes, absent manifest error.

(c) Whenever any payment hereunder or under the Notes shall be stated to be due on a day other than a Business Day, such payment shall be made on the next succeeding Business Day, and such extension of time shall in such case be included in the computation of payment of interest or fees, as the case may be; provided, however, that, if such extension would cause payment of interest on or principal of Eurodollar Rate Loans to be made in the next following calendar month, such payment shall be made on the next preceding Business Day.

(d) Unless the Agent shall have received notice from the Borrower prior to the date on which any payment is due to the Lenders hereunder that the Borrower will not make such payment in full, the Agent may assume that the Borrower has made such payment in full to the Agent on such date and the Agent may, in reliance upon such assumption, cause to be distributed to each Lender on such due date an amount equal to the amount then due to such Lender. If and to the extent the Borrower shall not have so made such payment in full to the Agent, each Lender shall repay to the Agent forthwith on demand such amount distributed to such Lender together with interest thereon, for each day from the date such amount is distributed to such Lender until the date such Lender repays such amount to the Agent, at the Federal Funds Rate.

Section 2.12 Taxes.

(a) Payments Free of Taxes; Obligation to Withhold; Payments on Account of Taxes.

(i) Any and all payments by or on account of any obligation of the Borrower hereunder or under any other Loan Document shall to the extent permitted by applicable Laws be made free and clear of and without reduction or withholding for any Taxes. If, however, applicable Laws require the Borrower or the Agent to withhold or deduct any Tax, such Tax shall be withheld or deducted in accordance with such Laws as determined by the Borrower or the Agent, as the case may be, upon the basis of the information and documentation to be delivered pursuant to subsection (e) below.

(ii) If the Borrower or the Agent shall be required by the Internal Revenue Code to withhold or deduct any Taxes, including both United States of America Federal backup withholding and withholding taxes, from any payment, then (A) the Agent shall withhold or make such deductions as are determined by the Agent to be required based upon the information and documentation it has received pursuant to subsection (e) below, (B) the Agent shall timely pay the full amount withheld or deducted to the relevant Governmental Authority in accordance with the Internal Revenue Code, and (C) to the extent that the withholding or deduction is made on account of Indemnified Taxes or Other Taxes, the sum payable by the Borrower shall be increased as necessary so that after any required withholding or the making of all required deductions (including deductions applicable to additional sums payable under this Section) the Agent or each Lender, as the case may be, receives an amount equal to the sum it would have received had no such withholding or deduction been made.

(b) Payment of Other Taxes by the Borrower. Without limiting the provisions of subsection (a) above, the Borrower shall timely pay any Other Taxes to the relevant Governmental Authority in accordance with applicable Laws.

(c) Tax Indemnifications.

(i) Without limiting the provisions of subsection (a) or (b) above, the Borrower shall, and does hereby, indemnify the Agent and each Lender, and shall make payment in respect thereof within 30 days after written demand therefor, for the full amount of any Indemnified Taxes or Other Taxes (including Indemnified Taxes or Other Taxes imposed or asserted on or attributable to amounts payable under this Section) withheld or deducted by the Borrower or the Agent or paid by the Agent or such Lender, as the case may be, and any penalties, interest and reasonable expenses arising therefrom or with respect thereto, whether or not such Indemnified Taxes or Other Taxes were correctly or legally imposed or asserted by the relevant Governmental Authority. The Borrower shall also, and does hereby, indemnify the Agent, and shall make payment in respect thereof within 10 days after demand therefor, for any amount which a Lender for any reason fails to pay indefeasibly to the Agent as required by clause (ii) of this subsection. A certificate as to the amount of any such payment or liability delivered to the Borrower by a Lender (with a copy to the Agent), or by the Agent on its own behalf or on behalf of a Lender, shall be conclusive absent manifest error.

(ii) Without limiting the provisions of subsection (a) or (b) above, each Lender shall, and does hereby, indemnify the Borrower and the Agent, and shall make payment in respect thereof within 30 days after demand therefor, against any and all Taxes and any and all related losses, claims, liabilities, penalties, interest and expenses (including the fees, charges and disbursements of any counsel for the Borrower or the Agent) incurred by or asserted against the Borrower or the Agent by any Governmental Authority as a result of the failure by such Lender to deliver, or as a result of the inaccuracy, inadequacy or deficiency of, any documentation required to be delivered by such Lender to the Borrower or the Agent pursuant to subsection (e). Each Lender hereby authorizes the Agent to set off and apply any and all amounts at any time owing to such Lender under this Agreement or any other Loan Document against any amount due to the Agent under this clause (ii). The agreements in this clause (ii) shall survive the resignation and/or replacement of the Agent, any assignment of rights by, or the replacement of, a Lender and the repayment, satisfaction or discharge of all or any portion of the Obligations.

(d) Evidence of Payments. Upon request by the Borrower or the Agent, as the case may be, after any payment of Taxes by the Borrower or by the Agent to a Governmental Authority as provided in this Section 2.12, the Borrower shall deliver to the Agent or the Agent shall deliver to the Borrower, as the case may be, the original or a certified copy of a receipt issued by such Governmental Authority evidencing such payment, a copy of any return required by Laws to report such payment or other evidence of such payment reasonably satisfactory to the Borrower or the Agent, as the case may be.

(e) Status of Lenders; Tax Documentation.

(i) Each Lender shall deliver to the Borrower and to the Agent, at the time or times prescribed by applicable Laws or when reasonably requested by the Borrower or the Agent, such properly completed and executed documentation prescribed by applicable Laws or by the taxing authorities of any jurisdiction and such other reasonably requested information as will permit the Borrower or the Agent, as the case may be, to determine (A) whether or not payments made hereunder or under any other Loan Document are subject to Taxes, (B) if applicable, the required rate of withholding or deduction, and (C) such Lender's entitlement to any available exemption from, or reduction of, applicable Taxes in respect of all payments to be made to such Lender by the Borrower pursuant to this Agreement or otherwise to establish such Lender's status for withholding tax purposes in the applicable jurisdiction.

(ii) Without limiting the generality of the foregoing, if the Borrower is resident for tax purposes in the United States of America,

(A) any Lender that is a "United States person" within the meaning of Section 7701(a)(30) of the Internal Revenue Code shall deliver to the Borrower and the Agent executed originals of Internal Revenue Service Form W-9 or such other documentation or information prescribed by applicable Laws or reasonably requested by the Borrower or the Agent as will enable the Borrower or the Agent, as the case may be, to determine whether or not such Lender is subject to backup withholding or information reporting requirements; and

(B) each Foreign Lender that is entitled under the Internal Revenue Code or any applicable treaty to an exemption from or reduction of withholding tax with respect to payments hereunder or under any other Loan Document shall deliver to the Borrower and the Agent (in such number of copies as shall be requested by the recipient) on or prior to the date on which such Foreign Lender becomes a Lender under this Agreement (and from time to time thereafter upon the request of the Borrower or the Agent, but only if such Foreign Lender is legally entitled to do so), whichever of the following is applicable:

(1) executed originals of Internal Revenue Service Form W-8BEN claiming eligibility for benefits of an income tax treaty to which the United States of America is a party,

(2) executed originals of Internal Revenue Service Form W-8ECI,

(3) executed originals of Internal Revenue Service Form W-8IMY and all required supporting documentation,

(4) in the case of a Foreign Lender claiming the benefits of the exemption for portfolio interest under section 881(c) of the Internal Revenue Code, (x) a certificate to the effect that such Foreign Lender is not (A) a “bank” within the meaning of section 881(c)(3)(A) of the Internal Revenue Code, (B) a “10 percent shareholder” of the Borrower within the meaning of section 881(c)(3)(B) of the Internal Revenue Code, or (C) a “controlled foreign corporation” described in section 881(c)(3)(C) of the Internal Revenue Code and (y) executed originals of Internal Revenue Service Form W-8BEN, or

(5) executed originals of any other form prescribed by applicable Laws as a basis for claiming exemption from or a reduction in United States of America Federal withholding tax together with such supplementary documentation as may be prescribed by applicable Laws to permit the Borrower or the Agent to determine the withholding or deduction required to be made.

(iii) Each Lender shall promptly (A) notify the Borrower and the Agent of any change in circumstances which would modify or render invalid any claimed exemption or reduction, and (B) take such steps as shall not be materially disadvantageous to it, in the reasonable judgment of such Lender, and as may be reasonably necessary (including the re-designation of its Applicable Lending Office) to avoid any requirement of applicable Laws of any jurisdiction that the Borrower or the Agent make any withholding or deduction for taxes from amounts payable to such Lender.

(f) Treatment of Certain Refunds . Unless required by applicable Laws, at no time shall the Agent have any obligation to file for or otherwise pursue on behalf of a Lender, or have any obligation to pay to any Lender, any refund of Taxes withheld or deducted from funds paid for the account of such Lender. If the Agent or any Lender determines, in its sole discretion, that it has received a refund of any Taxes or Other Taxes as to which it has been indemnified by the Borrower or with respect to which the Borrower has paid additional amounts pursuant to this Section, it shall pay to the Borrower an amount equal to such refund (but only to the extent of indemnity payments made, or additional amounts paid, by the Borrower under this Section with respect to the Taxes or Other Taxes giving rise to such refund), net of all reasonable out-of-pocket expenses incurred by the Agent or such Lender, as the case may be, and without interest (other than any interest paid by the relevant Governmental Authority with respect to such refund), provided that the Borrower, upon the request of the Agent or such Lender, agrees to repay the amount paid over to the Borrower (plus any penalties, interest or other charges imposed by the relevant Governmental Authority) to the Agent or such Lender in the event the Agent or such Lender is required to repay such refund to such Governmental Authority. This subsection shall not be construed to require the Agent or any Lender to make available its tax returns (or any other information relating to its taxes that it deems confidential) to the Borrower or any other Person.

(g) Payments . Failure or delay on the part of the Agent or any Lender to demand compensation pursuant to the foregoing provisions of this Section 2.12 shall not constitute a waiver of the Agent's or such Lender's right to demand such compensation, provided that the Borrower shall not be required to compensate the Agent or a Lender pursuant to the foregoing provisions of this Section 2.12 for any Indemnified Taxes or Other Taxes imposed or asserted by the relevant Governmental Authority more than three months prior to the date that the Agent or such Lender, as the case may be, claims compensation with respect thereto (except that, if a Change in Law giving rise to such Indemnified Taxes or Other Taxes is retroactive, then the three-month period referred to above shall be extended to include the period of retroactive effect thereof).

(h) The Agent and each Lender agrees to cooperate with any reasonable request made by the Borrower in respect of a claim of a refund in respect of Indemnified Taxes as to which it has been indemnified by the Borrower or with respect to which the Borrower has paid additional amounts pursuant to this Section 2.12 if (i) the Borrower has agreed in writing to pay all of the Agent's or such Lender's reasonable out-of-pocket costs and expenses relating to such claim, (ii) the Agent or such Lender determines, in its good faith judgment, that it would not be disadvantaged, unduly burdened or prejudiced as a result of such claim and (iii) the Borrower furnishes, upon request of the Agent or such Lender, an opinion of tax counsel (such opinion, which can be reasoned, and such counsel to be reasonably acceptable to such Lender or the Agent) that the Borrower is likely to receive a refund or credit.

Section 2.13 Sharing of Payments, Etc . If any Lender shall obtain any payment (whether voluntary, involuntary, through the exercise of any right of set-off, or otherwise) on account of the Loans owing to it (other than pursuant to Section 2.09, 2.10, 2.12, 2.17 or 8.04(e) or any payment obtained by a Lender as consideration for the assignment of or sale of a participation in any of its Loans to any assignee or participant, other than to the Borrower or any Subsidiary thereof if permitted hereby (as to which the provisions of this Section 2.13 shall apply) in excess of its Ratable Share of payments on account of the Loans obtained by all the Lenders, such Lender shall forthwith purchase from the other Lenders (for cash at face value) such participations in the Loans owing to them as shall be necessary to cause such purchasing Lender to share the excess payment ratably with each of them; provided, however, that if all or any portion of such excess payment is thereafter recovered from such purchasing Lender, such purchase from each Lender shall be rescinded and such Lender shall repay to the purchasing Lender the purchase price to the extent of such recovery together with an amount equal to such Lender's ratable share (according to the proportion of (i) the amount of such Lender's required repayment to (ii) the total amount so recovered from the purchasing Lender) of any interest or other amount paid or payable by the purchasing Lender in respect of the total amount so recovered. The Borrower agrees that any Lender so purchasing a participation from another Lender pursuant to this Section 2.13 may, to the fullest extent permitted by Law, exercise all its rights of payment (including the right of set-off) with respect to such participation as fully as if such Lender were the direct creditor of the Borrower in the amount of such participation.

Section 2.14 Evidence of Debt.

(a) Each Lender shall maintain in accordance with its usual practice an account or accounts evidencing the indebtedness of the Borrower to such Lender resulting from each Loan owing to such Lender from time to time, including the amounts of principal and interest payable and paid to such Lender from time to time hereunder in respect of Loans. The Borrower agrees that upon notice by any Lender to the Borrower (with a copy of such notice to the Agent) to the effect that a Note is required or appropriate in order for such Lender to evidence (whether for purposes of pledge, enforcement or otherwise) the Loans owing to, or to be made by, such Lender, the Borrower shall promptly execute and deliver to such Lender a Note payable to the order of such Lender in a principal amount equal to the Loans owing to, or to be made by, such Lender.

(b) The Register maintained by the Agent pursuant to Section 8.07(c) shall include a control account, and a subsidiary account for each Lender, in which accounts (taken together) shall be recorded (i) the date and amount of each Borrowing made hereunder, the Type of Loans comprising such Borrowing and, if appropriate, the Interest Period applicable thereto, (ii) the terms of each Assignment and Assumption delivered to and accepted by it, (iii) the amount of any principal or interest due and payable or to become due and payable from the Borrower to each Lender hereunder and (iv) the amount of any sum received by the Agent from the Borrower hereunder and each Lender's share thereof.

(c) Entries made in good faith by the Agent in the Register pursuant to subsection (b) above, and by each Lender in its account or accounts pursuant to subsection (a) above, shall be prima facie evidence of the amount of principal and interest due and payable or to become due and payable from the Borrower to, in the case of the Register, each Lender and, in the case of such account or accounts, such Lender, under this Agreement, absent manifest error; provided, however, that the failure of the Agent or such Lender to make an entry, or any finding that an entry is incorrect, in the Register or such account or accounts shall not limit or otherwise affect the obligations of the Borrower under this Agreement.

Section 2.15 Use of Proceeds . The proceeds of the Loans shall be available (and the Borrower agrees that it shall use such proceeds) solely to repay and refinance the Senior Notes.

Section 2.16 Affected Lenders . Notwithstanding any provision of this Agreement to the contrary, if any Lender becomes an Affected Lender, then the following provisions shall apply for so long as such Lender is an Affected Lender:

(a) the outstanding principal amount of the Loans of such Affected Lender shall not be included in determining whether the Required Lenders have taken or may take any action hereunder (including any consent to any amendment or waiver pursuant to Section 8.01), other than any waiver, amendment or modification requiring the consent of all Lenders or of each Lender affected;

(b) to the extent the Agent receives any payments or other amounts for the account of an Affected Lender under this Agreement, such Affected Lender shall be deemed to have requested that the Agent use such payment or other amount to fulfill such Affected Lender's previously unsatisfied obligations to fund a Loan under Section 2.01 or any other unfunded payment obligation of such Affected Lender under this Agreement; and

(c) for the avoidance of doubt, the Borrower, the Agent and each other Lender shall retain and reserve its other rights and remedies respecting each Affected Lender.

In the event that the Agent and the Borrower each agrees that an Affected Lender has adequately remedied all matters that caused such Lender to be an Affected Lender, then this Section 2.16 will no longer apply to such Lender.

Section 2.17 Replacement of Lenders . If any Lender requests compensation under Section 2.09, or if the Borrower is required to pay any additional amount to any Lender or any Governmental Authority for the account of any Lender pursuant to Section 2.12, or if any Lender is an Affected Lender, then the Borrower may, at its sole expense and effort, upon notice to such Lender and the Agent, require such Lender to assign and delegate, without recourse (in accordance with and subject to the restrictions contained in, and consents required by, Section 8.07), all of its interests, rights and obligations under this Agreement and the related Loan Documents to one or more assignees that shall assume such obligations (which any such assignee may be another Lender (other than an Affected Lender), if such Lender accepts such assignment), provided that:

(a) the Borrower shall have paid to the Agent the assignment fee specified in Section 8.07(b);

(b) such Lender shall have received payment of an amount equal to the outstanding principal amount of its Loans, accrued interest thereon, accrued fees and all other amounts payable to it hereunder and under the other Loan Documents (including any amounts under Section 8.04(e)) from the assignee (to the extent of such outstanding principal and accrued interest and fees) or the Borrower (in the case of all other amounts);

(c) in the case of any such assignment resulting from a claim for compensation under Section 2.09 or payments required to be made pursuant to Section 2.12, such assignment will result in a reduction in such compensation or payments thereafter; and

(d) such assignment does not conflict with applicable Laws.

A Lender shall not be required to make any such assignment or delegation if, prior thereto, as a result of a waiver by such Lender or otherwise, the circumstances entitling the Borrower to require such assignment and delegation cease to apply.

ARTICLE III

CONDITIONS PRECEDENT

Section 3.01 Conditions Precedent to Effectiveness. This Agreement shall become effective on and as of the first date (the “Effective Date”) on which the following conditions precedent have been satisfied:

(a) The Lenders shall have been given such access to the management, records, books of account, contracts and properties of the Borrower and its Subsidiaries as they shall have requested.

(b) The Borrower shall have paid all accrued fees and agreed expenses of the Agent, the Arrangers and the Lenders and the reasonable accrued fees and expenses of counsel to the Agent that have been invoiced at least one Business Day prior to the Effective Date.

(c) On the Effective Date, the following statements shall be true and the Agent shall have received a certificate signed by a duly authorized officer of the Borrower, dated the Effective Date, stating that:

(i) The representations and warranties contained in Section 4.01 are true and correct on and as of the Effective Date, both before and after giving effect to the Initial Borrowing and the application of the proceeds thereof, as though made on and as of such date; and

(ii) No event has occurred and is continuing, or would result from the Initial Borrowing or the application of the proceeds thereof, that constitutes a Default.

(d) The Agent shall have received the Notice of Initial Borrowing pursuant to Section 2.02.

(e) The Agent shall have received on or before the Effective Date the following, each dated such day, in form and substance satisfactory to the Agent and the Lenders:

(i) Receipt by the Agent of executed counterparts of this Agreement properly executed by a duly authorized officer of the Borrower and by each Lender.

(ii) The Notes, payable to the order of the Lenders to the extent requested by any Lender pursuant to Section 2.14(a).

(iii) The articles of incorporation of the Borrower certified to be true and complete as of a recent date by the appropriate governmental authority of the state or other jurisdiction of its incorporation and certified by a secretary, assistant secretary or associate secretary of the Borrower to be true and correct as of the Effective Date.

(iv) The bylaws of the Borrower certified by a secretary, assistant secretary or associate secretary of the Borrower to be true and correct as of the Effective Date.

(v) Certified copies of the resolutions of the Board of Directors of the Borrower approving this Agreement and the Notes, and of all documents evidencing other necessary corporate action, third party consents and governmental approvals, if any, with respect to this Agreement and the Notes.

(vi) A certificate of the secretary, assistant secretary or associate secretary of the Borrower certifying the names and true signatures of the officers of the Borrower authorized to sign this Agreement and the Notes and the other documents to be delivered hereunder.

(vii) A certificate as of a recent date from the Borrower's state of incorporation evidencing that the Borrower is in good standing in such state.

(viii) A favorable opinion of counsel for the Borrower, in form and substance reasonably acceptable to the Lenders.

(ix) A written opinion of Hughes Hubbard & Reed LLP, special New York counsel for the Agent, addressed to the Agent and the Lenders, with respect to the enforceability of this Agreement and the Notes issued on the Effective Date, in form and substance reasonably acceptable to the Agent.

Section 3.02 Determinations Under Section 3.01. For purposes of determining compliance with the conditions specified in Section 3.01 and the satisfaction of each Lender with respect to letters delivered to it from the Borrower as set forth in Sections 4.01 (a), 4.01(e) and 4.01(f), each Lender that has signed this Agreement shall be deemed to have consented to, approved or accepted or to be satisfied with each document or other matter required thereunder to be consented to or approved by or acceptable or satisfactory to the Lenders unless an officer of the Agent responsible for the transactions contemplated by this Agreement shall have received notice from such Lender prior to the date that the Borrower designates as the proposed Effective Date, specifying its objection thereto. The Agent shall promptly notify the Lenders and the Borrower of the occurrence of the Effective Date.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES

Section 4.01 Representations and Warranties of the Borrower. The Borrower represents and warrants as follows:

(a) Each of the Borrower and each Material Subsidiary: (i) is a corporation or other entity duly organized and validly existing under the Laws of the jurisdiction of its incorporation or organization; (ii) has all requisite corporate or if the Material Subsidiary is not a corporation, other comparable power necessary to own its assets and carry on its business as presently conducted; (iii) has all governmental licenses, authorizations, consents and approvals necessary to own its assets and carry on its business as presently conducted, if the failure to have any such license, authorization, consent or approval is reasonably likely to have a Material Adverse Effect and except as disclosed to the Agent in the SEC Reports or by means of a letter from the Borrower to the Lenders (such letter, if any, to be delivered to the Agent for prompt distribution to the Lenders) delivered prior to the execution and delivery of this Agreement (which, in each case, shall be satisfactory to each Lender in its sole discretion) and except that (A) APS from time to time may make minor extensions of its lines, plants, services or systems prior to the time a related franchise, certificate of convenience and necessity, license or permit is procured, (B) from time to time communities served by APS may become incorporated and considerable time may elapse before such a franchise is procured, (C) certain such franchises may have expired prior to the renegotiation thereof, (D) certain minor defects and exceptions may exist which, individually and in the aggregate, are not material and (E) certain franchises, certificates, licenses and permits may not be specific as to their geographical scope); and (iv) is qualified to do business in all jurisdictions in which the nature of the business conducted by it makes such qualification necessary and where failure so to qualify is reasonably likely to have a Material Adverse Effect.

(b) The execution, delivery and performance by the Borrower of this Agreement and the other Loan Documents, and the consummation of the transactions contemplated hereby, are within the Borrower's corporate powers, have been duly authorized by all necessary corporate action, and do not (i) contravene the Borrower's articles of incorporation or by-laws, (ii) contravene any Law, decree, writ, injunction or determination of any Governmental Authority, in each case applicable to or binding upon the Borrower or any of its properties, (iii) contravene any contractual restriction binding on or affecting the Borrower or (iv) cause the creation or imposition of any Lien upon the assets of the Borrower or any Material Subsidiary, except for Liens created under this Agreement and except where such contravention or creation or imposition of such Lien is not reasonably likely to have a Material Adverse Effect.

(c) No authorization or approval or other action by, and no notice to or filing with, any Governmental Authority is required for the due execution, delivery and performance by the Borrower of this Agreement or the Notes to be delivered by it.

(d) This Agreement has been, and each of the other Loan Documents upon execution and delivery will have been, duly executed and delivered by the Borrower. This Agreement is, and each of the other Loan Documents upon execution and delivery will be, the legal, valid and binding obligation of the Borrower enforceable against the Borrower in accordance with their respective terms, subject, however, to the application by a court of general principles of equity and to the effect of any applicable bankruptcy, insolvency, reorganization, moratorium or similar Laws affecting creditors' rights generally.

(e) The Consolidated balance sheet of the Borrower as of December 31, 2010, and the related Consolidated statements of income and cash flows of the Borrower for the fiscal year then ended, accompanied by an opinion thereon of Deloitte & Touche LLP, independent registered public accountants, copies of which have been furnished to the Agent, fairly present in all material respects the Consolidated financial condition of the Borrower as at such date and the Consolidated results of the operations of the Borrower for the fiscal year ended on such date, all in accordance with GAAP (except as disclosed therein). Except as disclosed to the Agent in the SEC Reports or by means of a letter from the Borrower to the Lenders (such letter, if any, to be delivered to the Agent for prompt distribution to the Lenders) delivered prior to the execution and delivery of this Agreement (which, in each case, shall be satisfactory to each Lender in its sole discretion), since December 31, 2010, there has been no Material Adverse Effect.

(f) There is no pending or, to the knowledge of an Authorized Officer of the Borrower, threatened action, suit, investigation, litigation or proceeding, including, without limitation, any Environmental Action, affecting the Borrower or any of its Subsidiaries before any court, governmental agency or arbitrator that (i) purports to affect the legality, validity or enforceability of this Agreement or any other Loan Document or the consummation of the transactions contemplated hereby or (ii) would be reasonably likely to have a Material Adverse Effect (except as disclosed to the Agent in the SEC Reports or by means of a letter from the Borrower to the Lenders (such letter, if any, to be delivered to the Agent for prompt distribution to the Lenders) delivered prior to the execution and delivery of this Agreement (which, in each case, shall be satisfactory to each Lender in its sole discretion)), and there has been no adverse change in the status, or financial effect on the Borrower or any of its Subsidiaries, of such disclosed litigation that would be reasonably likely to have a Material Adverse Effect.

(g) No proceeds of any Loan will be used to acquire any equity security not issued by the Borrower of a class that is registered pursuant to Section 12 of the Securities Exchange Act of 1934.

(h) The Borrower is not engaged in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulation U issued by the Board of Governors of the Federal Reserve System), and no proceeds of any Loan will be used to purchase or carry any margin stock or to extend credit to others for the purpose of purchasing or carrying any margin stock, in any case in violation of Regulation U.

(i) The Borrower and its Material Subsidiaries have filed all United States of America Federal income tax returns and all other material tax returns which are required to be filed by them and have paid all taxes due pursuant to such returns or pursuant to any assessment received by the Borrower or any of its Material Subsidiaries, except to the extent that (i) such taxes are being contested in good faith and by appropriate proceedings and that appropriate reserves for the payment thereof have been maintained by the Borrower and its Material Subsidiaries in accordance with GAAP or (ii) the failure to make such filings or such payments is not reasonably likely to have a Material Adverse Effect. The charges, accruals and reserves on the books of the Borrower and its Material Subsidiaries as set forth in the most recent financial statements of the Borrower delivered to the Agent pursuant to Section 4.01(e) or Section 5.01(h)(i) or (ii) hereof in respect of taxes and other governmental charges are, in the opinion of the Borrower, adequate.

(j) Set forth on Schedule 4.01(j) hereto (as such schedule may be modified from time to time by the Borrower by written notice to the Agent) is a complete and accurate list of all the Material Subsidiaries of the Borrower.

(k) Set forth on Schedule 4.01(k) hereto is a complete and accurate list identifying any Indebtedness of the Borrower outstanding in a principal amount equal to or exceeding \$5,000,000 and which is not described in the financial statements referred to in Section 4.01(e).

(l) The Borrower is not an “investment company”, or a company “controlled” by an “investment company”, within the meaning of the Investment Company Act of 1940, as amended.

(m) No report, certificate or other written information furnished by the Borrower or any of its Subsidiaries to the Agent, any Arranger or any Lender in connection with the transactions contemplated hereby and the negotiation of this Agreement or delivered hereunder or any other Loan Document (as modified or supplemented by other information so furnished) at the time so furnished, when taken together as a whole with all such written information so furnished, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, except as would not reasonably be expected to result in a Material Adverse Effect; provided that with respect to any projected financial information, forecasts, estimates or forward-looking information, the Borrower represents only that such information and materials have been prepared in good faith on the basis of assumptions believed to be reasonable at the time of preparation of such forecasts, and no representation or warranty is made as to the actual attainability of any such projections, forecasts, estimates or forward-looking information.

ARTICLE V

COVENANTS OF THE BORROWER

Section 5.01 Affirmative Covenants. So long as any Loan or any other Obligations shall remain unpaid, the Borrower shall:

(a) Compliance with Laws, Etc. (i) Comply, and cause each of its Material Subsidiaries to comply, in all material respects, with all applicable Laws of Governmental Authorities, such compliance to include, without limitation, compliance with ERISA and Environmental Laws, unless the failure to so comply is not reasonably likely to have a Material Adverse Effect and (ii) comply at all times with all Laws, orders, decrees, writs, injunctions or determinations of any Governmental Authority relating to the incurrence or maintenance of Indebtedness by the Borrower, unless the failure to so comply is not reasonably likely to have a Material Adverse Effect.

(b) Payment of Taxes, Etc. . Pay and discharge, and cause each of its Material Subsidiaries to pay and discharge, before the same shall become delinquent, all taxes, assessments and governmental charges or levies imposed upon it or upon its property; provided, however, that neither the Borrower nor any of its Material Subsidiaries shall be required to pay or discharge any such tax, assessment, charge or levy (i) that is being contested in good faith and by proper proceedings and as to which appropriate reserves are being maintained in accordance with GAAP or (ii) if the failure to pay such tax, assessment, charge or levy is not reasonably likely to have a Material Adverse Effect.

(c) Maintenance of Insurance . Maintain, and cause each of its Material Subsidiaries to maintain, insurance with responsible and reputable insurance companies or associations in such amounts and covering such risks as is usually carried by companies engaged in similar businesses and owning similar properties in the same general areas in which the Borrower or such Material Subsidiary operates; provided, however, that the Borrower and its Subsidiaries may self-insure to the same extent as other companies engaged in similar businesses and owning similar properties in the same general areas in which the Borrower or such Subsidiary operates and to the extent consistent with prudent business practice.

(d) Preservation of Corporate Existence, Etc. . Preserve and maintain, and cause each of its Material Subsidiaries to preserve and maintain, its corporate existence, rights (charter and statutory) and franchises (other than “franchises” as described in Arizona Revised Statutes, Section 40-283 or any successor provision) reasonably necessary in the normal conduct of its business, if the failure to maintain such rights or privileges is reasonably likely to have a Material Adverse Effect, and, in the case of APS, will cause APS to use its commercially reasonable efforts to preserve and maintain such franchises reasonably necessary in the normal conduct of its business, except that (i) APS from time to time may make minor extensions of its lines, plants, services or systems prior to the time a related franchise, certificate of convenience and necessity, license or permit is procured, (ii) from time to time communities served by APS may become incorporated and considerable time may elapse before such a franchise is procured, (iii) certain such franchises may have expired prior to the renegotiation thereof, (iv) certain minor defects and exceptions may exist which, individually and in the aggregate, are not material and (v) certain franchises, certificates, licenses and permits may not be specific as to their geographical scope; provided, however, that the Borrower and its Subsidiaries may consummate any merger or consolidation permitted under Section 5.02(b).

(e) Visitation Rights . At any reasonable time and from time to time, permit and cause each of its Subsidiaries to permit the Agent or any of the Lenders or any agents or representatives thereof, to examine and make copies of and abstracts from the records and books of account of, and visit the properties of, the Borrower and any of its Subsidiaries, and to discuss the affairs, finances and accounts of the Borrower and any of its Subsidiaries with any of their officers or directors; provided, however, that the Borrower and its Subsidiaries reserve the right to restrict access to any of its properties in accordance with reasonably adopted procedures relating to safety and security; and provided further that the costs and expenses incurred by such Lender or its agents or representatives in connection with any such examinations, copies, abstracts, visits or discussions shall be, upon the occurrence and during the continuation of a Default, for the account of the Borrower and, in all other circumstances, for the account of such Lender.

(f) Keeping of Books. Keep, and cause each of its Material Subsidiaries to keep, proper books of record and account, in which full and correct entries shall be made of all financial transactions and the assets and business of the Borrower and each such Subsidiary in a manner that permits the preparation of financial statements in accordance with GAAP.

(g) Maintenance of Properties, Etc. Keep, and cause each Material Subsidiary to keep, all property useful and necessary in its business in good working order and condition (ordinary wear and tear excepted), if the failure to do so is reasonably likely to have a Material Adverse Effect, it being understood that this covenant relates only to the working order and condition of such properties and shall not be construed as a covenant not to dispose of properties.

(h) Reporting Requirements. Furnish to the Agent:

(i) as soon as available and in any event within 50 days after the end of each of the first three fiscal quarters of each fiscal year of the Borrower, (A) for each such fiscal quarter of the Borrower, statements of income and cash flows of the Borrower and its Consolidated Subsidiaries for such fiscal quarter setting forth in each case in comparative form the corresponding figures for the corresponding fiscal quarter in the preceding fiscal year and (B) for the period commencing at the end of the previous fiscal year and ending with the end of each fiscal quarter, statements of income and cash flows of the Borrower and its Consolidated Subsidiaries for such period setting forth in each case in comparative form the corresponding figures for the corresponding period in the preceding fiscal year; provided that so long as the Borrower remains subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, the Borrower may provide, in satisfaction of the requirements of this first sentence of this Section 5.01(h)(i), its report on Form 10-Q for such fiscal quarter. Each set of financial statements provided under this Section 5.01(h)(i) shall be accompanied by a certificate of an Authorized Officer, which certificate shall state that said financial statements fairly present in all material respects the financial condition and results of operations of the Borrower and its Consolidated Subsidiaries in accordance with GAAP (except as disclosed therein) as at the end of, and for, such period (subject to normal year-end audit adjustments) and shall set forth reasonably detailed calculations demonstrating compliance with Section 5.03;

(ii) as soon as available and in any event within 90 days after the end of each fiscal year of the Borrower, statements of income and cash flows of the Borrower and its Consolidated Subsidiaries for such year and the related balance sheet of the Borrower and its Consolidated Subsidiaries as at the end of such year, setting forth in each case in comparative form the corresponding figures for the preceding fiscal year; provided that, so long as the Borrower remains subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, the Borrower may provide, in satisfaction of the requirements of this first sentence of this Section 5.01(h)(ii), its report on Form 10-K for such fiscal year. Each set of financial statements provided pursuant to this Section 5.01(h)(ii) shall be accompanied by (A) an opinion thereon of independent certified public accountants of recognized national standing, which opinion shall state that said financial statements fairly present in all material respects the financial condition and results of operations of the Borrower and its Consolidated Subsidiaries as at the end of, and for, such fiscal year, in accordance with GAAP (except as disclosed therein) and (B) a certificate of an Authorized Officer, which certificate shall set forth reasonably detailed calculations demonstrating compliance with Section 5.03;

(iii) as soon as possible and in any event within five days after any Authorized Officer of the Borrower knows of the occurrence of each Default continuing on the date of such statement, a statement of an Authorized Officer of the Borrower setting forth details of such Default and the action that the Borrower has taken and proposes to take with respect thereto;

(iv) promptly after the sending or filing thereof, copies of all reports and registration statements (other than exhibits thereto and registration statements on Form S-8 or its equivalent) that the Borrower or any Subsidiary files with the Securities and Exchange Commission;

(v) promptly after an Authorized Officer becomes aware of the commencement thereof, notice of all actions and proceedings before any court, governmental agency or arbitrator affecting the Borrower or any of its Subsidiaries of the type described in Section 4.01(f), except, with respect to any matter referred to in Section 4.01(f)(ii), to the extent disclosed in a report on Form 8-K, Form 10-Q or Form 10-K of the Borrower;

(vi) promptly after an Authorized Officer becomes aware of the occurrence thereof, notice of any change by Moody's or S&P of its respective Public Debt Rating or of the cessation (or subsequent commencement) by Moody's or S&P of publication of its respective Public Debt Rating;

(vii) promptly after the occurrence thereof, notice of the occurrence of any ERISA Event, together with (x) a written statement of an Authorized Officer of the Borrower specifying the details of such ERISA Event and the action that the Borrower has taken and proposes to take with respect thereto, (y) a copy of any notice with respect to such ERISA Event that may be required to be filed with the PBGC and (z) a copy of any notice delivered by the PBGC to the Borrower or an ERISA Affiliate with respect to such ERISA Event; and

(viii) such other information respecting the Borrower or any of its Subsidiaries as any Lender through the Agent may from time to time reasonably request.

Information required to be delivered pursuant to Sections 5.01(h)(i), (ii) and (iv) above shall be deemed to have been delivered on the date on which the Borrower provides notice to the Agent that such information has been posted on the Borrower's website on the Internet at www.pinnaclewest.com, at sec.gov/edaux/searches.htm or at another website identified in such notice and accessible by the Lenders without charge; provided that (i) such notice may be included in a certificate delivered pursuant to Section 5.01(h)(i) or (ii) and (ii) the Borrower shall deliver paper copies of the information referred to in Section 5.01(h)(i), (ii), and (iv) to any Lender which requests such delivery.

(i) Change in Nature of Business. Conduct directly or through its Subsidiaries the same general type of business conducted by the Borrower and its Material Subsidiaries on the date hereof.

(j) Ownership of APS. Except to the extent permitted under Section 5.02(b), at all times continue to own directly or indirectly at least 80% of the outstanding capital stock of APS.

Section 5.02 Negative Covenants. So long as Loan or any other Obligations shall remain unpaid, the Borrower shall not:

(a) Liens, Etc. Directly or indirectly create, incur, assume or permit to exist any Lien securing Indebtedness for borrowed money on or with respect to any property or asset (including, without limitation, the capital stock of APS) of the Borrower, whether now owned or held or hereafter acquired (unless it makes, or causes to be made, effective provision whereby the Obligations will be equally and ratably secured with any and all other obligations thereby secured so long as such other Indebtedness shall be so secured, such security to be pursuant to an agreement reasonably satisfactory to the Required Lenders); provided, however, that this Section 5.02(a) shall not apply to Liens securing Indebtedness for borrowed money (other than Indebtedness for borrowed money secured by the capital stock of APS) which do not in the aggregate exceed at any time outstanding the principal amount of \$50,000,000.

(b) Mergers, Etc. Merge or consolidate with or into any Person, or permit any of its Material Subsidiaries to do so, except that (i) any Material Subsidiary of the Borrower may merge or consolidate with or into any other Material Subsidiary of the Borrower, (ii) any Subsidiary of the Borrower may merge into the Borrower or any Material Subsidiary of the Borrower and (iii) the Borrower or any Material Subsidiary may merge with any other Person so long as the Borrower or such Material Subsidiary is the surviving corporation, provided, in each case, that no Default shall have occurred and be continuing at the time of such proposed transaction or would result therefrom.

(c) Sales, Etc. of Assets. Sell, lease, transfer or otherwise dispose of, or permit any of its Material Subsidiaries to sell, lease, transfer or otherwise dispose of, any assets, or grant any option or other right to purchase, lease or otherwise acquire any assets to any Person other than the Borrower or any Subsidiary of the Borrower, except (i) dispositions in the ordinary course of business, including, without limitation, sales or other dispositions of electricity and related and ancillary services, other commodities, emissions credits and similar mechanisms for reducing pollution, and damaged, obsolete, worn out or surplus property no longer required or useful in the business or operations of the Borrower or any of its Subsidiaries, (ii) sale or other disposition of patents, copyrights, trademarks or other intellectual property that are, in the Borrower's reasonable judgment, no longer economically practicable to maintain or necessary in the conduct of the business of the Borrower or its Subsidiaries and any license or sublicense of intellectual property that does not interfere with the business of the Borrower or any Material Subsidiary, (iii) in a transaction authorized by subsection (b) of this Section, (iv) individual dispositions occurring in the ordinary course of business which involve assets with a book value not exceeding \$5,000,000, (v) sales, leases, transfers or other dispositions of assets during the term of this Agreement having an aggregate book value not to exceed 30% of the total of all assets properly appearing on the most recent balance sheet of the Borrower provided pursuant to Section 4.01(e) or 5.01(h)(ii) hereof, (vi) at any time following the consummation of the Four Corners Acquisition and the closure by APS of Units 1, 2 and 3 of the Four Corners Power Plant near Farmington, New Mexico, as described in the SEC Reports, disposition of all or any portion of APS' interests in such Units 1, 2 and 3, and (vii) any Lien permitted under Section 5.02(a).

Section 5.03 Financial Covenant. So long as any Loan or any other Obligations shall remain unpaid, the Borrower will maintain a ratio of (a) Consolidated Indebtedness to (b) the sum of Consolidated Indebtedness plus Consolidated Net Worth of not greater than 0.65 to 1.

ARTICLE VI

EVENTS OF DEFAULT

Section 6.01 Events of Default. If any of the following events (“Events of Default”) shall occur and be continuing:

(a) The Borrower shall fail to pay when due (i) any principal of any Loan or (ii) any interest on any Loan or any fees or other amounts payable under this Agreement or any other Loan Documents, and (in the case of this clause (ii) only) such failure shall continue for a period of three Business Days; or

(b) Any representation or warranty made by the Borrower herein or by the Borrower (or any of its officers) in any certificate or other document delivered in connection with this Agreement or any other Loan Document shall prove to have been incorrect in any material respect when made or deemed made or furnished; or

(c) (i) The Borrower shall fail to perform or observe any term, covenant or agreement contained in Section 5.01(d) (as to the corporate existence of the Borrower), Section 5.01(h)(iii), Section 5.01(h)(vi), Section 5.01(j), Section 5.02 or Section 5.03; or (ii) the Borrower shall fail to perform or observe any term, covenant or agreement contained in Section 5.01(e) if such failure shall remain unremedied for 15 days after written notice thereof shall have been given to the Borrower by the Agent or any Lender; or (iii) the Borrower shall fail to perform or observe any other term, covenant or agreement contained in this Agreement or any other Loan Document on its part to be performed or observed if such failure shall remain unremedied for 30 days after written notice thereof shall have been given to the Borrower by the Agent or any Lender; or

(d) (i) The Borrower or any of its Material Subsidiaries shall fail to pay (A) any principal of or premium or interest on any Indebtedness that is outstanding in a principal amount of at least \$35,000,000 in the aggregate (but excluding Indebtedness outstanding hereunder), or (B) an amount, or post collateral as contractually required in an amount, of at least \$35,000,000 in respect of any Hedge Agreement, of the Borrower or such Material Subsidiary (as the case may be), in each case, when the same becomes due and payable (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise), and such failure shall continue after the applicable grace period, if any, specified in the agreement or instrument relating to such Indebtedness or Hedge Agreement; or (ii) any event of default shall exist under any agreement or instrument relating to any such Indebtedness and shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such event is to accelerate, or to permit the acceleration of, the maturity of such Indebtedness; or

(e) The Borrower or any of its Material Subsidiaries shall fail to pay any principal of or premium or interest in respect of any operating lease in respect of which the payment obligations of the Borrower have a present value of at least \$35,000,000, when the same becomes due and payable (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise), and such failure shall continue after the applicable grace period, if any, specified in such operating lease, if the effect of such failure is to terminate, or to permit the termination of, such operating lease; or

(f) The Borrower or any of its Material Subsidiaries shall generally not pay its debts as such debts become due, or shall admit in writing its inability to pay its debts generally, or shall make a general assignment for the benefit of creditors; or any proceeding shall be instituted by or against the Borrower or any of its Material Subsidiaries seeking to adjudicate it a bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief, or composition of it or its debts under any Debtor Relief Law, or seeking the entry of an order for relief or the appointment of a receiver, trustee, custodian or other similar official for it or for any substantial part of its property and, in the case of any such proceeding instituted against it (but not instituted by it), either such proceeding shall remain undismissed or unstayed for a period of 60 days, or any of the actions sought in such proceeding (including, without limitation, the entry of an order for relief against, or the appointment of a receiver, trustee, custodian or other similar official for, it or for any substantial part of its property) shall occur; or the Borrower or any of its Material Subsidiaries shall take any corporate action to authorize any of the actions set forth above in this subsection (f); or

(g) Judgments or orders for the payment of money that exceed any applicable insurance coverage (the insurer of which shall be rated at least "A" by A.M. Best Company) by more than \$35,000,000 in the aggregate shall be rendered against the Borrower or any Material Subsidiary and such judgments or orders shall continue unsatisfied or unstayed for a period of 45 days; or

(h) (i) Any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, but excluding any employee benefit plan of such person or its subsidiaries, and any person or entity acting in its capacity as trustee, agent or other fiduciary or administrator of any such plan) becomes the "beneficial owner" (as defined in Rules 13d-3 and 13d-5 under the Securities Exchange Act of 1934), directly or indirectly, of 30% or more of the equity securities of the Borrower entitled to vote for members of the board of directors of the Borrower; or (ii) during any period of 24 consecutive months, a majority of the members of the board of directors of the Borrower cease (other than due to death or disability) to be composed of individuals (A) who were members of that board on the first day of such period, (B) whose election or nomination to that board was approved by individuals referred to in clause (A) above constituting at the time of such election or nomination at least a majority of that board or (C) whose election or nomination to that board was approved by individuals referred to in clauses (A) and (B) above constituting at the time of such election or nomination at least a majority of that board; or

(i) (i) An ERISA Event occurs with respect to a Pension Plan or Multiemployer Plan which has resulted or could reasonably be expected to result in liability of the Borrower under Title IV of ERISA to the Pension Plan, Multiemployer Plan or the PBGC in an aggregate amount in excess of \$35,000,000; or (ii) the Borrower or any ERISA Affiliate fails to pay when due, after the expiration of any applicable grace period, any installment payment with respect to its withdrawal liability under Section 4201 of ERISA under a Multiemployer Plan in an aggregate amount in excess of \$35,000,000;

then, and in any such event, the Agent shall at the request, or may with the consent, of the Required Lenders, by notice to the Borrower, (i) declare the Loans, all interest thereon and all other amounts payable under this Agreement to be forthwith due and payable, whereupon the Loans, all such interest and all such amounts shall become and be forthwith due and payable, without presentment, demand, protest or further notice of any kind, all of which are hereby expressly waived by the Borrower; provided, however, that in the event of an actual or deemed entry of an order for relief with respect to the Borrower under the Bankruptcy Code of the United States of America, the Loans, all such interest and all such amounts shall automatically become and be due and payable, without presentment, demand, protest or any notice of any kind, all of which are hereby expressly waived by the Borrower, and (ii) exercise all rights and remedies available to it under this Agreement, the other Loan Documents and applicable Law.

ARTICLE VII

THE AGENT

Section 7.01 Appointment and Authority. Each of the Lenders hereby irrevocably appoints Union Bank to act on its behalf as the Agent hereunder and under the other Loan Documents and authorizes the Agent to take such actions on its behalf and to exercise such powers as are delegated to the Agent by the terms hereof or thereof, together with such actions and powers as are reasonably incidental thereto. Except as set forth in Section 7.06, the provisions of this Article are solely for the benefit of the Agent and the Lenders, and neither the Borrower nor any of its Affiliates shall have rights as a third party beneficiary of any of such provisions.

Section 7.02 Rights as a Lender. The Person serving as the Agent hereunder shall have the same rights and powers in its capacity as a Lender as any other Lender and may exercise the same as though it were not the Agent and the term "Lender" or "Lenders" shall, unless otherwise expressly indicated or unless the context otherwise requires, include the Person serving as the Agent hereunder in its individual capacity. Such Person and its Affiliates may accept deposits from, lend money to, act as the financial advisor or in any other advisory capacity for and generally engage in any kind of business with the Borrower or any Subsidiary or other Affiliate thereof as if such Person were not the Agent hereunder and without any duty to account therefor to the Lenders.

Section 7.03 Exculpatory Provisions. The Agent shall not have any duties or obligations except those expressly set forth herein and in the other Loan Documents. Without limiting the generality of the foregoing, the Agent:

(a) shall not be subject to any fiduciary or other implied duties, regardless of whether a Default has occurred and is continuing;

(b) shall not have any duty to take any discretionary action or exercise any discretionary powers, except discretionary rights and powers expressly contemplated hereby or by the other Loan Documents that the Agent is required to exercise as directed in writing by the Required Lenders (or such other number or percentage of the Lenders as shall be expressly provided for herein), provided that the Agent shall not be required to take any action that, in its opinion or the opinion of its counsel, may expose the Agent to liability or that is contrary to any Loan Document or applicable Law; and

(c) shall not, except as expressly set forth herein and in the other Loan Documents, have any duty to disclose, and shall not be liable for the failure to disclose, any information relating to the Borrower or any of its Affiliates that is communicated to or obtained by the Person serving as the Agent or any of its Affiliates in any capacity.

The Agent shall not be liable for any action taken or not taken by it (i) with the consent or at the request of the Required Lenders (or such other number or percentage of the Lenders as shall be necessary, or as the Agent shall believe in good faith shall be necessary, under the circumstances as provided in Section 6.01 and Section 8.01) or (ii) in the absence of its own gross negligence or willful misconduct. The Agent shall be deemed not to have knowledge of any Default unless and until notice describing such Default is given to the Agent by the Borrower or a Lender.

The Agent shall not be responsible for or have any duty to ascertain or inquire into (i) any statement, warranty or representation made in or in connection with this Agreement or any other Loan Document, (ii) the contents of any certificate, report or other document delivered hereunder or thereunder or in connection herewith or therewith, (iii) the performance or observance of any of the covenants, agreements or other terms or conditions set forth herein or therein or the occurrence of any Default, (iv) the validity, enforceability, effectiveness or genuineness of this Agreement, any other Loan Document or any other agreement, instrument or document or (v) the satisfaction of any condition set forth in Article III or elsewhere herein, other than to confirm receipt of items expressly required to be delivered to the Agent.

Section 7.04 Reliance by Agent. The Agent shall be entitled to rely upon, and shall not incur any liability for relying upon, any notice, request, certificate, consent, statement, instrument, document or other writing (including any electronic message, internet or intranet website posting or other distribution) believed by it to be genuine and to have been signed, sent or otherwise authenticated by the proper Person. The Agent also may rely upon any statement made to it orally or by telephone and believed by it to have been made by the proper Person, and shall not incur any liability for relying thereon. In determining compliance with any condition hereunder to the making of any Loan that by its terms must be fulfilled to the satisfaction of a Lender, the Agent may presume that such condition is satisfactory to such Lender unless the Agent shall have received notice to the contrary from such Lender prior to the making of such Loan. The Agent may consult with legal counsel (who may be counsel for the Borrower), independent accountants and other experts selected by it, and shall not be liable for any action taken or not taken by it in good faith in accordance with the advice of any such counsel, accountants or experts.

Section 7.05 Delegation of Duties. The Agent may perform any and all of its duties and exercise its rights and powers hereunder or under any other Loan Document by or through any one or more sub-agents appointed by the Agent. The Agent and any such sub-agent may perform any and all of its duties and exercise its rights and powers by or through their respective Related Parties. The exculpatory provisions of this Article shall apply to any such sub-agent and to the Related Parties of the Agent and any such sub-agent, and shall apply to their respective activities in connection with the syndication of the credit facilities provided for herein as well as activities as Agent.

Section 7.06 Resignation of Agent. The Agent may at any time give notice of its resignation to the Lenders and the Borrower. Upon receipt of any such notice of resignation, the Required Lenders shall have the right, with the consent of the Borrower so long as no Event of Default has occurred and is continuing, to appoint a successor, which shall be a bank with an office in the United States of America, or an Affiliate of any such bank with an office in the United States of America. If no such successor shall have been so appointed by the Required Lenders and shall have accepted such appointment within 45 days after the retiring Agent gives notice of its resignation, then the retiring Agent may, on behalf of the Lenders, appoint a successor Agent meeting the qualifications set forth above; provided that if the Agent shall notify the Borrower and the Lenders that no qualifying Person has accepted such appointment, then such resignation shall nonetheless become effective in accordance with such notice and (1) the retiring Agent shall be discharged from its duties and obligations hereunder and under the other Loan Documents (except that in the case of any collateral security held by the Agent on behalf of the Lenders under any of the Loan Documents, the retiring Agent shall continue to hold such collateral security until such time as a successor Agent is appointed) and (2) all payments, communications and determinations provided to be made by, to or through the Agent shall instead be made by or to each Lender directly, until such time as the Required Lenders appoint a successor Agent as provided for above in this Section. Upon the acceptance of a successor's appointment as Agent hereunder, such successor shall succeed to and become vested with all of the rights, powers, privileges and duties of the retiring (or retired) Agent, and the retiring Agent shall be discharged from all of its duties and obligations hereunder or under the other Loan Documents (if not already discharged therefrom as provided above in this Section). The fees payable by the Borrower to a successor Agent shall be as agreed between the Borrower and such successor. After the retiring Agent's resignation hereunder and under the other Loan Documents, the provisions of this Article and Section 8.04 shall continue in effect for the benefit of such retiring Agent, its sub-agents and their respective Related Parties in respect of any actions taken or omitted to be taken by any of them while the retiring Agent was acting as Agent.

Section 7.07 Non-Reliance on Agent and Other Lenders. Each Lender acknowledges that it has, independently and without reliance upon the Agent or any other Lender or any of their Related Parties and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. Each Lender also acknowledges that it will, independently and without reliance upon the Agent or any other Lender or any of their Related Parties and based on such documents and information as it shall from time to time deem appropriate, continue to make its own decisions in taking or not taking action under or based upon this Agreement, any other Loan Document or any related agreement or any document furnished hereunder or thereunder.

Section 7.08 No Other Duties, Etc. . Anything herein to the contrary notwithstanding, none of the Arrangers, the Syndication Agent, the Documentation Agent, the Joint Bookrunners or any other agents listed on the cover page hereof shall have any powers, duties or responsibilities under this Agreement or any of the other Loan Documents, except in its capacity, as applicable, as the Agent or a Lender hereunder.

ARTICLE VIII

MISCELLANEOUS

Section 8.01 Amendments, Etc. . No amendment or waiver of any provision of this Agreement or any other Loan Document, nor consent to any departure by the Borrower therefrom, shall in any event be effective unless the same shall be in writing and signed by the Required Lenders, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided, however, that no amendment, waiver or consent shall

(a) unless agreed to by each Lender directly affected thereby, (i) reduce or forgive the principal amount of any Loan, reduce the rate of or forgive any interest thereon (provided that only the consent of the Required Lenders shall be required to waive the applicability of any post-default increase in interest rates), or reduce or forgive any fees hereunder (other than fees payable to the Agent or the Arrangers for their own respective accounts), (ii) extend the final scheduled maturity date or any other scheduled date for the payment of any principal of or interest on any Loan, or extend the time of payment of any fees hereunder (other than fees payable to the Agent or the Arrangers for their own respective accounts), or (iii) increase any Commitment of any such Lender over the amount thereof in effect or extend the maturity thereof (it being understood that a waiver of any Default, if agreed to by the Required Lenders or all Lenders (as may be required hereunder with respect to such waiver), shall not constitute such an increase);

(b) unless agreed to by all of the Lenders, (i) reduce the percentage of the aggregate Commitments or of the aggregate unpaid principal amount of the Loans, or the number or percentage of Lenders, that shall be required for the Lenders or any of them to take or approve, or direct the Agent to take, any action hereunder or under any other Loan Document (including as set forth in the definition of "Required Lenders"), (ii) change any other provision of this Agreement or any of the other Loan Documents requiring, by its terms, the consent or approval of all the Lenders for any amendment, modification, waiver, discharge or termination thereof or any consent to any departure by the Borrower therefrom, or (iii) change or waive any provision of Section 2.13, any other provision of this Agreement or any other Loan Document requiring pro rata treatment of any Lenders, or this Section 8.01 or Section 2.17(b); and

(c) unless agreed to by the Agent in addition to the Lenders required as provided hereinabove to take such action, affect the respective rights or obligations of the Agent hereunder or under any of the other Loan Documents.

Section 8.02 Notices, Etc.

(a) All notices and other communications provided for hereunder shall be either (x) in writing (including facsimile communication) and mailed, faxed or delivered or (y) delivered, furnished, distributed or made available as and to the extent set forth in Sections 8.02(b) and (c), if to the Borrower, at the address specified on Schedule 8.02; if to any Lender, at its Domestic Lending Office; and if to the Agent, at the address specified on Schedule 8.02; or, as to the Borrower or the Agent, at such other address as shall be designated by such party in a written notice to the other parties and, as to each other party, at such other address as shall be designated by such party in a written notice to the Borrower and the Agent. All such notices and communications shall, when mailed or faxed, be effective when deposited in the mails or faxed, respectively, except that notices and communications to the Agent pursuant to Article II, III or VII shall not be effective until received by the Agent. Delivery by facsimile of an executed counterpart of any amendment or waiver of any provision of this Agreement or the Notes or of any Exhibit hereto to be executed and delivered hereunder shall be effective as delivery of a manually executed counterpart thereof. Notices delivered through electronic communications to the extent provided in subsection (b) below, shall be effective as provided in such subsection (b). Upon request of the Borrower, the Agent will provide to the Borrower (i) copies of each Administrative Questionnaire or (ii) the address of each Lender.

(b) Notices and other communications to the Lenders and the Agent hereunder may be delivered or furnished by electronic communication (including e-mail and Internet or intranet websites) pursuant to procedures approved by the Agent and agreed to by the Borrower, provided that the foregoing shall not apply to notices to any Lender pursuant to Article II if such Lender has notified the Agent and the Borrower that it is incapable of receiving notices under such Article by electronic communication. The Agent or the Borrower may, in its discretion, agree to accept notices and other communications to it hereunder by electronic communications pursuant to procedures approved by it, provided that approval of such procedures may be limited to particular notices or communications. Unless the Agent and the Borrower otherwise agree, (i) notices and other communications sent to an e-mail address shall be deemed received upon the sender's receipt of an acknowledgement from the intended recipient (such as by the "return receipt requested" function, as available, return e-mail or other written acknowledgement), provided that if such notice or other communication is not sent during the normal business hours of the recipient, such notice or communication shall be deemed to have been sent at the opening of business on the next business day for the recipient, and (ii) notices or communications posted to an Internet or intranet website shall be deemed received upon the deemed receipt by the intended recipient at its e-mail address as described in the foregoing clause (i) of notification that such notice or communication is available and identifying the website address therefor.

(c) The Borrower agrees that the Agent may make materials delivered to the Agent pursuant to Sections 5.01(h)(i), (ii) and (iv), as well as any other written information, documents, instruments and other material relating to the Borrower or any of its Subsidiaries and relating to this Agreement, the Notes or the transactions contemplated hereby, or any other materials or matters relating to this Agreement, the Notes or any of the transactions contemplated hereby (collectively, the “Communications”) available to the Lenders by posting such notices on Intralinks or a substantially similar electronic system (the “Platform”). The Borrower acknowledges that (i) the distribution of material through an electronic medium is not necessarily secure and that there are confidentiality and other risks associated with such distribution, (ii) the Platform is provided “as is” and “as available” and (iii) neither the Agent nor any of its Affiliates warrants the accuracy, adequacy or completeness of the Communications or the Platform and each expressly disclaims liability for errors or omissions in the Communications or the Platform. No warranty of any kind, express, implied or statutory, including, without limitation, any warranty of merchantability, fitness for a particular purpose, non-infringement of third party rights or freedom from viruses or other code defects, is made by the Agent or any of its Affiliates in connection with the Platform.

(d) Each Lender agrees that notice to it (as provided in the next sentence) (a “Notice”) specifying that any Communications have been posted to the Platform shall constitute effective delivery of such information, documents or other materials to such Lender for purposes of this Agreement; provided that if requested by any Lender the Agent shall deliver a copy of the Communications to such Lender by e-mail, facsimile or mail. Each Lender agrees (i) to notify the Agent in writing of such Lender’s e-mail address to which a Notice may be sent by electronic transmission (including by electronic communication) on or before the date such Lender becomes a party to this Agreement (and from time to time thereafter to ensure that the Agent has on record an effective e-mail address for such Lender) and (ii) that any Notice may be sent to such e-mail address.

(e) The Borrower hereby acknowledges that certain of the Lenders may be “public-side” Lenders (*i.e.*, Lenders that do not wish to receive material non-public information with respect to the Borrower or its securities) (each, a “Public Lender”). The Borrower hereby agrees that (w) all Communications that are to be made available to Public Lenders shall be clearly and conspicuously marked “PUBLIC” which shall mean that the word “PUBLIC” shall appear prominently on the first page thereof; (x) by marking Communications “PUBLIC,” the Borrower shall be deemed to have authorized the Agent, the Arrangers and the Lenders to treat such Communications as not containing any material non-public information with respect to the Borrower or its securities for purposes of United States of America federal and state securities laws; (y) all Communications marked “PUBLIC” are permitted to be made available through a portion of the Platform designated as “Public Investor;” and (z) the Agent and the Arrangers shall be entitled to treat any Communications that are not marked “PUBLIC” as being suitable only for posting on a portion of the Platform not marked as “Public Investor.” Notwithstanding the foregoing, the Borrower shall be under no obligation to mark any Communications “PUBLIC.” Notwithstanding anything to the contrary herein, the Borrower need not provide to any Public Lender any information, notice, or other document hereunder that is not public information, including without limitation, the Notice of Initial Borrowing and any notice of Default.

Section 8.03 No Waiver; Cumulative Remedies; Enforcement. No failure by any Lender or the Agent to exercise, and no delay by any such Person in exercising, any right, remedy, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power or privilege. The rights, remedies, powers and privileges herein provided are cumulative and not exclusive of any rights, remedies, powers and privileges provided by Law.

Notwithstanding anything to the contrary contained herein or in any other Loan Document, the authority to enforce rights and remedies hereunder and under the other Loan Documents against the Borrower shall be vested exclusively in, and all actions and proceedings at Law in connection with such enforcement shall be instituted and maintained exclusively by, the Agent in accordance with Article VI for the benefit of all the Lenders; provided, however, that the foregoing shall not prohibit (a) the Agent from exercising on its own behalf the rights and remedies that inure to its benefit (solely in its capacity as Agent) hereunder and under the other Loan Documents, (b) any Lender from exercising setoff rights in accordance with Section 8.05 (subject to the terms of Section 2.13), or (c) any Lender from filing proofs of claim or appearing and filing pleadings on its own behalf during the pendency of a proceeding relative to the Borrower under any Debtor Relief Law; and provided, further, that if at any time there is no Person acting as Agent hereunder and under the other Loan Documents, then (i) the Required Lenders shall have the rights otherwise ascribed to the Agent pursuant to Article VI and (ii) in addition to the matters set forth in clauses (b) and (c) of the preceding proviso and subject to Section 2.13, any Lender may, with the consent of the Required Lenders, enforce any rights and remedies available to it and as authorized by the Required Lenders.

Section 8.04 Costs and Expenses; Indemnity; Damage Waiver.

(a) The Borrower agrees to pay on demand all costs and expenses of the Agent in connection with the administration, modification and amendment of this Agreement, the Notes and the other Loan Documents to be delivered hereunder, including, without limitation, the reasonable fees and expenses of counsel for the Agent with respect thereto and with respect to advising the Agent as to its rights and responsibilities under this Agreement. The Borrower further agrees to pay on demand all costs and expenses of the Agent and the Lenders, if any (including, without limitation, reasonable counsel fees and expenses), in connection with the enforcement (whether through negotiations, legal proceedings or otherwise) of this Agreement, the Notes and the other Loan Documents to be delivered hereunder, including, without limitation, reasonable fees and expenses of counsel for the Agent and each Lender in connection with the enforcement of rights under this Section 8.04(a).

(b) The Borrower agrees to indemnify and hold harmless the Agent (and any sub-agent thereof), each Lender, each Arranger, the Syndication Agent, the Documentation Agent, each Joint Bookrunner and each Related Party of any of the foregoing (each, an “Indemnified Party”) from and against any and all claims, damages, losses, liabilities and expenses (including, without limitation, reasonable fees and expenses of counsel) incurred by or asserted or awarded against any Indemnified Party, in each case arising out of or in connection with or by reason of (including, without limitation, in connection with any investigation, litigation or proceeding or preparation of a defense in connection therewith, whether based on contract, tort or any other theory) (i) the Notes, this Agreement, any other Loan Document, any of the transactions contemplated herein or the actual or proposed use of the proceeds of any Loan, or (ii) the actual or alleged presence of Hazardous Materials on any property of the Borrower or any of its Subsidiaries or any

Environmental Action relating in any way to the Borrower or any of its Subsidiaries, provided that such indemnity shall not, as to any Indemnified Party, be available to the extent (a) such fees and expenses are expressly stated in this Agreement to be payable by the Indemnified Party, included expenses payable under Section 2.12, Section 5.01(e) and Section 8.07(b) or (b) such claim, damage, loss, liability or expense is found in a final, non-appealable judgment by a court of competent jurisdiction to have resulted from such Indemnified Party's gross negligence, willful misconduct or material breach of its obligations under this Agreement, in which case any fees and expenses previously paid or advanced by the Borrower to such Indemnified Party in respect of such indemnified obligation will be returned by such Indemnified Party. In the case of an investigation, litigation or other proceeding to which the indemnity in this Section 8.04(b) applies, such indemnity shall be effective whether or not such investigation, litigation or proceeding is brought by the Borrower, its directors, equityholders or creditors or an Indemnified Party or any other Person, whether or not any Indemnified Party is otherwise a party thereto, and whether or not the transactions contemplated hereby are consummated, provided that if the Borrower and such Indemnified Party are adverse parties in any such litigation or proceeding, and the Borrower prevails in a final, non-appealable judgment by a court of competent jurisdiction, any fees or expenses previously paid or advanced by the Borrower to such Indemnified Party pursuant to this Section 8.04(b) will be returned by such Indemnified Party.

(c) To the extent that the Borrower for any reason fails to indefeasibly pay any amount required under subsection (a) or (b) of this Section to be paid by it to the Agent (or any sub-agent thereof) or any Related Party of any of the foregoing (and without limiting its obligation to do so), each Lender severally agrees to pay to the Agent (or any such sub-agent) or such Related Party, as the case may be, such Lender's Ratable Share (determined as of the time that the applicable unreimbursed expense or indemnity payment is sought) of such unpaid amount, provided that the unreimbursed expense or indemnified loss, claim, damage, liability or related expense, as the case may be, was incurred by or asserted against the Agent (or any such sub-agent) in its capacity as such, or against any Related Party of any of the foregoing acting for the Agent (or any such sub-agent) in connection with such capacity.

(d) Each party hereto also agrees not to assert any claim for special, indirect, consequential or punitive damages against the other parties hereto, or any Related Party of any party hereto, on any theory of liability, arising out of or otherwise relating to the Notes, this Agreement, any other Loan Document, any of the transactions contemplated herein or the actual or proposed use of the proceeds of the Loans. No Indemnified Party shall be liable for any damages arising from the use by unintended recipients of any information or other materials distributed by it through telecommunications, electronic or other information transmission systems (including Intralinks, SyndTrak or similar systems) in connection with this Agreement or the other Loan Documents, provided that such indemnity shall not, as to any Indemnified Party, be available to the extent such damages are found in a final, non-appealable judgment by a court of competent jurisdiction to have resulted from such Indemnified Party's gross negligence or willful misconduct.

(e) If any payment of principal of, or Conversion of, any Eurodollar Rate Loan is made by the Borrower to or for the account of a Lender other than on the last day of the Interest Period for such Loan, as a result of a payment or Conversion pursuant to Section 2.06 (d) or (e), 2.08 or 2.10, acceleration of the maturity of the Loans pursuant to Section 6.01 or for any other reason, or by an Eligible Assignee to a Lender other than on the last day of the Interest Period for such Loan upon an assignment of rights and obligations under this Agreement pursuant to Section 8.07 as a result of a demand by the Borrower pursuant to Section 2.17, the Borrower shall, upon demand by such Lender (with a copy of such demand to the Agent), pay to the Agent for the account of such Lender any amounts required to compensate such Lender for any additional losses, costs or expenses that it may reasonably incur as a result of such payment or Conversion, including, without limitation, any loss (excluding loss of anticipated profits), cost or expense incurred by reason of the liquidation or reemployment of deposits or other funds acquired by any Lender to fund or maintain such Loan.

(f) Without prejudice to the survival of any other agreement of the Borrower hereunder, the agreements and obligations of the Borrower contained in Sections 2.09, 2.12 and 8.04 shall survive the payment in full of principal, interest and all other amounts payable hereunder and under the Notes.

Section 8.05 Right of Set-off. Upon (i) the occurrence and during the continuance of any Event of Default and (ii) the making of the request or the granting of the consent specified by Section 6.01 to authorize the Agent to declare the Loans due and payable pursuant to the provisions of Section 6.01, each Lender and each of its Affiliates is hereby authorized at any time and from time to time, to the fullest extent permitted by Law, to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by such Lender or any such Affiliate to or for the credit or the account of the Borrower against any and all of the obligations of the Borrower now or hereafter existing under this Agreement or any other Loan Document to such Lender, whether or not such Lender shall have made any demand under this Agreement or such Note and although such obligations may be contingent or unmatured or are owed to a branch or office of such Lender different from the branch or office holding such deposit or obligated on such indebtedness. Each Lender agrees promptly to notify the Borrower after any such set-off and application, provided that the failure to give such notice shall not affect the validity of such set-off and application. The rights of each Lender under this Section are in addition to other rights and remedies (including, without limitation, other rights of set-off) that such Lender may have.

Section 8.06 Effectiveness; Binding Effect. Except as provided in Section 3.01, this Agreement shall become effective when it shall have been executed by the Borrower and the Agent and when the Agent shall have received counterparts hereof that, when taken together, bear the signatures of each of the other parties hereto and thereafter shall be binding upon and inure to the benefit of the Borrower, the Agent and each Lender and their respective successors and assigns, except that the Borrower shall not have the right to assign its rights hereunder or any interest herein without the prior written consent of the Lenders (and any purported assignment without such consent shall be null and void).

Section 8.07 Successors and Assigns .

(a) The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns permitted hereby, except that the Borrower may not assign or otherwise transfer any of its rights or obligations hereunder without the prior written consent of the Agent and each Lender (and any purported assignment or transfer without such consent shall be null and void) and no Lender may assign or otherwise transfer any of its rights or obligations hereunder except (i) to an assignee in accordance with the provisions of subsection (b) of this Section, (ii) by way of participation in accordance with the provisions of subsection (d) of this Section, or (iii) by way of pledge or assignment of a security interest subject to the restrictions of subsection (f) of this Section. Nothing in this Agreement, expressed or implied, shall be construed to confer upon any Person (other than the parties hereto, their respective successors and assigns permitted hereby, Participants to the extent provided in subsection (d) of this Section and, to the extent expressly contemplated hereby, the Related Parties of each of the Agent and the Lenders) any legal or equitable right, remedy or claim under or by reason of this Agreement.

(b) Any Lender may at any time assign to one or more assignees (other than to an Affected Lender) all or a portion of its rights and obligations under this Agreement (including all or a portion of the Loans owing to it at such time); provided that any such assignment shall be subject to the following conditions:

(i) Minimum Amounts.

(A) in the case of an assignment of the entire principal amount of the assigning Lender's Loans at the time owing to it or in the case of an assignment to a Lender, no minimum amount need be assigned; and

(B) in any case not described in subsection (b)(i)(A) of this Section, the aggregate outstanding principal amount of the Loans of the assigning Lender subject to each such assignment, determined as of the date the Assignment and Assumption with respect to which such assignment is delivered to the Agent or, if "Trade Date" is specified in the Assignment and Assumption, as of the Trade Date, shall not be less than \$5,000,000 unless each of the Agent and, so long as no Event of Default has occurred and is continuing, the Borrower otherwise consents (each such consent not to be unreasonably withheld or delayed).

(ii) Proportionate Amounts. Each partial assignment shall be made as an assignment of a proportionate part of all the assigning Lender's rights and obligations under this Agreement with respect to the Loans assigned, and each such assignment shall be of a constant, and not a varying, percentage of all rights and obligations under this Agreement;

(iii) Required Consents. No consent shall be required for any assignment except to the extent required by subsection (b)(i)(B) of this Section and, in addition:

(A) the consent of the Borrower (such consent not to be unreasonably withheld or delayed) shall be required unless (1) an Event of Default has occurred and is continuing at the time of such assignment or (2) such assignment is to a Lender, an Affiliate of a Lender or an Approved Fund; and

(B) the consent of the Agent (such consent not to be unreasonably withheld or delayed) shall be required if such assignment is to a Person that is not a Lender, an Affiliate of a Lender or an Approved Fund with respect to such Lender.

(iv) Assignment and Assumption. The parties to each assignment shall execute and deliver to the Agent an Assignment and Assumption, together with a processing and recordation fee in the amount of \$3,500; provided, however, that no such fee shall be payable in the case of an assignment made at the request of the Borrower to an existing Lender. The assignee, if it is not a Lender, shall deliver to the Agent an Administrative Questionnaire.

(v) No Assignment to Borrower. No such assignment shall be made to the Borrower or any of the Borrower's Affiliates or Subsidiaries.

(vi) No Assignment to Natural Persons. No such assignment shall be made to a natural person.

Subject to acceptance and recording thereof by the Agent pursuant to subsection (c) of this Section and notice thereof to the Borrower, from and after the effective date specified in each Assignment and Assumption, the assignee thereunder shall be a party to this Agreement and, to the extent of the interest assigned by such Assignment and Assumption, have the rights and obligations of a Lender under this Agreement, and the assigning Lender thereunder shall, to the extent of the interest assigned by such Assignment and Assumption, be released from its obligations under this Agreement (and, in the case of an Assignment and Assumption covering all of the assigning Lender's rights and obligations under this Agreement, such Lender shall cease to be a party hereto) but shall continue to be entitled to the benefits of Sections 2.09, 2.12 and 8.04 with respect to facts and circumstances occurring prior to the effective date of such assignment. Upon request, the Borrower (at its expense) shall execute and deliver a Note to the assignee Lender. Any assignment or transfer by a Lender of rights or obligations under this Agreement that does not comply with this subsection shall be treated for purposes of this Agreement as a sale by such Lender of a participation in such rights and obligations in accordance with subsection (d) of this Section.

(c) Register. The Agent shall maintain at the Agent's Office a copy of each Assignment and Assumption delivered to it and a register for the recordation of the names and addresses of the Lenders, and the Commitments of, and principal amounts of the Loans owing to, each Lender pursuant to the terms hereof from time to time (the "Register"). The entries in the Register shall be conclusive, absent manifest error, and the Borrower, the Agent and the Lenders may treat each Person whose name is recorded in the Register pursuant to the terms hereof as a Lender hereunder for all purposes of this Agreement, notwithstanding notice to the contrary. The Register shall be available for inspection by the Borrower and any Lender, at any reasonable time and from time to time upon reasonable prior notice.

(d) Participations. Any Lender may at any time, without the consent of, or notice to, the Borrower or the Agent, sell participations to any Person (other than a natural person, an Affected Lender or the Borrower or any of the Borrower's Affiliates or Subsidiaries) (each, a "Participant") in all or a portion of such Lender's rights and/or obligations under this Agreement (including all or a portion of the Loans owing to it); provided that (i) such Lender's obligations under this Agreement shall remain unchanged, (ii) such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations, (iii) the Borrower, the Agent and the Lenders shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under this Agreement and (iv) no participant under any such participation shall have any right to approve any amendment or waiver of any provision of this Agreement or any Note, or any consent to any departure by the Borrower therefrom, except to the extent that such amendment, waiver or consent would reduce the principal of, or interest on, any Obligations or any fees or other amounts payable hereunder, in each case to the extent subject to such participation, or postpone any date fixed for any payment of principal of, or interest on, any Obligations or any fees or other amounts payable hereunder, in each case to the extent subject to such participation.

Any agreement or instrument pursuant to which a Lender sells such a participation shall provide that such Lender shall retain the sole right to enforce this Agreement and to approve any amendment, modification or waiver of any provision of this Agreement; provided that such agreement or instrument may provide that such Lender will not, without the consent of the Participant, agree to any amendment, waiver or other modification addressing the matters set forth in clause (iv) above to the extent subject to such participation. Subject to subsection (e) of this Section, the Borrower agrees that each Participant shall be entitled to the benefits of Sections 2.09, 2.12 and 8.04(e) to the same extent as if it were a Lender and had acquired its interest by assignment pursuant to subsection (b) of this Section. To the extent permitted by Law, each Participant also shall be entitled to the benefits of Section 8.05 as though it were a Lender, provided such Participant agrees to be subject to Section 2.13 as though it were a Lender.

(e) Limitations upon Participant Rights. A Participant shall not be entitled to receive any greater payment under Section 2.09 or 2.12 than the applicable Lender would have been entitled to receive with respect to the participation sold to such Participant, unless the sale of the participation to such Participant is made with the Borrower's prior written consent. A Participant that would be a Foreign Lender if it were a Lender shall not be entitled to the benefits of Section 2.12 unless the Borrower is notified of the participation sold to such Participant and such Participant agrees, for the benefit of the Borrower, to comply with Section 2.12(e) as though it were a Lender.

(f) Certain Pledges. Any Lender may at any time pledge or assign a security interest in all or any portion of its rights under this Agreement (including under its Note, if any) to secure obligations of such Lender, including any pledge or assignment to secure obligations to a Federal Reserve Bank; provided that no such pledge or assignment shall release such Lender from any of its obligations hereunder or substitute any such pledgee or assignee for such Lender as a party hereto.

(g) The words "execution," "signed," "signature," and words of like import in any Assignment and Assumption shall be deemed to include electronic signatures or the keeping of records in electronic form, each of which shall be of the same legal effect, validity or enforceability as a manually executed signature or the use of a paper-based recordkeeping system, as the case may be, to the extent and as provided for in any applicable Law, including the Federal Electronic Signatures in Global and National Commerce Act, the New York State Electronic Signatures and Records Act, or any other similar state Laws based on the Uniform Electronic Transactions Act.

Section 8.08 Confidentiality. Neither the Agent nor any Lender may disclose to any Person any confidential, proprietary or non-public information of the Borrower furnished to the Agent or the Lenders by the Borrower (such information being referred to collectively herein as the “Borrower Information”), except that each of the Agent and the Lenders may disclose Borrower Information (i) to its and its affiliates’ employees, officers, directors, agents and advisors having a need to know in connection with this Agreement (it being understood that the Persons to whom such disclosure is made will be informed of the confidential nature of such Borrower Information and instructed to keep such Borrower Information confidential on substantially the same terms as provided herein), (ii) to the extent requested by any regulatory authority, (iii) to the extent required by applicable Laws or regulations or by any subpoena or similar legal process, (iv) to any other party to this Agreement, (v) in connection with the exercise of any remedies hereunder or any suit, action or proceeding relating to this Agreement or the enforcement of rights hereunder, (vi) subject to an agreement containing provisions substantially the same as those of this Section 8.08, (A) to any assignee or participant or prospective assignee or participant, (B) to any direct, indirect, actual or prospective counterparty (and its advisor) to any swap, derivative or securitization transaction related to the obligations under this Agreement and (C) to any credit insurance provider relating to the Borrower and its Obligations, (vii) to the extent such Borrower Information (A) is or becomes generally available to the public on a non-confidential basis other than as a result of a breach of this Section 8.08 by the Agent or such Lender or their Related Parties, or (B) is or becomes available to the Agent or such Lender on a nonconfidential basis from a source other than the Borrower (provided that the source of such information was not known by the recipient after inquiry to be bound by a confidentiality agreement with or other contractual, legal or fiduciary obligation of confidentiality to the Borrower or any other Person with respect to such information) and (viii) with the consent of the Borrower. The obligations under this Section 8.08 shall survive for two calendar years after the date of the termination of this Agreement.

Section 8.09 Governing Law. This Agreement and the Notes shall be governed by, and construed in accordance with, the Laws of the State of New York (including Sections 5-1401 and 5-1402 of the General Obligations Law but otherwise without regard to conflict of law principles).

Section 8.10 Counterparts; Integration. This Agreement may be executed in counterparts (and by different parties hereto in different counterparts), each of which shall constitute an original, but all of which when taken together shall constitute a single contract. Delivery of an executed counterpart of a signature page of this Agreement by telecopy or other electronic imaging means shall be effective as delivery of a manually executed counterpart of this Agreement. This Agreement and the other Loan Documents constitute the entire contract among the parties relating to the subject matter hereof and supersede any and all previous agreements and understandings, oral or written, relating to the subject matter hereof.

Section 8.11 Jurisdiction, Etc.

(a) Each of the parties hereto hereby submits to the non-exclusive jurisdiction of any New York State court or federal court of the United States of America sitting in New York City, and any appellate court from any thereof, in any action or proceeding arising out of or relating to this Agreement or the other Loan Documents, or for recognition or enforcement of any judgment, and each of the parties hereto hereby agrees that all claims in respect of any such action or proceeding may be heard and determined in any such New York State court or, to the extent permitted by Law, in such federal court. Nothing in this Agreement shall affect any right that any party may otherwise have to bring any action or proceeding relating to this Agreement or the Notes in the courts of any jurisdiction.

(b) Each of the parties hereto irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, any objection that it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Agreement or the Notes in any New York State court or federal court of the United States of America sitting in New York City, and any appellate court from any thereof. Each of the parties hereto hereby irrevocably waives, to the fullest extent permitted by Law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such court.

Section 8.12 Payments Set Aside. To the extent that any payment by or on behalf of the Borrower is made to the Agent or any Lender, or the Agent or any Lender exercises its right of setoff, and such payment or the proceeds of such setoff or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by the Agent or such Lender in its discretion) to be repaid to a trustee, receiver or any other party, in connection with any proceeding under any Debtor Relief Law or otherwise, then (a) to the extent of such recovery, the obligation or part thereof originally intended to be satisfied shall be revived and continued in full force and effect as if such payment had not been made or such setoff had not occurred, and (b) each Lender severally agrees to pay to the Agent upon demand its applicable share (without duplication) of any amount so recovered from or repaid by the Agent, plus interest thereon from the date of such demand to the date such payment is made at a rate *per annum* equal to the Federal Funds Rate from time to time in effect. The obligations of the Lenders under clause (b) of the preceding sentence shall survive the payment in full of the Obligations and the termination of this Agreement.

Section 8.13 Patriot Act. The Agent and each Lender hereby notifies the Borrower that pursuant to the requirements of the USA Patriot Act (Title III of Pub. L. 107-56 (signed into law October 26, 2001)) (the “Act”), it is required to obtain, verify and record information that identifies each borrower (including the Borrower), guarantor or grantor (the “Loan Parties”), which information includes the name and address of each Loan Party and other information that will allow such Lender to identify such Loan Party in accordance with the Act. The Borrower shall provide, to the extent commercially reasonable, such information and take such actions as are reasonably requested by the Agent or any Lender in order to assist the Agent and such Lender in maintaining compliance with the Act.

Section 8.14 Waiver of Jury Trial. EACH OF THE BORROWER, THE AGENT AND THE LENDERS HEREBY IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT, THE NOTES OR ANY OTHER LOAN DOCUMENT OR THE ACTIONS OF THE BORROWER, THE AGENT OR ANY LENDER IN THE NEGOTIATION, ADMINISTRATION, PERFORMANCE OR ENFORCEMENT THEREOF.

Section 8.15 No Advisory or Fiduciary Responsibility. In connection with all aspects of each transaction contemplated hereby, the Borrower acknowledges and agrees that: (i) the credit facilities provided for hereunder and any related arranging or other services in connection therewith (including in connection with any amendment, waiver or other modification hereof or of any other Loan Document) are an arm's-length commercial transaction between the Borrower, on the one hand, and the Agent, each of the Lenders and each of the Arrangers, on the other hand, and the Borrower is capable of evaluating and understanding and understands and accepts the terms, risks and conditions of the transactions contemplated hereby and by the other Loan Documents (including any amendment, waiver or other modification hereof or thereof); (ii) in connection with the process leading to such transaction, each of the Agent, the Lenders and the Arrangers is and has been acting solely as a principal and is not the financial advisor, agent or fiduciary, for the Borrower or any of its Affiliates, stockholders, creditors or employees or any other Person; (iii) neither the Agent nor any Lender or Arranger has assumed or will assume an advisory, agency or fiduciary responsibility in favor of the Borrower with respect to any of the transactions contemplated hereby or the process leading thereto, including with respect to any amendment, waiver or other modification hereof or of any other Loan Document (irrespective of whether the Agent or any Lender or Arranger has advised or is currently advising the Borrower or any of its Affiliates on other matters) and neither the Agent nor any Lender or Arranger has any obligation to the Borrower with respect to the transactions contemplated hereby except those obligations expressly set forth herein and in the other Loan Documents; (iv) the Agent, each of the Lenders and the Arrangers and their respective Affiliates may be engaged in a broad range of transactions that involve interests that differ from those of the Borrower and its Affiliates, and neither the Agent nor any Lender or Arranger has any obligation to disclose any of such interests by virtue of any advisory, agency or fiduciary relationship; and (v) the Agent and each Lender and Arranger have not provided and will not provide any legal, accounting, regulatory or tax advice with respect to any of the transactions contemplated hereby (including any amendment, waiver or other modification hereof or of any other Loan Document) and the Borrower has consulted its own legal, accounting, regulatory and tax advisors to the extent it has deemed appropriate. The Borrower hereby waives and releases, to the fullest extent permitted by Law, any claims that it may have against the Agent and each Lender and Arranger with respect to any breach or alleged breach of agency or fiduciary duty in connection with the Loan Documents.

Section 8.16 Survival of Representations and Warranties. All representations and warranties made hereunder and in any other Loan Document or other document delivered pursuant hereto or thereto or in connection herewith or therewith shall survive the execution and delivery hereof and thereof. Such representations and warranties have been or will be relied upon by the Agent and each Lender, regardless of any investigation made by the Agent or any Lender or on their behalf, and shall continue in full force and effect as long as any Loan or any other Obligation hereunder shall remain unpaid or unsatisfied.

Section 8.17 Severability. If any provision of this Agreement or the other Loan Documents is held to be illegal, invalid or unenforceable, (a) the legality, validity and enforceability of the remaining provisions of this Agreement and the other Loan Documents shall not be affected or impaired thereby and (b) the parties shall endeavor in good faith negotiations to replace the illegal, invalid or unenforceable provisions with valid provisions the economic effect of which comes as close as possible to that of the illegal, invalid or unenforceable provisions. The invalidity of a provision in a particular jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK; SIGNATURE PAGES FOLLOW]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers thereunto duly authorized, as of the date first above written.

PINNACLE WEST CAPITAL CORPORATION

By: /s/ Lee R. Nickloy
Name: Lee R. Nickloy
Title: Vice President & Treasurer

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ADMINISTRATIVE AGENT:

UNION BANK, N.A. ,
as Agent, a Joint Lead Arranger and a Lender

By: /s/ Efrain Soto

Name: Efrain Soto

Title: Vice President

LENDERS:

THE ROYAL BANK OF SCOTLAND FINANCE (IRELAND),
as Syndication Agent, a Joint Lead Arranger and a Lender

By: /s/ Len O'Connell

Name: Len O'Connell

Title: Director

By: /s/ Muiris O'Dwyer

Name: Muiris O'Dwyer

Title: Director

SUNTRUST BANK , as Documentation Agent and a Lender

By: /s/ Andrew Johnson

Name: Andrew Johnson

Title: Director

SUNTRUST ROBINSON HUMPHREY, INC. , as a Joint
Lead Arranger

By: /s/ Jeff Titus

Name: Jeff Titus

Title: Mg Director

SCOTIABANC INC. , as a Lender

By: /s/ J.F. Todd

Name: J.F. Todd

Title: Managing Director

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U.S. BANK NATIONAL ASSOCIATION , as a Lender

By: /s/ Holland Williams

Name: Holland Williams

Title: AVP & Portfolio Mgr.

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SCHEDULE 1.01

COMMITMENTS AND RATABLE SHARES

<u><i>Lender</i></u>	<u><i>Commitment</i></u>	<u><i>Ratable Share</i></u>
Union Bank, N.A.	\$ 35,000,000.00	20.0%
The Royal Bank of Scotland Finance (Ireland)	\$ 35,000,000.00	20.0%
SunTrust Bank	\$ 35,000,000.00	20.0%
Scotiabanc Inc.	\$ 35,000,000.00	20.0%
U.S. Bank National Association	\$ 35,000,000.00	20.0%
TOTAL	<u>\$175,000,000.00</u>	<u>100.00%</u>

SCHEDULE 4.01(j)

SUBSIDIARIES

Arizona Public Service Company

SCHEDULE 4.01(k)
EXISTING INDEBTEDNESS

None

SCHEDULE 8.02

CERTAIN ADDRESSES FOR NOTICES

BORROWER:

Pinnacle West Capital Corporation
400 North Fifth Street
Mail Station 9040
Phoenix, AZ 85004
Attention: Treasurer
Telephone: (602) 250-3300
Telecopier: (602) 250-3902
Electronic Lee.Nickloy@PinnacleWest.com

AGENT :

Agent's Office
(for payments):

Union Bank, N.A.
1980 Saturn Drive
Mail Code: 4-957-161
Monterey Park, CA 91755
Attention: Rodolfo Quintero
Telephone: (323) 720-2575
Telecopier: (323) 656-2837
Electronic Mail: rodolfo.quintero@unionbank.com

Agent's Account/Wiring Information:

Union Bank, N.A., Monterey Park, CA
ABA No.: 122-000-496
Account No: 77070-196431
Account Name: Clearing Account
Ref: Pinnacle West Capital Corporation

Other Notices as Agent:

Union Bank, N.A.
445 South Figueroa Street, 15th floor
Los Angeles, CA 90071
Attention: Pascal Uttinger
Telephone: (213) 236-5549
Telecopier: (213) 236-4096
Electronic Mail: pascal.uttinger@unionbank.com

**PERFORMANCE SHARE AGREEMENT
UNDER THE
PINNACLE WEST CAPITAL CORPORATION
2007 LONG-TERM INCENTIVE PLAN**

THIS AWARD AGREEMENT is made and entered into as of February 15, 2011 (the "Date of Grant"), by and between Pinnacle West Capital Corporation (the "Company"), and _____ ("Employee").

BACKGROUND

- A. The Board of Directors of the Company has adopted, and the Company's shareholders have approved, the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (the "Plan"), pursuant to which Performance Shares and Dividend Equivalents may be granted to employees of the Company and its Subsidiaries and certain other individuals.
- B. The Company desires to grant to Employee Performance Shares and Dividend Equivalents under the terms of the Plan.
- C. Pursuant to the Plan, the Company and Employee agree as follows:

AGREEMENT

- 1. **Grant of Award**. Pursuant to action of the Committee, which was taken on the Date of Grant, the Company grants to Employee _____ (_____) Performance Shares and Dividend Equivalents. The Performance Shares granted under this Section 1 are referred to in this Award Agreement as the "Base Grant."
 - 2. **Award Subject to Plan**. This Performance Share Award and the related Dividend Equivalent Award are granted under and are expressly subject to all of the terms and provisions of the Plan, which terms are incorporated herein by reference, and this Award Agreement.
 - 3. **Performance Period**. The Performance Period for this Award begins January 1, 2011 and ends December 31, 2013.
 - 4. **Payment**.
 - (a) **Performance Shares Payable In Stock**. As soon as practicable in the fiscal year immediately following the end of the Performance Period, the Company will determine (i) the Company's Total Shareholder Return (as defined herein) as compared to the Total Shareholder Return of the companies in the S&P 1500 Super Composite Electric Utility Index (the "Growth Index") over the Performance Period and (ii) the Company's Average Performance with respect to the Performance Metrics (as defined herein). The Company will then deliver to Employee one (1) share of the Company's Stock for each then-outstanding Performance Share under this Award Agreement, subject to adjustment pursuant to Section 5 below. The Company anticipates that the Stock payout, if any, related to the Company's Total Shareholder Return will be made on or about January 25, 2014. The Company anticipates that the Stock payout, if any, related to the Performance Metrics will be made on or about November 30, 2014. In no event will the Stock payouts described in this Subsection 4(a) be made later than December 31, 2014.
-

- (b) **Retirement**. In the case of Employee's Retirement (as defined herein) during the Performance Period, Employee shall be deemed to have been employed by the Company through the end of the Performance Period and Employee will receive the Stock and Dividend Equivalents, if any, to which Employee is entitled at the time specified in this Section; provided, however, in the event Employee is terminated for Cause regardless of Employee's Retirement or eligibility for Retirement, Employee shall not be deemed to have been employed through the end of the Performance Period and will forfeit the right to receive any Stock hereunder. For purposes of this Award Agreement, (i) "Retirement" means a termination of employment which constitutes an "Early Retirement" or a "Normal Retirement" under the Pinnacle West Capital Corporation Retirement Plan, and (ii) "Cause" means (A) embezzlement, theft, fraud, deceit and/or dishonesty by the Employee involving the property, business or affairs of the Company or any of its Subsidiaries, or (B) an act of moral turpitude which in the sole judgment of the Chief Executive Officer of the Company reflects adversely on the business or reputation of the Company or any of its Subsidiaries or negatively affects any of the Company's or any of its Subsidiaries' employees or customers.
- (c) **Dividend Equivalents**. In satisfaction of the Dividend Equivalents Award made pursuant to Section 1, at the time of the Company's delivery of Stock to Employee pursuant to Subsection 4(a) above, the Company also will deliver to Employee fully transferrable shares of stock equal in value to the amount of dividends, if any, that Employee would have received if Employee had directly owned the Stock to which the Performance Shares relate from the Date of Grant to the date of the Stock payout, plus interest on such amount at the rate of 5 percent compounded quarterly, as determined pursuant to the Plan. The number of shares of Stock distributed to Employee will be determined by dividing the amount due by the Fair Market Value of one share of Stock as of the date of the Stock payout. No fractional Stock shall be issued. If the Stock payout results in a fractional share of one-half or greater, such fraction will be increased to provide for the issuance of a full share of Stock.
- (d) **Pension**. The value of the shares of Stock distributed upon payment for the Performance Shares and Dividend Equivalents will be disregarded for purposes of calculating the amount of Employee's benefit under any Company retirement plans.
5. **Performance Criteria and Adjustments**. Fifty percent (50%) of the Performance Shares awarded under this Award Agreement will be determined pursuant to Section 5(a) and fifty percent (50%) of the Performance Shares awarded under this Award Agreement will be determined pursuant to Section 5(b). In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Award Agreement greater than 2.0 times the Base Grant.
- (a) **Adjustment of Base Grant for Total Shareholder Return**. Fifty percent (50%) of the Base Grant will increase or decrease based upon the Company's "Total Shareholder Return" as compared to the Total Shareholder Return of the companies in the Growth Index during the Performance Period, as follows:

If the Company's Total Shareholder Return Over The Performance Period As Compared to the Total Shareholder Return of the Companies in the Growth Index is:

The Number of Performance Shares will be:

90th Percentile or greater	1.0 X Base Grant
75th Percentile	.75 X Base Grant
50th Percentile	0.5 X Base Grant
25th Percentile	0.25 X Base Grant
Less than 25th Percentile	None

If intermediate percentiles are achieved, the number of Performance Shares awarded will be prorated (partial shares will be rounded down to the nearest whole share when applicable). For example, if the Company's Total Shareholder Return during the Performance Period places the Company's performance in the 60th percentile, then the number of Performance Shares would be increased to 0.60 (0.5 X 60/50) multiplied by the Base Grant. In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Subsection 5(a) greater than 1.0 times the Base Grant.

- (b) **Adjustment of Base Grant for Performance Metrics**. Fifty percent (50%) of the Base Grant will increase or decrease based upon the Company's "Average Performance" with respect to the "Performance Metrics," as follows:

If the Company's Average Performance is:	The Number of Performance Shares will be:
90th Percentile or greater	1.0 X Base Grant
75th Percentile	.75 X Base Grant
50th Percentile	0.5 X Base Grant
25th Percentile	0.25 X Base Grant
Less than 25th Percentile	None

If intermediate percentiles are achieved, the number of Performance Shares awarded pursuant to this Subsection 5(b) will be prorated (partial shares will be rounded down to the nearest whole share when applicable). For example, if the Company's Average Performance during the Performance Period places the Company's performance in the 60th percentile, then the number of Performance Shares would be increased to .60 (0.5 X 60/50) multiplied by the Base Grant. In no event will Employee be entitled to receive a number of Performance Shares pursuant to this Subsection (b) greater than 1.0 times the Base Grant.

6. **Definitions**.

- (a) **Performance Metrics**. The "Performance Metrics" for the Performance Period are: (i) the JD Power Residential Survey for investor-owned utilities in the Western Region; (ii) the System Average Interruption Frequency Index (Major Events Excluded) ("SAIFI"); (iii) Arizona Public Service Company's customer to employee improvement ratio; (iv) the OSHA rate (All Incident Injury Rate); (v) nuclear capacity factor; and (vi) coal capacity factor.
- (1) With respect to the Performance Metric described in clause (i) of this Subsection 6(a), the JD Power Residential Survey will provide data on an annual basis reflecting the Company's percentile ranking, relative to other participating companies.
 - (2) With respect to the Performance Metric described in clause (ii) of this Subsection 6(a), the Edison Electric Institute ("EEI") will provide on an annual basis the quartile rankings (or percentile rankings, if available) associated with the SAIFI result of the participating companies; the Company will determine its SAIFI result for the year in question and determine its quartile ranking (or percentile ranking, if percentile rankings are available) based on the information provided by EEI.

- (3) With respect to the Performance Metric described in clause (iii) of this Subsection 6(a), SNL, an independent third party data system, will provide data on an annual basis regarding the customer and employee counts; the Company will use its customer and employee counts for the year in question and determine its percentile ranking based on the information provided by SNL. Only those companies whose customers and employees were included in the data provided by SNL in each of the years of the Performance Period will be considered.
- (4) With respect to the Performance Metric described in clause (iv) of this Subsection 6(a), EEI will provide data on an annual basis regarding the OSHA rate of the participating companies; the Company will calculate its OSHA rate for the year in question and determine its percentile ranking based on the information provided by EEI.
- (5) With respect to the Performance Metric described in clause (v) of this Subsection 6(a), SNL will provide data on an annual basis regarding the nuclear capacity factors of the participating nuclear plants; the Company will calculate its nuclear capacity factor for the year in question and determine its percentile ranking based on the information provided by SNL. Only those plants that were included in the data provided by SNL in each of the years of the Performance Period will be considered.
- (6) With respect to the Performance Metric described in clause (vi) of this Subsection 6(a), SNL will provide data on an annual basis regarding the coal capacity factors of the participating coal plants; the Company will calculate its coal capacity factor for the year in question and determine its percentile ranking based on the information provided by SNL. Only those plants that were included in the data provided by SNL in each of the years of the Performance Period will be considered.
- (7) The Company's percentile ranking during the Performance Period for each Performance Metric will be the average of the Company's percentile ranking for each Performance Metric during each of the three years of the Performance Period (each, an "Average Performance Metric"); provided, however, that if a Performance Metric for 2012 is not calculable by December 15, 2013, the Performance Metric shall consist of the three most recent years for which such Performance Metric is calculable. The Company's "Average Performance," for purposes of determining any Base Grant adjustments pursuant to Subsection 5(b) above will be the average of the Average Performance Metrics. If only quartile, rather than percentile, rankings are available for a particular Performance Metric, the Average Performance Metric for any such Performance Metric shall be expressed as a percentile. For example, if the Performance Metric was in the top quartile for two Performance Periods and in the lowest quartile in the other Performance Period, the average of these quartiles would be 3 (the average of 4, 4, and 1) and the Average Performance Metric would be the 75th percentile (3 /4). The calculations in this Subsection 6(a)(7) will be verified by the Company's internal auditors.
- (8) If either EEI or SNL discontinues providing the data specified above, the Committee shall select a data source that, in the Committee's judgment, will provide data most comparable to the data provided by EEI or SNL, as the case may be. If the JD Power Residential Survey for investor-owned utilities in the Western Region (or a successor JD Power survey) is not available during each of the years of the Performance Period, the Performance Metric associated with the JD Power Residential Survey (Subsection 6(b)(1)) will be disregarded and not included in the Company's Average Performance for purposes of determining any Base Grant adjustments pursuant to Subsection 5(b).

- (b) **Total Shareholder Return**. “ Total Shareholder Return ” for the Performance Period is the measure of a company’s stock price appreciation plus any dividends paid during the Performance Period. Only those companies that were included in the Growth Index in each of the years of the Performance Period will be considered. Total Shareholder Return for the Company and the companies in the Growth Index will be determined using the Daily Comparative Return as calculated by Bloomberg (or other independent third party data system). If the Growth Index is discontinued, the Committee shall select the most comparable index then in use for the sector comparison. In addition, if the sector comparison is no longer representative of the Company’s industry or business, the Committee shall replace the Growth Index with the most representative index then in use. Once the Total Shareholder Returns of the Company and all relevant companies in the Growth Index have been determined, the member companies will be ranked from greatest to least. Percentiles will be calculated based on a company’s relative ranking. For example, company 1 out of 26 companies is given a percentile of 96.2% (1.0 — 1/26). Percentiles will be carried out to one (1) decimal place. If the Company is not in the Growth Index, then its percentile will be interpolated between the companies listed in the relative ranking. These calculations will be verified by the Company’s internal auditors.
7. **Termination of Award**. This Award Agreement will terminate and be of no further force or effect on the date that Employee is no longer actively employed by the Company or any of its Subsidiaries, whether due to voluntary or involuntary termination, death, retirement, disability, or otherwise, except as specifically set forth in Section 4. Employee will, however, be entitled to receive any Stock and Dividend Equivalents payable under Section 4 of this Award Agreement if Employee’s employment terminates after the end of the Performance Period but before Employee’s receipt of such Stock and Dividend Equivalents.
8. **Section 409A Compliance**.
- (a) **Purpose of this Provision**. Section 409A of the Code imposes a number of requirements on “non-qualified deferred compensation” plans and arrangements. Based on regulations issued by the Internal Revenue Service, the Company has concluded that this Performance Share Award is subject to Section 409A. As a result, unless the Plan and this Award Agreement are administered to comply with Section 409A and the new rules, Employee will be required to pay an additional twenty percent (20%) tax (in addition to regular income taxes) on the compensation provided by this Award Agreement. In addition, under Section 409A additional interest will be payable.
- (b) **Compliance with Section 409A**. The Company intends to comply with Section 409A by assuring that all amounts to which Employee becomes entitled hereunder are payable at a specified time or pursuant to a fixed schedule within the meaning of Treas. Reg. § 1.409A-3(a)(4). As a result, no payment or transfer to Employee shall be made at the time specified in Section 4. The provisions of this Subsection 8(b) apply to all amounts due pursuant to this Award Agreement.
- (c) **Miscellaneous Payment Provisions**. If a payment is not made due to a dispute in payments, payments can be delayed in accordance with Treas. Reg. § 1.409A-3(g).
- (d) **Restriction on Acceleration or Further Deferral**. Under no circumstances may the time or schedule of any payment made or benefit provided pursuant to this Award Agreement be accelerated or subject to a further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code.

- (e) **No Elections** . Employee does not have any right to make any election regarding the time or form of any payment due under this Award Agreement other than the election described in Section 4(b) .
 - (f) **Compliant Operation and Interpretation** . The Plan and this Award Agreement shall be administered in compliance with Section 409A and each provision of the Award Agreement and the Plan shall be interpreted, to the extent possible, to comply with Section 409A.
9. **Tax Withholding** . Employee is responsible for any and all federal, state, and local income, payroll or other tax obligations or withholdings (collectively, the "Taxes") arising out of this Award. Employee shall pay any and all Taxes due in connection with a payout of Stock hereunder by check or by having the Company withhold shares of Stock from such payout. Within 75 days after the Date of Grant, Employee must elect, on the election form described in Section 4(b) , how Employee will satisfy the tax obligations upon a payout. In the absence of a timely election by Employee, Employee's tax withholding obligation will be satisfied through the Company's withholding of shares of Stock as set forth above.
 10. **Continued Employment** . Nothing in the Plan or this Award Agreement shall be interpreted to interfere with or limit in any way the right of the Company or its Subsidiaries to terminate Employee's employment or services at any time. In addition, nothing in the Plan or this Award Agreement shall be interpreted to confer upon Employee the right to continue in the employ or service of the Company or its Subsidiaries.
 11. **Non-Transferability** . Neither this Award nor any rights under this Award Agreement may be assigned, transferred, or in any manner encumbered except by will or the laws of descent and distribution, and any attempted assignment, transfer, mortgage, pledge or encumbrance except as herein authorized, will be void and of no effect.
 12. **Definitions: Copy of Plan and Plan Prospectus** . To the extent not specifically defined in this Award Agreement, all capitalized terms used in this Award Agreement will have the same meanings ascribed to them in the Plan. Employee will receive a copy of the Plan and the related Plan Prospectus. In the event of any conflict between the terms and conditions of this Award Agreement and the Plan, the provisions of the Plan shall control.
 13. **Amendment** . Except as otherwise provided in the Plan, this Award Agreement may be amended only by a written agreement executed by the Company and Employee.
 14. **Choice of Law** . This Award Agreement will be governed by the laws of the State of Arizona, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Award Agreement to another jurisdiction.

An authorized representative of the Company has signed this Award Agreement as of the Date of Grant.

PINNACLE WEST CAPITAL CORPORATION

By: _____

Its: _____

**RESTRICTED STOCK UNIT AGREEMENT
UNDER THE
PINNACLE WEST CAPITAL CORPORATION
2007 LONG-TERM INCENTIVE PLAN**

THIS AWARD AGREEMENT is made and entered into as of February 15, 2011 (the "Date of Grant"), by and between Pinnacle West Capital Corporation (the "Company"), and _____ ("Employee").

BACKGROUND

- A. The Board of Directors of the Company (the "Board of Directors") has adopted, and the Company's shareholders have approved, the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (the "Plan"), pursuant to which Restricted Stock Units and Dividend Equivalents may be granted to employees of the Company and its Subsidiaries and certain other individuals.
- B. The Company desires to grant to Employee Restricted Stock Units and Dividend Equivalents under the terms of the Plan.
- C. Pursuant to the Plan, the Company and Employee agree as follows:

AGREEMENT

1. **Grant of Award** . Pursuant to action of the Committee which was taken on the Date of Grant, the Company grants to Employee _____ (x,xxx) Restricted Stock Units and Dividend Equivalents based on the dividends declared on the shares of Stock to which such Restricted Stock Units relate.
2. **Award Subject to Plan** . This Restricted Stock Unit Award and the related Dividend Equivalent Award are granted under and are expressly subject to all of the terms and provisions of the Plan, which terms are incorporated herein by reference, and this Award Agreement.
3. **Vesting of Restricted Stock Units** . The Restricted Stock Units granted pursuant to Section 1 will vest and no longer be subject to the restrictions of and forfeiture under this Award Agreement on four (4) "Vesting Dates" as follows:
 - (a) x,xxx Restricted Stock Units will vest on February 20, 2012;
 - (b) x,xxx Restricted Stock Units will vest on February 20, 2013;
 - (c) x,xxx Restricted Stock Units will vest on February 20, 2014; and
 - (d) The remaining x,xxx Restricted Stock Units will vest on February 20, 2015.

In addition, the Restricted Stock Units will fully vest and (subject to Section 4(a)) no longer be subject to the restrictions of and forfeiture under this Award Agreement upon Employee's Retirement; provided, however, all Restricted Stock Units and the related Dividend Equivalents not vested prior to the date of Employee's Retirement (and that will vest solely as a result of this provision) will be forfeited and Employee shall not be entitled to receive any payment in connection therewith if Employee's employment is terminated for Cause regardless of Employee's Retirement or eligibility for Retirement. For purposes of this Award Agreement, (i) "Retirement" means a termination of employment which constitutes an "Early Retirement" or a "Normal Retirement" under the Pinnacle West Capital Corporation Retirement Plan, and (ii) "Cause" means (A) embezzlement, theft, fraud, deceit and/or dishonesty by the Employee involving the property, business or affairs of the Company or any of its Subsidiaries, or (B) an act of moral turpitude which in the sole judgment of the Chief Executive Officer of the Company reflects adversely on the business or reputation of the Company or any of its Subsidiaries or negatively affects any of the Company's or any of its Subsidiaries' employees or customers.

For avoidance of doubt, no acceleration of vesting of the Restricted Stock Units will occur on a Change of Control of the Company.

4. **Payment**.

- (a) **Time and Form of Payment**. Subject to the provisions of this Award Agreement and the Plan, when a Restricted Stock Unit vests on one of the Vesting Dates set forth in clauses (a), (b), (c) or (d) of Section 3 above, Employee shall receive in exchange for each Restricted Stock Unit one unrestricted fully transferrable share of Stock. Employee may elect, pursuant to Section 4(b), to receive payment for the Restricted Stock Units payable on any Vesting Date in the form of fully transferrable shares of Stock or 50% cash and 50% in unrestricted fully transferrable shares of Stock. If a Restricted Stock Unit vests prior to the applicable Vesting Date due to Employee's Retirement, the transfer or payment will be deferred until the applicable Vesting Date. Any cash payment will be based on the Fair Market Value of one share of Stock determined as of the Vesting Date on which the Restricted Stock Unit vests. The transfer or payment shall be made within 90 days of the applicable Vesting Date.
- (b) **Election of Form of Payment**. Within 75 days after the Date of Grant, Employee must elect to receive payment for Employee's vested Restricted Stock Units and Dividend Equivalents in fully transferable shares of Stock or 50% in cash and 50% in fully transferrable shares of Stock by completing and returning to the Company the election form attached to this Agreement. In the absence of a timely election by Employee, Employee will receive payment for the vested Restricted Stock Units and Dividend Equivalents in fully transferable shares of Stock.
- (c) **Dividend Equivalents**. In satisfaction of the Dividend Equivalents Award made pursuant to Section 1, at the time of the Company's delivery of payment pursuant to Section 4(a), the Company also will deliver to Employee a payment equal to the amount of dividends, if any, that Employee would have received if Employee had directly owned the Stock to which the Restricted Stock Units relate from the Date of Grant to the applicable Vesting Date, plus interest on such amount at the rate of 5 percent compounded quarterly, as determined pursuant to the Plan. Pursuant to the election filed by the Employee pursuant to Section 4 (b), payment for the Dividend Equivalents and interest will be made in fully transferrable shares of Stock, or 50% in cash and 50% in fully transferrable shares of Stock. The number of shares of Stock distributed to Employee will be determined by dividing the amount for the Dividend Equivalents and interest allocated to the Stock by the Fair Market Value of one share of Stock as of the applicable Vesting Date. No fractional Stock shall be issued. If the Stock payout results in a fractional share of one-half or greater, such fraction will be increased to provide for the issuance of a full share of Stock.
- (d) **Pension**. The value of the shares of Stock distributed upon payment for the Restricted Stock Units and Dividend Equivalents will be disregarded for purposes of calculating the amount of Employee's benefit under any Company retirement plans.

5. **Termination of Award** . Except as otherwise provided in Section 3 with respect to Employee's Retirement, in the event of the termination of Employee's active employment with the Company or any of its Subsidiaries, whether due to voluntary or involuntary termination, death, disability or otherwise, Employee's right to vest in any additional Restricted Stock Units or Dividend Equivalents under the Plan or this Award Agreement, if any, will terminate. Any unvested Restricted Stock Units and the related Dividend Equivalents will be forfeited effective as of the date that Employee terminates active employment with the Company or any of its Subsidiaries.
6. **Section 409A Compliance** .
- (a) **Purpose of this Provision** . Section 409A of the Code imposes a number of requirements on "non-qualified deferred compensation" plans and arrangements. Based on regulations issued by the Internal Revenue Service, the Company has concluded that this Award of Restricted Stock Units is subject to Section 409A. As a result, unless the Plan and this Award Agreement are administered to comply with Section 409A and the new rules, Employee will be required to pay an additional twenty percent (20%) tax (in addition to regular income taxes) on the compensation provided by this Award Agreement. In addition, under Section 409A additional interest will be payable.
- (b) **Compliance with Section 409A** . The Company intends to comply with Section 409A by assuring that all amounts to which Employee becomes entitled hereunder are payable at a specified time or pursuant to a fixed schedule within the meaning of Treas. Reg. § 1.409A-3(a)(4). As a result, no payment or transfer shall be made to Employee prior to the applicable Vesting Date. The provisions of this Section 6(b) apply to all amounts due pursuant to this Award Agreement.
- (c) **Miscellaneous Payment Provisions** . If the Company fails to make a payment (including a transfer of Stock), either intentionally or unintentionally, within the period required by Section 4, but the payment is made within the same calendar year, it will be treated as made within the period required by Section 4 pursuant to Treas. Reg. § 1.409A-3(d). In addition, if a payment is not made due to a dispute in payments, payments can be delayed in accordance with Treas. Reg. § 1.409A-3(g).
- (d) **Restriction on Acceleration or Further Deferral** . Under no circumstances may the time or schedule of any payment made or benefit provided pursuant to this Award Agreement be accelerated or subject to a further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code.
- (e) **No Elections** . Employee does not have any right to make any election regarding the time or form of any payment due under this Award Agreement other than the election described in Section 4(b).
- (f) **Compliant Operation and Interpretation** . The Plan and this Award Agreement shall be administered in compliance with Section 409A and each provision of the Award Agreement and the Plan shall be interpreted, to the extent possible, to comply with Section 409A.

7. **Tax Withholding** . Employee is responsible for any and all federal, state, and local income, payroll or other tax obligations or withholdings (collectively, the "Taxes") arising out of this Award. Employee shall pay any and all Taxes due prior to the payout of Stock or cash hereunder by check or other arrangement acceptable to the Company. Employee shall pay any and all Taxes due in connection with a payout of Stock or cash hereunder by check or by having the Company withhold cash or shares of Stock from such payout. Within 75 days after the Date of Grant, Employee must elect, on the election form described in Section 4(b), how Employee will satisfy the tax obligations upon a payout. In the absence of a timely election by Employee, Employee's tax withholding obligation upon a payout will be satisfied through the Company's withholding of cash or shares of Stock as set forth above.
8. **Continued Employment** . Nothing in the Plan or this Award Agreement shall be interpreted to interfere with or limit in any way the right of the Company or its Subsidiaries to terminate Employee's employment or services at any time. In addition, nothing in the Plan or this Award Agreement shall be interpreted to confer upon Employee the right to continue in the employ or service of the Company or its Subsidiaries.
9. **Non-Transferability** . Neither this Award nor any rights under this Award Agreement may be assigned, transferred, or in any manner encumbered except by will or the laws of descent and distribution, and any attempted assignment, transfer, mortgage, pledge or encumbrance except as herein authorized, will be void and of no effect.
10. **Definitions: Copy of Plan and Plan Prospectus** . To the extent not specifically defined in this Award Agreement, all capitalized terms used in this Award Agreement will have the same meanings ascribed to them in the Plan. Employee will receive a copy of the Plan and the related Plan Prospectus. In the event of any conflict between the terms and conditions of this Award Agreement and the Plan, the provisions of the Plan shall control.
11. **Amendment** . Except as otherwise provided in the Plan, this Award Agreement may be amended only by a written agreement executed by the Company and Employee.
12. **Choice of Law** . This Award Agreement will be governed by the laws of the State of Arizona, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Award Agreement to another jurisdiction.

An authorized representative of the Company has signed this Award Agreement as of the Date of Grant.

PINNACLE WEST CAPITAL CORPORATION

By: _____

Its: _____

Pinnacle West Capital Corporation
RESTRICTED STOCK UNIT AWARD
ELECTION FORM
 (applies to Award Agreement dated 02/15/2011)

INFORMATION ABOUT YOU

Last **First** **Middle Initial** **Employee ID#**

1. PAYMENT ELECTION

In accordance with the terms of the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan and pursuant to Section 4(b) of the Award Agreement, I hereby elect to receive payment for the Restricted Stock Units and Dividend Equivalents that vest on the dates set forth below in the following form (place an "X" in the "Stock" column or in the "50% Cash/50% Stock" column for each of the years and types of Awards set forth below):

	Restricted Stock Units and Dividend Equivalents	
Vesting Date	Stock	50% Cash/ 50% Stock
02/20/2012	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2013	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2014	<input type="checkbox"/>	<input type="checkbox"/>
02/20/2015	<input type="checkbox"/>	<input type="checkbox"/>

2. TAX WITHHOLDING ELECTION

I hereby elect to satisfy any tax withholding obligation associated with my receipt of Stock or Stock and cash in exchange for my Restricted Stock Units and Dividend Equivalents in the following form (place an "X" in the "Check" column or in the "Stock/Cash" column):

Check

(I will write a check for my taxes that are due and deliver it to the Company within one (1) day of the release date of my Stock or cash payment)

Withholding

(The Company should withhold shares of my Stock or cash payment to cover my taxes)

To the extent permitted by law, I hereby elect Federal tax withholding of _____ percent (minimum may not be less than 25% and maximum may not exceed 35%)

 PARTICIPANT NAME (PLEASE PRINT)

 PARTICIPANT SIGNATURE

 DATE

IMPORTANT NOTE: Please complete and return this Election Form to Jennifer Mellegers at Mail Station 9996 by _____, 2011.

**RESTRICTED STOCK UNIT AGREEMENT
UNDER THE
PINNACLE WEST CAPITAL CORPORATION
2007 LONG-TERM INCENTIVE PLAN
(SUPPLEMENTAL 2010 AWARD)**

THIS AWARD AGREEMENT is made and entered into as of February 15, 2011 (the "Date of Grant"), by and between Pinnacle West Capital Corporation (the "Company"), and _____ ("Employee").

BACKGROUND

- A. The Board of Directors of the Company (the "Board of Directors") has adopted, and the Company's shareholders have approved, the Pinnacle West Capital Corporation 2007 Long-Term Incentive Plan (the "Plan"), pursuant to which Restricted Stock Units and Dividend Equivalents may be granted to employees of the Company and its Subsidiaries and certain other individuals.
- B. The Company desires to grant to Employee Restricted Stock Units and Dividend Equivalents under the terms of the Plan.
- C. Pursuant to the Plan, the Company and Employee agree as follows:

AGREEMENT

1. **Grant of Award** . Pursuant to action of the Committee which was taken on the Date of Grant, the Company grants to Employee _____ (x,xxx) Restricted Stock Units and Dividend Equivalents based on the dividends declared on the shares of Stock to which such Restricted Stock Units relate.
 2. **Award Subject to Plan** . This Restricted Stock Unit Award and the related Dividend Equivalent Award are granted under and are expressly subject to all of the terms and provisions of the Plan, which terms are incorporated herein by reference, and this Award Agreement.
 3. **Vesting of Restricted Stock Units** . The Restricted Stock Units granted pursuant to Section 1 and Section 4 (b) will vest and no longer be subject to the restrictions of and forfeiture under this Award Agreement on three (3) "Vesting Dates" as follows:
 - (a) x,xxx (fifty percent) of the Restricted Stock Units will vest on February 15, 2013;
 - (b) x,xxx (twenty-five percent) of the Restricted Stock Units will vest on February 15, 2014; and
 - (c) x,xxx (the remaining twenty-five percent) of the Restricted Stock Units will vest on February 15, 2015.
-

4. Payment.

- (a) **Time and Form of Payment**. Subject to the provisions of this Award Agreement and the Plan, Employee (or in the case of Employee's death, Employee's beneficiary) shall receive in exchange for each vested Restricted Stock Unit one unrestricted fully transferrable share of Stock. The Stock will be delivered to Employee within ninety (90) days following the earliest to occur of Employee's Retirement, death, Disability or other Separation from Service. If the distribution is due to Employee's Separation from Service or Retirement, and if Employee is considered to be a "Specified Employee" on the date of Employee's Separation from Service or Retirement, the payment to Employee may not commence prior to the first business day following the date which is six (6) months after the date of Employee's Separation from Service. The six (6) month delay does not apply if the Stock is being delivered to Employee (or Employee's beneficiary) due to Employee's death or Disability. If the ninety (90) day period described above spans two (2) calendar years, payment will be made to Employee in the second (2nd) calendar year.

For purposes of this Award Agreement, the term "Retirement" means a termination of employment which constitutes an "Early Retirement" or a "Normal Retirement" under the Pinnacle West Capital Corporation Retirement Plan (as in effect on the date of Retirement) (the "Retirement Plan"). The terms "Separation from Service" and "Specified Employee" shall be given the meanings ascribed to them in the Deferred Compensation Plan of 2005 for Employees of Pinnacle West Capital Corporation and Affiliates (as in effect on the date of this Award Agreement). The term "Disability" means Employee is, by reason of any medically determinable physical or mental impairment that can be expected to (i) result in death or (ii) last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident and health plan covering employees of the Company.

For avoidance of doubt, no acceleration of vesting of the Restricted Stock Units will occur on a Change of Control of the Company.

The value of the shares of Stock distributed upon payment for the Restricted Stock Units will be disregarded for purposes of calculating the amount of Employee's benefit under any Company retirement plans.

- (b) **Dividend Equivalents**. On each day on which a dividend is paid on shares of Stock from the Date of Grant until Employee's Separation from Service or Retirement, Employee will be credited with additional Restricted Stock Units in satisfaction of the Dividend Equivalent Award made pursuant to Section 1. The number of additional Restricted Stock Units credited to Employee shall be determined by dividing (i) the aggregate dollar amount of the dividends paid on the number of shares of Stock equal to the Restricted Stock Units previously credited to Employee pursuant to Section 1 or this Section 4(b) by (ii) the Fair Market Value of one share of Stock on the day on which the dividend is paid. No fractional Restricted Stock Units shall be issued. If, but for the preceding sentence, a crediting would have resulted in the issuance of a fractional Restricted Stock Unit of one-half or greater, such fraction will be increased to provide for the issuance of an additional Restricted Stock Unit. The additional Restricted Stock Units issued pursuant to this Section 4(b) will vest pursuant to the same vesting schedule as the underlying Restricted Stock Units that were the basis for the Dividend Equivalents giving rise to such additional Restricted Stock Units. Vested Restricted Stock Units credited in satisfaction of the Dividend Equivalent Award will be delivered to Employee at the same time and in the same manner as all other Restricted Stock Units credited to Employee.

5. **Termination of Award**. In the event of Employee's death, Disability, or other Separation from Service, whether due to Retirement, voluntary or involuntary termination or otherwise, Employee's right to vest in any additional Restricted Stock Units or Dividend Equivalents under the Plan or this Award Agreement, if any, will terminate. Any unvested Restricted Stock Units and Dividend Equivalents will be forfeited effective as of the date of Employee's death, Disability or Separation from Service, as the case may be.

6. **Confidentiality** . During and after the termination of Employee's employment, for any reason, Employee agrees that Employee will not, directly or indirectly, in one or a series of transactions, disclose to any person, or use or otherwise exploit for Employee's own benefit or for the benefit of anyone other than the Company or any of its Subsidiaries any Confidential Information (as hereinafter defined), whether prepared by Employee or not; provided, however, that during the term of Employee's employment, any Confidential Information may be disclosed (i) to officers, representatives, employees and agents of the Company and its Subsidiaries who need to know such Confidential Information in order to perform the services or conduct the operations required or expected of them in the business, and (ii) in good faith by Employee in connection with the performance of Employee's job duties to persons who are authorized to receive such information by the Company or its Subsidiaries. Employee shall have no obligation to keep confidential any Confidential Information, if and to the extent disclosure of any such information is specifically required by law; provided, however, that in the event disclosure is required by applicable law, Employee shall provide the Company with prompt notice of such requirement, prior to making any disclosure, so that it may seek an appropriate protective order.

Employee agrees that all Confidential Information of the Company and its Subsidiaries (whether now or hereafter existing) conceived, discovered or made by him during employment exclusively belongs to the Company or its Subsidiaries (and not to Employee). Employee will promptly disclose such Confidential Information to the Company and perform all actions reasonably requested by the Company to establish and confirm such exclusive ownership. For purposes of this Section 6 , the term "Confidential Information" shall mean and include any information disclosed to Employee any time during Employee's employment with the Company or its Subsidiaries or thereafter which is not generally known to the public, including, but not limited to, information concerning the Company's or its Subsidiaries' assets and valuations, business plans, methods of operation, management, information systems, procedures, processes, practices, policies, plans, programs, personnel and/or reports or other information prepared by appraisers, consultants, advisors, bankers or attorneys.

7. **Restrictive Covenants** .

- (a) **Non-Competition** . Employee agrees that for a period of twelve (12) months following any termination of employment voluntarily by Employee (other than due to Disability), Employee shall not, without the prior written consent of the Company's General Counsel, participate, whether as a consultant, employee, contractor, partner, owner, co-owner, or otherwise, with any business, corporation, group, entity or individual that is engaged in the business activity of generating, transmitting or distributing electricity in Arizona.
- (b) **Employee Non-Solicitation** . Employee agrees that for a period of twelve (12) months following Employee's termination of employment for any reason, Employee will not encourage, induce, or otherwise solicit, or actively assist any other person or organization to encourage, induce or otherwise solicit, directly or indirectly, any employee of the Company or any of its Subsidiaries to terminate his or her employment with the Company or its Subsidiaries, or otherwise interfere with the advantageous business relationship of Pinnacle West and its Subsidiaries with their employees.
- (c) **Remedies** . If Employee fails to comply with Sections 6, 7(a) or 7(b) in a material respect, the Company may (i) cause any of Employee's unvested Restricted Stock Units and related Dividend Equivalents to be cancelled and forfeited, (ii) refuse to deliver shares of stock in exchange for vested Restricted Stock Units, and/or (iii) pursue any other rights and remedies the Company may have pursuant to this Award Agreement or the Plan at law or in equity including, specifically, injunctive relief.

8. **Section 409A Compliance** .

- (a) **Purpose of this Provision** . Section 409A of the Code imposes a number of requirements on “non-qualified deferred compensation” plans and arrangements. Based on regulations issued by the Internal Revenue Service, the Company has concluded that this Award of Restricted Stock Units is subject to Section 409A. As a result, unless the Plan and this Award Agreement are administered in compliance with Section 409A and the regulations, Employee will be required to pay an additional twenty percent (20%) tax (in addition to regular income taxes) on the compensation provided by this Award Agreement. In addition, under Section 409A additional interest will be payable.
- (b) **Compliance with Section 409A** . In order to assure compliance with Section 409A, no payment will be made prior to the earliest of Employee’s death, Disability or other Separation from Service.
- (c) **Miscellaneous Payment Provisions** . If the Company fails to make a payment (including a transfer of Stock), either intentionally or unintentionally, within the period required by Section 4 , but the payment is made within the same calendar year, it will be treated as made within the period required by Section 4 pursuant to Treas. Reg. § 1.409A-3(d). In addition, if a payment is not made due to a dispute in payments, payments can be delayed in accordance with Treas. Reg. § 1.409A-3(g).
- (d) **Restriction on Acceleration or Further Deferral** . Under no circumstances may the time or schedule of any payment made or benefit provided pursuant to this Award Agreement be accelerated or subject to a further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code.
- (e) **No Elections** . Employee does not have any right to make any election regarding the time or form of any payment due under this Award Agreement.
- (f) **Compliant Operation and Interpretation** . The Plan and this Award Agreement shall be administered in compliance with Section 409A and each provision of the Award Agreement and the Plan shall be interpreted, to the extent possible, to comply with Section 409A.

9. **Tax Withholding** . Employee is responsible for any and all federal, state, and local income, payroll or other tax obligations or withholdings (collectively, the “Taxes”) arising out of this Award. Employee shall pay any and all Taxes due in connection with the vesting of any Restricted Stock Units by check or by having the Company withhold a sufficient number of shares of Stock to cover the tax and withholdings obligation. Employee shall pay any and all Taxes due in connection with a payout of Stock by the Company withholding a sufficient number of shares of Stock from any payout to cover the tax and withholdings obligation. Concurrently with the return to the Company of an executed copy of this Agreement, Employee must return the attached form regarding tax withholding for the Restricted Stock Unit Award and the related Dividend Equivalent Award.

10. **Continued Employment** . Nothing in the Plan or this Award Agreement shall be interpreted to interfere with or limit in any way the right of the Company or its Subsidiaries to terminate Employee's employment or services at any time. In addition, nothing in the Plan or this Award Agreement shall be interpreted to confer upon Employee the right to continue in the employ or service of the Company or its Subsidiaries.
11. **Non-Transferability** . Neither this Award nor any rights under this Award Agreement may be assigned, transferred, or in any manner encumbered except by will or the laws of descent and distribution, and any attempted assignment, transfer, mortgage, pledge or encumbrance except as herein authorized, will be void and of no effect.
12. **Definitions: Copy of Plan and Plan Prospectus** . To the extent not specifically defined in this Award Agreement, all capitalized terms used in this Award Agreement will have the same meanings ascribed to them in the Plan. Employee will receive a copy of the Plan and the related Plan Prospectus. In the event of any conflict between the terms and conditions of this Award Agreement and the Plan, the provisions of the Plan shall control.
13. **Amendment** . Except as otherwise provided in the Plan, this Award Agreement may be amended only by a written agreement executed by the Company and Employee.
14. **Severability** . If a court of competent jurisdiction determines that any provision of this Award Agreement is invalid, then that invalidity shall not affect other provisions or applications that can be given effect without the invalid provision or application.
15. **Choice of Law** . This Award Agreement will be governed by the laws of the State of Arizona, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Award Agreement to another jurisdiction.

An authorized representative of the Company has signed this Award Agreement as of the Date of Grant.

PINNACLE WEST CAPITAL CORPORATION

By: _____

Its: _____

EMPLOYEE

Name: _____

Signature: _____

Exhibit 12.1

**PINNACLE WEST CAPITAL CORPORATION
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)**

	Three Months	Twelve Months Ended December 31,				
	Ended March 31, 2011	2010	2009	2008	2007	2006
Earnings:						
Income (loss) from continuing operations attributable to common shareholders	\$ (14,795)	\$ 330,435	\$ 233,349	\$ 260,840	\$ 283,370	\$ 265,320
Income taxes	(5,649)	164,321	136,506	95,544	142,330	123,915
Fixed charges	62,361	248,664	241,568	224,453	213,531	203,899
Total earnings	\$ 41,917	\$ 743,420	\$ 611,423	\$ 580,837	\$ 639,231	\$ 593,134
Fixed Charges:						
Interest expense	\$ 61,077	\$ 244,174	\$ 237,527	\$ 219,916	\$ 209,354	\$ 200,411
Estimated interest portion of annual rents	1,284	4,490	4,041	4,537	4,177	3,488
Total fixed charges	\$ 62,361	\$ 248,664	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899
Ratio of Earnings to Fixed Charges (rounded down)	0.67	2.98	2.53	2.58	2.99	2.90

Exhibit 12.2

**ARIZONA PUBLIC SERVICE COMPANY
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)**

	Three Months	Twelve Months Ended December 31,				
	Ended March 31, 2011	2010	2009	2008	2007	2006
Earnings:						
Income (loss) from continuing operations attributable to common shareholders	\$ (12,081)	\$ 335,663	\$ 251,225	\$ 262,344	\$ 283,940	\$ 269,730
Income taxes	(4,663)	170,465	152,574	107,261	151,157	138,927
Fixed charges	59,431	234,184	227,274	206,896	195,144	184,059
Total earnings	\$ 42,687	\$ 740,312	\$ 631,073	\$ 576,501	\$ 630,241	\$ 592,716
Fixed Charges:						
Interest charges	\$ 57,045	\$ 225,269	\$ 218,969	\$ 197,964	\$ 186,702	\$ 176,459
Amortization of debt discount	1,157	4,559	4,675	4,702	4,639	4,363
Estimated interest portion of annual rents	1,229	4,356	3,630	4,230	3,803	3,237
Total fixed charges	\$ 59,431	\$ 234,184	\$ 227,274	\$ 206,896	\$ 195,144	\$ 184,059
Ratio of Earnings to Fixed Charges (rounded down)	0.71	3.16	2.77	2.78	3.22	3.22

Exhibit 12.3

**PINNACLE WEST CAPITAL CORPORATION
COMPUTATION OF EARNINGS TO FIXED CHARGES
(dollars in thousands)**

	Three Months	Twelve Months Ended December 31,				
	Ended March 31, 2011	2010	2009	2008	2007	2006
Earnings:						
Income (loss) from continuing operations attributable to common shareholders	\$ (14,795)	\$ 330,435	\$ 233,349	\$ 260,840	\$ 283,370	\$ 265,320
Income taxes	(5,649)	164,321	136,506	95,544	142,330	123,915
Fixed charges	62,361	248,664	241,568	224,453	213,531	203,899
Total earnings	\$ 41,917	\$ 743,420	\$ 611,423	\$ 580,837	\$ 639,231	\$ 593,134
Fixed Charges:						
Interest expense	\$ 61,077	\$ 244,174	\$ 237,527	\$ 219,916	\$ 209,354	\$ 200,411
Estimated interest portion of annual rents	1,284	4,490	4,041	4,537	4,177	3,488
Total fixed charges	\$ 62,361	\$ 248,664	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899
Preferred Stock Dividend Requirements:						
Income (loss) before income taxes attributable to common shareholders	\$ (20,444)	\$ 494,756	\$ 369,855	\$ 356,384	\$ 425,700	\$ 389,235
Net income (loss) from continuing operations attributable to common shareholders	(14,795)	330,435	233,349	260,840	283,370	265,320
Ratio of income before income taxes to net income	1.38	1.50	1.58	1.37	1.50	1.47
Preferred stock dividends	—	—	—	—	—	—
Preferred stock dividend requirements — ratio (above) times preferred stock dividends	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Fixed Charges and Preferred Stock Dividend Requirements:						
Fixed charges	\$ 62,361	\$ 248,664	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899
Preferred stock dividend requirements	—	—	—	—	—	—
Total	\$ 62,361	\$ 248,664	\$ 241,568	\$ 224,453	\$ 213,531	\$ 203,899
Ratio of Earnings to Fixed Charges (rounded down)	0.67	2.98	2.53	2.58	2.99	2.90

CERTIFICATION

I, Donald E. Brandt, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2011.

/s/ Donald E. Brandt
Donald E. Brandt
Chairman, President and
Chief Executive Officer

CERTIFICATION

I, James R. Hatfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2011.

/s/ James R. Hatfield
James R. Hatfield
Senior Vice President &
Chief Financial Officer

CERTIFICATION

I, Donald E. Brandt, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arizona Public Service Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2011.

/s/ Donald E. Brandt

Donald E. Brandt
Chairman and Chief Executive Officer

CERTIFICATION

I, James R. Hatfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Arizona Public Service Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2011.

/s/ James R. Hatfield
James R. Hatfield
Senior Vice President &
Chief Financial Officer

**CERTIFICATION
OF
CHIEF EXECUTIVE OFFICER
AND
CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald E. Brandt, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation for the fiscal quarter ended March 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Pinnacle West Capital Corporation.

Date: April 29, 2011.

/s/ Donald E. Brandt

Donald E. Brandt
Chairman, President and
Chief Executive Officer

I, James R. Hatfield, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Pinnacle West Capital Corporation for the fiscal quarter ended March 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Pinnacle West Capital Corporation.

Date: April 29, 2011.

/s/ James R. Hatfield

James R. Hatfield
Senior Vice President and
Chief Financial Officer

**CERTIFICATION
OF
CHIEF EXECUTIVE OFFICER
AND
CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald E. Brandt, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Arizona Public Service Company for the fiscal quarter ended March 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Arizona Public Service Company.

Date: April 29, 2011.

/s/ Donald E. Brandt

Donald E. Brandt

Chairman and Chief Executive Officer

I, James R. Hatfield, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Arizona Public Service Company for the fiscal quarter ended March 31, 2011 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Arizona Public Service Company.

Date: April 29, 2011.

/s/ James R. Hatfield

James R. Hatfield

Senior Vice President and
Chief Financial Officer