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SUBJECT: Forwards "Addl Info re Application in Respect of Sale &
 Leaseback Transactions by Arizona Public Svc Co," including
 860724 opinion & order of State of AZ Corporation
 Commission, per NRC request.

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*OF COUNSEL
**ON LEAVE OF ABSENCE

August 2, 1986

Director of Nuclear Reactor Regulation
Attention: Mr. George W. Knighton, Project Director
PWR Project Directorate #7
Division of Pressurized Water Reactor Licensing-B
Nuclear Regulatory Commission
Washington, DC 20555

Re: Application in Respect of Sale and Leaseback Transactions by
Arizona Public Service Company
Dated May 2, 1986 -
Palo Verde Nuclear Generating Station Unit 2
(Docket No. STN 50-529)

Dear Mr. Knighton:

Arizona Public Service Company (APS) submits herewith three
copies of Additional Information with Respect to the Application in
Respect of Sale and Leaseback Transactions by Arizona Public Service
Company, dated May 2, 1986. The Additional Information consists of

Item No.	Description
1:	Additional Information Requested by NRC Staff
2.	Report of AZP Group, Inc., for the First Quarter of 1986
3.	Quarterly Report of APS (Form 10-Q)
4.	Opinion and Order of the Arizona Corporation Commission, dated July 24, 1986
5.	Application of PVNGS Funding Corporation for an Order under Section 6(c) of the Investment Company Act of 1940.

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Director of Nuclear Reactor Regulation
August 2, 1986
Page Two

APS is continuing its efforts to secure equity investors in addition to those identified in Item 1 (see questions 5 and 7). Upon receipt of a commitment from any additional equity investor, we promptly advise you and submit the required information.

If we can be of further assistance, please call me.

Very truly yours,

SNELL & WILMER


Arthur C. Gehr

ACG/smp

Enclosures

6-17-12

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SNELL & WILMER

Copies with enclosure to:

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Arizona Public Service Company

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Treasurer
Arizona Public Service Company

UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the matter of
ARIZONA PUBLIC SERVICE
COMPANY, et al.,
(Palo Verde Nuclear
Generating Station, Unit 2)

DOCKET NO. STN 50-529

APPLICATION IN RESPECT OF
SALE AND LEASEBACK TRANSACTIONS BY
ARIZONA PUBLIC SERVICE COMPANY

ITEM 1:

ADDITIONAL INFORMATION REQUESTED BY NRC STAFF

8608050316

1. Arizona Public Service Company (APS) is currently required to pay 29.1% of all Palo Verde unit 2 (PV2) operating costs and 29.1% of future decommissioning costs to Arizona Nuclear Power Project (ANPP). Please explain in detail the source of this 29.1% share of total PV2 costs under the proposed refinancing arrangement. Include an explanation of the manner in which all increases in operating and decommissioning costs will be covered following the refinancing for the terms of the license.

RESPONSE:

As indicated in the question, APS is currently required to pay its share of PV2 operating costs and will be required to pay its share of future decommissioning costs under the terms of the ANPP participation agreement, as amended. This result flows from APS's status as a participant under the ANPP participation agreement.

The simple answer to the question posed above is that there will be no change in the source of the 29.1% share of total PV2 operating costs under the proposed refinancing arrangement. As indicated in Section 3.6 of the application filed with the commission in this matter, the leases which will be entered into in connection with the refinancing will be "net leases." This means that APS will be responsible for paying all taxes, insurance premiums, operating and maintenance costs and all other similar costs associated with the leased facilities (including obligations as a participant under the ANPP participation agreement). As indicated in the application, the purpose of these provisions is to ensure that the lessors are subject only to normal financing risks and not to operational risks or responsibilities.

The ultimate source of the funds for paying such costs will be revenues from APS's customers. This is true both before and after the refinancing. The refinancing itself will not impact operating and decommissioning costs. With respect to increases in such costs which may otherwise occur, APS will be liable for its share of all increases in operating and decommissioning costs following the refinancing under the "net lease" concept. The source of funds to pay for such increases will be the same sources as mentioned above.

If APS's leases expire and APS does not purchase the facilities from the lessors by exercising its purchase option, APS will remain responsible under the ANPP participation agreement for operating and decommissioning costs until a transferee (a new lessee or a purchaser) from the lessor assumes such obligations and the other PV2 participants have consented to a release of APS from such liabilities. Under the lease transaction, APS will retain ultimate responsibility for decommissioning costs although a transferee may in fact provide some funding for decommissioning. Also, the NRC will have control

over responsibilities for decommissioning since a transferee will require action from the NRC in the form of a license transfer or amendment. Responsibility for decommissioning costs would assuredly be a consideration by the NRC in such action.

Under the ANPP participation agreement, if APS (or the subsequent transferee) should default in its obligations, then the nondefaulting participants are required to pay a pro rata share of such defaulted amounts to assure that such costs will be paid. If a default continues for the period of time specified in the ANPP participation agreement, then the defaulting participant may be required to lose its share of the power and energy from PV2 and also lose its representation on the project committees until the defaults are cured.

2. Please provide a detailed explanation of the expected financial effects on APS resulting from the refinancing of its PV2 interest. Include effects on its income statement and balance sheet and on its ability to fund its share of PV2 operating and decommissioning costs including any future cost increases.

RESPONSE:

APS's proposed sale and leaseback financing of its share of PV2 is expected to have substantial positive economic effects on the company and its customers. The proceeds of the sale will provide APS with funds which will allow APS to strengthen its balance sheet and to defer previously anticipated future financings. In addition, the fixed costs to APS of its share of PV2 will be reduced due to the lower cost of the lease financing. The net result is that APS's ability to fund its share of operating and decommissioning costs (including any future cost increases) can be expected to improve as a result of the transaction.

If 50% of APS's interest in the facility is sold in the transaction, APS will have available net after-tax cash proceeds of approximately \$484 million. This will allow APS to defer future financings, to reduce its level of short-term debt and to retire some outstanding debt capitalization. Because the transaction will be an operating lease, APS's balance sheet will be strengthened as the common equity ratio will increase with the retirement of debt and/or elimination of future debt issues. This will provide APS with greater future financing flexibility and should provide enhanced access to the financial markets.

In the absence of revenue adjustments, APS's income can be expected to be improved because the lease costs are lower than the financing costs under ownership. The annual lease rentals (\$56 million) are accounted for as an operating expense. This is offset by reductions in interest expense (\$48 million) and depreciation expense (\$11 million). The net income increase is about \$3.4 million as shown below. However, since the company is proposing to pass through this benefit to rate payers, it will result in nearly \$39 million first year revenue savings to the rate payers of the company.

	<u>Lease</u>	<u>Ownership</u>	<u>Net</u>
Expenses			
O & M	\$ 55,440	-	\$ 55,440
Depreciation	<u>-</u>	<u>\$ 11,429</u>	<u>(11,429)</u>
Operating Income	(55,440)	(11,429)	(44,011)
Interest Expense	<u>(48,400)</u>	<u>-</u>	<u>(48,400)</u>
Earnings Before Taxes	(7,040)	(11,429)	4,389
Income Taxes	<u>(2,175)</u>	<u>(3,190)</u>	<u>1,015</u>
Net Income	\$ (4,865)	\$ (8,239)	\$ 3,374

3. Explain the ratemaking authority and responsibility of the Arizona Corporation Commission as it will relate to provision of revenues to cover PV2 operating and decommissioning costs applicable to APS's refinanced ownership interest.

RESPONSE:

The proposed refinancing will not result in any change in the existing ratemaking authority and responsibility of the Arizona Corporation Commission (the ACC) as it will relate to the provision of revenues for operating and decommissioning costs. APS will continue as the utility responsible for such costs and subject to the regulation of the ACC with respect to such costs.

With respect to the recovery of decommissioning costs, the company intends to recover these costs from its customers over the useful life of the facilities. Hearings on this topic will be the subject of a separate docket before the commission. However, the sale-leaseback of PV2 does not absolve the company from responsibility for funding the full cost of decommissioning regardless of whether or not it is in the possession of undivided interest.

4. Provide copies of the most recent interim financial statements and SEC Form 10-Q for APS and for the First National Bank of Boston.

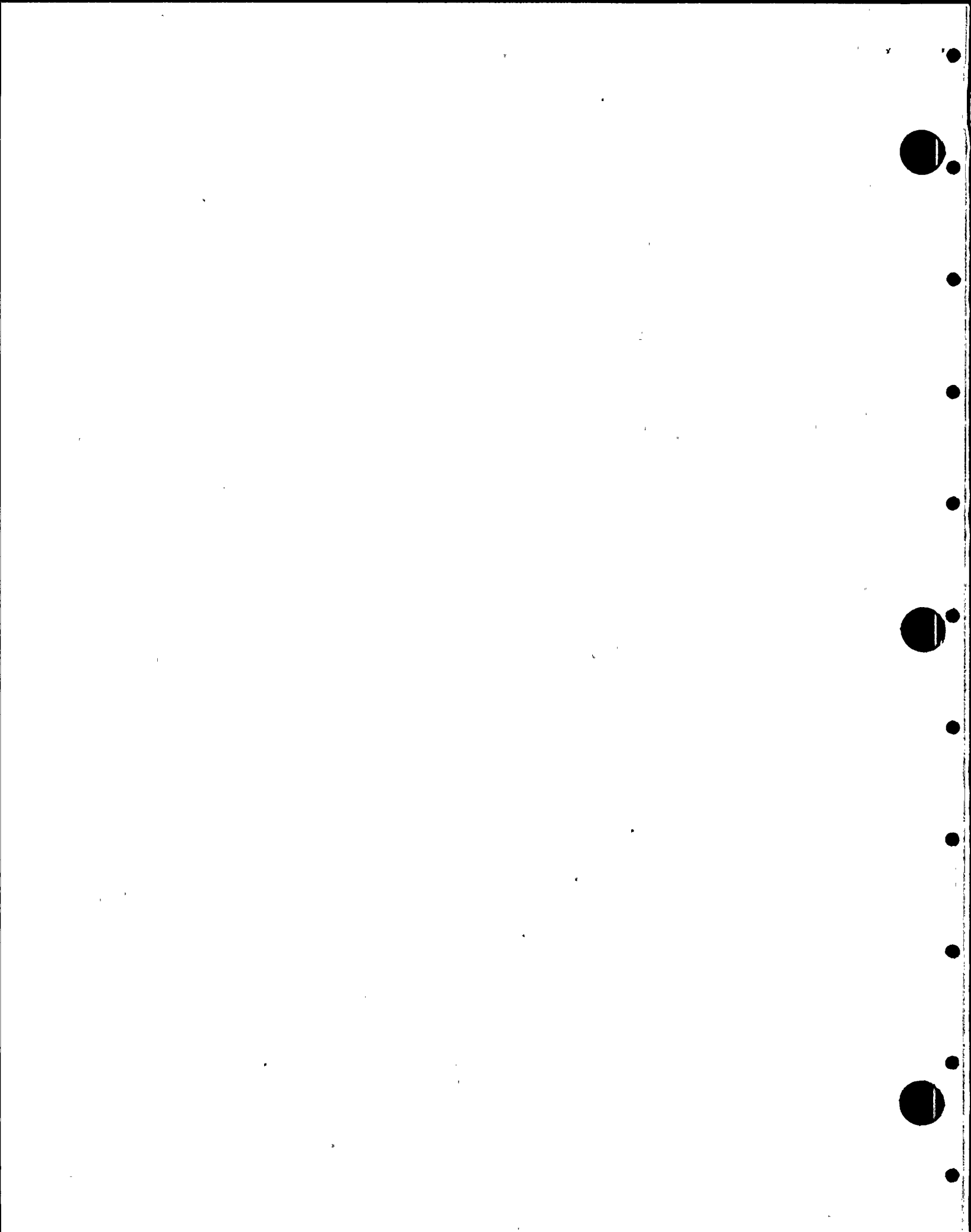
RESPONSE:

First quarter 1986 interim reports to shareholders for APS as well as APS's report on Form 10-Q for the quarter ended March 31, 1986 are attached hereto.

The 1985 Annual Report of the Bank of Boston Corporation and its Annual Report on Form 10-K for the fiscal year ended December 31, 1985 were included as a part of the Application in Respect of Sale and Leaseback Transactions by El Paso Electric Company, dated April 15, 1986, filed in this Docket No. 50-529 and are incorporated by reference. The Bank of Boston Corporation is the parent corporation of the First National Bank of Boston.

Of course, neither the Bank of Boston Corporation nor the First National Bank of Boston will have any responsibility whatsoever with respect to operating and decommissioning costs or increases in such costs.

If additional financial statements for the Bank of Boston Corporation are required, they will be supplied.



5. Indicate the total purchase price for the refinanced PV2 interest and a detailed dollar breakdown of the portions to be financed by debt and by investment of each equity investor.

RESPONSE:

Currently, the equity investors listed below are participating for a total of \$230 million. Their estimated equity and debt participation is also presented below.

	<u>Debt</u>	(\$ in millions) <u>Equity</u>	<u>Total</u>
SPBB Leasing, Inc.	\$104	\$26	\$130
Emerson Finance Co.	80	20	100

APS is currently seeking additional equity commitments from other potential investors. Information will be provided to the NRC if and when any additional equity commitments are received.



6. Describe the sources of funds and amounts for each equity investor's investment in PV 2.

RESPONSE:

The sources of the equity investment funds to be provided by Security and Emerson have not been made available to APS. The sources of such funds are not relevant since the purchase price will have been paid to APS at closing and APS will not be looking to such investors for future funding. We can only assume that the source of funding for the investors' equity participation will be from general corporate funds. Each equity investor's estimated dollar investment is detailed above in response to question 5.

7. Provide copies of the most recent interim and annual financial statements for each equity investor.

RESPONSE:

The equity investors identified in the answer to question 5, i.e., SPBB Leasing, Inc., and Emerson Finance Co., are subsidiaries of the Security Pacific Bank and Emerson Electric Co., respectively. The 1985 Annual Report and Report on SEC Form 10-Q for the quarter ended March 31, 1986 of Security Pacific Bank, are being transmitted under separate cover. The Annual Report, Form 10-K, for the fiscal year ended September 30, 1985, and the Quarterly Report, Form 10-Q, for the quarter ended December 31, 1985, for Emerson Electric Co. were included in the financial information (tabs 5 and 6) submitted on behalf of Public Service Company of New Mexico with the letter, dated June 10, 1986 from T. M. Toy to G. W. Knighton, and are incorporated herein by reference.

It should be emphasized that the equity investors will not, as a result of their interest in PV2, have any liability for payment of operating and decommissioning costs of the facilities. The leases which will be entered into in connection with the refinancing will be "net leases." This means that APS will be responsible for paying all taxes, insurance premiums, operating and maintenance costs and all other similar costs associated with the leased facilities (including obligations as a participant under the ANPP participation agreement).

If additional equity commitments are received, similar information will be provided for the new equity investors.



UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the matter of

ARIZONA PUBLIC SERVICE
COMPANY, et al.,

(Palo Verde Nuclear
Generating Station, Unit 2)

DOCKET NO. STN 50-529

APPLICATION IN RESPECT OF
SALE AND LEASEBACK TRANSACTIONS BY
ARIZONA PUBLIC SERVICE COMPANY

ITEM 2

REPORT OF AZP GROUP, INC., FOR THE FIRST QUARTER OF 1986



PO BOX 53900
PHOENIX, AZ
85072-3900

QUARTERLY

PUBLISHED QUARTERLY 1986

Summary report of Keith L. Turley

AZP and its predecessor companies—including APS—have not missed paying a quarterly dividend since our modern-day corporation was born in 1920, said AZP Chairman and President Keith Turley during the April 24 Annual Meeting of Shareholders in Phoenix.

Turley's comments followed an audio-visual presentation which reviewed the company's 100-year history, beginning with the granting of the company's first gas and electric franchise on April 29, 1886 and leading to shareholder approval of the holding company, AZP Group, Inc., in April 1985.

Turley told about 700 shareholders attending AZP's first annual meeting and APS' 66th annual meeting that the company's 100th year of operation was also one of its best. Among 1985's results: dividends were \$2.72 on an annualized basis; earnings per share were \$3.88; cash flow was 22 percent of

construction requirements; debt coverage was at 2.3 times, excluding Allowance for Funds Used During Construction; cash earnings were 31 percent; and return on equity was 15.9 percent. Turley added that, during recent weeks, AZP common stock had been selling at about 120 percent of book value, the highest level since 1967.

Turley also lauded recent successes at the Palo Verde Nuclear Generating Station. Unit 1 began commercial operation on February 13, 1986 and,
(Continued pg. 2)

Quarterly dividends unchanged

On April 24, the AZP board of directors approved a quarterly dividend of 68 cents per share on the company's common stock, which is unchanged from the previous quarter. The dividends are payable June 1, to shareholders of record at the close of business May 5.

The board of directors of APS—a subsidiary of AZP—declared quarterly dividends at the regular rates on 18 outstanding issues of cumulative preferred stock. Additionally, a quarterly dividend of \$1.8375 was declared on the APS adjustable rate cumulative preferred stock, Series Q. Preferred dividends also are payable June 1, to shareholders of record at the close of business May 5.

12-month earnings increase

AZP Group, Inc. (AZP) earnings for the first quarter ended March 31, 1986, were 65 cents per share, down from 67 cents per share for the same period in 1985. However, earnings for the 12 months ended March 31, 1986, increased to \$3.84 per share of common stock, up from \$3.70 (from continuing operations) for the previous 12-month period. The improvement in 12-month earnings is due primarily to APS' higher revenues which resulted from higher rates and increased electric sales.

SHAREHOLDER INFORMATION

AZP Quarterly is published for shareholders of AZP Group, Inc. (AZP) and its regulated subsidiary, Arizona Public Service (APS). The New York and Pacific Exchanges list AZP common stock as AZP and APS preferred stock as ARP.

If you have a question about your individual account, or about AZP or APS in general, please call us TOLL FREE:

In Phoenix/local	In Arizona	Outside Arizona
250-2973	1-800-621-9093	1-800-457-2983

or write:

AZP Group, Inc.

Office of the Secretary, Sta. 1891

P.O. Box 53900

Phoenix, AZ 85072-3900

Note: when writing, please include your telephone number to help us expedite our reply. Also, when submitting a change of address card or requesting other changes which affect your account, be sure to include the signatures of all owners whose names appear on the account.

Highlights

	12 Months Ended		
	March 31, 1986	March 31, 1985	% Increase
Income, Earnings, Dividends			
Net income	\$ 280,955,000	\$ 228,015,000	23.2
Average common shares outstanding	73,242,752	69,130,213	5.9
Earnings per share of common stock	\$ 3.84	\$ 3.30	16.4
Dividends per share of common stock	\$ 2.72	\$ 2.60	4.6
Electric Sales and Customers			
Operating revenues	\$1,205,480,000	\$1,034,582,000	16.5
Sales (mwh)	13,843,090	13,412,880	3.2
Customers, end of period	529,661	505,634	4.8

Turley summary report (Continued)

on April 23, 1986, Unit 2 received a Nuclear Regulatory Commission (NRC) license allowing it to operate at full power. In granting the license, one NRC official called Palo Verde "a show place" for the industry, and said it has a good design, is well located and should be a point of pride. Unit 2 is scheduled for full commercial operation by the end of the third quarter of 1986, while Unit 3 is scheduled for commercial operation in late 1987.

Although Palo Verde is one of several nuclear projects undergoing prudency audits, Turley said that "any fair and objective audit will result in a verdict that the project has been managed prudently." The audit was ordered by regulators from four states involved in Palo Verde and was to be funded by all participants based on each utility's share of the project. However, Turley pointed out that Public Service of New Mexico and El Paso Electric Company recently withdrew their funding because of concerns about the audit's necessity and objectivity.

"While we share the concern, APS is bound by Commission order to continue to pay for 29.1% of the audit's cost," Turley said. "Of course, we do not know what the impact of the withdrawal of the two companies will mean to the audit effort."

Turley also discussed APS' efforts to achieve rate increases to cover Palo Verde's costs. "We are providing the Commission with all necessary information, so it should be clear to them that we are entitled to—and simply must have—a rate

increase for Unit 1 and a plan in place for the other two units."

While earnings per share were up from the same period last year, Turley said they would begin to deteriorate if the company is not granted a rate increase. "The costs of operating Palo Verde Unit 1 for the benefit of our customers is approximately \$9 million per month after taxes. If we are unable to achieve sufficient rate increases in a timely fashion to cover these costs, we will have to seek an interim increase subject to refund. Failing that, of course, we would be obligated to seek relief from the courts."

Turley said he was giving a worst-possible picture of the situation, and assured shareholders that the company's ability to pay dividends in 1986 would not be impaired. He added that, once all three units are fully reflected in rates, the company would see steady improvement in its financial outlook.

He also said that AZP has moved forward with a strategy for developing significant earnings from its non-regulated subsidiaries. El Dorado Investment Company's most important project for 1986 is to form its own venture capital fund to which it has committed \$50 million over the next five to seven years, and Energy Development Company has entered into a real estate partnership and changed its name to SunCor Development Company. Turley said that as much as \$50 million in equity capital will be allocated to the new joint venture over the next five years.

(Continued pg. 3)

Turley summary report (Continued)

Meanwhile, Malapai Resources Company owns a ranch which has proven uranium reserves and has an option to acquire an adjoining property. A demonstration plant and cost analyses for both projects are expected to be completed within the next eight to twelve months.

Turley emphasized that the AZP Stock Purchase and Dividend Reinvestment Plan—not APS rate-payers—is financing these non-utility activities. He also thanked shareholders for their continued participation in the plan and noted that, because of their investment, AZP sees no need for additional public offerings of common stock in the foreseeable future.

AZP forms new partnerships

Through its subsidiaries, AZP Group has formed partnerships for both a joint real estate venture and a venture capital fund. The real estate partnership was announced in March 1986, while the new venture fund was announced in early May 1986.

The real estate venture, known as SunCor Partners, is a partnership with Gerald Diddy, formerly president of First Service Corporation, the development subsidiary of MeraBank Inc. Diddy has been named managing partner of the new venture and AZP's existing real estate subsidiary, Energy Development Company, has changed its name to SunCor Development Company.

SunCor Partners recently acquired a large tract of commercial property, suitable for a regional shopping mall or other commercial development, in Tempe, Arizona. Diddy, an attorney with over 15 years experience in real estate, said the new joint venture will continue to invest in a portfolio consisting of a mix of development and income properties. Under his leadership, First Service Corporation's real estate development portfolio had a cumulative retail value of approximately \$1 billion.

The SunCor Development Company, meanwhile, is wrapping up an earlier joint venture involving the sale of a golf course and potential resort property at Scottsdale Country Club. This transaction is expected to produce profits of about \$2,600,000 after income taxes. (Continued pg. 4)

AZP GROUP INC. CONSOLIDATED BALANCE SHEET

ASSETS	(Unaudited) Mar. 31, 1986	Dec. 31, 1985
	(Thousands of Dollars)	
Utility Plant		
Property, plant and equipment	\$5,845,048	\$5,712,507
Less accumulated depreciation and amortization	861,810	838,684
Utility plant-net	4,983,238	4,873,823
Investments and Other Assets	116,544	90,257
Current Assets		
Cash	13,304	7,338
Temporary cash investments	1,000	5,100
Accounts receivable-net	107,454	126,395
Fuel and materials	91,145	71,958
Deferred fuel	68,749	74,335
Other	12,809	7,215
Total current assets	294,461	292,341
Deferred Debits		
Unamortized gas exploration costs	9,994	10,417
Unamortized debt issue costs	16,504	16,705
Other	67,263	41,402
Total deferred debits	93,761	68,524
TOTAL	\$5,488,004	\$5,324,945
LIABILITIES		
Capitalization		
Common stock (no par value)	\$1,322,252	\$1,294,623
Retained earnings	588,203	590,872
Common stock equity	1,910,455	1,885,495
Non-redeemable preferred stock of APS	218,561	218,561
Redeemable preferred stock of APS	209,821	219,421
Long-term debt less current maturities	2,230,333	2,205,940
Total capitalization	4,569,170	4,529,417
Current Liabilities		
Commercial paper	118,735	18,000
Current maturities of long-term debt	17,456	17,456
Accounts payable	80,077	87,121
Accrued taxes	71,117	52,296
Accrued interest	59,733	72,678
Accrued dividends on preferred stock	3,449	3,566
Other	28,619	26,269
Total current liabilities	379,186	277,386
Deferred Credits and Other		
Deferred income taxes	257,748	230,553
Deferred investment tax credit	177,859	174,503
Unamortized credit related to sale of tax benefits	43,224	43,645
Other	60,817	69,441
Total deferred credits & other	539,648	518,142
TOTAL	\$5,488,004	\$5,324,945



Shareholder Mary Gindhart, a resident of Sun City, AZ., helped AZP Chairman and President Keith Turley cut the company's centennial cake following the Annual Meeting.

AZP partnerships (Continued)

El Dorado Investment Company has formed its partnership with Brent T. Rider, formerly president of Union Venture Capital Corporation, a subsidiary of Union Bank in Los Angeles. The new venture capital fund, known as El Dorado Ventures, will concentrate on investments in the Sun Belt region.

Rider, who earned his Masters of Business Administration at Harvard Business School, is a prominent leader in venture capital and has invested in a variety of successful businesses. More information on both subsidiaries, including investment commitments, is included in AZP Chairman Keith Turley's annual meeting summary.

New dividend reinvestment provisions

The AZP board of directors has approved several changes to the AZP Stock Purchase and Dividend Reinvestment Plan, including a provision that

would allow AZP to handle the sale of Plan shares for participants who wish to sell all or a portion of their shares.

According to Corporate Secretary Faye Widenmann, AZP will sell your requested number of Plan shares, then mail you the proceeds minus the brokerage fee. She added that, due to the large volume of sales which can be handled by AZP, brokerage fees will be less than on sales handled by an individual's broker. The company will only sell shares held in Plan accounts and will not handle the sale of stock certificates.

That change, along with others approved during the April 24 board meeting, is described in a new Stock Purchase and Dividend Reinvestment Plan Prospectus to be mailed to Plan participants by June 1, the date all changes become effective. The new prospectus has also been rewritten in a question/answer format to allow for easier reading.

Other changes described in the prospectus include the authorization of additional new shares for the Plan and a provision which would allow the company to acquire added Plan shares through open market purchases. AZP does not intend to exercise the open-market option at this time.

PVNGS boasts safe technology

Responding to media inquiries after the Soviet nuclear accident in late April, Ed Van Brunt, executive vice president of the Arizona Nuclear Power Project, said that "there is almost no similarity between Palo Verde and the Chernobyl nuclear power plant near Kiev."

The Soviet reactor is based on a different technology and used graphite in its design; Palo Verde does not, said Van Brunt. He added that the Soviet's nuclear system did not have a heavy-duty reactor vessel, as does Palo Verde, to contain the radioactivity being released by damaged fuel.

In addition to the reactor vessel, Palo Verde, like all commercial nuclear plants in the U.S., has a large containment building that encloses all of the nuclear equipment. The containment structure is constructed to confine any of the harmful radioactivity that would be produced by even the worst nuclear accident possible.

AZP GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION (Thousands of Dollars) Unaudited

Source of Funds:	Three Months Ended March 31,		Twelve Months Ended March 31,	
	1986	1985	1986	1985
<i>Funds from operations:</i>				
Continuing Operations:				
Income from continuing operations	\$ 48,327	\$ 46,921	\$ 280,955	\$ 255,915
Principal non-fund charges (credits) to income:				
Depreciation and amortization	28,253	23,406	104,068	89,463
Allowance for equity funds used during construction	(30,583)	(37,213)	(136,982)	(138,690)
Deferred income taxes—net	13,486	11,963	107,681	48,387
Deferred investment tax credit—net	3,356	5,709	34,030	51,587
Other	(7,972)	6,186	17,203	5,192
Total funds from continuing operations	<u>54,867</u>	<u>56,972</u>	<u>406,955</u>	<u>311,854</u>
Discontinued operations:				
Income (loss) from discontinued operations	—	—	—	(27,900)
Principal non-fund charges (credits) to income:				
Loss on disposal of gas system— noncurrent	—	—	—	19,513
Other—net	—	—	—	821
Total funds from discontinued operations	<u>—</u>	<u>—</u>	<u>—</u>	<u>(7,566)</u>
Total funds from operations	<u>54,867</u>	<u>56,972</u>	<u>406,955</u>	<u>304,288</u>
<i>Funds from external sources:</i>				
Proceeds from sale of gas system	—	—	—	114,657
Common stock	27,629	14,772	116,971	64,003
Preferred stock of APS	—	—	—	50,000
Long-term debt	203,667	266,091	682,606	523,441
Other items—net	(7,473)	(472)	(8,617)	(6,448)
Total funds from external sources	<u>223,823</u>	<u>280,391</u>	<u>790,960</u>	<u>745,653</u>
Total source of funds	<u>\$ 278,690</u>	<u>\$ 337,363</u>	<u>\$1,197,915</u>	<u>\$1,049,941</u>
<i>Application of Funds:</i>				
Funds used for capital expenditures:				
Continuing operations	\$ 112,107	\$ 106,823	\$ 499,389	\$ 396,370
Discontinued operations	—	—	—	23,536
Investments and other assets	26,287	(203)	49,466	(9,785)
Short-term borrowings—net	(100,735)	139,977	(98,912)	96,994
Repayment of long-term debt	179,380	61,400	393,401	320,233
Redemption of redeemable preferred stock of APS	9,600	34,262	38,657	38,718
Dividends on common stock	50,996	45,646	199,441	179,415
Increase (Decrease) in working capital:*	1,055	(50,542)	116,473	4,460
Total application of funds	<u>\$ 278,690</u>	<u>\$ 337,363</u>	<u>\$1,197,915</u>	<u>\$1,049,941</u>
Increase (Decrease) in Working Capital*				
Current assets	\$ 2,120	\$ (784)	\$ 99,818	\$ (3,475)
Current liabilities	(1,065)	(49,758)	16,655	7,935
Net increase (decrease)	<u>\$ 1,055</u>	<u>\$ (50,542)</u>	<u>\$ 116,473</u>	<u>\$ 4,460</u>

*Excluding short-term borrowings—net and current maturities of long-term debt.

Note: Pursuant to corporate restructuring plan effective April 29, 1985 APS became a subsidiary of AZP. Additionally, effective November 1, 1984 APS sold its gas distribution system. Accordingly, the consolidated financial statements have been adjusted for the effects of these changes.



Summary report of Mark De Michele

In his April 24 report, Mark De Michele, president and chief operating officer of APS and executive vice president of AZP, said that, in addition to securing adequate rates, APS was committed to the efficient operation of its plants, attention to safety, cost effectiveness and concern for employees.

After reviewing APS' three-phase rate case (see related story), De Michele said that APS was exploring the possibility of refinancing Palo Verde Unit 2 by selling all or a portion of the unit to investors, then leasing it back as an operating plant. "This is a financing technique that may or may not be feasible; but I want to emphasize that APS will still control the 29.1 percent interest in Palo Verde we have always had," he said.

De Michele noted that other measures, such as refinancing high coupon debt, have helped reduce the company's interest costs by more than \$20 million annually, and additional refundings are also planned for 1986. APS has also frozen the salaries of top-management, placed a partial freeze on hiring, and reduced marketing and advertising.

Operating costs are further being reduced by keeping our plants at peak capacity and operating them at their highest efficiency. "Recent studies

show that we are saving our customers over \$40 million a year by operating our coal plants 15 percent better than the national average," De Michele said. "Scheduling maintenance time properly and ensuring the best mix of fuel for our entire system has provided additional savings."

De Michele reiterated APS' commitment to avoid financing any major new power plants until the next century. He added that, although Arizona is experiencing rapid growth, APS could meet increased electric needs through various load management programs, power purchases from other utilities and continued upgrading of existing plants.

He also emphasized efforts to call the public's attention to the company's many positive stories such as APS' involvement in and contributions to the community, cost-saving measures, and programs to increase employee participation through both quality circle and employee suggestion programs. He noted that the company is planning to move its headquarters to a new, larger building, also in downtown Phoenix. The new headquarters would bring employees, currently scattered in several locations, together in one building, and serve as a focal point for downtown redevelopment.

Lower interest rates spur refundings

On May 1, 1986, APS called \$75 million in 12½ percent bonds at a price of 109.15. The call was part of a continuing program to refund APS' high-coupon debt as interest rates and issuance terms of securities permit.

Earlier this year, APS used proceeds from the January sale of \$100 million in 30-year, 11 percent First Mortgage Bonds to refund \$25 million of 7-year, 16 percent Eurobonds and \$75 million of 7-year, 16.25 percent Eurobonds, both at a premium of 101 percent. Proceeds from the March sale of \$100 million in 10-year, 9.25 percent First Mortgage Bonds were used to tender for \$79.4 million of 15 percent series First Mortgage Bonds due in 1994 at 123.228 percent.

APS has also filed a shelf registration statement with the Securities and Exchange Commission proposing public sales of up to \$350 million in

First Mortgage Bonds. On April 28, APS sold \$125 million of 10-year, 9 percent First Mortgage Bonds. Proceeds of that issue will be applied to the redemption of a 12½ percent series of First Mortgage Bonds due 2009 and repayment of short-term debt incurred in connection with the company's construction programs. Proceeds from additional sales will also be applied either to the redemption, repayment or retirement of the company's outstanding indebtedness or to the financing of construction expenditures.

In other financing, APS plans the early redemption of two preferred issues on June 2, 1986, including \$10.70 Series I at a price of \$103 and \$11.95 Series M at a price of \$101.99. APS has also doubled up—from \$12.33 million to \$24.66 million—on a regular sinking fund due May 15 on its 12½ percent series First Mortgage Bonds.

APS rate hearings continue

Hearings on the main portion of the company's Palo Verde Unit 1 rate case began March 27 with the announcement that APS was reducing its rate request from \$78.2 million (8.6 percent) to \$54.6 million (6 percent).

The reduction was due to a decrease in the company's requested return on equity from 16.5 percent to 15 percent. Henry Sargent, APS executive vice president and chief financial officer, said the lower return on equity reflects significant improvements in the capital markets since the request was filed in May 1985.

The revised request would recover the remaining capital and operating costs of Palo Verde Unit 1. About half of the unit's construction costs are currently reflected in rates and the company had hoped to have the remainder added when the unit began commercial operation in February 1986.

Phase II rate hearings, expected to last through mid-June, are part of a three-phase rate case. Hearings on Phase 1—dealing with a purchased power and fuel adjustment clause—were completed March 7, and the company is waiting for a proposed order from the ACC hearing officer. APS has requested that the fuel adjustor be increased from four mills

per kilowatt-hour to seven mills, allowing the recovery of approximately \$74 million in uncollected fuel costs.

Phase III hearings—dealing with a proposed accounting order for Palo Verde Unit 2—are expected to begin immediately after completion of Phase II hearings. The accounting order would allow APS to defer Palo Verde Unit 2 costs until 1987, thus allowing the company to phase-in rates to cover the unit's costs.

The phase-in plan is one of two alternatives presented in the Palo Verde Unit 2 rate case which was originally filed in December 1985 using a test year ended May 1985. The ACC hearing officer ordered APS to update the test year to include the remainder of 1985, and refile the case by April 30, 1986.

The refiled case also includes two alternatives for bringing Palo Verde Unit 2 in rates: a traditional approach which asks for a single rate increase of 20.1 percent, to take effect at the time Unit 2 goes commercial in the third quarter 1986; and the phase-in plan which asks for three smaller increases of 6.4 percent each to take effect in January of 1987, 1988 and 1989. Hearings on the request are scheduled to begin September 27.

Shareholders tour PVNGS

Efforts to keep shareholders informed about AZP Group, Inc. and their investment in the company are continuing this year with a series of regional shareholder meetings and tours of the Palo Verde Nuclear Generating Station.

"These meetings not only give shareholders a better understanding of how we're managing their investment, but also give us a better insight into the needs and concerns of our shareholders," AZP Chairman and President Keith Turley said. Other members of senior management are also on hand during regional shareholder meetings. The next meeting is planned for June 12 in Denver, Colo.

The first tours of Palo Verde exclusively for shareholders began in December 1985. More than 1,300 AZP shareholders from across Arizona have participated. Other Arizona shareholders, or shareholders who plan to visit Arizona, may still arrange tours by calling AZP's toll-free number.

NRC proposes civil penalty

On May 6, 1986, just before *Quarterly* went to press, ANPP was notified by the NRC of a proposed \$100,000 civil penalty for violations involving Palo Verde security. ANPP has 30 days in which to mitigate, appeal or pay the penalty.

The proposed penalty resulted from an NRC inspection this spring which found ANPP failed to comply with certain security guidelines. The items were corrected or compensated for at the time they were identified, and measures have been taken to ensure they do not reoccur.

In releasing the inspection report, an NRC spokesperson said there was no violation that compromised the plant's overall safety. Information from that report was apparently leaked to non-authorized parties, prompting ANPP to initiate an investigation which included the use of polygraph tests.

If ANPP is required to pay the penalty, the cost would be divided among all project participants.



AZP GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME (Dollars in Thousands Except Per Share Amounts) Unaudited

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	1986	1985	1986	1985
Electric Operating Revenues	\$ 274,530	\$ 243,552	\$ 1,205,480	\$ 1,034,582
Fuel Expenses:				
Fuel for electric generation	41,495	44,904	216,166	191,560
Purchased power and interchange—net	15,844	4,491	28,142	8,880
Total	57,339	49,395	244,308	200,440
Operating Revenues less Fuel Expenses	217,191	194,157	961,172	834,142
Other Operating Expenses:				
Operations excluding fuel expenses	30,711	27,447	126,015	102,502
Maintenance	20,564	28,236	81,198	76,369
Depreciation and amortization	28,253	23,406	104,068	89,463
Income taxes—current	4,571	11,598	13,938	43,404
Income taxes—deferred	44,428	29,790	209,709	156,192
Other taxes	27,430	24,228	107,478	95,631
Total	155,957	144,705	642,406	563,561
Operating Income	61,234	49,452	318,766	270,581
Other Income (Deductions):				
Allowance for equity funds used during construction	30,583	37,213	136,982	138,690
Income taxes—current	(425)	(749)	(1,412)	836
Income taxes—deferred	13,495	12,164	54,743	53,732
Other—net	525	132	(6,310)	(772)
Total	44,178	48,760	184,003	192,486
Income before Interest and Other Deductions	105,412	98,212	502,769	463,067
Interest and Other Deductions:				
Interest on long-term debt	56,095	47,909	217,406	192,448
Interest on short-term borrowings	1,938	2,204	6,685	11,488
Debt discount, premium and expense	1,136	789	3,960	2,729
Allowance for borrowed funds used during construction—credit	(12,665)	(11,709)	(49,132)	(48,863)
Preferred stock dividend requirements of APS	10,581	12,098	42,895	49,350
Total	57,085	51,291	221,814	207,152
Income From Continuing Operations	48,327	46,921	280,955	255,915
Discontinued Operations:				
Income (loss) from operations of gas system—net of tax	—	—	—	(1,430)
Loss on disposal of gas system—net of tax	—	—	—	(26,470)
Income (Loss) from discontinued operations	—	—	—	(27,900)
Net Income	\$ 48,327	\$ 46,921	\$ 280,955	\$ 228,015
Average Common Shares Outstanding	74,887,388	70,360,843	73,242,752	69,130,213
Earnings (Loss) Per Average Share of Common Stock:				
Continuing operations	\$ 0.65	\$ 0.67	\$ 3.84	\$ 3.70
Discontinued operations	—	—	—	(0.40)
Total	\$ 0.65	\$ 0.67	\$ 3.84	\$ 3.30
Dividends Per Common Share	\$ 0.68	\$ 0.65	\$ 2.72	\$ 2.60

Note: Pursuant to corporate restructuring plan effective April 29, 1985 APS became a subsidiary of AZP. Additionally, effective November 1, 1984 APS sold its gas distribution system. Accordingly, the consolidated financial statements have been adjusted for the effects of these changes.

UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the matter of

ARIZONA PUBLIC SERVICE
COMPANY, et al.,

(Palo Verde Nuclear
Generating Station, Unit 2)

DOCKET NO. STN 50-529

APPLICATION IN RESPECT OF
SALE AND LEASEBACK TRANSACTIONS BY
ARIZONA PUBLIC SERVICE COMPANY

ITEM 3

QUARTERLY REPORT OF APS (FORM 10-Q)

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For Quarter Ended March 31, 1986

Commission file number 1-4473

ARIZONA PUBLIC SERVICE COMPANY

(Exact name of registrant as specified in its charter)

Arizona

(State or other jurisdiction
of incorporation or organization)

86-0011170

(I.R.S. Employer
Identification No.)

411 North Central Avenue, P. O. Box 53999, Phoenix, Arizona 85072-3999
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code 602-250-1000

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the 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 the filing requirements for the past 90 days.

Yes X No

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

Number of shares of common stock, \$2.50 par value,
outstanding as of May 9, 1986: 71,264,947

Suite 1000
First Interstate Bank Plaza
Phoenix, Arizona 85003-1893
(602) 257-8333
ITT Telex: 4995608

Arizona Public Service Company:

We have made a review of the consolidated balance sheet of Arizona Public Service Company (the "Company") and its subsidiaries as of March 31, 1986 and the related consolidated statements of income for the three-month and twelve-month periods ended March 31, 1986 and 1985 and of changes in financial position for the three-month periods ended March 31, 1986 and 1985, included in the Company's quarterly report on Form 10-Q, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the above-mentioned consolidated financial statements for them to be in conformity with generally accepted accounting principles.

Deloitte Haskins & Sells

May 12, 1986

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

ARIZONA PUBLIC SERVICE COMPANY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

Three Months
Ended March 31,
1986 1985
(Dollars in Thousands,
Except Per Share Amounts)

ELECTRIC OPERATING REVENUES	\$ 274,530	\$ 243,552
FUEL EXPENSES:		
Fuel for electric generation.	41,495	44,904
Purchased power and interchange - net	15,844	4,491
Total	<u>57,339</u>	<u>49,395</u>
OPERATING REVENUES LESS FUEL EXPENSES	<u>217,191</u>	<u>194,157</u>
OTHER OPERATING EXPENSES:		
Operations excluding fuel expenses.	30,621	27,447
Maintenance	20,564	28,236
Depreciation and amortization	28,253	23,406
Income taxes - current	4,612	11,598
Income taxes - deferred	44,428	29,790
Other taxes	27,430	24,228
Total	<u>155,908</u>	<u>144,705</u>
OPERATING INCOME	<u>61,283</u>	<u>49,452</u>
OTHER INCOME (DEDUCTIONS):		
Allowance for equity funds used during construction	30,583	37,213
Income taxes - current	(391)	(749)
Income taxes - deferred	13,495	12,164
Other - net	797	132
Total	<u>44,484</u>	<u>48,760</u>
INCOME BEFORE INTEREST DEDUCTIONS.	<u>105,767</u>	<u>98,212</u>
INTEREST DEDUCTIONS:		
Interest on long-term debt	56,095	47,909
Interest on short-term borrowings	1,938	2,204
Debt discount, premium and expense.	1,136	789
Allowance for borrowed funds used during construction - credit	<u>(12,665)</u>	<u>(11,709)</u>
Total	<u>46,504</u>	<u>39,193</u>
NET INCOME	<u>59,263</u>	<u>59,019</u>
PREFERRED STOCK DIVIDEND REQUIREMENTS.	<u>10,581</u>	<u>12,098</u>
EARNINGS FOR COMMON STOCK.	\$ <u>48,682</u>	\$ <u>46,921</u>
AVERAGE COMMON SHARES OUTSTANDING.	71,264,947	70,360,843
PER SHARE OF COMMON STOCK:		
Earnings (based on average common shares outstanding)	\$ 0.68	\$ 0.67
Dividends declared	\$ 0.72	\$ 0.65

See Notes to Consolidated Financial Statements

ARIZONA PUBLIC SERVICE COMPANY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

		Twelve Months Ended March 31,	
		1986	1985
		(Dollars in Thousands, Except Per Share Amounts)	
ELECTRIC OPERATING REVENUES		\$ 1,205,480	\$ 1,034,582
FUEL EXPENSES:			
Fuel for electric generation		216,166	191,560
Purchased power and interchange - net		28,142	8,880
Total		<u>244,308</u>	<u>200,440</u>
OPERATING REVENUES LESS FUEL EXPENSES		<u>961,172</u>	<u>834,142</u>
OTHER OPERATING EXPENSES:			
Operations excluding fuel expenses		125,925	102,502
Maintenance		81,198	76,369
Depreciation and amortization		104,068	89,463
Income taxes - current		13,979	43,404
Income taxes - deferred		209,709	156,192
Other taxes		107,478	95,631
Total		<u>642,357</u>	<u>563,561</u>
OPERATING INCOME		<u>318,815</u>	<u>270,581</u>
OTHER INCOME (DEDUCTIONS):			
Allowance for equity funds used during construction		136,982	138,690
Income taxes - current		(2,297)	836
Income taxes - deferred		54,743	53,732
Other - net		(3,657)	(772)
Total		<u>185,771</u>	<u>192,486</u>
INCOME BEFORE INTEREST DEDUCTIONS		<u>504,586</u>	<u>463,067</u>
INTEREST DEDUCTIONS:			
Interest on long-term debt		217,406	192,448
Interest on short-term borrowings		6,685	11,488
Debt discount, premium and expense		3,960	2,729
Allowance for borrowed funds used during construction - credit		<u>(49,132)</u>	<u>(48,863)</u>
Total		<u>178,919</u>	<u>157,802</u>
INCOME FROM CONTINUING OPERATIONS		<u>325,667</u>	<u>305,265</u>
LOSS FROM DISPOSAL AND OPERATION OF DISCONTINUED GAS SYSTEM, NET OF TAX		<u>---</u>	<u>(27,900)</u>
NET INCOME		325,667	277,365
PREFERRED STOCK DIVIDEND REQUIREMENTS		42,895	49,350
EARNINGS FOR COMMON STOCK		<u>\$ 282,772</u>	<u>\$ 228,015</u>
AVERAGE COMMON SHARES OUTSTANDING		71,254,157	69,130,213
PER SHARE OF COMMON STOCK:			
Earnings (loss) (based on average common shares outstanding):			
Continuing operations		\$ 3.97	\$ 3.70
Discontinued operations		0.00	(0.40)
Total		<u>\$ 3.97</u>	<u>\$ 3.30</u>
Dividends declared		\$ 2.80	\$ 2.60

See Notes to Consolidated Financial Statements

ARIZONA PUBLIC SERVICE COMPANY
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
(Unaudited)

	Three Months Ended March 31,	
	1986	1985
	(Thousands of Dollars)	
SOURCE OF FUNDS:		
Funds from operations:		
Net income	\$ 59,263	\$ 59,019
Principal non-fund charges (credits) to income:		
Depreciation and amortization	28,253	23,406
Allowance for equity funds used during construction	(30,583)	(37,213)
Deferred income taxes - net	27,060	11,963
Deferred investment tax credit - net	3,356	5,709
Other	(7,972)	6,186
Total funds from operations	<u>79,377</u>	<u>69,070</u>
Funds from external sources:		
Common stock	---	14,772
Long-term debt	203,667	266,091
Other items - net	(21,047)	(472)
Decrease in working capital*	<u>71</u>	<u>50,542</u>
Total funds from external sources	<u>182,691</u>	<u>330,933</u>
Total source of funds	<u>\$ 262,068</u>	<u>\$ 400,003</u>
APPLICATION OF FUNDS:		
Funds used for capital expenditures	\$ 112,107	\$ 106,823
Investments and other assets	139	(203)
Short-term borrowings - net	(100,735)	139,977
Repayment of long-term debt	179,380	61,400
Redemption of redeemable preferred stock	9,600	34,262
Dividends on preferred and common stock	<u>61,577</u>	<u>57,744</u>
Total application of funds	<u>\$ 262,068</u>	<u>\$ 400,003</u>
INCREASE (DECREASE) IN WORKING CAPITAL*:		
Current assets	\$ 1,204	\$ (784)
Current liabilities	<u>(1,275)</u>	<u>(49,758)</u>
Net decrease	<u>\$ (71)</u>	<u>\$ (50,542)</u>

*Excluding short-term borrowings - net and current maturities of long-term debt.
See Notes to Consolidated Financial Statements

ARIZONA PUBLIC SERVICE COMPANY
CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31, 1986 (Unaudited) (Thousands of Dollars)	December 31, 1985
UTILITY PLANT:		
Electric utility plant in service and held for future use	\$4,173,661	\$2,970,368
Less accumulated depreciation and amortization	<u>861,810</u>	<u>838,684</u>
Total	3,311,851	2,131,684
Construction work in progress	1,628,997	2,742,139
Nuclear fuel, net of amortization	<u>42,390</u>	<u>---</u>
Utility Plant - net	<u>4,983,238</u>	<u>4,873,823</u>
INVESTMENTS AND OTHER ASSETS:		
Investments in and receivables from affiliates	16,513	16,513
Other investments and notes receivable	<u>6,130</u>	<u>5,991</u>
Total investments and other assets	<u>22,643</u>	<u>22,504</u>
CURRENT ASSETS:		
Cash and marketable securities	8,474	7,871
Special deposits and working funds	3,397	3,342
Accounts receivable:		
Service customers	71,595	84,533
Other	37,850	43,415
Allowance for doubtful accounts	(1,486)	(1,395)
Materials and supplies (at average cost)	55,676	41,525
Fuel (at average cost)	35,469	30,433
Deferred fuel	68,749	74,335
Other	<u>9,412</u>	<u>3,873</u>
Total current assets	<u>289,136</u>	<u>287,932</u>
DEFERRED DEBITS:		
Unamortized gas exploration costs	9,994	10,417
Unamortized debt issue costs	16,504	16,705
Other	<u>65,807</u>	<u>39,946</u>
Total deferred debits	<u>92,305</u>	<u>67,068</u>
TOTAL	<u>\$5,387,322</u>	<u>\$5,251,327</u>

See Notes to Consolidated Financial Statements

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ARIZONA PUBLIC SERVICE COMPANY
CONSOLIDATED BALANCE SHEETS

LIABILITIES

	March 31, 1986 (Unaudited) (Thousands of Dollars)	December 31, 1985
CAPITALIZATION:		
Common stock.	\$ 178,162	\$ 178,162
Premiums and expenses - net	1,040,909	1,040,909
Retained earnings	590,020	592,334
Common stock equity.	1,809,091	1,811,405
Non-redeemable preferred stock.	218,561	218,561
Redeemable preferred stock	209,821	219,421
Long-term debt	2,230,333	2,205,940
Total capitalization	<u>4,467,806</u>	<u>4,455,327</u>
CURRENT LIABILITIES:		
Commercial paper	118,735	18,000
Current maturities of long-term debt.	17,456	17,456
Accounts payable.	80,077	87,113
Accrued taxes	71,117	52,976
Accrued interest.	60,401	72,678
Accrued dividends	3,449	3,566
Other	28,633	26,069
Total current liabilities.	<u>379,868</u>	<u>277,858</u>
DEFERRED CREDITS AND OTHER:		
Deferred income taxes	257,748	230,553
Deferred investment tax credit.	177,859	174,503
Unamortized credit - sale of tax benefits	43,224	43,645
Customer advances for construction	23,779	23,991
Other	37,038	45,450
Total deferred credits and other	<u>539,648</u>	<u>518,142</u>
TOTAL.	<u>\$5,387,322</u>	<u>\$5,251,327</u>

See Notes to Consolidated Financial Statements

ARIZONA PUBLIC SERVICE COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The consolidated financial statements include the accounts of Arizona Public Service Company (the "Company" or "APS") and those of two of its wholly-owned subsidiaries, APS Finance Company N.V., organized to serve as a financing corporation to raise funds outside the United States of America, and APS Fuels Company, organized to manage investments in certain fuel resources. All significant intercompany balances and transactions have been eliminated.

2. In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (comprising only normal recurring accruals) necessary to present fairly the financial position of the Company and its subsidiaries as of March 31, 1986, the results of their operations for the three months and twelve months ended March 31, 1986 and 1985 and the changes in their financial position for the three months ended March 31, 1986 and 1985.

3. The Company's operations are subject to seasonal fluctuations with variations occurring in energy usage by customers from season to season and from month to month within a season, primarily as a result of changing weather conditions. For this and for other reasons, the results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

4. The Company sold its gas distribution system effective November 1, 1984.

5. On April 18, 1985 the Company's shareholders approved a plan for corporate restructuring. Effective April 29, 1985, APS became a subsidiary of a holding company, AZP Group, Inc.

6. See "Construction and Financing Programs" under Part II, Item 5 for changes in capitalization since December 31, 1985.

7. See "Palo Verde Nuclear Generating Station" under Part II, Item 5 for discussion of the Prudency Audit.

ARIZONA PUBLIC SERVICE COMPANY

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating Results for the Three Months and Twelve Months Ended March 31, 1986, as Compared with Corresponding Periods Ended March 31, 1985.

Although the Company has experienced increases and decreases in unit costs of generating fuel and purchased power, most of such changes are passed on to customers pursuant to the purchased power and fuel adjustment mechanism in the Company's rate schedules. Accordingly, such changes are reflected in fuel revenues and do not materially affect earnings. See, however, "Retail Rates" in Part II, Item 5 of this Report for a discussion of the Arizona Corporation Commission (the "ACC") hearings and other legal proceedings regarding the Company's purchased power and fuel adjustment mechanism.

The increases in electric operating revenues of 12.7% and 16.5% in the three-month and twelve-month periods, respectively, were largely due to an increase in the portion of a coal-fired plant's capacity that is being temporarily sold and to a retail rate increase of 4.98% effective February 1, 1985. In addition, a 1.5% retail rate increase effective October 1, 1984 contributed to increased revenues in the twelve-month period. Increased revenues also reflect an increase in rates pursuant to operation of the Company's fuel adjustment clause and increased unit sales to residential, commercial and industrial customers in the twelve-month period. For the three-month and twelve-month periods, the average number of electric customers increased by 4.7% and 4.8%, respectively, with these increases occurring in the residential and commercial customer classes. Unit sales declined by 4.1% for the three-month period and increased by 3.2% for the twelve-month period. Unit sales in the three-month period declined primarily due to decreased residential usage which reflects warmer winter weather conditions, partially offset by the increase in residential customers. Unit sales increased for the twelve-month period largely due to an increase in customers, increased commercial usage, and increased industrial sales reflecting the impact of one mining customer. Sales to resale customers decreased in both periods largely due to curtailed purchases by two resale customers.

Fuel for electric generation expense decreased by 7.6% during the three-month period primarily due to decreased generation as a result of lower sales, partially offset by an increase in coal prices resulting from an increase in coal royalties. For the twelve-month period, the fuel for electric generation expense increased by 12.8% primarily due to the increased unit fuel price for coal resulting from a retroactive adjustment to 1981 for coal royalties that was recorded in June 1985.

Purchased power and interchange-net increased in both periods. The primary reason for the increase in the three-month period is the operation of the Company's fuel adjustment clause partially offset by a decrease in the average price of purchased power resulting from the availability of test energy. The increase in the twelve-month period was

largely due to increased purchase power requirements resulting from increased sales as well as lower interchange sales to other utilities, partially offset by the operation of the Company's fuel adjustment clause.

Operations excluding fuel expenses increased in both periods due to increased customer service expenses associated with increased customers, increased insurance expenses resulting from rising premiums, and increased operations expenses associated with the start of commercial operation of a new generating unit.

Maintenance expenses were affected in both periods by the timing of scheduled power plant maintenance overhauls and by increased maintenance expenses associated with the start of commercial operation of a new generating unit.

Depreciation and amortization expenses increased in the three-month and twelve-month periods ended March 31 reflecting increases in the Company's utility plant in service including a new generating unit which started commercial operation in February 1986. Ad valorem taxes, a function of the size of the Company's utility plant, and sales taxes, a function of operating revenues, also increased in both periods. Sales taxes and ad valorem taxes are the principal components of other taxes.

The increases in income taxes in both periods were largely a result of increased income.

The aggregate amount of AFC, shown as other income and a credit to interest deductions, decreased in both the three-month and twelve-month periods. AFC is primarily a function of the amount of construction work in progress during any given period and ceases to accrue on those portions of construction work in progress that are included in rate base or on those generating facilities transferred to plant in service including those portions of a new generating unit which started commercial operation in February 1986. See Note 1e of "Notes to Consolidated Financial Statements" in Part II, Item 8 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1985 (the "1985 10-K").

Interest on long-term debt increased in the three-month and twelve-month periods ended March 31 due primarily to large amounts of new borrowings, partially offset by lower interest rates. The decrease in interest on short-term borrowings in the same periods resulted primarily from decreased borrowings and the effects of lower interest rates.

Consolidated net income represents a composite of cash and non-cash items and reflects accounting practices unique to regulated public utilities.

For additional information regarding the Company's sources of liquidity and commitments for capital expenditures, see "Construction and Financing Programs" in Part II, Item 5 of this Report, incorporated herein by this reference.

PART II. OTHER INFORMATION

Item 5. Other Information

Retail Rates

In May 1985, the Company filed a request with the Arizona Corporation Commission (the "ACC") for a \$78.2 million (8.6%) increase in annual retail electric rates premised upon Palo Verde Unit 1 being fully included in the Company's rate base (the "Unit 1 Rate Case"). See "Rates-State" in Part I, Item 1 of the Company's Annual Report on Form 10-K for the fiscal year ended 1985 (the "1985 Form 10-K"). On March 27, 1986, the Company lowered the request in the Unit 1 Rate Case to \$54.6 million (a 6% increase), reflecting improvements in capital markets since the request was filed in May 1985.

On December 18, 1985, the Company filed an application with the ACC for a \$193.9 million (19.36%) increase in annual retail electric rates, to be effective on the date Palo Verde Unit 2 is placed in service (the "Unit 2 Rate Case"). On December 30, 1985, the ACC instructed the Company to resubmit all schedules relating to the Unit 2 Rate Case on or before April 30, 1986, so as to reflect a calendar 1985 test year. See "Rates-State" in Part I, Item 1 of the 1985 10-K. On April 30, 1986, the Company resubmitted schedules based upon the 1985 test year, which resulted in a revision of the rate request from \$193.9 million to \$202.5 million (20.12%). Hearings concerning the Unit 2 Rate Case are scheduled to begin September 26, 1986.

Palo Verde Nuclear Generating Station

On April 24, 1986, the Nuclear Regulatory Commission (the "NRC") issued, subject to certain conditions, a full power operating license for Palo Verde Unit 2, thus removing the five percent restriction on generating capability contained in the Unit 2 operating license issued in December 1985. Unit 2 is scheduled to achieve commercial operation during the third quarter of 1986. See "Properties" in Part I, Item 2 of the 1985 Form 10-K.

The Company has been evaluating the use of long-term lease financing for its interest in Palo Verde Unit 2. On April 22, 1986, and May 2, 1986, the Company filed separate applications with the ACC and the NRC, respectively, seeking authorization to enter into one or more sale and leaseback transactions relating to all or a portion of the Company's 29.1% undivided

ownership interest in Palo Verde Unit 2. Consummation of any sale and leaseback transaction is subject to further evaluation, general market conditions, and the receipt of regulatory approvals from the ACC, the NRC, and the Securities and Exchange Commission.

By letter dated May 5, 1986, the NRC sent a Notice of Violation and Proposed Imposition of Civil Penalty (the "NRC Notice") notifying the Company, as operating agent at Palo Verde, that the NRC proposes to impose a \$100,000 civil penalty for violations categorized in the aggregate as a "Severity Level III" problem (on a scale of I to V in accordance with the "General Statement of Policy and Procedure for NRC Enforcement Actions"). The NRC Notice relates to deficiencies noted by the NRC during security inspections at Palo Verde from February 11 to March 13, 1986. The base civil penalty for a Severity Level III problem is \$50,000. The NRC indicated that the proposed civil penalty was doubled because the Company had prior notice of similar problems and because several violations involved multiple examples. The NRC requires APS to respond and, among other things, either to pay or to protest the civil penalty within 30 days of the NRC Notice. The Company is currently evaluating its response to the NRC Notice.

In 1984 the utility regulatory bodies of Arizona, California, New Mexico, and Texas formed the Four State Monitoring Committee to oversee an independent construction audit of Palo Verde. See "Rates-State" in Part I, Item 1 of the 1985 10-K. In April 1986, Public Service Company of New Mexico ("PNM") and El Paso Electric Company ("El Paso"), two of the participants in Palo Verde, informed their respective regulatory commissions that they were withdrawing from, and would not fund, the audit because of concerns that the audit will not produce balanced and objective conclusions. The Company is under order by the ACC to pay for 29.1 percent (the Company's ownership interest in Palo Verde) of all costs incurred in conducting the audit.

Construction and Financing Programs

For the three months ended March 31, 1986, the Company incurred approximately \$99,000,000 in construction expenditures, accounting for approximately 26% of the most recently estimated 1986 construction expenditures. The Company has estimated total construction expenditures for the years 1986, 1987, and 1988 at \$386,000,000, \$258,000,000, and \$226,000,000, respectively.

In addition to funds required for capital expenditures, repayment or refunding obligations of senior securities and

installment obligations, including certain anticipated early redemptions based upon current interest rates, are expected to total \$325,000,000, \$248,000,000, and \$246,000,000 for the years 1986, 1987, and 1988, respectively. The Company refunded or otherwise paid approximately 58% (\$189,000,000) of the expected 1986 total during the three months ended March 31, 1986.

In January 1986, the Company issued \$100 million in 30-year 11% first mortgage bonds. The proceeds were applied to the redemption of outstanding European debentures issued by the Company's wholly-owned finance subsidiary. In March 1986, the Company issued \$100 million in 10-year 9 1/4% first mortgage bonds. Substantially all of the proceeds were applied to purchase approximately \$80 million of the Company's \$100 million 15% Series First Mortgage Bonds due 1994 at 123.23% of their principal amount plus accrued interest. In May 1986, the Company issued \$125 million in 10-year 9% first mortgage bonds, and applied a portion of the proceeds to redeem the Company's \$75 million 12 1/8% Series First Mortgage Bonds due 2009 at 109.15 percent of principal amount plus accrued interest.

Provisions in the Company's Mortgage Bond Indenture and Articles of Incorporation restrict it from issuing additional first mortgage bonds or preferred stock, respectively, unless its earnings (as defined) cover by at least the prescribed number of times the amount of interest (as to bonds) and the amount of interest plus preferred stock dividend requirements (as to preferred stock) on the securities to be outstanding after completion of the new issue. Operation of the latter such provision has at times limited the Company's ability to issue preferred stock. As calculated in accordance with the applicable document, and assuming 10% as the rate of interest on new bonds or as the dividend requirement on new preferred stock that might have been issued on March 31, 1986, and treating the issuance of \$125,000,000 of 9 percent series first mortgage bonds as though consummated on that date, the coverage afforded by defined earnings for the twelve months ended on that date would have allowed the issuance of either \$1,643,000,000 in aggregate principal amount of additional first mortgage bonds (as compared to approximately \$1,072,000,000 in bonds issuable on the basis of net "property additions" to March 31, 1986), or \$598,000,000 in aggregate par value of additional preferred stock. Required coverages are 2.0 for bonds and 1.5 for preferred stock. Coverages afforded by defined earnings for the twelve-month period ended March 31, 1986 were 4.10 for bonds and 1.90 for preferred stock.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

<u>Exhibit</u>	<u>Description</u>	<u>Page Number in Manually Signed Original on Which Exhibit May be Found</u>
15.1	Letter Regarding Unaudited Interim Financial Information	18

In addition to the Exhibit shown above, the Company hereby incorporates the following Exhibits pursuant to Exchange Act Rule 12b-32 and Regulation § 201.24 by reference to the filings set forth below:

<u>Exhibit No.</u>	<u>Description</u>	<u>Originally Filed as Exhibit:</u>	<u>File No.</u>	<u>Date Effective</u>
4.1	Mortgage and Deed of Trust Relating to the Company's First Mortgage Bonds, to- gether with twenty-seven indentures supplemental thereto	4.1 to Form S-3 Registration Statement	2-84605	7-6-83
	Twenty-eighth Supplemental Indenture	4.2 to Form S-3 Registration Statement No. 2-84605 by means of July 7, 1983 Form 8-K Report	1-4473	7-7-83
	Twenty-ninth Supplemental Indenture	4.2 to Form S-3 Registration Statement No. 2-86955 by means of October 13, 1983 Form 8-K Report	1-4473	10-14-83
	Thirtieth Supplemental Indenture	4.4 to Form S-3 Registration Statement No. 2-86955 by means of June 14, 1984 Form 8-K Report	1-4473	6-15-84

Thirty-first Supplemental Indenture	4.4 to Form S-3 Registration Statements (Nos. 2-86955 and 2-95340) by means of January 24, 1985 Form 8-K Report	1-4473	1-25-85
Thirty-second Supplemental Indenture	4.7 to Form S-3 Registration Statement	2-97956	5-24-85
Thirty-third Supplemental Indenture	4.5 to Form S-3 Registration Statement Nos. 2-95340 and 2-97956 by means of June 6, 1985 Form 8-K Report	1-4473	6-7-85
Thirty-fourth Supplemental Indenture	4.1 to Form S-3 Registration Statement by means of Post-Effective Amendment No. 2	2-99739	11-21-85
Thirty-fifth Supplemental Indenture	4.1 to Form S-3 Registration Statement No. 33-2297 by means of January 22, 1986 Form 8-K Report	1-4473	1-23-86
Thirty-sixth Supplemental Indenture	4.1 to Form S-3 Registration Statement No. 33-3354 by means of February 24, 1986 Form 8-K Report	1-4473	2-25-86
Thirty-seventh Supplemental Indenture	4.1 to Registration Statement No. 33-4306 by means of April 29, 1986 Form 8-K Report	1-4473	4-30-86

(b) During the quarter ended March 31, 1986, the Company filed, on the dates indicated, the following reports on Form 8-K:

Report filed January 20, 1986, relating to (1) delays

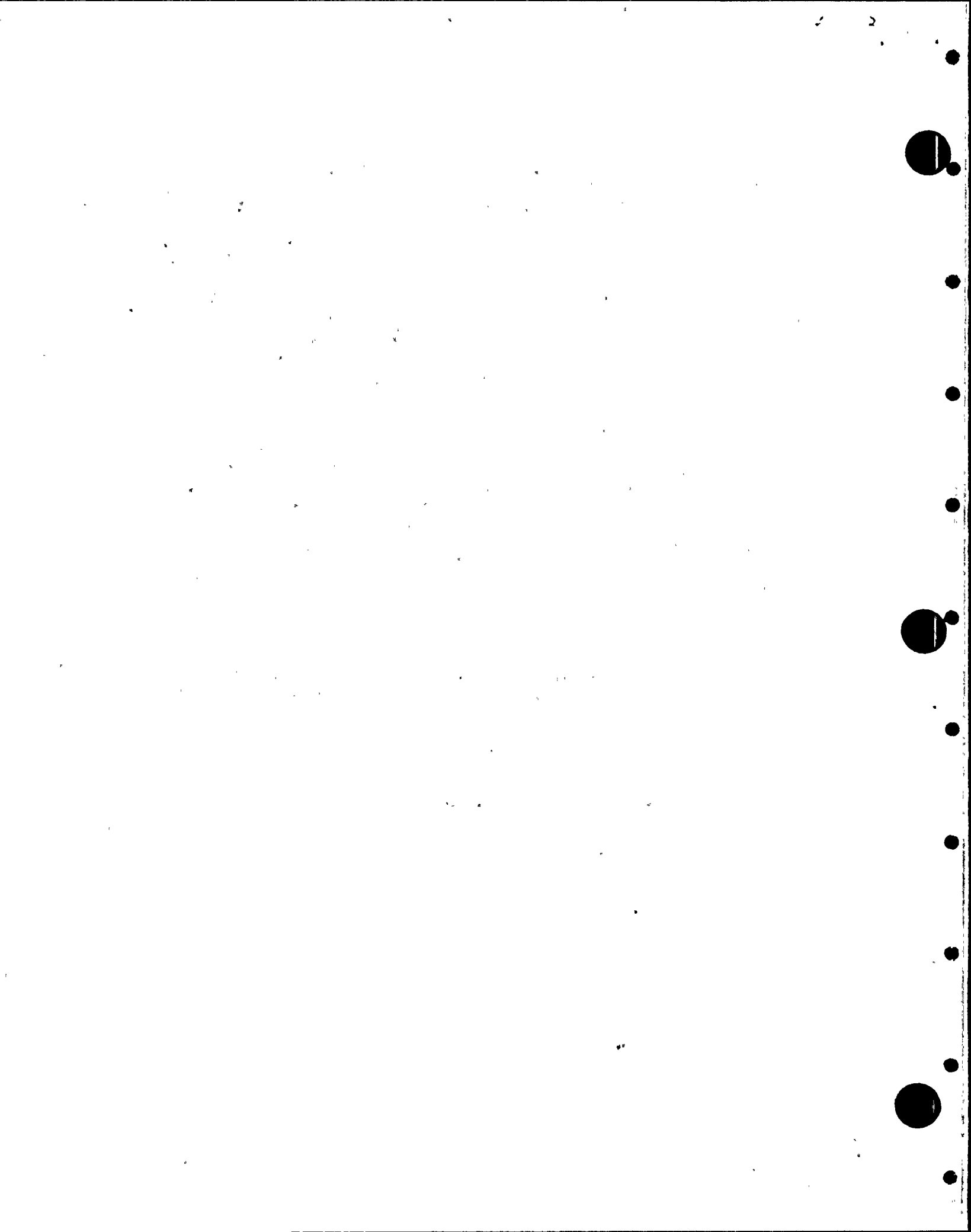
in the projected commercial operation dates of Palo Verde Units 2 and 3, (2) the impact on the Company if the ACC does not grant the requested accounting/rate-making order relating to Unit 2, (3) the court order upholding the ACC's order purporting to subject AZP and its subsidiaries, including the Company, to certain reporting requirements, (4) the ACC's refusal to grant a motion by RUCO involving the emergency rate reduction application filed by RUCO, and (5) the ACC's refusal to grant a motion by RUCO involving a requested emergency adoption of a new ACC rule to require public service corporations to prove by a preponderance of the evidence that their investments were prudent.

Report filed January 23, 1986 comprised of exhibits to the Company's Registration Statement on Form S-3 (Registration No. 33-2297), relating to the Company's registration of \$100,000,000 in aggregate principal amount of the Company's First Mortgage Bonds.

Report filed February 24, 1986 comprised of exhibits to the Company's Registration Statement on Form S-3 (Registration No. 33-3356), relating to the Company's registration of \$100,000,000 in aggregate principal amount of the Company's First Mortgage Bonds.

Report filed February 25, 1986 comprised of exhibits to the Company's Registration Statement on Form S-3 (Registration No. 33-3356), relating to the Company's registration of \$100,000,000 in aggregate principal amount of the Company's First Mortgage Bonds.

Report filed May 6, 1986 comprised of exhibits to the Company's Registration Statement on Form S-3 (Registration No. 33-4306), relating to the Company's registration of \$125,000,000 in aggregate principal amount of the Company's First Mortgage Bonds.



SIGNATURES

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

ARIZONA PUBLIC SERVICE COMPANY
(Registrant)

Date May 9, 1986

/s/ Henry B. Sargent, Jr.
Henry B. Sargent, Jr. Executive Vice
President and Chief Financial Officer
(Principal Financial Officer and
Officer Duly Authorized to sign this
Report)

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1. The first part of the report is a general statement of the purpose and scope of the study. It is followed by a brief review of the literature on the subject.

2. The second part of the report is a description of the methods used in the study.

3. The third part of the report is a presentation of the results of the study. It is followed by a discussion of the results and their implications.

UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the matter of
ARIZONA PUBLIC SERVICE
COMPANY, et al.,
(Palo Verde Nuclear
Generating Station, Unit 2)

DOCKET NO. STN 50-529

APPLICATION IN RESPECT OF
SALE AND LEASEBACK TRANSACTIONS BY
ARIZONA PUBLIC SERVICE COMPANY

ITEM 4

OPINION AND ORDER OF THE ARIZONA CORPORATION
COMMISSION, DATED JULY 24, 1986

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
SHARON B. MEGDAL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR AN)
ORDER OR ORDERS: (1) AUTHORIZING IT TO)
ENTER INTO VARIOUS TRANSACTIONS AND)
AGREEMENTS RELATING TO THE SALE AND)
OPERATING LEASE OF ALL OR A PORTION OF)
THE COMPANY'S UNDIVIDED OWNERSHIP)
INTEREST IN UNIT 2 OF THE PALO VERDE)
NUCLEAR GENERATING STATION AND CERTAIN)
COMMON FACILITIES; (2) AUTHORIZING IT)
TO ISSUE OR INCUR EVIDENCES OF INDEBTED-)
NESS IN CONNECTION THEREWITH; (3) CON-)
FIRMING THAT THE OWNER TRUSTEE AND THE)
EQUITY INVESTORS WILL NOT BE "PUBLIC)
SERVICE CORPORATIONS"; (4) CONFIRMING)
THAT THE LEASES WILL BE "OPERATING)
LEASES" FOR ACCOUNTING PURPOSES; AND,)
(5) DESCRIBING THE RATE-MAKING)
TREATMENT OF THE PROPOSED TRANSACTIONS.)

DOCKET NO. U-1345-86-105

DECISION NO. 55120

Arizona Corporation Commission

DOCKETED

JUL 24 1986

DOCKETED BY

dmk

OPINION AND ORDER

DATE OF HEARING: July 10, 1986

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Thomas L. Mumaw, Chief Hearing Officer

IN ATTENDANCE: Renz D. Jennings, Chairman
Marcia Weeks, Commissioner
Sharon B. Megdal, Commissioner

APPEARANCES: Jaron B. Norberg, Senior Vice President and Corporate
Counsel, Raymond Heyman, and Snell & Wilmer,
by Steven M. Wheeler, Attorneys for Arizona Public
Service.

Elizabeth Kushibab, Attorney, Legal Division, for
the Arizona Corporation Commission Staff

Steven Avilla, Attorney, for the Residential Utility
Consumer Office

...

...

1 BY THE COMMISSION:

2 On April 22, 1986, Arizona Public Service Company ("APS" or "Company")
3 filed an Application with the Commission requesting an Order authorizing the
4 Company, among other things, to enter into various transactions and agreements
5 relating to the sale and operating lease of all or a portion of the Company's
6 undivided ownership interest in the Palo Verde Unit 2 Facilities as hereinafter
7 defined.

8 On April 27, and May 21, 1986, the Coalition for Responsible Energy
9 Education ("CREE") and the Residential Utility Consumer Office ("RUCO") filed
10 Petitions to Intervene herein. Both said Petitions were granted by Procedural
11 Order prior to the scheduled hearing on APS's Application.

12 Pursuant to Notice dated June 26, 1986, APS's Application came on for
13 hearing before a duly authorized Hearing Officer of the Commission at its
14 offices in Phoenix, Arizona, on July 10, 1986. APS, RUCO, and the
15 Commission's Utilities Division Staff ("Staff") appeared through counsel, and
16 each presented testimony and exhibits in support of APS's Application. At the
17 conclusion of a full public hearing, this matter was adjourned pending
18 submission of a Recommended Opinion and Order by the Presiding Officer to the
19 Commission.

20 DISCUSSION

21 As indicated above, both Staff and Intervenor RUCO supported the
22 Application. Staff did propose various reporting requirements which would keep
23 the Commission informed as to the details of the sale and leaseback (as well as
24 any material changes in the transaction both prior to and after closing), and
25 suggested that proceeds derived from such sale and leaseback be placed in a
26 separate interest bearing bank account. Staff and RUCO further recommended
27 that the Commission be circumspect in its language approving this matter so as
28 to retain its flexibility to disallow all or part of the operating lease

1 payments from APS's cost of service in its pending rate proceeding (Docket No.
2 U-1345-85-367). Finally, RUCO noted that recoverability of these lease
3 payments in rates should be subject to performance criteria, and that it would
4 be proposing such criteria in the aforementioned rate Docket.

5 As in Docket No. U-1933-86-036, decided this same day, we will adopt
6 Staff's reporting requirements and will use the same language generally
7 disclaiming any prior judgement on the recoverability through rates of these
8 operating lease payments.¹ We also agree that performance criteria for Palo
9 Verde are appropriate. See Decision No. 55118 in Docket No. U-1345-85-156
10 (Phase I), also decided this day. We will not require that APS separately
11 deposit the funds received through the sale and leaseback transaction.
12 However, periodic reporting on APS's use of such proceeds will serve to
13 reassure the Commission that the limitations on their use both agreed to by APS
14 and ordered hereinafter are being properly observed.

15 * * * * *

16 Having considered the entire record herein and being fully advised in the
17 premises, the Commission finds, concludes and orders that:

18 FINDINGS OF FACT

19 1. APS is an Arizona corporation engaged in providing electric service
20 within various portions of Arizona pursuant to authority granted by this
21 Commission.

22 2. By its Application and testimony in this matter, the Company
23 requests one or more orders granting the following:

- 24 (a) authorization to refinance its construction financing for
25 Unit 2 of the Palo Verde Nuclear Generating Station
26 ("Palo Verde") by entering into one or more sale and leaseback
27 transactions (the "Lease Transactions") relating to (1) all or
28

¹ Similar language is included in all Commission Decisions authorizing financing transactions.

1 a portion of the Company's 29.1% undivided ownership interest
 2 in Unit 2, including, without limitation, all or a portion
 3 of the Company's generation entitlement share in Unit 2 and
 4 (ii) certain real property interests in the Palo Verde plant
 5 site and related real property (such interest in Unit 2
 6 and the real property interests being hereinafter collectively
 7 referred to as the "Unit 2 Facilities");

8 (b) authorization for the Company to issue, assume, guarantee, or
 9 incur evidences of indebtedness in connection with the Lease
 10 Transactions;

11 (c) confirmation that the Leases (as hereinafter defined) will be
 12 treated as "operating leases" for accounting and rate-making
 13 purposes;

14 (d) confirmation of the rate-making treatment of the Lease
 15 Transactions; and,

16 (e) confirmation that the Lessors and the Equity Investors (as
 17 hereinafter defined) will not be "public service corporations"
 18 subject to regulation under Arizona law by reason of their
 19 holding title to, or possessing an interest in, the Unit 2
 20 Facilities.

21 3. The Lease Transactions will involve the Company's sale of the Unit 2
 22 Facilities to, and then the lease of the Unit 2 Facilities back from,
 23 institutional investors ("Equity Investors").

24 4. Each of the Equity Investors will form a trust for the purpose of
 25 holding title to its undivided interest in the Unit 2 Facilities, and the
 26 trustees under the trusts will act as lessors ("Lessors") of the Unit 2

27 . . .

28 . . .

1 Facilities and will lease the Unit 2 Facilities to APS under one or more leases
2 ("Leases").

3 5. If the Lease Transactions are completed as to less than all of APS's
4 interest in the Unit 2 Facilities, APS will retain an undivided ownership
5 interest in the remainder of the Unit 2 Facilities.

6 6. The Unit 2 Facilities will be sold to the Lessors at a fair market
7 price, and prior to the closing of the Lease Transactions, an appraisal will
8 confirm that the purchase price is a reasonable estimate of fair market value
9 in order to comply with certain Internal Revenue Service requirements to
10 preserve certain tax benefits of the transactions.

11 7. APS's profit on the sale at fair market value of the Unit 2
12 Facilities (net of associated income tax) will be amortized as a credit against
13 APS's operating lease expense over the term of the lease.

14 8. Lessors will borrow approximately 70% to 80% of the purchase price
15 from a funding corporation (the "Funding Corporation") formed for that purpose,
16 and the Funding Corporation, in turn, will borrow the debt portion of the
17 purchase price by issuing debt that will be non-recourse to the Lessors and the
18 Equity Investors.

19 9. The debt referred to in Finding of Fact No. 8, hereinabove, will be
20 indirectly secured by an assignment of the rentals and other payments due from
21 the Company under the Leases.

22 10. APS will be named the "Registrant" in any Registration Statement
23 filed with the Securities and Exchange Commission in connection with the
24 issuance of such debt.

25 11. Upon the occurrence of certain events to be described in the leases,
26 APS will be required to assume the Lessors' debt to the Funding Corporation.

27 12. Throughout the terms of the Leases, APS may direct the Lessors to
28 refund the Lessors' debt to the Funding Corporation at then prevailing interest

1 rates, with net benefits of such refunding to be reflected in the Company's
2 rental payments under the Leases.

3 13. Financial support in the form of letters of credit or financial
4 guarantees will also be obtained to secure the Equity Investors for the payment
5 of amounts by the Company under the leases and related documents, and APS may
6 be required to issue or incur evidences of indebtedness in connection with such
7 financial support.

8 14. Although the Lessors will be the owners of the Unit 2 Facilities,
9 APS will remain responsible for all expenses of operation and maintenance.

10 15. The initial term of the Leases will be approximately 29-1/2 years,
11 and the Company will have certain renewal options.

12 16. APS will have certain options to repurchase the Unit 2 Facilities.

13 17. The rent to be paid by APS over the term of the Leases will be a
14 function of the interest rates payable on the debt issued by the Funding
15 Corporation, the purchase price, marginal tax rates, etc.

16 18. Throughout the term of the Leases, APS will be required with respect
17 to the Unit 2 Facilities to be and to act as a "participant" under the ANPP
18 Participation Agreement, as amended, which governs the construction, operation,
19 and maintenance of Palo Verde and the rights and duties of the joint owners of,
20 and participants in Palo Verde.

21 19. The Company will also continue to serve as "Operating Agent" of Unit
22 2 responsible to the other Palo Verde participants, and as the sole licensee
23 responsible to the Nuclear Regulatory Commission (the "NRC"), for the use and
24 operation of Unit 2, including decommissioning.

25 20. Although APS will remain liable for its share of the decommissioning
26 cost of Unit 2 under NRC regulations, the Lease Transactions may require the
27 Equity Investors to fund a portion of the estimated costs of decommissioning
28 the portion of the Unit 2 Facilities acquired by the Equity Investors.

1 21. Any addition, betterment, or enlargement of the Unit 2 Facilities,
2 or replacement of units of the property within the Unit 2 Facilities ("Capital
3 Improvements") will be APS's obligation under the Leases.

4 22. APS may, but will not be obligated to, request that the Lessors provide
5 financing under the Leases ("Supplemental Financings") for their respective
6 shares of Capital Improvements.

7 23. The terms and conditions of Supplemental Financing will be subject
8 to mutual agreement between the Company and each Equity Investor, and each
9 Equity Investor will have the option, but no obligation, to make additional
10 equity investments in Capital Improvements that are the subject of Supplemental
11 Financings.

12 24. If any such Capital Improvement is not funded by an Equity Investor,
13 such Equity Investor will, subject to certain conditions, permit the Lessor to
14 borrow additional funds from the Funding Corporation in an amount sufficient to
15 fund such Equity Investor's share of the Capital Improvement.

16 25. Concurrently with any Supplemental Financings, the rent payments
17 will be adjusted to support the amortization of the additional debt issued in
18 connection with the Supplemental Financing and to preserve the Equity
19 Investors' net economic return.

20 26. The Company and the Lessors will enter into support agreements that
21 will provide the Lessors with such rights in parts of the company's interest in
22 Palo Verde not constituting Unit 2 Facilities as may be necessary to enable the
23 Lessors and their successors and assigns to realize the residual values of
24 their interests under the Lease Transactions that may be consummated.

25 27. The proposed Leases will be "operating leases" as defined in
26 accordance with generally accepted accounting principles, and for rate-making
27 purposes the aggregate amount of Lease payments will be accounted for by the
28 Company as an operating and maintenance expense, with the recoverability of

1 such Lease payments through rates to be decided in Docket U-1345-85-367.

2 28. APS intends to use the net proceeds from the Lease Transactions for
3 the redemption, retirement, or refunding of outstanding long-term debt and/or
4 preferred stock that previously financed construction projects and, if
5 necessary, the satisfaction of certain of the Company's working capital and
6 other cash requirements, including the financing of APS's ongoing construction
7 program.

8 29. The payments under the Leases will be chargeable to the Company's
9 operative expenses or to income.

10 30. The issuance, assumption, guarantee, or incurrence of evidences of
11 indebtedness by the Company in connection with the lease Transactions will be
12 for the purpose of allowing the company to perform its obligations and/or
13 exercise its options under the Lease Transactions.

14 31. It has been estimated by Staff and APS that the expected present
15 value savings to ratepayers resulting from the Lease Transactions will range
16 from roughly \$10,000,000 to \$128,000,000.

17 32. The above savings assume the subtraction from APS's rate base of all
18 tax credits generated by the Lease Transactions and retained by APS, subject to
19 ratable restoration over a 35 year period.

20 33. The Lease Transactions and the issuance, assumption, guarantee, or
21 incurrence of evidences of indebtedness in connection therewith are compatible
22 with the public interest, with sound financial practices, and with the proper
23 performance by the Company of service as a public service corporation and will
24 not impart its ability to perform that service.

25 34. The Lease Transactions and the issuance, assumption, guarantee, or
26 incurrence of evidences of indebtedness in connection therewith are reasonably
27 necessary or appropriate for the purposes set forth herein and, except as
28 otherwise set forth herein, are not, wholly or in part, reasonably chargeable

1 to the Company's operative expenses or to income.

2 35. Performance criteria are specifically required in order to assure
3 that ratepayers pay only the allowable costs under efficient operations. The
4 Commission expects the parties to present such performance criteria in the rate
5 case involving the sale and leaseback.

6 CONCLUSIONS OF LAW

7 1. APS is a public service corporation within the meaning of Article XV
8 of the Arizona Constitution and A.R.S. §§ 40-285 and 40-301, et seq.

9 2. The Commission has jurisdiction over APS and of the subject matter
10 of the Application.

11 3. The proposed Lease Transactions and the issuance, assumption,
12 guarantee, or incurrence of evidences of indebtedness in connection therewith,
13 as well as the other matters set forth in the Application, exhibits, and
14 testimony relating to this matter are for lawful purposes within the corporate
15 powers of APS and are compatible with the public interest.

16 4. APS's leasehold interest in the Unit 2 Facilities, including its
17 contractual rights under said Leases, shall be subject to the Commission's
18 authority under A.R.S. § 40-285(A).

19 ORDER

20 IT IS THEREFORE ORDERED that Arizona Public Service Company is hereby
21 authorized:

- 22 (a) to undertake and consummate the Lease Transactions and to
23 take all such actions as may be necessary or appropriate in
24 connection therewith, subject to the limitations and conditions
25 contained in this Decision;
- 26 (b) to issue, assume, guarantee, and incur evidences of indebtedness
27 in order to consummate, and to perform its obligations and exercise
28 its options under, the Lease Transactions (including the issuance

1 or incurrence of evidences of indebtedness in connection with the
2 financing of Capital Improvements as required or permitted by the
3 terms of the Leases, the costs of which will be reflected in an
4 adjustment to lease rentals) including, but not limited to, (i) the
5 issuance or incurrence of evidences of indebtedness by the Funding
6 Corporation, secured by the direct obligation of the Company; (ii)
7 the issuance or incurrence of evidences of indebtedness in
8 connection with any letter of credit or financial guarantee securing
9 the Equity Investors for the payment of amounts payable by the
10 Company under the Lease and related documents; (iii) the issuance
11 or incurrence of evidences of indebtedness necessary for any
12 refunding of indebtedness; (iv) the assumption of indebtedness
13 by the Company upon the occurrence of certain events as
14 required by the leases; (v) the adjustment of rents from time
15 to time as required by the Leases; and (vi) the execution of
16 supplements to the Lease as required or permitted by the
17 Leases; and

- 18 (c) to exercise its options to renew the Leases and to repurchase
19 all or any portion of the Unit 2 Facilities in accordance with
20 the terms of the Leases.

21 IT IS FURTHER ORDERED that the Leases will be treated as operating leases
22 for both accounting and rate-making purposes and that the aggregate amount of
23 Lease payments will be accounted for by the Company as an operating and
24 maintenance expense.

25 IT IS FURTHER ORDERED that all profit from the sale of the Unit 2
26 Facilities (less associated income tax) should be amortized over the initial
27 term of the lease as a credit against such lease expense.

28 IT IS FURTHER ORDERED that Arizona Public Service Company shall treat any

1 tax credits generated by the sale of the Unit 2 Facilities and retained by the
2 Company as an offset (deduction) against its "fair value" rate base, subject to
3 rateable restoration over a 35 year period.

4 IT IS FURTHER ORDERED that approval of the requested Lease Transactions as
5 set forth in the Application and authorized hereinabove does not constitute or
6 imply approval or disapproval by the Commission of any particular expenditure
7 for purposes of establishing just and reasonable rates.

8 IT IS FURTHER ORDERED that Arizona Public Service Company shall file a
9 Plan of Disposition with the Commission within thirty (30) days of the entry of
10 this Decision, which Plan shall indicate the use to be made of the proceeds
11 derived from the transactions authorized herein over the succeeding twelve (12)
12 month period.

13 IT IS FURTHER ORDERED that Arizona Public Service Company shall thereafter
14 annually update such Plan and shall keep the Commission informed of any
15 material change in said Plan.

16 IT IS FURTHER ORDERED that the purposes for which the proposed Lease
17 Transactions are herein authorized are to redeem, retire, or refund outstanding
18 long-term debt and/or preferred stock that previously financed construction
19 projects and, if necessary, to satisfy certain of the Company's working capital
20 and other cash requirements, including the financing of Arizona Public Service
21 Company's ongoing construction program, regardless of the extent to which such
22 purposes may be reasonably chargeable to operative expenses or income.

23 IT IS FURTHER ORDERED that the purpose for which the proposed issuance,
24 assumption, guarantee, or incurrence of evidences of indebtedness in connection
25 with the Lease Transactions is herein authorized is to allow Arizona Public
26 Service Company to perform its obligations and/or exercise its options under
27 the Lease Transactions, which purpose is hereby specifically authorized
28 regardless of the extent to which it may be reasonably chargeable to operative

1 expenses or to income.

2 IT IS FURTHER ORDERED that the terms of the Leases and other documents to
3 be entered into in connection with the Lease Transactions are hereby approved
4 for the specific purpose of enabling each of the Equity Investors and the
5 Lessors to qualify for an exemption by the Securities and Exchange Commission
6 from the Public Utility Holding Company Act of 1935, as amended.

7 IT IS FURTHER ORDERED that Arizona Public Service Company's assumption,
8 guarantee, and incurrence of evidences of indebtedness as herein authorized
9 shall be separate and apart from, and not counted against, Arizona Public
10 Service Company's existing Debt limitation, or against such limitation as it
11 may be hereafter modified by the Commission, that limitation presently being
12 \$2,698,917,000, as approved in the Commission's Order in Decision No. 55017
13 (May 6, 1986).

14 IT IS FURTHER ORDERED that the Commission hereby declares that the Lease
15 Transactions will not cause any of the Equity Investors or the Lessors to be
16 deemed to be a "public service corporation" subject to the jurisdiction,
17 control, or regulation of the Commission under current provisions of Article XV
18 of the Arizona Constitution.

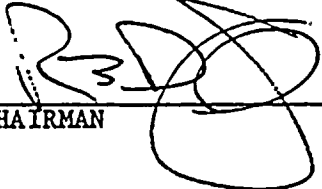
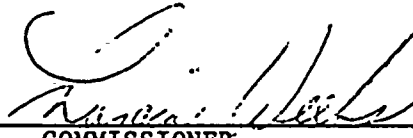

19 IT IS FURTHER ORDERED that Arizona Public Service Company shall file with
20 the Commission any and all documents executed pursuant to the authorizations
21 granted hereinabove (including amendments to such documents executed subsequent
22 to closing) within five (5) business days of their execution, or with regard to
23 those documents executed prior to the effective date of this Decision, within
24 five (5) business days of such date.

25 IT IS FURTHER ORDERED that Arizona Public Service Company shall notify the
26 Commission of any material changes in the terms and conditions of the sale and
27 leaseback transaction authorized hereinabove as soon as is reasonably possible,
28

1 but in any event, at least five (5) business days prior to the closing date.

2 IT IS FURTHER ORDERED that this Decision shall become effective
3 immediately.

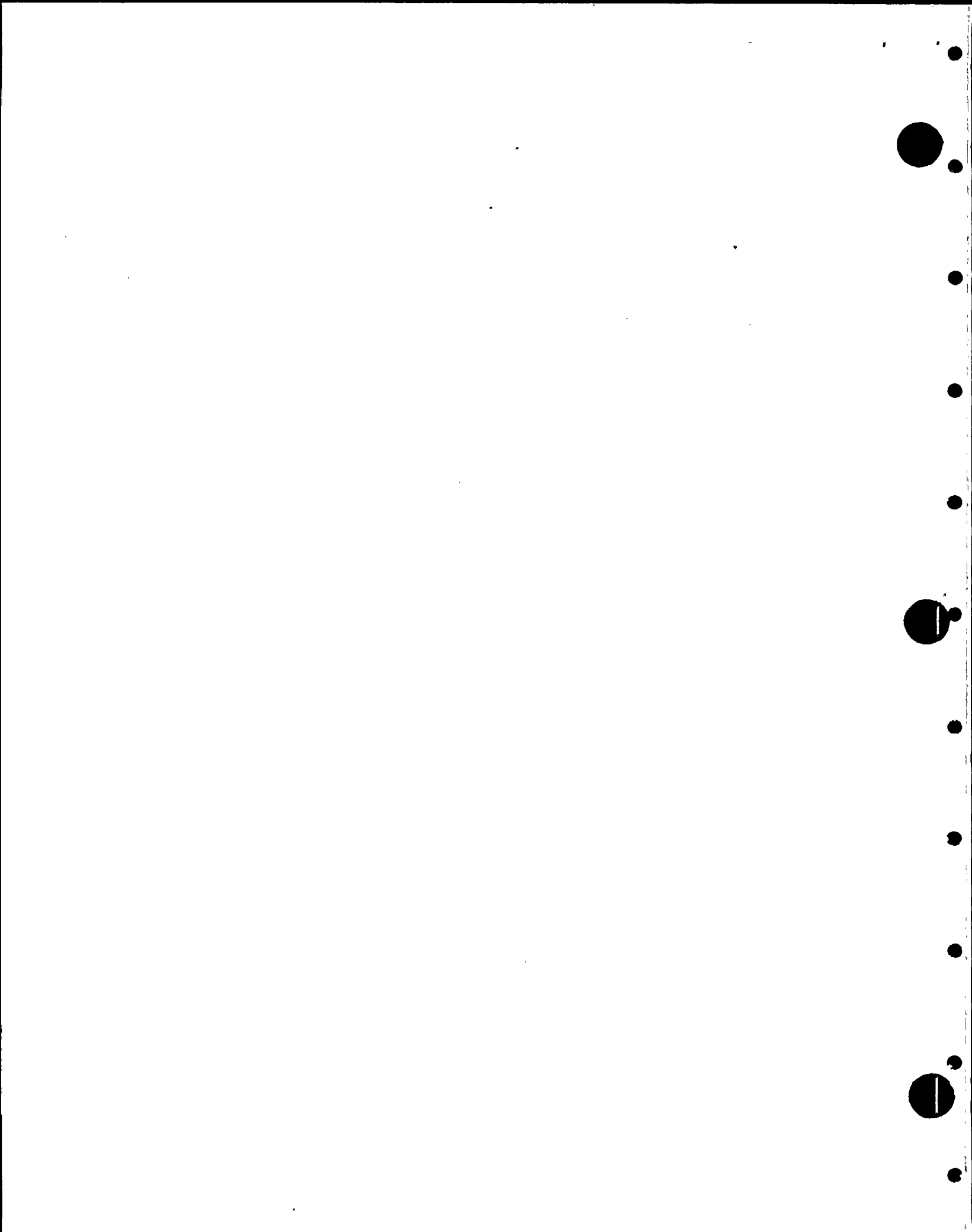
4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

5   
6 CHAIRMAN COMMISSIONER COMMISSIONER

7 IN WITNESS WHEREOF, I, JAMES MATTHEWS,
8 Executive Secretary of the Arizona
9 Corporation Commission, have hereunto set my
10 hand and caused the official seal of this
11 Commission to be affixed at the Capitol, in
12 the City of Phoenix, this 24 day
13 of July, 1986.

14 
15 JAMES MATTHEWS
16 Executive Secretary

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UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

In the matter of)

ARIZONA PUBLIC SERVICE)
COMPANY, et al.,)

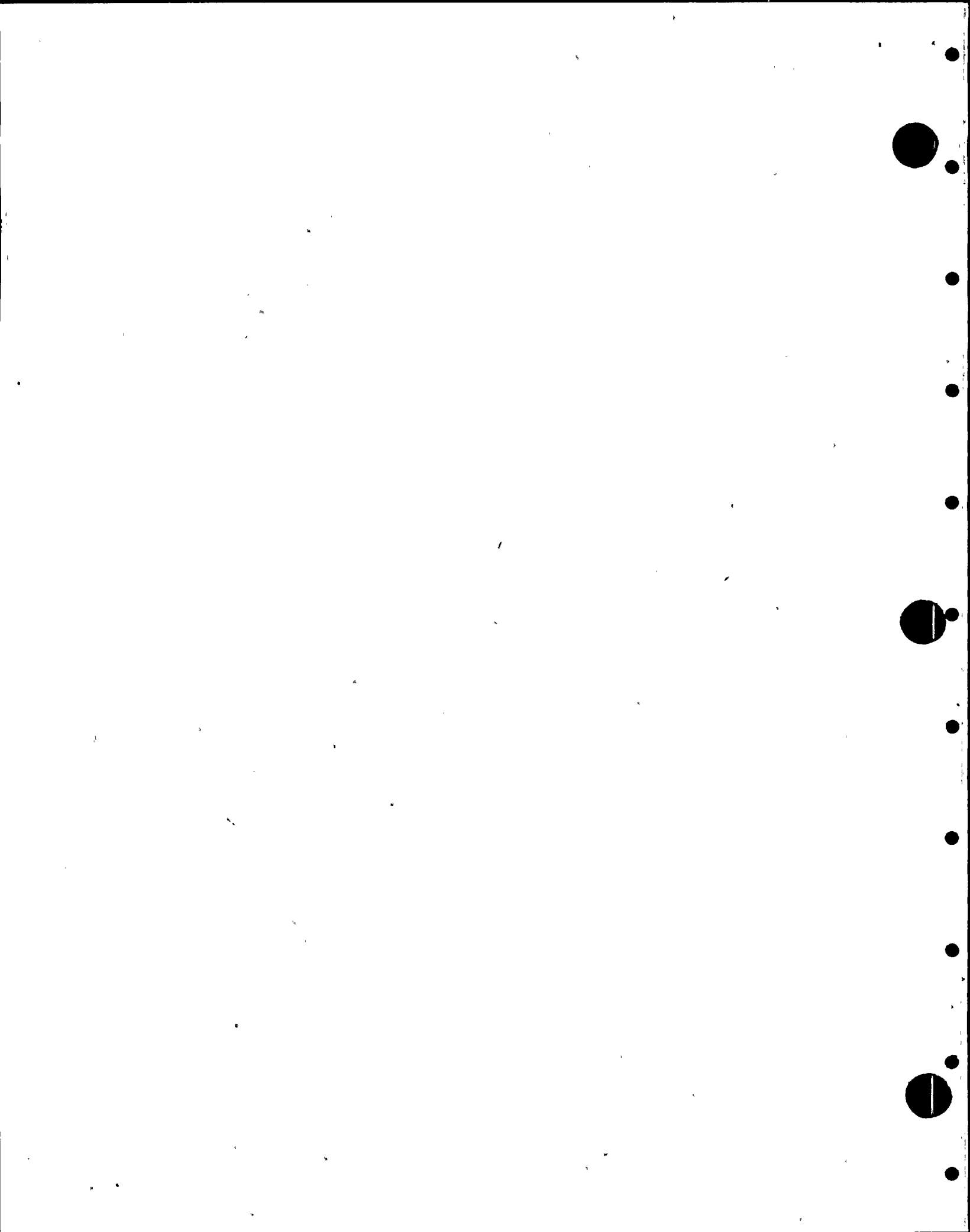
(Palo Verde Nuclear)
Generating Station, Unit 2))

DOCKET NO. STN 50-529

APPLICATION IN RESPECT OF
SALE AND LEASEBACK TRANSACTIONS BY
ARIZONA PUBLIC SERVICE COMPANY

ITEM 5

APPLICATION OF PVNGS FUNDING CORPORATION



SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

Application for an Order Under
Section 6(c) of the Investment Company
Act of 1940 Exempting PVNGS Funding Corp., Inc.
from all Provisions of such Act

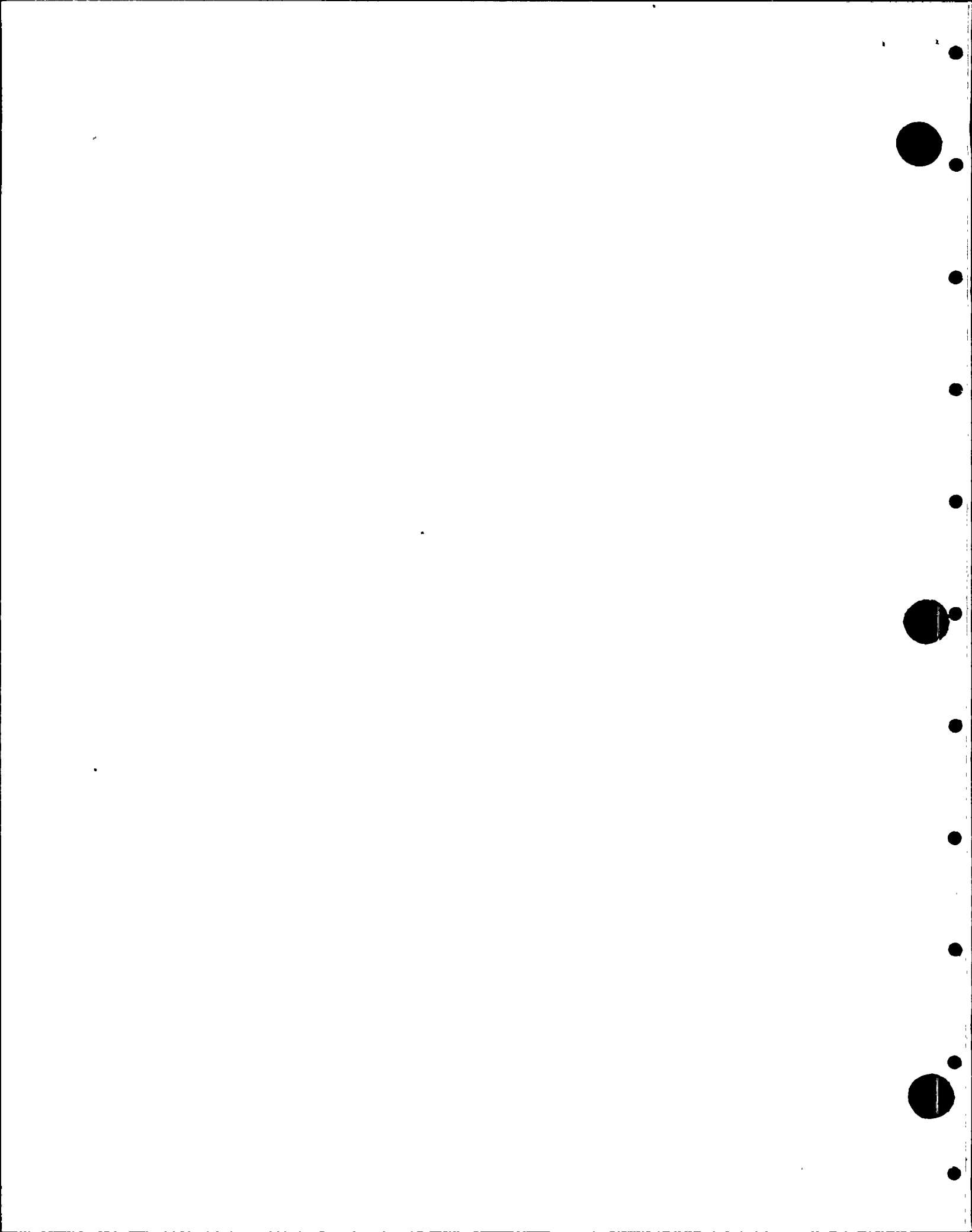
PVNGS Funding Corp., Inc.
(Name of Applicant)

1209 Orange Street
Wilmington, Delaware 19801
(Address of Principal Office of Applicant)

May 13, 1986

Please send copies of all communications to:

Teresa Davidson
Snell & Wilmer
3100 Valley Bank Center
Phoenix, Arizona 85073
(602) 257-7290



UNITED STATES OF AMERICA

Before the Securities and Exchange Commission

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In the Matter of)	Application for an Order
)	Pursuant to Section 6(c)
PVNGS Funding)	of the Investment Company
Corp., Inc.)	Act of 1940 Exempting
)	Applicant from All Pro-
)	visions of the Act
-----)	

The undersigned applicant, PVNGS Funding Corp., Inc. (the "Applicant"), hereby applies, pursuant to Section 6(c) of the Investment Company Act of 1940 (the "Act"), for an Order unconditionally exempting it from each and every provision of the Act on the ground that such exemption is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. No form having been specifically prescribed for this Application, the Applicant proceeds under Rule 0-2 of the General Rules and Regulations of the Securities and Exchange Commission (the "Commission") under the Act and pursuant to Release No. IC-14492, dated April 30, 1985.

I. FACTUAL BASIS OF APPLICATION

The documentation relating to the establishment of the Applicant and the structure and documentation of the transactions for which the Applicant has been formed (as hereinafter described) are not different in any manner material to the Commission's consideration of this Application from those presented to the Commission by First PV Funding Corporation in its application for an exemptive order under Section 6(c) of the Act (Application filed on September 20, 1985 and amended on November 8 and 20, 1985; Notice: Release No. 14833; Order dated December 31, 1985: Release No. 14880). See also the Application of El Paso Funding Corporation for an Order Pursuant to Section 6(c) of the Act filed on April 11, 1986.

First PV Funding Corporation was created for the sole purpose of assisting Public Service Company of New Mexico ("PNM") in financing and refinancing of property through leveraged lease financing transactions in which PNM is the lessee. El Paso Funding Corporation was created for the sole purpose of aiding El Paso Electric Company ("El Paso") in the financing and refinancing of property through leveraged lease

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financing transactions in which El Paso is the lessee. Similarly, the Applicant has been created for the sole purpose of assisting Arizona Public Service Company, an Arizona corporation ("APS"), in the financing and refinancing of property through leveraged lease financing transactions in which APS will be the lessee.

A statement of the facts relied on as a basis for the action of the Commission herein requested is as follows:

A. The Applicant and Summary of Transactions

The Applicant is organized under the laws of the State of Delaware and will have nominal paid-in capital. A copy of its Certificate of Incorporation is included herewith as Exhibit A. The address of the Applicant is Corporation Trust Center, 1209 Orange Street, City of Wilmington, Delaware 19801.

All of the shares of Common Stock, \$1.00 par value, of the Applicant authorized to be issued under the terms of its Certificate of Incorporation will be issued to, and in the future all outstanding shares of such Common Stock are expected to be owned by, The Corporation Trust Company, a Delaware corporation, or a company controlled by it ("CT"). After such issuance, all of the directors and officers of the Applicant are expected to be officers or other employees of CT. The Applicant represents that there has been, and undertakes that in the future there will be, no public offering of the Applicant's Common Stock or of any other equity security of the Applicant. The Applicant represents that there is, and in the future there will be, no class of equity securities of the Applicant authorized other than its Common Stock.

The Applicant has been created for the sole purpose of assisting APS in the refinancing, in whole or in part, of APS's 29.1% undivided ownership interest in the Palo Verde Nuclear Generating Station ("PVNGS"). PVNGS consists primarily of three 1,270 megawatt electric generating units, each containing a pressurized water reactor nuclear steam supply system, certain facilities the use of which is common to all three units, certain related transmission facilities, and pipeline, and of which, the latter three components may or may not be included in the refinancing. PVNGS is located approximately 55 miles west of downtown Phoenix, Arizona. APS participates in PVNGS with three other investor-owned utilities -- El Paso (15.8%), Southern California Edison Company (15.8%) and PNM (10.2%) and three public utilities -- Salt River Agricultural Improvement and Power District (17.14%), Southern California Public Power Authority (5.91%), and the Department of Water and Power of the City of Los

Angeles (5.7%). Ownership of PVNGS is governed by the Arizona Nuclear Power Project Participation Agreement, dated August 23, 1973, as amended, among the owners of PVNGS. Under such Project Participation Agreement, APS is authorized to act as agent for the other owners of PVNGS, and has responsibility and control over construction, operation and maintenance of PVNGS.

APS was incorporated in 1920 under the laws of Arizona and is engaged principally in providing electricity in all or a part of the 11 of the 15 counties of the State of Arizona. APS is subject to, and during the preceding 12 months has filed all documents required to be filed pursuant to, the reporting requirements of Section 13 of the Securities Exchange Act of 1934 (the "1934 Act") (See Commission File Number 1-4473), and has securities registered under Sections 12(b) and 12(g) of the 1934 Act.

The Applicant will assist APS' financing and refinancing of APS' ownership interest in PVNGS by participating as lender in one or more leveraged lease transactions to be selected by APS in which APS is lessee (in such capacity, the "Lessee"). APS will make an initial determination as to whether or not the financing or refinancing of any unit of PVNGS will be accomplished in whole or in part through one or more leveraged lease financing transactions and whether or not the debt portion of such transaction will be funded through the Applicant's sale of one or more series of its debt securities ("Debt Securities"). With respect to PVNGS Unit 2, APS has determined to utilize such transactions and so to use the Applicant. Because significant capital improvements (additions, betterments, enlargements of property in place, and replacements of such property with other property) will be required to be installed at PVNGS from time to time, each leveraged lease financing transaction may also provide for the financing thereunder (via lease supplements) of capital improvements relating to property subject to such transaction. Such leveraged lease financing transactions, including any applicable supplemental financings, are hereinafter individually called a "Lease" and collectively the "Leases."

The participation of the Applicant as lender in the Leases will be limited to making loans to the lessors under such Leases which will be repayable from rentals and other payments by the Lessee pursuant to such Leases. It is expected that such lessors (the "Lessors") will be grantor trusts formed exclusively for the purpose of the lease financing. The beneficiary of such a grantor trust may be an institutional or other investor or a direct or indirect subsidiary of APS. The loans to be made by the Applicant will

be without recourse to the general credit of the Lessors or their respective beneficiaries and will be evidenced by non-recourse obligations of the respective Lessors (the "Lessor Notes") which will be secured as more fully described herein. Each of the Leases will be required to provide for the payment of rentals and other payments by the Lessee in amounts and at times sufficient to provide for the payment and performance of all the obligations of the related Lessor under its Lessor Note. Such obligation of the Lessee will be required to be absolute and unconditional, without right of counterclaim, set off, deduction, or defense. In this regard, the terms of the Lessor Notes, the Leases, and the obligations of the Lessee to make payments under the Leases will be typical of those in customary leveraged lease financing transactions.

Neither APS nor its subsidiaries will have any right by stock ownership, contract, or otherwise to control the management or operation of the Applicant. It is expected, however, that the Applicant will enter into a commitment agreement (the "Commitment Agreement") with APS pursuant to which the Applicant will agree to participate in one or more Leases relating to PVNGS. Such participation will be more specifically identified with respect to each Lease by the terms of a Participation Agreement relating to such Lease in which the Applicant will agree to make loans to the Lessor therein designated. Such loans will have interest rates, maturities, sinking fund provisions, and other terms as shall be approved by the Lessee and the Lessor to which the loan is to be made. The obligation of the Applicant to participate in such Leases and to make such loans will be subject to certain terms and conditions, including (a) the ability of the Applicant to issue Debt Securities on such terms and conditions as shall, in the opinion of the Applicant after consultation with its financial advisor, permit the Applicant to make such loans on a financially prudent basis, (b) the execution and delivery by each Lessor to which a loan is to be made of a Lease Indenture (as defined below) or Lease Indenture supplement and one or more related Lessor Notes, (c) the receipt by the trustee ("Trustee") under the Collateral Trust Indenture (as defined below) of the original Lessor Note and copies of the agreements relating thereto, (d) the receipt by the trustee under the Lease Indenture of the original executed counterpart of the related Lease or Lease supplement, (e) the receipt by the Applicant of opinions of counsel for the Lessee, the related Lessor and/or its beneficiaries with respect to, among other things, the due authorization, execution, delivery, and binding effect of agreements and documents and the priority of the assignment of rentals under the Lease Indenture and (f) such other matters as the Applicant may reasonably request.

The Applicant intends to acquire the funds necessary for the purchase of the Lessor Notes through the issuance of its Debt Securities which may or may not be secured on a parity basis by a first lien on, and security interest in, all of the assets of the Applicant, consisting primarily of the Lessor Notes so acquired and theretofore acquired (if so secured, the Debt Securities may be referred to as "Lease Obligation Bonds"). Lessor Notes acquired and held by the Applicant may include only Lessor Notes issued in connection with any Leases to which APS is a party, as lessee, in connection with its ownership interest in PVNGS.

B. The Leases

It is expected that the Lessor in each of the Leases will be a bank or trust company acting as trustee for one or more beneficiaries pursuant to a trust agreement (a "Trust Agreement") entered into exclusively for the purpose of the particular lease financing. A portion of the purchase price of the property owned by the Lessor and leased to the Lessee pursuant to a Lease will be paid by the beneficiaries of the grantor trust that acts as Lessor as the beneficiaries' equity investment in the property. The balance of the purchase price of such property will be borrowed from the Applicant by the Lessor, which borrowings will be evidenced by one or more Lessor Notes issued by such Lessor pursuant to either a loan and security agreement ("Loan and Security Agreement") or a trust indenture and security agreement ("Trust Indenture and Security Agreement") (in either case a "Lease Indenture"). It is expected that the Lessor Notes will be issued under circumstances making such transactions exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). The Applicant will receive assurances from each Lessor and each beneficiary thereof that at the time the Applicant acquires Lessor Notes issued by such Lessor and so long as the Lessor Notes issued by such Lessor are outstanding (a) neither such Lessor nor any beneficiary thereof is or will be an investment company within the meaning of Section 3(a) of the Act or (b) such Lessor and any beneficiary thereof are and will be deemed to be excluded from the definition of an investment company by virtue of the provisions of Section 3(b) or Section 3(c) of the Act.

Each Lease will provide for the payment of rentals and other payments by the Lessee in amounts and at times sufficient to provide for the payment and performance of all of the obligations of the related Lessor under its Lessor Note or Notes and its Lease Indenture. Each Lease will be a net lease and the obligations and liabilities of the Lessee thereunder will be required to be absolute and unconditional without any right of counterclaim, setoff, deduction, or

defense on the part of the Lessee. Each Lease will include, without limitation, as events of default (a) failure by the Lessee to make payments customarily referred to as basic rent, stipulated loss value, or casualty value that are intended to be the source of payment of the related Lessor Notes, (b) failure by the Lessee to make payments customarily referred to as supplemental rent or other payments thereunder, and (c) certain bankruptcy-related events involving the Lessee.

Under each Lease, the Lessee will be obligated to make rental payments sufficient to pay the principal of, the premium, if any, and the interest on the Lessor Notes issued in connection therewith and such rental payments are also anticipated to provide an investment return to the beneficiaries of the Lessor which provide equity financing for the property that is the subject of such Lease.

C. The Lease Indentures and the Lessor Notes

Lessor Notes will be issued by the applicable Lessor under and pursuant to the terms of separate but substantially identical Lease Indentures with the Applicant being the secured party thereunder if such Lease Indentures are Loan and Security Agreements or with a bank or trust company acting as trustee for the holder of the Lessor Notes issued thereunder if such Lease Indentures are Trust Indentures and Security Agreements. Each Lease Indenture will require the Lessor to grant to the Applicant or the trustee under the Lease Indenture, as the case may be, an assignment of rents, including basic rentals and certain other payments, to be made by the Lessee under the applicable Lease. The Applicant or the trustee under the Lease Indenture may have a lien on or security interest in the property which is the subject of the Lease (the "Leased Property"). In the event that no such lien or security interest is created or granted the Lessor will covenant that, so long as any Lessor Note is outstanding, it will not create or permit the creation of a lien on or otherwise encumber its interest in the Leased Property (except for certain permitted encumbrances). The Applicant will be precluded from purchasing any Lessor Note unless (i) such Lessor Note is issued in respect of Leased Property having a fair market sales value at the time of purchase at least equal to 110% of the original principal amount of such Lessor Note or (ii) such Lessor Note and all other Lessor Notes (if any) of the relevant Lessor are issued in respect of Leased Property having an aggregate fair market value (measured, in each case, as of the date such Leased Property was first financed under the Lease) at least equal to 110% of the original principal amount of such Lessor Note and such other Lessor Notes. For example, if the initial financing

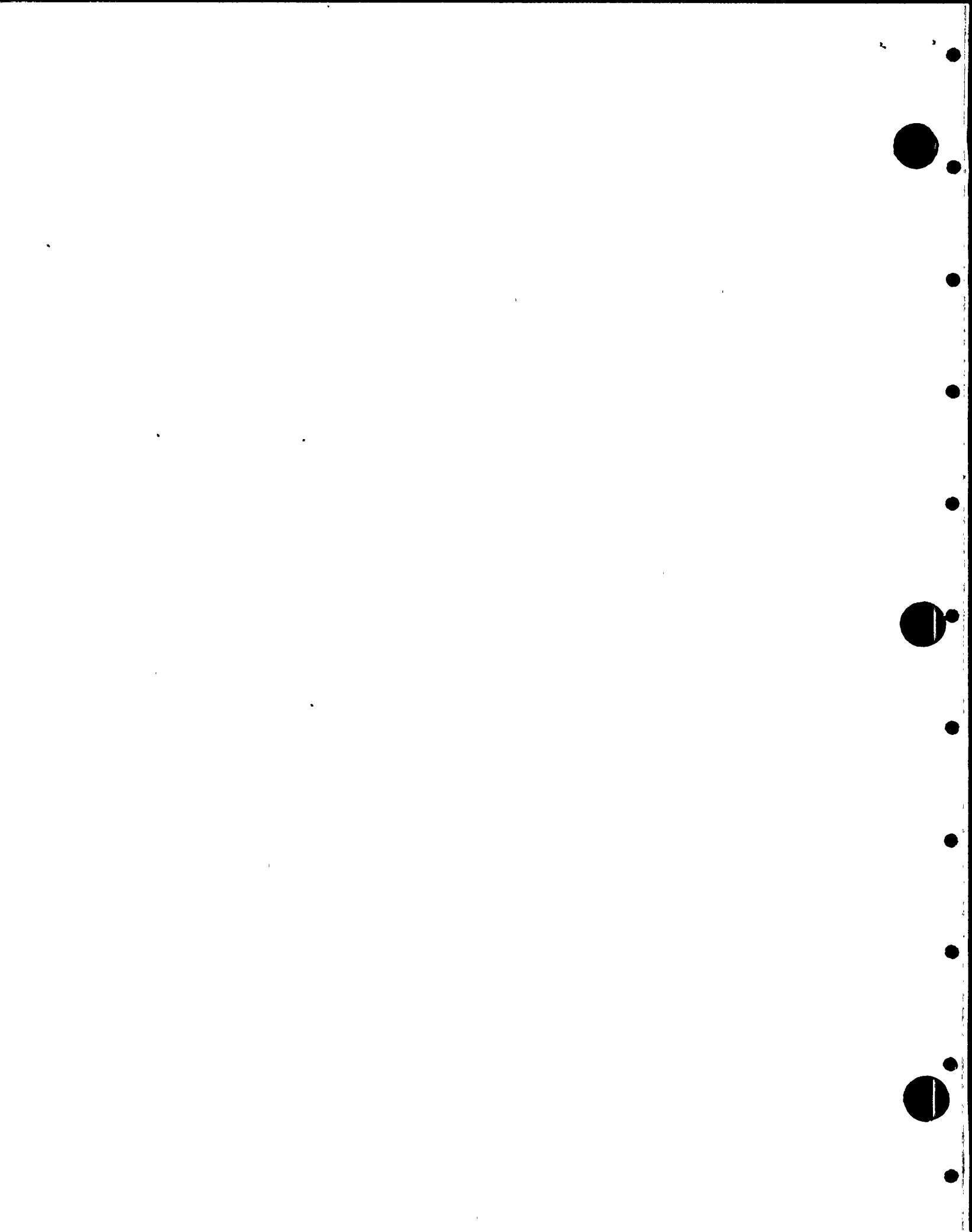


under a particular Lease involved \$100 million of Leased Property and the issuance of \$85 million in Lessor Notes (117.6% coverage of the Lessor Notes by Leased Property) and one year later \$10 million in capital improvements were to be financed under such Lease, the entire \$10 million could be financed with Lessor Notes and Debt Securities in accordance with clause (ii) of the preceding sentence because the resulting percentage overall would be 115.8% (\$95 million in Lessor Notes secured by \$110 million in Leased Property). Each Lease Indenture will include as events of default, without limitation, payment defaults on the Lessor Notes issued thereunder and events of default under the related Lease.

The aggregate of the principal amount of all Lessor Notes issued pursuant to all Lease Indentures will be required to be equal to the sum of the aggregate principal amount of the related Debt Securities issued to fund the loans evidenced by such Lessor Notes. The interest payable with respect to each Lessor Note will be the related Lessor's share of the Applicant's "Cost of Money" as of any interest payment date for such Lessor Note. The Applicant's "Cost of Money" in respect of any period will be equal to the total interest and other costs and expenses which the Applicant has incurred or accrued with respect to the Debt Securities and its obligations incurred in the performance of its agreements under the Lease Indenture, reduced by any income which it has received or expects to receive on or prior to the next succeeding payment on the Debt Securities and not expended as of such date resulting from the temporary investment of payments made in respect of Lessor Notes prior to the date on which payments are required in respect of Debt Securities.

The Lessor Notes and the Lease Indentures will provide that, upon the occurrence of certain casualty events, termination events, deemed loss events, and special loss events, either (i) APS shall assume the obligations represented by the Lessor Notes or (ii) APS shall purchase from the beneficiaries the beneficial interest in the trusts created by the Trust Agreements and the Lessors will grant a lien and security interest in the Leased Property to the Applicant (if the Lease Indentures are Loan and Security Agreements) or the trustee under the Lease Indentures (if the Lease Indentures are Trust Indentures and Security Agreements) to secure the Lessor Notes. The assumption or purchase described in the preceding sentence will be in partial satisfaction of APS' obligation to make payments required of it upon early termination of the Leases in consequence of any such event.

In the event that the Lessor issuing a Lessor Note does not grant a lien on or security interest in the property

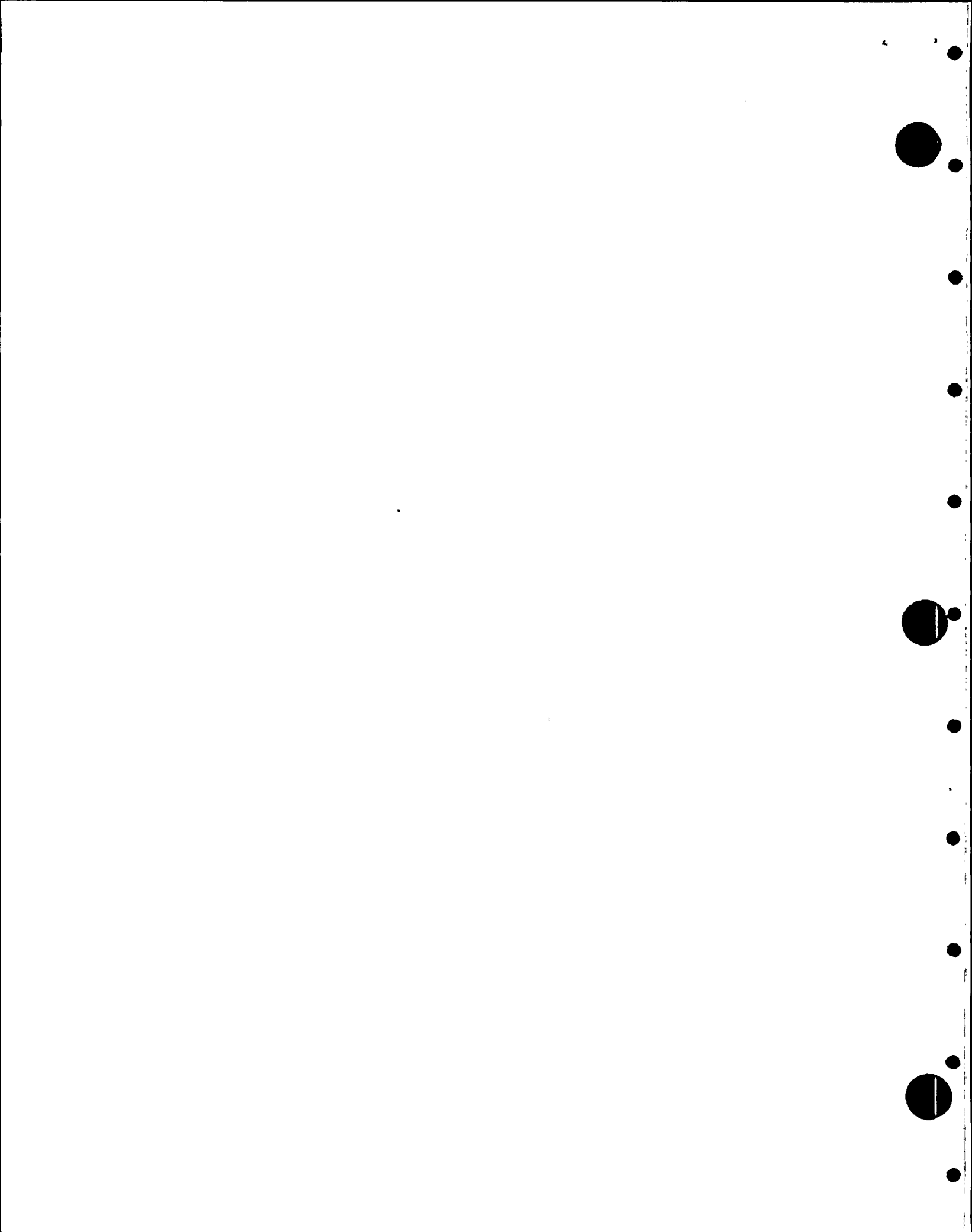


purchased with the proceeds of such Note, the Lessor will covenant that (i) it will not incur any other debt not constituting Lessor Notes or otherwise in connection with the Leased Property and (ii) except for certain limited permitted liens, it will not create any lien on or security interest in such property. These two covenants, taken together, will insure that, upon a default by the Lessor on its Lessor Note, the Leased Property will be available to satisfy the claims of the Collateral Trust Trustee as pledgee of the Lessor Notes. The most significant difference under this structure is that, in order to receive the value of the Leased Property, the Collateral Trust Trustee would first have to cause the obligation on the Lessor Notes to be reduced to judgment and thereafter seek execution of such judgment, rather than proceeding directly against the Leased Property.

D. Debt Securities

The various series of Debt Securities will have terms which may differ as to maturity dates, interest rates, sinking fund obligations of the Applicant, the right of the Applicant to redeem such Debt Securities, and other matters. Such Debt Securities, which may include commercial paper and intermediate-term and long-term obligations, may be issued in the private or public markets in the United States, and in offerings outside the United States under circumstances reasonably designed to assure that such Debt Securities are not offered or sold to citizens and/or residents of the United States. Individual series of Debt Securities may be supported by bank letters of credit, bank lines of credit, bonds of insurance or other credit or liquidity support facilities. The terms and manner of offering of Debt Securities of a particular series will be determined by prevailing market conditions. The terms of the Lessor Notes held or to be acquired by the Applicant with the proceeds of such Debt Securities will reflect the terms of such Debt Securities, although there will be no requirement that the scheduled payment dates on the Debt Securities match the payment dates on the Lessor Notes. In addition, the Applicant may engage in interest rate swaps with respect to one or more series or maturities of Debt Securities.

All Debt Securities will be issued under a common indenture and a separate supplemental indenture for each series (other than the initial series) (collectively called the "Collateral Trust Indenture") which will establish the terms of the Debt Securities of that series. It is expected that the trustee under the Collateral Trust Indenture (hereinafter called the "Trustee") will be a bank or trust company not affiliated with any of the Lessor and will not be a trustee under any indenture of APS or its subsidiaries. All series of Debt Securities of the Applicant will be issued under the Collateral Trust Indenture and will be *pari passu*. If the registration requirements of the Securities Act are



applicable to a particular issuance of Debt Securities, APS will file a registration statement under the Securities Act covering such Debt Securities.

The Applicant proposes that the initial issuance of Debt Securities will be through an underwritten public offering or private placement of one or more series having an aggregate principal amount of approximately \$1.1 billion (assuming a total sales price for APS' 29.1% interest in PVNGS Unit 2 and the common facilities of \$1.3 billion, however, such amount may vary according to market conditions). The initial series of Debt Securities may be registered under the Securities Act, and it is expected that the Collateral Trust Indenture will be qualified under the Trust Indenture Act of 1939, as amended (the "1939 Act"). Although APS will not be the actual obligor of the Debt Securities, it will be considered the issuer thereof for purposes of the Securities Act and the obligor with respect thereto for purposes of the 1939 Act. Any registration statement filed under the Securities Act relating to the Debt Securities will name APS as the sole registrant and will be signed on behalf of APS, as the sole registrant, by such officers and directors of APS as may be required under the Securities Act and the rules, regulations and forms of the Commission thereunder, all in accordance with such practice and procedures as the Commission shall from time to time require or permit. The net proceeds to the Applicant from the initial issuance of Debt Securities will be used by the Applicant principally to purchase Lessor Notes issued by the Lessors in connection with the currently contemplated leveraged lease financings of PVNGS Unit 2.

The Applicant may seek approval for the listing of one or more series of Debt Securities on one or more national securities exchanges if the Applicant and such series of Debt Securities meet the requirements of such an exchange for the listing of securities thereon. In connection with any such listing, such series of Debt Securities will be registered with the Commission pursuant to Section 12 of the 1934 Act.

As security for the due and punctual payment of the principal of, premium, if any, and interest on all Debt Securities, the Applicant will assign and pledge to the Trustee under the Collateral Trust Indenture, as security for the equal and ratable benefit of the holders from time to time of all Debt Securities, the Lessor Notes and any other assets held by the Applicant. Each such Lessor Note will in turn be secured by a security interest in the related Lease and an assignment of rentals arising under the related Lease and may be secured by the Leased Property thereunder.

Except to the extent payable from the proceeds of refunding Debt Securities, the proceeds of Temporary Holdings (defined below) or the proceeds of the initial issuance of Debt Securities where the relevant closing date for a leveraged lease financing transaction (the "Lease Closing Date") does not occur as described below, due to the nonrecourse nature of the Lessor Notes and the limited scope of the Applicant's activities, payment of the principal of, premium, if any, and interest on the Debt Securities will be made exclusively from amounts paid by the Lessee under the Leases.

The interest rates, maturities, principal amounts, and other terms of each series of Debt Securities will be established on the basis of prevailing market conditions and the Applicant expects to have the flexibility to take advantage of changing market conditions by issuing Debt Securities from time to time in such markets and on such terms as are required under the terms of the Commitment Agreement and are, in the judgment of the Applicant, after consultation with its financial advisor, financially prudent to the Applicant. Furthermore, as mentioned above, there will be no requirement that the payment dates on the Debt Securities correspond exactly to the scheduled payment dates on the Lessor Notes. As a consequence, the cash flow of the Applicant derived from payments of principal of and premium, if any, and interest on the Lessor Notes may from time to time exceed the cash requirements of the Applicant at such times for the payment of principal of, premium, if any, and interest on the Debt Securities. Until such funds ("Temporary Funds") are required by the Applicant for the payment of principal of, premium, if any, and interest on the Debt Securities, the Applicant will be permitted to invest Temporary Funds in permitted investments ("Permitted Investments") (the investment of Temporary Funds in Permitted Investments resulting in "Temporary Holdings"), in each case maturing at such times as are required to pay the Applicant's obligations under the Debt Securities, after taking into account the then scheduled payments under the Lessor Notes. Permitted Investments will be defined under the Collateral Trust Indenture as follows:

(i) direct obligations of the United States of America, or (ii) obligations fully guaranteed by the United States of America, or (iii) certificates of deposit issued by, or bankers' acceptances of, or time deposits with, any bank, trust company or national banking association incorporated or doing business under the laws of the United States of America or one of the States thereof (but not exceeding \$15,000,000 in principal amount

or in deposits at any given time for any one bank, trust company or national banking association) having a combined capital and surplus of at least \$300,000,000 (including the Trustee, a trustee under any Lease Indenture, a Lessor and any paying agent if such conditions are met), or (iv) commercial paper of companies incorporated or doing business under the laws of the United States of America or one of the States thereof (but not exceeding \$15,000,000 in principal amount at any given time for any one company) and in each case having a rating assigned to such commercial paper by Standard & Poor's Corporation or Moody's Investors Service, Inc. (or, if neither such organization shall rate such commercial paper at any time, by any nationally recognized rating organization in the United States of America) equal to the highest rating assigned by such organization, or (v) repurchase agreements fully collateralized by an obligation of the type described in clauses (i) through (iv) above, pursuant to which a bank, trust company or national banking association referred to in clause (iii) above or another financial institution having a net worth of at least \$200,000,000 is obligated to repurchase any such obligation not later than 90 days after the purchase of any such obligation.

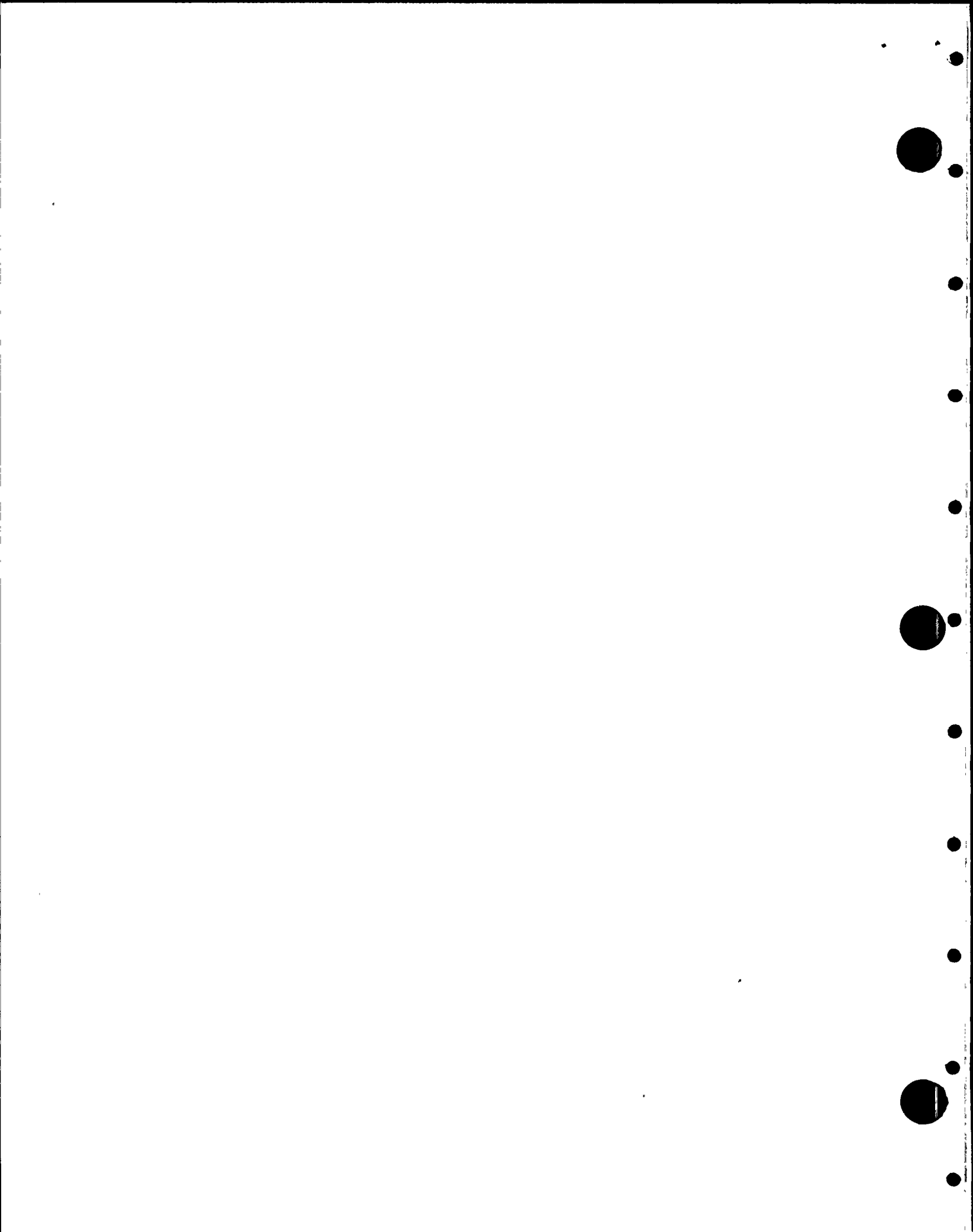
Temporary Funds of the Applicant may also be used to acquire all or a portion of the Debt Securities of any series in order to meet required sinking fund redemptions. During any fiscal year of the Applicant, the average of the daily balance of the amount of the Temporary Holdings plus the amount of Temporary Funds will not exceed ten percent of the average of the daily balance of the aggregate principal amount of the Debt Securities outstanding during such fiscal year. Temporary Funds and Temporary Holdings arising in connection with the issuance of Debt Securities prior to the acquisition of the related Lessor Notes as described in the preceding paragraph are to be disregarded for purposes of this ten percent limitation.

In order to provide flexibility so that the Applicant may be able to take advantage of market conditions without being tied to a particular Lease Closing Date, it is

proposed that the issue, sale and delivery of a particular series of Debt Securities may take place up to two months prior to the Lease Closing Date applicable to the property being financed with the proceeds thereof. Pending the Lease Closing Date, the net proceeds from sale of the Debt Securities would be held by the Trustee pursuant to the terms of the Collateral Trust Indenture, which would permit the investment of such proceeds in Temporary Holdings.

If Debt Securities have been sold in advance of the Lease Closing Date for the property financed thereby, then, pending the Lease Closing Date, such Debt Securities, and any other Debt Securities theretofore issued, will be secured by (i) the proceeds of the sale of such Debt Securities, (ii) Temporary Holdings and Temporary Funds, if any, (iii) Lessor Notes previously pledged to the Trustee under the Collateral Trust Indenture and (iv) with respect to the new series of Debt Securities only, an obligation of the Lessee which will expire on the related Lease Closing Date and which will provide for the payment of amounts sufficient for the payment of such series of Debt Securities. On the applicable Lease Closing Date, APS will pay to the Trustee an amount equal to the difference between (i) the interest accrued on the new series of Debt Securities from the date of issuance to such Lease Closing Date and (ii) the income derived from Temporary Holdings, if any, through such Lease Closing Date. In the event that the Lease Closing Date does not occur by the date which is two months from issuance of such new series of Debt Securities, APS may at any time (but must by the date which is three months after the expiration of such two month period) cause (and, if necessary, provide funds necessary for) the redemption of all Debt Securities of such series only.

On each Lease Closing Date, pursuant to a supplement to the Collateral Trust Indenture (Indenture Supplement), the Lessor Notes issued on such date will be subjected to the lien of the Collateral Trust Indenture (securing all outstanding Debt Securities, including the new series) and will serve as the basis for the release from such lien of the net cash proceeds held by the Trustee under the Collateral Trust Indenture which are necessary to purchase such Lessor Notes. The Indenture Supplement and the mechanics of this release will be in accordance with the 1939 Act and the terms of the Collateral Trust Indenture (which will have been qualified under such Act).



E. Interrelation of the Lease Indentures and the Collateral Trust Indenture for the Protection of Holders of Debt Securities.

On each Lease Closing Date, the Lessor Notes will be pledged and assigned directly to the Trustee who will hold the Lessor Notes under the terms of the Collateral Trust Indenture as security for the Debt Securities. As a holder of the Lessor Notes, the Trustee will have the right to exercise any voting powers and give consents and waivers in respect of such Lessor Notes and the Lease Indentures under which such Lessor Notes are issued and to exercise the rights and remedies afforded a holder of such Lessor Notes under the respective Lease Indentures, including the right to exercise remedies under the Leases and with respect to the Lease rentals and other payments in lieu thereof securing such Lessor Notes, provided such Leases are then in default.

To the extent that the Trustee under the Collateral Trust Indenture has the right to exercise any voting powers in respect of the Lessor Notes, to give any consents or waivers with respect thereto, or to exercise any rights or remedies in respect thereof, the Trustee will be obligated to give immediate notice of such fact to the holders of the Debt Securities. The Collateral Trust Indenture under which the Debt Securities will be issued will authorize the holders of Debt Securities to direct by notice to the Trustee within a specific period of time that it take any action or cast any vote in its capacity as the holder of the Lessor Notes. As a result of this pass-through voting mechanism, the rights and remedies of the holders of the Lessor Notes will be exercisable directly by the holders of Debt Securities through their fiduciary, the Trustee. The principal amount of the Lessor Notes directing any action or being voted for or against any proposal will be the principal amount of the Debt Securities taking the corresponding position. To the extent that the Trustee has not received any such instructions it would be required to take such action with respect to the Lessor Notes as a prudent man would take in respect of his own property.

Thus, if APS were to default in the payment of rent (or were otherwise in default under any Lease), the Applicant (if the Lease Indenture was a Loan Agreement and Security Agreement) or the trustee (if the Lease Indenture was a Trust Indenture and Security Agreement) under the related Lease Indenture would have the right, and, upon the direction of a majority in principal amount of the Lessor Notes relating to such Lease (which by virtue of the pass-through voting mechanism, would be a majority of the principal amount of the Debt Securities), would be required to declare all of such Lessor Notes to be due and payable and to exercise the remedies

available under such Lease Indenture. These remedies include the right to demand after a specified grace period that APS pay all unpaid basic rent plus a stipulated amount which, in all cases, will be sufficient to pay the principal of, premium, if any, and interest on all such Lessor Notes. To the extent that the Trustee has not received any such instructions in the event of a default in payment under any Lease, it would be required to cause such action to be taken by the Applicant or the trustee under the Lease Indenture with respect to assigned rentals and other assigned payments under such Lease as a prudent man would take in respect of his own property. The amounts payable by APS under the Leases, at least to the extent of the amount of the principal of, interest and premium, if any, on the related Lessor Notes, will be required to be paid directly to the Trustee for distribution to the holders of Debt Securities.

The holders of Debt Securities would therefore have access under the Collateral Trust Indenture and the Lease Indentures to the credit of APS. In addition, by exercising such rights, holders of Debt Securities would be entitled to realize on the security afforded by the assignment of rentals up to the aggregate unpaid amount of the relevant Lessor Notes secured by such assignment of rentals, free of any rights of APS or any creditor thereof.

Based on the foregoing and the other information included in this Application, the Applicant believes that the combination of the Lessor Notes and the Leases ultimately constitutes an obligation of APS with respect to the debt service on the Debt Securities and serves as a functional equivalent of a guaranty by APS. In light of the nature of APS' obligations in this financing and the remedies available to the holders of Debt Securities, it is appropriate to view the Debt Securities as essentially the debt of APS for purposes of the Act.

II. ORDER REQUESTED

The Applicant may be deemed to be an "investment company" as defined in either Section 3(a)(1) or 3(a)(3) of the Act (i) by reason of its proposed acquisition of the Lessor Notes, which will constitute substantially all of its assets and (ii) because the Debt Securities which it intends to offer may be held by more than 100 persons.

The Applicant respectfully requests that the Commission consider this Application and issue an Order pursuant to Section 6(c) of the Act unconditionally exempting it from each and every provision of the Act.

III. REASONS FOR GRANTING THE ORDER REQUESTED

Subsection 6(c) of the Act provides that the Commission upon application may by order conditionally or unconditionally exempt any person from the provisions of the Act if the exemption would be (i) either necessary or appropriate in the public interest; (ii) consistent with the protection of investors; and (iii) consistent with the purposes fairly intended by the policy and provisions of the Act. On the basis of the facts stated in this Application and the reasons set forth below, Applicant believes that the exemption requested in this Application would fulfill each of these three conditions.

Because the Applicant will not be engaged in the business of issuing "redeemable securities", "face-amount certificates of the installment type" or "periodic payment plan certificates" (as such terms are defined in the Act) and will be primarily engaged in purchasing the Lessor Notes which will represent a portion of the sales price of the property leased to the Lessee under the Leases, pursuant to the provisions of Section 3(c)(5) of the Act the Applicant would appear to be excluded from the definition of investment company. The activities of the Applicant are essentially those of a special purpose finance company which will advance funds to, or acquire notes of, the purchasers of property constituting merchandise, or which will purchase or otherwise acquire mortgages and other liens on and interests in real property, which merchandise and real property are to be leased to the Lessee by such purchasers. The Lessor Notes will represent loans to the Lessors, as purchasers, incurred to finance a portion of the purchase price of such property. Notwithstanding the exemption provided by Section 3(c)(5) of the Act, because of the complexity of the structure of the proposed issuance of the Applicant's Debt Securities and in order to eliminate any uncertainty as to the status of the Applicant as an investment company under the Act, it seeks an exemption from all of the provisions of the Act pursuant to Section 6(c) thereof.

The Applicant believes that the response of the Commission to this Application should be governed by the position taken by the Commission on December 31, 1985 (Investment Company Act Release No. 14880) in granting the Order requested in the First PV Funding Corporation Application pursuant to Section 6(c) of the Act.

- A. Order is Necessary or Appropriate in the Public Interest and Consistent with the Purposes Fairly Intended by the Policy and Provisions of the Act

The business in which the Applicant proposes to engage is not of the type intended to be regulated by the Act. The activities of the Applicant are similar to those of certain finance subsidiaries which the Commission has exempted from the Act under Rule 3a-5 promulgated pursuant to the Act. Although the Applicant is not a subsidiary of, or in any way affiliated with, APS or any of its subsidiaries and the Applicant's Debt Securities will not be guaranteed by APS or any of its subsidiaries, as a special purpose corporation engaged only in the business of the issuance of the Debt Securities, the Applicant and its activity come within the general policies expressed in Rule 3a-5. APS is obligated to make payments under the respective "come hell or high water" Leases. Although these Lease obligations are technically not a guarantee of the Debt Securities, the flow-through of such obligations under the related Lessor Notes and ultimately the Debt Securities makes such Lease obligations the functional equivalent of a guaranty by APS. The Leases, pursuant to which rental payments by APS will be applied to payment of the Lessor Notes and ultimately to payment of the Applicant's Debt Securities, provide the mechanism by means of which holders of the Applicant's Debt Securities will look to APS for their assurance of repayment.

The grant to the Applicant of an exemption from all of the provisions of the Act is appropriate in the public interest. Leveraged leases are a widely accepted form of financing designed to provide business, financial, and other benefits to the lessees, lessors, and lenders involved. Such transactions provide companies such as APS with a financially favorable method of acquiring the use of capital assets necessary to conduct their businesses. Heretofore, parties to leveraged lease financings have faced a limited source of debt financing for the purchase of leased property, particularly when the term of the debt is in excess of 20 years. Such financing has been obtainable almost exclusively from the institutional private placement market. As a consequence, lessees, whose rental payments must be sufficient to service the debt incurred by their lessors in connection with such financings, have been generally confined to structuring their financing transactions on the basis of the terms offered by the institutional private placement market. The proposed issuance of the Applicant's Debt Securities would provide a convenient mechanism for APS to obtain the benefits of access to public as well as other segments of the debt capital markets.

B. Order is Consistent with the Protection of Investors

The grant to the Applicant of an exemption from all of the provisions of the Act would also be consistent with the protection of investors and the purposes intended by the policy and provisions of the Act. The Applicant's operations do not lend themselves to the abuses against which the Act was directed--excessive management and brokerage fees, insider loans at highly favorable terms, investments in companies in which the managers of the investment company have a personal interest, pyramiding of control, issuances of new securities, reorganizations, and excessive borrowings in derogation of the rights of holders of existing securities, and operation without adequate assets or reserves. Because all of the securities issued by the Applicant, other than its outstanding Common Stock, will be *pari passu* secured debt securities, none of the inherent conflicts between holders of different classes of securities will exist. The debt securities will not be redeemable at the option of the holder at a price based on the net asset value of the Applicant. Valuation questions and similar problems raised by such redeemable securities will not be present in respect of the Applicant's Debt Securities.

Similarly, the Applicant will not purchase or hold securities of other investment companies so there will be no pyramiding of control of investment companies or other inequitable methods of control. The financial statements of the Applicant will be reported on by independent auditors. In the case of the Applicant's Debt Securities which may be publicly offered in the United States, disclosure with respect to the Applicant, the terms of such securities, the security therefor, and the underlying arrangements with the Lessors and with APS pursuant to the Leases will be made in a prospectus forming part of a registration statement that will have been declared effective under the Securities Act.

By virtue of the Collateral Trust Indenture, the Lease Indentures, the Lessor Notes, and the Leases, the purchasers of the Debt Securities will have access to the credit of APS. As the assignee of rentals and other payments under the Leases as security for payment of the Lessor Notes, the trustees under the Lease Indentures or the Applicant as secured party under the Lease Indentures directly will be entitled to exercise, subject to the provisions of the Lease Indentures, on behalf of and for the benefit of all holders of the Applicant's Debt Securities, all of the rights and remedies against APS provided in the Leases with respect to such assigned payments. The exercise of such rights and remedies will be at the direction of holders of the Debt

Securities through the Trustee's instructions to the trustees under the Lease Indentures or as pledges of the Applicant's interest in the Lease Indentures. Purchasers of the Debt Securities will enjoy comparable assurances that the principal of, premium, if any, and interest on these obligations will be paid when due as purchasers of similar obligations issued directly by APS would have. Because investors will be well protected under the proposed arrangements which are independent of the applicability of the Act, the protection of investors does not require subjecting the Applicant to the Act and, accordingly, it is appropriate for the Applicant to be exempted from the Act.

CONCLUSION

The Applicant's proposed activities are necessary or appropriate in the public interest and are consistent with the protection of investors and the purposes of the Act. Denial of this Application would advance no interests sought to be achieved by the Act.

WHEREFORE, the Applicant requests that the Commission enter an order pursuant to Section 6(c) of the Act unconditionally exempting the Applicant from all of the provisions of the Act.

AUTHORIZATION REQUIRED BY RULE 0-2 UNDER THE ACT

Section 141(a) of the General Corporation Law of the State of Delaware provides in pertinent part that:

"The business and affairs of every Corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may otherwise be provided in this chapter or in its certificate of incorporation."

Section 1 of Article III of the By-Laws of the Applicant provides in pertinent part that:

"The business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors."

The Board of Directors of the Applicant duly adopted on May 13, 1986 the following resolution authorizing the filing of this Application:

"RESOLVED, that the President, any Vice President or the Secretary of the

Corporation and any Assistant Treasurer or Assistant Secretary and each hereby is, authorized to take any action which such officer seems necessary or desirable on behalf of the Corporation in connection with an application to be filed with the Securities and Exchange Commission for an Order under Section 6(c) of the Investment Company Act of 1940 exempting the Corporation from each and every provision of said Act including, without limiting the generality of the foregoing, full power and authority to execute and deliver applications and documents, and any amendments thereto, and to make personal appearance for and on behalf of the Corporation in connection therewith."

The Applicant therefore respectfully submits that all the requirements in Rule 0-2 of the General Rules and Regulations of the Commission under the Act have been complied with and that Secretary of the Applicant, who signed and filed this Application, is duly authorized to do so.

Pursuant to Rule 0-2(g) of the General Rules and Regulations of the Commission under the Act, the Applicant attaches hereto as Exhibit B a proposed Notice of Application For an Order Pursuant to Section 6(c) of the Act Exempting Applicant From All Provisions of the Act.

IV. COMMUNICATIONS

Please direct any questions and send all communications relating to this Application to the following:

Teresa Davidson
Snell & Wilmer
3100 Valley Bank Center
Phoenix, Arizona 85073
(602) 257-7290

Dated: May 13, 1986

PVNGS FUNDING CORP., INC.

By G. M. Horne
Secretary

STATE OF DELAWARE)
) ss.
NEW CASTLE COUNTY)

The undersigned, being duly sworn deposes and says that he has duly executed the attached Application dated May 13, 1986, for and on behalf of PVNGS FUNDING CORP., INC., that he is Secretary of such company; and that all actions by stockholders, directors, and other bodies necessary to authorize deponent to execute and file such instrument has been taken. Deponent further states that he is familiar with such instrument, and the contents thereof, and that the facts set forth therein are true to the best of his knowledge, information, and belief.

G. M. Horne

Subscribed and sworn to before me, a notary public, this 13th day of May, 1986.

Carmel M. Henry
Notary Public

[Notary Seal]

CERTIFICATE OF INCORPORATION
OF
PVNGS FUNDING CORP., INC.

FIRST: The name of the corporation (hereinafter referred to as the Corporation) is:

PVNGS Funding Corp., Inc.

SECOND: The registered office of the Corporation is to be located at Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801. The name of its registered agent at such address is The Corporation Trust Company.

THIRD: The nature of the business or purposes to be conducted or promoted by the Corporation are:

(1) To lend funds on a non-recourse basis to each Owner Trust or corporation acting as lessor on one or more leveraged lease transactions in which Arizona Public Service Company, an Arizona corporation (APS), acts as lessee and which relates to any portion of APS's 29.1% undivided ownership interest in each of three 1,270 megawatt electric generating units, each containing a pressurized water reactor nuclear steam supply system, certain facilities the use of which is common to all such units, and certain related transmission facilities and pipeline, such units, facilities, transmission facilities and pipelines being known variously as Palo Verde Nuclear Generating Station and Arizona Nuclear Power Project in commercial operation or under construction at a site located approximately 55 miles west of downtown Phoenix, Arizona, and to acquire, own, hold, sell, transfer, assign, pledge, finance, exercise any and all rights with respect to and otherwise deal with such loans, including exercising all rights and remedies upon the occurrence of a default with respect to any thereof, such rights and remedies to include the foreclosure upon or other acquisition of the collateral securing such loans.

(2) To authorize, issue, sell and deliver notes, bonds or other evidences of indebtedness (or warrants, options or other rights to purchase any such bonds, notes or other evidences of indebtedness) other than "redeemable securities" (as that term is defined in the Investment Company Act of 1940, as amended) in order to provide funds for the purpose described in clause (1) of this Article THIRD; and

(3) To engage in any activity permitted to corporations under the laws of the State of Delaware, but only to the extent that such activities are incidental to any

of the foregoing or are necessary or convenient for the accomplishment of any of the foregoing.

FOURTH: The total number of shares of stock which the Corporation shall have authority to issue is one thousand (1,000), all or which are to be of \$1 par value per share and of one class, which class is hereby designated as Common Stock.

FIFTH: The name and mailing address of the sole incorporator is J. A. Barbera, 1209 Orange Street, Wilmington, Delaware 19801.

SIXTH: Notwithstanding any other provision of this Certificate and any provision of law that may otherwise so empower the Corporation, the Corporation shall not, without the prior written consent of each trustee from time to time under any indenture pursuant to which the Corporation shall issue and have outstanding notes, bonds or other evidences of indebtedness (which consent must be given in accordance with the terms of the applicable indenture), do any of the following:

(1) Dissolve or liquidate, in whole or in part;

(2) Merge into or consolidate with, or sell all of any part of its assets to, any person, firm, corporation, partnership or other entity unless, in the case of a merger or consolidation, the surviving corporation in such merger or the corporation resulting from such consolidation shall have a certificate of incorporation containing provisions identical to the provisions of Article THIRD and this Article SIXTH and, in the case of a sale of assets, the acquiring corporation shall have assumed all of the liabilities and obligations of the Corporation and shall have a certificate of incorporation containing provisions identical to the provisions of Article THIRD and this Article SIXTH, provided that nothing herein contained shall prevent or restrict in any manner the Corporation from assigning or pledging its assets to secure its outstanding indebtedness;

(3) Declare or pay any dividend on any of the Corporation's stock; or

(4) Amend this Certificate to alter in any manner or to delete Article THIRD or this Article SIXTH.

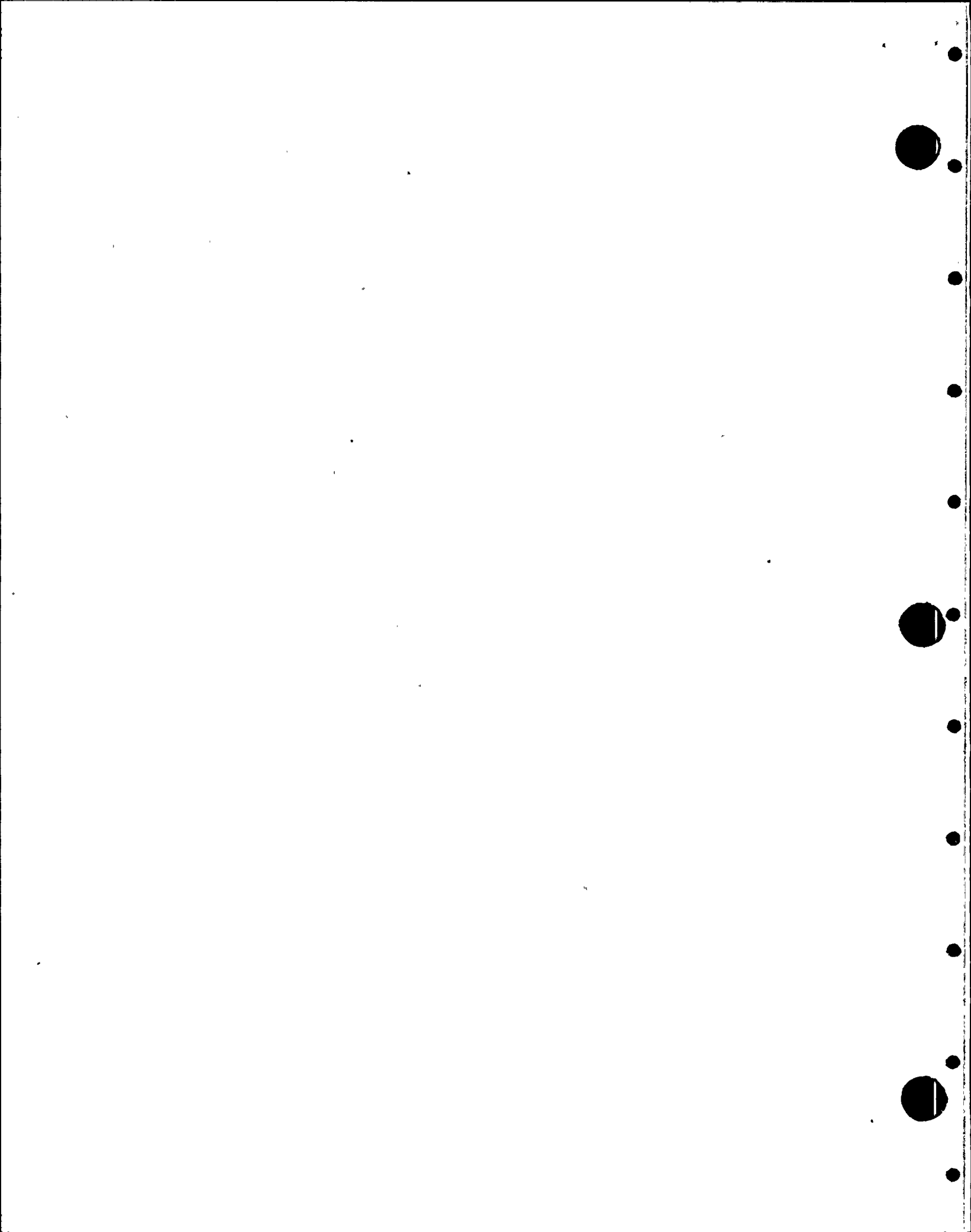
SEVENTH: Subject to the limitation provided in Article SIXTH of this Certificate, the Corporation reserves the right to amend the provisions contained in this

Certificate and in any certificate amendatory hereof in the manner now or hereafter prescribed by law, and all rights conferred on stockholders or other hereunder of thereunder are granted subject to such reservation.

IN WITNESS WHEREOF, the undersigned, the incorporator hereinbefore named, does hereby certify that the facts herein stated are true, and has accordingly hereunto set his name the 13th day of May, 1986.

/s/ J. A. Barbera

J. A. Barbera



UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940

Release No. _____, 1986

In the Matter of)
PVNGS FUNDING CORP., INC.)
_____)
_____)
(File No. 812-_____))
_____)

NOTICE OF APPLICATION FOR AN ORDER PURSUANT TO
SECTION 6(c) OF THE ACT FOR EXEMPTION FROM ALL
PROVISIONS OF THE ACT

NOTICE IS HEREBY GIVEN that PVNGS Funding Corp., Inc. (Applicant), a Delaware corporation, filed an application on May 16, 1986, for an order of the Commission pursuant to Section 6(c) of the Investment Company Act of 1940 (the "Act"), exempting Applicant from all provisions of the Act. All interested persons are referred to the application on file with the Commission for a statement of the representations made therein, which are summarized below, and to the Act for the text of its relevant provisions.

According to the application, Applicant is a Delaware corporation and expects to have all of its shares of common stock owned by The Corporation Trust Company, or a company controlled by it. Applicant represents that there has been, and undertakes that in the future there will be, no public offering or Applicant's common stock or of any other equity security. Applicant further represents that there is, and in the future will be, no class of equity securities of Applicant other than its common stock. Applicant has been created to participate as lender in one or more leveraged lease transactions ("Leases"), in which Arizona Public Service Company, an Arizona corporation ("APS"), is the lessee ("Lessee").

Applicant's sole purpose is to assist APS in the financing and refinancing, in whole or in part, of APS's 29.1% undivided ownership interest in the Palo Verde Nuclear Generating Station ("PVNGS"). PVNGS, located near Phoenix, Arizona, consists primarily of three 1,270 megawatt electric generating units, each containing a pressurized water nuclear steam supply system, certain related common facilities, certain transmission facilities, and pipeline, and of which, the latter three components may or may not be included in such financings. Ownership of PVNGS is governed by the Arizona Nuclear Power Project Participation Agreement, dated August 23, 1973, as amended, and pursuant thereto, Arizona Public Service Company, an Arizona utility, is authorized to act as agent for the owners of PVNGS, and has responsibility and control over construction, operation and maintenance of PVNGS.

Applicant states that its participation as lender in the Leases will be limited to making loans pursuant to a loan and security agreement ("Loan and Security Agreement") or a trust indenture and security agreement ("Trust Indenture and Security Agreement") (in either case, a "Lease Indenture") to certain lessors ("Lessors") under such Leases which will be payable primarily from rentals and other payments by the Lessee. Applicant expects that the Lessors will be a bank or trust company acting as trustee for one or more beneficiaries pursuant to a trust agreement, formed exclusively for the purpose of the lease financing. Applicant states that a portion of the purchase price of the property owned by the Lessors and leased to the Lessee ("Leased Property") will be paid by the beneficiaries of the grantor trust that acts as Lessor and that amount will constitute their equity investment in the Leased Property. The loans by Applicant will be without recourse to the general credit of the Lessors of their respective beneficiaries, and will be evidenced by non-recourse obligations or the respective Lessors ("Lessor Notes"). Applicant states that under each Lease, the Lessee will be obligated to make rental payments sufficient to pay principal of and premiums, if any, and interest on the Lessor notes issued in connection therewith. Applicant further states that such obligations or the Lessee will be required to be absolute and unconditional, without right of counterclaim, setoff, deduction or defense. Applicant expects to enter into an agreement (the "Commitment Agreement") with APS pursuant to which Applicant will agree to make loans to one or more Lessors designated by APS from time to time.

Applicant intends to acquire the funds necessary for the purchase of the Lessor Notes through the issuance of its debt securities in one or more series with differing maturities ("Debt Securities") which may or may not be secured

on a parity basis by a first lien on, and a security interest in, all of the assets of the Applicant, consisting primarily of the Lessor Notes so acquired and previously acquired and which may included a lien on or security interest in the Leased Property (if so secured, the Debt Securities may be referred to as "Lease Obligation Bonds"). Lessor Notes held by Applicant may only consist of Lessor Notes issued in connection with any Leases to which APS is a party, as lessee, in conjunction with its ownership interest in PVNGS.

Applicant states that the Debt Securities will be issued under a common indenture and a separate supplemental indenture for each series other than the initial series (collectively, the "Collateral Trust Indenture") which will establish the terms of the Debt Securities of that series. It is expected that the trustee under the Collateral Trust Indenture ("Trustee") will be a bank or trust company not affiliated with any of the Lessors and will not be a trustee under any indenture of APS or its subsidiaries. At each Lease closing the Lessor Notes will be pledged and assigned directly to the Trustee. Applicant expects that the Lessor Notes will be issued under circumstances making such transactions exempt from the registration requirements under the Securities Act of 1933 ("Securities Act").

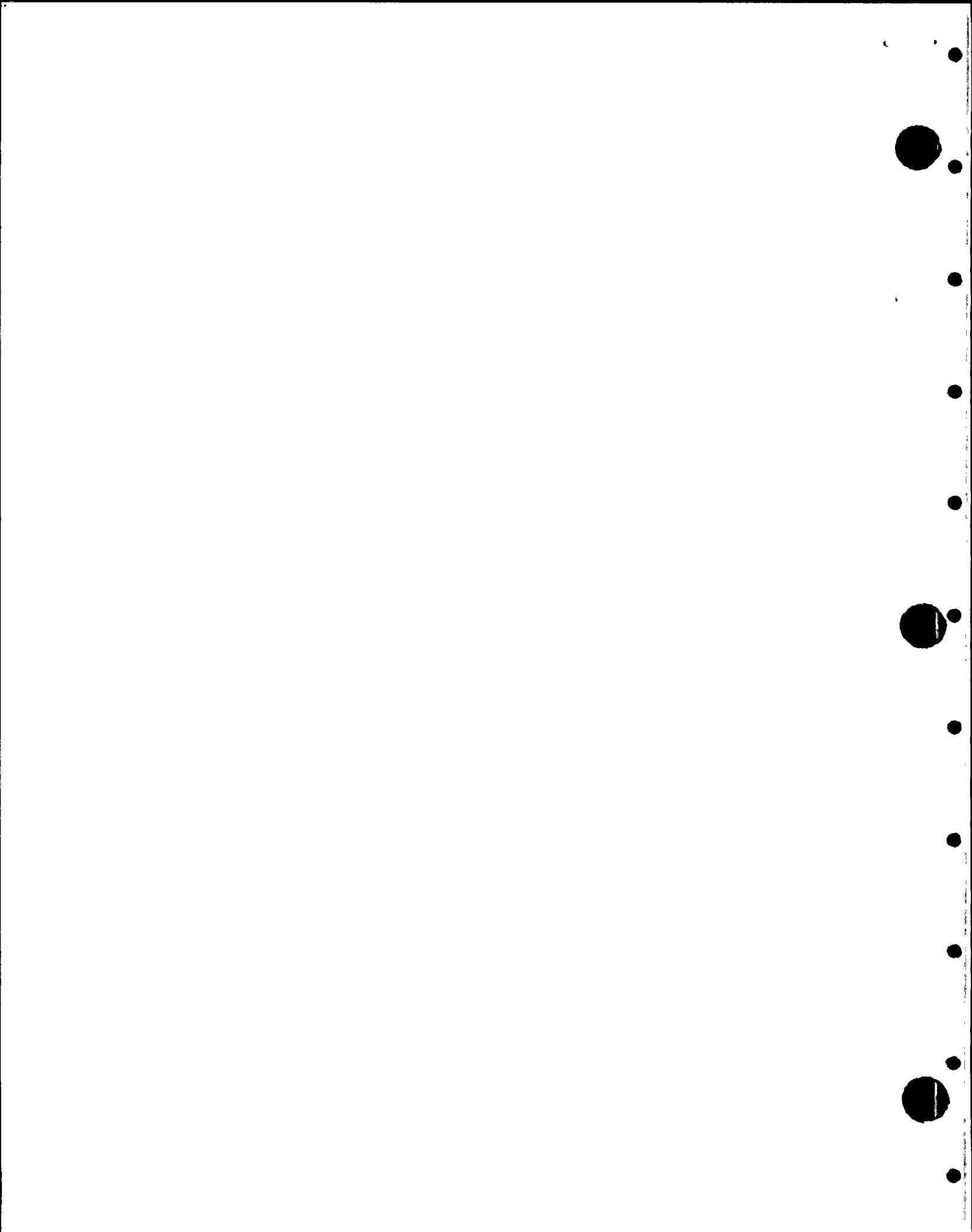
Applicant states that the Lease Indentures will set forth the terms and conditions under which the Lessor Notes will be issued. Applicant represents that each Lease Indenture will require the Lessor to grant to the Applicant (if the Lease Indenture is a Loan and Security Agreement) or (a trustee under the Lease Indenture ("Lease Indenture Trustee") if the Lease Indenture is a Trustee Indenture and Security Agreement), an assignment of rents, including basic rentals and certain other payments, to be made by the Lessee under the applicable Lease. The Lease Indenture Trustee or the Applicant may have a lien on or security interest in, the Leased Property. In the event no such lien or security interest is created, the Lessor will covenant that, so long as any Lessor Note is outstanding, it will not incur any other debt constituting Lessor Notes or otherwise in connection with the Leased Property, and except for certain limited permitted liens, it will not create any lien or security interest in such property. Thus, Applicant states, these two covenants combined ensure that if a Lessor defaults on a Lessor Note, the Leased Property will be available to satisfy the claims of the Trustee, acting for the benefit of holders of debt securities. Applicant states that it will be precluded from purchasing any Lessor Note unless (i) such Lessor Note is issued in respect of Leased Property having a fair market sales value at the time of purchase at least equal to 110% of the original principal amount of such Lessor

Note or, (ii) such Lessor Note and all other Lessor Notes (if any) issued by the relevant Lessor are issued in respect of Leased Property having an aggregate fair market value (measured, in each case, as of the date such Leased Property was first financed under the Lease) at least equal to 110% of the original principal amount of such Lessor Note and such other Lessor Notes. Further, Applicant states that each Lease Indenture will include as events of default, without limitation: (a) payment defaults on the Lessor Notes issued thereunder and (b) events of default under the related Lease.

According to the Application, the various series of Debt Securities will have terms which may differ as to interest rates, sinking fund obligations of Applicant, the right of Applicant to redeem such Debt Securities, and other matters. The interest rates, maturities and principal amounts of each series of Debt Securities will be established based on prevailing market conditions, thereby giving Applicant flexibility to take advantage of changing market conditions. If the maturity dates and cash flow of the Lessor Notes exceed the cash requirements of Applicant's obligations under the Debt Securities, the resulting funds ("Temporary Funds") will be invested by Applicant in certain investments ("Permitted Investments"), in each case maturing at such time as necessary to pay Applicant's obligations under the Debt Securities. Applicant states that Debt Securities, which may include commercial paper and intermediate-term and long-term obligations, will be issued in the private or public markets in the United States, and in offerings outside the United States under circumstances reasonably designed to assure that such Debt Securities are not offered or sold to citizens and/or residents of the United States.

Applicant proposes that the initial issuance of Debt Securities will be through an underwritten public offering or private placement of one or more series having an aggregate principal amount of approximately \$1.1 billion (assuming a total sales price for APS's 29.1% interest in PVNGS Unit 2 and the common facilities of \$1.3 billion). Applicant represents that, although APS will not be the actual issuer of the Debt Securities, it will be considered the "issuer" thereof for purposes of the Securities Act. Any registration statement filed under the Securities Act relating to the Debt Securities will name APS as the sole registrant and will be signed on behalf of APS as the sole registrant by such officers and directors of APS as may be required under the Securities Act and the rules, regulations and forms of the Commission thereunder.

Applicant represents that it will assign and pledge to the Trustee under the Collateral Trust Indenture, as



security for the payment of the principal of and premium, if any, and interest on all Debt Securities, the Lessor Notes and other assets held by the Applicant including any lien or security interest it may have in the Leased Property. Each such Lessor Note will in turn be secured by the assigned rentals and other assigned payments under such Lease and may be secured by a lien or security interest in the Leased Property. Applicant states that the Trustee will give immediate notice to the Debt Securities holders of any rights granted by the Collateral Trust Indenture to it, which will include the right to exercise voting powers in respect of the Lessor Notes, to give any consents or waivers with respect thereto or to exercise any rights and remedies in respect thereof. The Collateral Trust Indenture will authorize the Debt Securities holders to direct by notice to the Trustee within a specific period of time, that it take any action or cast any vote in its capacity as a holder of the Lessor Notes. As a result of this pass-through voting mechanism, the rights and remedies of Lessor Noteholders will be exercisable directly by the Debt Securities holders through their fiduciary, the Trustee. The principal amount of Lessor Notes directing any action or being voted for or against any proposal will be the principal amount of the Debt Securities holders taking the corresponding position. To the extent the Trustee does receive instruction, it will take such action with respect to the Lessor Notes as a prudent man would in the care of his own property.

Applicant states that in the event APS defaults in the payment of rent or otherwise under any Lease Indenture, the Applicant or the Lease Indenture Trustee, as the case may be, would have the right to exercise, subject to the provisions of the Lease Indenture, all of the rights and remedies against APS provided in the related Lease. The exercise of such rights and remedies would be at the direction of the holders of the Debt Securities through the Trustee's instructions to the Lease Indenture Trustee or as pledgee of the Applicant's interest in such Lease Indenture.

Applicant states that among the rights and remedies of a holder of Lessor Notes included under the Lease Indenture is the right to demand, after a specified grace period, that APS pay all unpaid basic rent plus a stipulated amount which, in all cases, will be sufficient to pay the principal of, premium, if any, and interest on the related Lessor Notes. Amounts payable by APS under the Leases, to the extent of the amount of the principal, interest, and premium, if any, on the relevant Lessor Notes, will be paid directly to the Trustee for distribution to the holders of the Debt Securities. Applicant thus asserts that holders of the Debt Securities will have access under the Collateral Trust

Indenture and the Lease Indentures to the credit of APS. Moreover, Applicant asserts that holders of the Debt Securities will be entitled to realize on the security afforded by the assignment of rentals to realize to the aggregate unpaid amount of the relevant Lessor Notes and the obligation of APS under the Leases, Applicant asserts, grants holders of Debt Securities access to the general credit of APS and is thus the equivalent of a general unsecured obligation of APS without limitation as to source of payment. The Lessor Notes and the Lease Indenture will provide that, upon the occurrence of certain casualty events, and certain other events which require the collapsing of the lease transaction, either (i) APS shall assume the obligations represented by the Lessor Notes or (ii) APS shall purchase from the beneficiaries or the trusts issuing the Lessor Notes the beneficial interest in such trusts and the Lessors will grant a lien and security interest in the Leased Property to secure the Lessor Notes. The assumption or purchase described in the preceding sentence will be in partial satisfaction of APS's obligation to make payments required of it upon early termination of the Leases in consequence of any such event. Applicant asserts that in circumstances where the Lessor Notes are not secured by the Leased Property, there will be no need to prepay the Lessor Notes in the event of a casualty. The preservation of a right for APS to assume the Lessor Notes in certain circumstances assure that APS will not be faced with an accelerated obligation to prepay the Lessor Notes under the provisions of the Leases.

Applicant states that the issue, sale and delivery of a particular series of Debt Securities may be effected, at maximum, two months prior to the date for the consummation of the Leases ("Lease Closing Date") applicable to the Leased Property financed with the Debt Securities proceeds. Pending the Lease Closing Date, the net proceeds of the Debt Securities will be held by the Trustee, pursuant to the terms of the Collateral Trust Indenture. The Trustee may invest proceeds in Permitted Investments, which include direct obligations of the United States or obligations fully guaranteed by the United States, certificates of deposit issued by or bankers' acceptances or, time deposits with, banks organized under United States law and limited to amounts of less than \$15 million in principal at any one time and from any one bank, or commercial paper of companies incorporated in or doing business under the laws of the United States or one State, in an amount not exceeding \$15 million in principal amount at any one time from any one company. The commercial paper will also have the highest rating by a nationally recognized rating organization. Permitted Investments, Applicant states, also include repurchase agreements, fully collateralized by the Permitted investments, pursuant to which a United States

bank, trust company or national banking association having a net worth or at least \$200 million is obligated to repurchase the obligation not later than 90 days after its purchase.

Except to the extent payable from the proceeds of refunding Debt Securities, proceeds of Temporary Investments or the proceeds of the initial issuance of the Debt Securities, where the relevant Lease Closing Date does not occur simultaneously, due to the nonrecourse nature of Lessor Notes and the limited scope of Applicant's activities, payment of the principal of, premium, if any, and interest on the Debt Securities will be made exclusively from amounts paid by the Lessee under the Leases.

Applicant asserts that its proposed activities are appropriate in the public interest because the proposed issuance of Debt Securities would provide a convenient mechanism for APS to obtain access to segments of the debt capital market other than the institutional private placement market. Applicant further asserts that an exemption would be consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act because, among other things, investors will be protected under the proposed arrangements to the same extent as under equivalent arrangements where the Act is inapplicable.

NOTICE IS FURTHER GIVEN that any interested person wishing to request a hearing on the application may, not later than _____, 1986, at 5:30 p.m., do so by submitting a written request setting forth the nature of his/her interest, the reasons for the request, and the specific issues of fact or law that are disputed, to the Secretary, Securities and Exchange Commission, Washington, D.C. 20549. A copy of the request should be served personally or by mail upon Applicant at the address stated above with a copy to Teresa Davidson, Snell & Wilmer, 3100 Valley Bank Center, Phoenix, Arizona 85073. Proof of service (by affidavit or, in the case of an attorney-at-law, by certificate shall be filed with the request. After said date, an order disposing of the application will be issued unless the Commission orders a hearing upon request or upon its own motion.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

John Wheeler
Secretary

04TDD1045

