Risk Factors Comparison 2024-02-27 to 2023-02-27 Form: 10-K

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In addition to the factors affecting specific business operations identified in the description of these operations contained elsewhere in this report, set forth below are risks and uncertainties that could affect our financial results. Unless otherwise indicated or the context otherwise requires, the following risks and uncertainties apply to Pinnacle West and its subsidiaries, including APS. REGULATORY RISKS Our financial condition depends upon APS' s ability to recover costs in a timely manner from customers through regulated rates and otherwise execute its business strategy. APS is subject to comprehensive regulation by several federal, state and local regulatory agencies that significantly influence its business, liquidity and results of operations and its ability to fully recover costs from utility customers in a timely manner. The ACC regulates APS' s retail electric rates and FERC regulates rates for wholesale power sales and transmission services. The profitability of APS is affected by the rates it may charge and the timeliness of recovering costs incurred through its rates and adjustor recovery mechanisms. Consequently, our financial condition and results of operations are dependent upon the satisfactory resolution of any APS rate proceedings, adjustor recovery and ancillary matters which may come before the ACC and FERC, including in some cases how court challenges to these regulatory decisions are resolved. Arizona, like certain other states, has a statute that allows the ACC to reopen prior decisions and modify otherwise final orders under certain circumstances. Additionally, given that APS is subject to oversight by several regulatory agencies, a resolution by one may not foreclose potential actions by others for similar or related matters. See Note 10. The ACC must also approve APS' s issuance of equity and debt securities and any significant transfer or encumbrance of APS property used to provide retail electric service and must approve or receive prior notification of certain transactions between us, APS, and our respective affiliates, including the infusion of equity into APS. Decisions made by the ACC or FERC could have a material adverse impact on our financial condition, results of operations, or cash flows. APS' s ability to conduct its business operations and avoid negative operational and financial impacts depends in part upon compliance with federal, state and local laws, judicial decisions, statutes, regulations and ACC requirements, which may be revised from time to time by legislative or other action, and obtaining and maintaining certain regulatory permits, approvals, and certificates. APS must comply in good faith with all applicable statutes, regulations, rules, tariffs, and orders of agencies that regulate APS' s business, including FERC, NRC, EPA, the ACC, and state and local governmental agencies. These agencies regulate many aspects of APS' s utility operations, including safety and performance, emissions, siting and construction of facilities, customer service and the rates that APS can charge retail and wholesale customers. Failure to comply can subject APS to, among other things, fines and penalties. For example, under the Energy Policy Act of 2005, FERC can impose penalties (approximately $ 1. 2 million per day per violation) for failure to comply with mandatory electric reliability standards. APS is also required to have numerous permits, approvals and certificates from these agencies. APS believes the necessary permits, approvals and certificates have been obtained for its existing operations and that APS' s business is conducted in accordance with applicable laws in all material respects. Changes in laws or regulations that govern APS, new interpretations of ~~law~~ **laws** and regulations, or the imposition of new or revised laws or regulations could have an adverse impact on the manner in which we operate our business and our results of operations. In particular, new or revised laws or interpretations of existing laws or regulations may impact or call into question the ACC' s permissive regulatory authority, which may result in uncertainty as to jurisdictional authority within our state, and uncertainty as to whether ACC decisions will be binding or challenged by other agencies or bodies asserting jurisdiction. In November 2021, the Arizona Court of Appeals issued an opinion that called into question the ACC-approved limitation of liability provision found in the APS Service Schedules. APS sought review of the decision at the Arizona Supreme Court, which was denied; however, the Supreme Court depublished portions of the Court of Appeals' decision. APS is seeking revised tariff language to mitigate potential adverse impacts on APS' s future, potential litigation exposure which may result from this court decision. We are unable to predict the impact on our business and operating results from any pending or future regulatory or legislative rulemaking. The operation of APS' s nuclear power plant exposes it to substantial regulatory oversight and potentially significant liabilities and capital expenditures. The NRC has broad authority under federal law to impose safety- related, security- related and other licensing requirements for the operation of nuclear generating facilities. Events at nuclear facilities of other operators or impacting the industry generally may lead the NRC to impose additional requirements and regulations on all nuclear generating facilities, including Palo Verde. In the event of noncompliance with its requirements, the NRC has the authority to impose a progressively increased inspection regime that could ultimately result in the shut- down of a unit or civil penalties, or both, depending upon the NRC' s assessment of the severity of the situation, until compliance is achieved. The increased costs resulting from penalties, a heightened level of scrutiny and implementation of plans to achieve compliance with NRC requirements may adversely affect APS' s financial condition, results of operations and cash flows. APS is subject to numerous environmental laws and regulations, and changes in, or liabilities under, existing or new laws or regulations may increase APS' s cost of operations or impact its business plans. APS is, or may become, subject to numerous environmental laws and regulations affecting many aspects of its present and future operations, including air emissions of conventional pollutants and GHGs, water quality, discharges of wastewater and waste streams originating from fly ash and bottom ash handling facilities, solid waste, hazardous waste, and coal combustion products, which consist of bottom ash, fly ash, and air pollution control wastes. These laws and regulations can result in increased capital, operating, and other costs, particularly with regard to enforcement efforts focused on power plant emissions obligations. These laws and regulations generally require APS to obtain and comply with a wide variety of environmental licenses, permits, and other approvals. If there is a delay or failure to obtain any required environmental regulatory approval, or if APS fails to obtain, maintain, or comply with any such approval, operations at affected facilities could be suspended or subject to additional expenses. In addition, failure to comply with applicable environmental laws and regulations could result in civil liability as a result of government enforcement actions or private claims or criminal penalties. Both public officials and private individuals may seek to enforce applicable environmental laws and regulations. APS cannot predict the outcome (financial or operational) of any related litigation that may arise. Environmental Clean Up. APS has been named as a PRP for ~~a~~ Superfund ~~site~~ **sites** in Phoenix, Arizona, and it could be named a PRP in the future for other environmental clean- up at sites identified by a regulatory body. APS cannot predict with certainty the amount and timing of all future expenditures related to environmental matters because of the difficulty of estimating clean- up costs. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability on all PRPs. Coal Ash. In December 2014, **the** EPA issued final regulations governing the handling and disposal of CCR, which are generated as a result of burning coal and consist of, among other things, fly ash and bottom ash. The rule regulates CCR as a non- hazardous waste. APS currently disposes of CCR in ash ponds and dry storage areas at Cholla and Four Corners. To the extent the rule requires the closure or modification of these CCR units, modification or changes to the manner of closure of such units, or the construction of new CCR units beyond what we currently anticipate, APS would incur significant additional costs for CCR disposal. In addition, the rule may also require corrective action to address releases from CCR disposal units or the presence of CCR constituents within groundwater near CCR disposal units above certain regulatory thresholds. Ozone National Ambient Air Quality Standards. In 2015, **the** EPA finalized revisions to the NAAQS for ozone, which set new, more stringent standards on emissions of nitrogen oxide, a precursor to ozone, in an effort to protect human health and human welfare. Depending on the final attainment designations for the new standards and the state implementation requirements, APS may be required to invest in new pollution control technologies and to generate emission offsets for new projects or facility expansions located in ozone nonattainment areas **. In addition, the EPA may in the future further increase the stringency of various NAAQS, including for ozone or other pollutants, such as particulate matter. With regard to even more stringent NAAQS requirements, additional control measures and compliance costs may become necessary for APS as well as its current and potential future customers** . APS cannot assure that existing environmental regulations will not be revised or that new regulations seeking to protect the environment will not be adopted or become applicable to it. Revised or additional regulations that result in increased compliance costs or additional operating restrictions, particularly if those costs incurred by APS are not fully recoverable from APS' s customers, could have a material adverse effect on its financial condition, results of operations, or cash flows. Due to current or potential future regulations or legislation coupled with trends in natural gas and coal prices, or other clean energy rules or initiatives, the economics or feasibility of continuing to own certain resources, particularly coal facilities, may deteriorate, warranting early retirement of those plants, which may result in asset impairments. APS would seek recovery in rates for the book value of any remaining investments in the plants as well as other costs related to early retirement but cannot predict whether it would obtain such recovery. **Such regulations may also act as a deterrent to future customer growth or create additional costs for existing customers, potentially slowing APS' s customer growth.** APS faces potential financial risks resulting from climate change litigation and legislative and regulatory efforts to limit GHG emissions, as well as physical and operational risks related to climate effects. Concern over climate change has led to significant legislative and regulatory efforts to limit CO2, which is a major byproduct of the combustion of fossil fuel, and other GHG emissions. Potential Financial Risks — Greenhouse Gas Regulation, the Clean Power Plan and Potential Litigation. ~~In 2015~~ **Following a U. S. Supreme Court decision on June 30** , **2022, which substantially narrowed** EPA ~~finalized a rule~~ **' s authority** to ~~limit CO2~~ **regulate power plant GHG** emissions **under** ~~from existing power plants,~~ the ~~Clean Power Plan, or CPP. The implementation of this rule within the jurisdictions where APS operates would have resulted in a shift in generation from coal to more natural gas and renewable generation. Because of a view that the federal~~ Clean Air Act ~~did not permit such an expansive use of administrative authority over utility generation resources~~ , **on May 23, 2023, EPA proposed new GHG emission standards for power plants. In contrast to measures finalized** in ~~2019~~ **2015 , EPA' s May 2023 proposal is** ~~regulations were issued that repealed the CPP and replaced it with a far narrower set of regulations~~ focused ~~solely~~ on **limiting** ~~coal- fired~~ power plant ~~efficiency improvements~~ **GHG emissions through control mechanisms that can be implemented at individual power plant facilities** . ~~On January 19~~ **These mechanisms would include carbon capture and sequestration** , ~~2021~~ **hydrogen co- firing** , **natural gas co- firing, and limits on facility output, among** ~~the~~ **other** ~~U~~ **measures** . ~~S. Court of Appeals for the D. C. Circuit vacated the ACE regulations and remanded them back to~~ EPA **expects** to **take final action** ~~develop new regulations governing carbon emissions from existing power plants consistent with the court' s ruling. That decision, which endorsed an expansive view of the federal Clean Air Act consistent with the CPP, was subsequently reversed by the U. S. Supreme Court~~ on ~~June 30,~~ **this proposal in the spring or summer of** ~~2022~~ **2024** ~~. While the current administration has expressed its intent to develop new carbon emission regulations governing existing power plants in 2023, such action will be constrained by the U. S. Supreme Court' s decision that the CPP violated the Clean Air Act~~ . Depending on the outcome of future carbon emission ~~rulemakings~~ - **rulemaking** under the Clean Air Act targeting new and existing power plants, the utility industry may become subject to more stringent and expansive regulations. Depending on the means of compliance with federal emission performance standards, the electric utility industry may be forced to incur substantial costs necessary to achieve compliance. In addition, we anticipate that such regulations will be challenged in federal court prior to their implementation. Depending on the outcome of such judicial review, the utility industry may face alternative efforts from private parties seeking to establish alternative GHG emission limitations from power plants. Alternative GHG emission limitations may arise from litigation under either federal or state common laws or citizen suit provisions of federal environmental statutes that attempt to force federal agency rulemaking or ~~imposing~~ **impose** direct facility emission limitations. Such lawsuits may also seek damages from harm alleged to have resulted from power plant GHG emissions. Physical and Operational Risks. Weather extremes such as drought and high temperature variations are common occurrences in the ~~southwest~~ **southwestern** United States' desert area, and these are risks that APS considers in the normal course of business in the engineering and construction of its electric system.

Large increases in ambient temperatures could require evaluation of certain materials used within its system and may represent a greater challenge. Limitations on water supplies necessary to operate electric generation infrastructure could arise from prolonged drought and shortage declarations associated with key surface water resources. As part of conducting its business, APS recognizes that the southwestern United States is particularly susceptible to the risks posed by climate change, which over time is projected to exacerbate high temperature extremes and prolong drought in the area where APS conducts its business. Co-owners of our jointly owned generation and transmission facilities may have unaligned goals and positions due to the effects of legislation, regulations, economic conditions, or changes in our industry, which could have a significant impact on our ability to continue operations of such facilities. APS owns certain of its power plants and transmission facilities jointly with other owners, with varying ownership interests in such facilities. Changes in the nature of our industry and the economic viability of certain plants and facilities, including impacts resulting from types and availability of other resources, fuel costs, legislation, and regulation, together with timing considerations related to **the** expiration of leases or other agreements for such facilities, could result in unaligned positions among co- owners. Differences in the co- owners' willingness or ability to continue their participation could lead to **the** eventual shut down of units or facilities and uncertainty related to the resulting cost recovery of such assets. See Note 3 for a discussion of the Navajo Plant and Cholla retirement and the related risks associated with APS' s continued recovery of its remaining investment in the plant. Deregulation or restructuring of the electric industry may result in increased competition, which could have a significant adverse impact on APS' s business and its results of operations. In 1999, the ACC approved rules for the introduction of retail electric competition in Arizona. Retail competition could have a significant adverse financial impact on APS due to an impairment of assets, a loss of retail customers, lower profit margins or increased costs of capital. Although some very limited retail competition existed in APS' s service area in 1999 and 2000, there are currently no active retail competitors offering unbundled energy or other utility services to APS' s customers. This is in large part due to a 2004 Arizona Court of Appeals decision that found critical components of the ACC' s rules to be violative of the Arizona Constitution. The ruling also voided the operating authority of all the competitive providers previously authorized by the ACC. On May 9, 2013, the ACC voted to re- examine the facilitation of a deregulated retail electric market in Arizona. The ACC subsequently opened a docket for this matter and received comments from a number of interested parties on the considerations involved in establishing retail electric deregulation in the state. One of these considerations is whether various aspects of a deregulated market, including setting utility rates on a " market " basis, would be consistent with the requirements of the Arizona Constitution. On September 11, 2013, after receiving legal advice from the ACC staff, the ACC voted 4- 1 to close the current docket and await full Arizona Constitutional authority before any further examination of this matter. In November 2018, the ACC voted to re- examine the facilitation of a deregulated retail electric market in Arizona. On July 1 and July 2, 2019, ACC Staff issued a report and initial proposed draft rules regarding possible modifications to the ACC' s retail electric competition rules. On February 10, 2020, two ACC Commissioners filed two sets of draft proposed retail electric competition rules. On February 12, 2020, ACC Staff issued its second report regarding possible modifications to the ACC' s retail electric competition rules. During a July 15, 2020, ACC Staff meeting, the ACC Commissioners discussed the possible development of a retail competition pilot program, but no action was taken. The ACC continues to discuss matters related to retail electric competition, including the potential for additional buy- through programs or other pilot programs. In April 2022, the Arizona Legislature passed and the Governor signed a bill that repealed the electric deregulation law that had been in place in Arizona since 1998. OPERATIONAL RISKS APS' s results of operations can be adversely affected by various factors impacting demand for electricity. Weather Conditions. Weather conditions directly influence the demand for electricity and affect the price of energy commodities. Electric power demand is generally a seasonal business. In Arizona, demand for power peaks during the hot summer months, with market prices also peaking at that time. As a result, APS' s overall operating results fluctuate substantially on a seasonal basis. In addition, APS has historically sold less power, and consequently earned less income, when weather conditions are milder. As a result, unusually mild weather could diminish APS' s financial condition, results of operations, or cash flows. Apart from the impact ~~upon~~ **on** electricity demand, weather conditions related to prolonged high temperatures or extreme heat events present operational challenges. In the southwestern United States, where APS conducts its business, the effects of climate change are projected to increase the overall average temperature, lead to more extreme temperature events, and exacerbate prolonged drought conditions leading to the declining availability of water resources. Extreme heat events and rising temperatures are projected to reduce the generation capacity of thermal- power plants and decrease the efficiency of the transmission grid. These operational risks related to rising temperatures and extreme heat events could affect APS' s financial condition, results of operations, or cash flows. Higher temperatures may decrease the snowpack, which might result in lowered soil moisture and an increased threat of forest fires. Forest fires could threaten APS' s communities and electric transmission lines and facilities. Any damage caused as a result of forest fires could negatively impact APS' s financial condition, results of operations, or cash flows. In addition, the decrease in snowpack can also lead to reduced water supplies in the areas where APS relies upon non- renewable water resources to supply cooling and process water for electricity generation. Prolonged and extreme drought conditions can also affect APS' s long- term ability to access the water resources necessary for thermal electricity generation operations. Reductions in the availability of water for power plant cooling could negatively impact APS' s financial condition, results of operations, or cash flows. Effects of Energy Conservation Measures and Distributed Energy Resources. APS customers in energy efficiency and conservation programs and other demand-side management efforts, which in turn impact the demand for electricity. APS must also meet certain distributed renewable energy requirements. A portion of APS' s total renewable energy requirement must be met with an increasing percentage of distributed renewable energy resources (generally, small **-** scale renewable technologies located on customers' properties). The distributed renewable energy requirement is 30 % of the applicable RES requirement for 2012 and subsequent years (this requirement has been waived by the ACC for 2023). Customer participation in distributed renewable energy programs would result in lower demand since customers would be meeting some of their own energy needs. In addition to these rules and requirements, energy efficiency technologies and distributed energy resources continue to evolve, which may have similar impacts on **the** demand for electricity. Reduced demand due to these energy efficiency requirements, distributed energy requirements and other emerging technologies, unless substantially offset through ratemaking mechanisms, could have a material adverse impact on APS’ s financial condition, results of operations and cash flows. Actual and Projected Customer and Sales Growth. Retail customers in APS’ s service territory increased 2. ~~1~~ **0** % for the year ended December 31, ~~2022~~ **2023** , compared with the prior- year period. For the three years through ~~2022~~ **2023** , APS’ s customer growth averaged 2. ~~2~~ **1** % per year. We currently project annual customer growth to be 1. 5 % to 2. 5 % for ~~2023~~ **2024** and the average annual growth to be in the range of 1. 5 % to 2. 5 % through ~~2025~~ **2026** based on anticipated steady population growth in Arizona during that period. Retail electricity sales in kWh, adjusted to exclude the effects of weather variations, increased ~~2~~ **1** . ~~4~~ **5** % for the year ended December 31, ~~2022~~ **2023** , compared with the prior- year period. While steady customer growth was **somewhat** offset by **weaker usage among residential customers,** energy savings driven by customer conservation, energy efficiency, and distributed renewable generation initiatives, the main drivers of positive sales for this period were ~~a~~ **continued** strong ~~improvement in~~ sales to commercial and industrial customers and the ramp- up of new data center customers. For the three years through ~~2022~~ **2023** , annual retail electricity sales growth averaged 2. ~~5~~ **7** %, adjusted to exclude the effects of weather variations. Due to the expected ~~rapid~~ growth of several large data centers and new large manufacturing facilities, we currently project that annual retail electricity sales in kWh will increase in the range of ~~3~~ **2** . ~~5~~ **0** % to ~~5~~ **4** . ~~5~~ **0** % for ~~2023~~ **2024** and that average annual growth will be in the range of 4. ~~5~~ **0** % to 6. ~~5~~ **0** % through ~~2025~~ **2026** , including the effects of customer conservation, energy efficiency, and distributed renewable generation initiatives, but excluding the effects of weather variations. ~~This~~ **These** projected sales growth ~~range~~ **ranges** ~~includes~~ **include** the impacts of several large data centers and new large manufacturing facilities, which are expected to contribute to **2024 growth in the range of 2. 5 % to 3. 5 % and to** average annual growth in the range of 3. **0 % to** 5 ~~% to 5~~ . ~~5~~ **0** % through ~~2025~~ **2026 . Longer term, APS has been preparing for and can serve significant load growth from residential and business customers. On top of these existing growth trends, APS is also now receiving unprecedented incremental requests for service from extra- large commercial energy users (over 25 MW) with very high energy demands that persist virtually around- the- clock. These incremental requests for service by extra- large energy users far exceed available generation and transmission resource capacity in the Southwest region for the foreseeable future. In April 2023, APS notified prospective extra- large customers without existing commitments from APS that it is not able to commit at this time to their future extra- large projects (over 25 MW). Because of the high growth in demand for such projects, APS has developed a prioritization queue that identifies and prioritizes projects while maintaining system reliability and affordability for existing APS customers. APS is exploring available options for securing sufficient electric generation and transmission to meet these projections of future customer needs** . Actual sales growth, excluding weather- related variations, may differ from our projections as a result of numerous factors, such as economic conditions, customer growth, usage patterns and energy conservation, slower ramp- up of and / or fewer data centers and large manufacturing facilities, slower than expected commercial and industrial expansions, impacts of energy efficiency programs ~~,~~ and growth in DG, ~~and~~ responses to retail price changes **, changes in regulatory standards, and impacts of new and existing laws and regulations, including environmental laws and regulations** . Based on past experience, a 1 % variation in our annual residential and small commercial and industrial kWh sales projections under normal business conditions can result in increases or decreases in annual net income of approximately $ 20 million, and a 1 % variation in our annual large commercial and industrial kWh sales projections under normal business conditions can result in increases or decreases in annual net income of approximately $ 5 million. The operation of power generation facilities and transmission systems involves risks that could result in reduced output or unscheduled outages **or** ~~, which~~ could ~~materially affect~~ **otherwise significantly impact** APS’ s results of operations. The operation of power generation, transmission and distribution facilities involves certain risks, including the risk of breakdown or failure of equipment, fuel interruption, and performance below expected levels of output or efficiency. Unscheduled outages, including extensions of scheduled outages due to mechanical failures or other complications, occur from time to time and are an inherent risk of APS’ s business. Because our transmission facilities are interconnected with those of third parties, the operation of our facilities could be adversely affected by unexpected or uncontrollable events occurring on the larger transmission power grid, and the operation or failure of our facilities could adversely affect the operations of others. Concerns over **the** physical security of these assets could include damage to certain of our facilities due to vandalism or other deliberate acts that could lead to outages or other adverse effects. If APS’ s facilities operate below expectations, especially during its peak seasons, it may lose revenue or incur additional expenses, including increased purchased power expenses. **Additionally, as APS’ s transmission infrastructure ages and its transmission system needs grow to support growth in our territory and in the Southwest, it will need to replace and expand certain portions of its transmission infrastructure, which requires significant investment of capital. Risks related to the timely completion of and costs associated with these projects may be exacerbated by a constrained supply chain limiting the availability of necessary parts and materials as well as APS’ s use, in some cases, of older, obsolete, or unsupported equipment. Certain replacements and expansions of the transmission infrastructure will also require the acquisition or renewal of land leases, easements, or other rights- of- way that may require approvals from landowners, including individuals, governmental agencies, and, at times, tribal nations. APS is unable to predict the outcomes of any pending or future required approvals, including any related costs, which could be significant. If APS is unable to successfully manage the replacement and expansion of its transmission infrastructure, it could face increased equipment failures, power quality challenges, reputational impact, and financial loss.** The impact of wildfires could negatively affect APS’ s results of operations. Wildfires have the potential to affect ~~the~~ communities ~~that~~ **within** APS **’ s** ~~serves~~ **service territory** and **the surrounding areas, as well as** APS’ s vast network of electric transmission and distribution lines and facilities. The potential likelihood of wildfires has increased due to many of the same weather and climate change impacts existing in Arizona as those that led to ~~the~~ catastrophic wildfires in California. ~~While~~

~~we proactively take steps to mitigate~~ **The continued expansion of the wildland urban interface has also increased** wildfire risk **to surrounding communities. APS currently intends to implement a public safety power shutoff (" PSPS ") program** in ~~the areas of our electrical assets, wildfire~~ **addition to its current fire mitigation efforts. While such technology is intended to mitigate fire** risk **, it also introduces additional risks to APS and** ~~is~~ **its** ~~always~~ **customers, such as claims for damages, and the timing and effectiveness of such fire mitigation efforts may be insufficient to** ~~present~~ **prevent** ~~due to~~ **wildfires in** APS' s expansive service territory **and surrounding areas** . APS could be held liable for damages incurred as a result of wildfires ~~if it was determined that~~ **regardless of fault and may not be able to recover all or a substantial portion of any such damages or costs from insurance or through rates. In addition, we could also experience credit rating downgrades, reputational harm, volatility in** ~~they~~ **the market** ~~were caused by or~~ **for** ~~enhanced due to APS' s negligence~~ **our common stock, and significant financial distress upon the occurrence of a wildfire event** . ~~Any~~ **Furthermore, any** damage caused to our assets, loss of service to our customers, or liability imposed as a result of wildfires could negatively impact APS' s financial condition, results of operations, or cash flows. The inability to successfully develop, acquire or operate generation resources to meet future resource needs and load forecasts in accordance with reliability requirements and other new or evolving standards and regulations could adversely impact our business. Potential changes in regulatory standards, impacts of new and existing laws and regulations, including environmental laws and regulations, and the need to obtain various regulatory approvals create uncertainty surrounding our current and future generation portfolio. The current regulatory standards, laws, and regulations create strategic challenges as to the appropriate generation portfolio and fuel diversification mix. In addition, APS is required by the ACC to meet certain energy resource portfolio requirements, including those related to renewables development and energy efficiency measures, in addition to specific competitive resource procurement requirements. The development and operation of any generation facility is also subject to many risks, including those related to financing, siting, permitting, new and evolving technology, **extreme weather events, workforce issues, cybersecurity attacks, supply chain constraints for critical spare parts,** and the construction of sufficient transmission capacity to support these facilities **among others** . APS needs to develop or acquire new generation facilities, potentially modernize existing facilities, and / or contract for additional capacity in order to meet future resource needs and load forecasts. APS' s inability to do so could have a material adverse impact on our business and results of operations. In expressing concerns about the environmental and climate- related impacts from continued extraction, transportation, delivery and combustion of fossil fuels, environmental advocacy groups and other third parties have in recent years undertaken greater efforts to oppose the permitting, construction, and operation of fossil fuel infrastructure projects. These efforts may increase in scope and frequency depending on a number of variables, including the future course of Federal environmental regulation and the increasing financial resources devoted to these opposition activities. APS cannot predict the effect that any such opposition may have on our ability to develop, construct, and operate fossil fuel infrastructure projects in the future. In January 2020, APS announced its goal to provide 100 % clean, carbon- free electricity by 2050 with an intermediate 2030 target of achieving a resource mix that is 65 % clean energy, with 45 % of the generation portfolio coming from renewable energy. APS' s ability to successfully execute its clean energy commitment is dependent upon a number of external factors, some of which include supportive national and state energy policies, a supportive regulatory environment, sales and customer growth, the development, deployment and advancement of clean energy technologies, adequate supply chain for generation resources, and continued access to capital markets. The lack of access to sufficient supplies of water could have a material adverse impact on APS' s business and results of operations. Assured supplies of water are important for APS' s generating plants. Water in the southwestern United States is limited, and various parties have made conflicting claims regarding the right to access and use such limited ~~supply~~ **supplies** of water. Both groundwater and surface water in areas important to the operation of APS' s generating plants have been and are the subject of inquiries, claims and legal proceedings. In addition, the region in which APS' s power plants are located ~~suffer~~ **suffers** from prolonged drought conditions, which could potentially affect the plants' water supplies. Climate change is also projected to exacerbate such drought conditions. In addition, Colorado River water supplies for Arizona are subject to a Tier ~~2a~~ **1** shortage declaration, which substantially limits the quantity of water available for the state. APS' s inability to access sufficient supplies of water, along with that of its customers, could have a material adverse impact on our business and results of operations. We are subject to cybersecurity risks and risks of unauthorized access to our systems that could adversely affect our business and financial condition. We operate in a highly regulated industry that requires the continued operation of sophisticated information technology systems and network infrastructure. In the regular course of our business, we handle a range of sensitive security, customer, and business systems information. There appears to be an increasing level of activity, sophistication, and maturity of threat actors, including from both nation **-** state and non- nation state actors, that seek to exploit potential vulnerabilities in the electric utility industry and wish to disrupt the U. S. bulk power system, our information technology systems, generation (including our Palo Verde nuclear facility), transmission and distribution facilities, and other infrastructure facilities and systems and physical assets. We have been and could be the target of attacks, and the aforementioned systems are critical areas of cyber protection for us. We rely extensively on IT systems, networks, and services, including internet sites, data hosting and processing facilities, and other hardware, software and technical applications and platforms. Some of these systems are managed, hosted, provided, or used ~~for~~ **by** third parties to assist in conducting our business. Malicious actors may attack vendors to disrupt the services these vendors provide to us or to use those vendors as a cyber conduit to attack us. As more third parties are involved in the operation of our business, there is a risk the confidentiality, integrity, privacy, or security of data held by, or accessible to, third parties may be compromised. If a significant cybersecurity event or breach were to occur, we may not be able to fulfill critical business functions and we could (i) experience property damage, disruptions to our business, theft of or unauthorized access to customer, employee, financial or system operation information or other information; (ii) experience loss of revenue or incur significant costs for repair, remediation and breach notification, and increased capital and operating costs to implement increased security measures; and (iii) be subject to increased regulation, litigation and reputational damage. If such disruptions or breaches are not detected quickly, their effects could be compounded or could delay our response or the effectiveness of our response and ability to limit our exposure to potential liability. These types of events would also require significant management attention and resources and could have a material adverse impact on our financial condition, results of operations, or cash flows. We develop and maintain systems and processes aimed at detecting and preventing information and cybersecurity incidents which require significant investment, maintenance, and ongoing monitoring and updating as technologies and regulatory requirements change. These systems and processes may be insufficient to mitigate the possibility of cybersecurity incidents, malicious social engineering, fraudulent or other malicious activities, and human error or malfeasance in the safeguarding of our data. We are subject to laws and rules issued by multiple government agencies concerning safeguarding and maintaining the confidentiality of our security, customer information and business information. One of these agencies, NERC, has issued comprehensive regulations and standards surrounding the security of bulk power systems, and is continually in the process of developing updated and additional requirements with which the utility industry must comply. The NRC also has issued regulations and standards related to the protection of critical digital assets at commercial nuclear power plants. The increasing promulgation of NERC and NRC rules and standards will increase our compliance costs and our exposure to the potential risk of violations of the standards. Experiencing a cybersecurity incident could cause us to be non- compliant with applicable laws and regulations, such as those promulgated by NERC and the NRC, privacy laws, or contracts that require us to securely maintain confidential data, causing us to incur costs related to legal claims or proceedings and regulatory fines or penalties. The risk of these system- related events and security breaches occurring continues to intensify. We have experienced, and expect to continue to experience, threats and attempted intrusions to our information technology systems and we could experience such threats and attempted intrusions to our operational control systems. To date, we do not believe we have experienced a material breach or disruption to our network or information systems or our service operations. We may not be able to anticipate and prevent all cyberattacks or information security breaches, and our ongoing investments in security resources, talent, and business practices may not be effective against all threat actors. We maintain cyber insurance to provide coverage for a portion of the losses and damages that may result from a security breach of our information technology systems, but such insurance is subject to a number of exclusions and may not cover the total loss or damage caused by a breach. Coverage for cybersecurity events continues to evolve as the industry matures. In the future, adequate insurance may not be available at rates that we believe are reasonable, and the costs of responding to and recovering from a cyber incident may not be covered by insurance or recoverable in rates. ~~The ownership and operation of power generation and transmission facilities on Indian lands could result in uncertainty related to continued leases, easements, and rights- of- way, which could have a significant impact on our business. Four Corners and portions of certain APS transmission lines are located on Indian lands pursuant to leases, easements or other rights- of- way that are effective for specified periods. APS is unable to predict the final outcomes of pending and future approvals by the applicable sovereign governing bodies with respect to renewals of these leases, easements, and rights- of- way.~~ There are inherent risks in the ownership and operation of nuclear facilities, such as environmental, health, fuel supply, spent fuel disposal, regulatory and financial risks and the risk of terrorist attack that could adversely affect our business and financial condition. APS has an ownership interest in and operates on behalf of a group of participants, Palo Verde, which is the largest nuclear electric generating facility in the United States. Palo Verde constitutes approximately 18 % of APS' s owned and leased generation capacity. Palo Verde is subject to environmental, health and financial risks, such as the ability to obtain adequate supplies of nuclear fuel; the ability to dispose of spent nuclear fuel; the ability to maintain adequate reserves for decommissioning; potential liabilities arising out of the operation of these facilities; the costs of securing the facilities against possible terrorist attacks; and unscheduled outages due to equipment and other problems. APS maintains nuclear decommissioning trust funds and external insurance coverage to minimize its financial exposure to some of these risks; however, it is possible that damages could exceed the amount of insurance coverage. APS may be required under federal law to pay up to $ ~~120~~ **144** . ~~1~~ **9** million (but not more than $ ~~17~~ **21** . ~~9~~ **6** million per year) of liabilities arising out of a nuclear incident not only at Palo Verde, but at any other nuclear power plant in the United States. In addition, APS is subject to retrospective premium adjustments under its nuclear property insurance policies with Nuclear Electric Insurance Limited (" NEIL ") for approximately $ 22. ~~3~~ **4** million if NEIL' s losses in any policy year exceed accumulated funds and if the retrospective premium assessment is declared by NEIL' s Board of Directors. Although APS has no reason to anticipate a serious nuclear incident at Palo Verde, if an incident did occur, it could materially and adversely affect our results of operations and financial condition. A major incident at a nuclear facility anywhere in the world could cause the NRC to limit or prohibit the operation or licensing of any domestic nuclear unit and to promulgate new regulations that could require significant capital expenditures and / or increase operating costs. Changes in technology could create challenges for APS' s existing business. Alternative energy technologies that produce power or reduce power consumption or emissions are being developed and commercialized, including renewable technologies such as photovoltaic (solar) cells, customer- sited generation, energy storage (batteries) and efficiency technologies. Advances in technology and equipment / appliance efficiency could reduce the demand for supply from conventional generation, including carbon- free nuclear generation, and increase the complexity of managing APS' s information technology and power system operations, which could adversely affect APS' s business. Customer- sited alternative energy technologies present challenges to APS' s operations due to misalignment with APS' s existing operational needs. When these resources lack " dispatchability " and other elements of utility- side control, they are considered " unmanaged " resources. The cumulative effect of such unmanaged resources results in added complexity for APS' s system management. APS continues to pursue and implement advanced grid technologies, including transmission and distribution system technologies and digital meters enabling two- way communications between the utility and its customers. Many of the products and processes resulting from these and other alternative technologies, including energy storage technologies, have not yet been widely used or tested on a long- term basis, and their use on large- scale systems is not as established or mature as APS' s existing technologies and equipment. The implementation of new and additional technologies adds complexity to our information technology and operational technology systems, which could require additional infrastructure and resources. Widespread installation and acceptance of new technologies could also enable the entry of new market participants, such as technology companies, into the interface between APS and its customers and could have other unpredictable effects on APS' s traditional business model. Deployment of renewable energy technologies is expected to continue across the western states and result in a larger portion of the overall energy production coming from these sources. These trends, which have benefited from historical and continuing government support for certain technologies, have the potential to put downward pressure on wholesale power prices throughout the western states which could make APS' s existing generating facilities less economical and impact their operational patterns and long- term viability. We are subject to employee workforce factors that could adversely affect our business and financial condition. Like many companies in the electric utility industry, our workforce is maturing, with approximately ~~30~~ **28** % of employees eligible to retire by the end of ~~2027~~ **2028** . Although we have undertaken efforts to recruit, train and develop new employees, we face increased competition for talent. We are subject to other employee workforce factors, such as the availability and retention of qualified personnel and the need to negotiate collective bargaining agreements with union employees. These or other employee workforce factors could negatively impact our business, financial condition, or results of operations. ~~COVID- 19 could negatively affect our business. COVID- 19 is a continually developing situation around the globe that has led to economic disruption and volatility in the financial markets. The spread of COVID- 19 and efforts to contain the virus and mitigate its public health effects, could decrease demand for energy, lower economic growth, impact our employees and contractors, cause disruptions in our supply chain, increase certain costs, further increase volatility in the capital markets (and result in increases in the cost of capital or an inability to access the capital markets or draw on available credit facilities), delay the completion of capital or other construction projects and other operations and maintenance activities, delay payments or increase uncollectable accounts, impact our ability to hire or retain qualified employees, or cause other unpredictable events, each of which could adversely affect our business, results of operations, cash flows or financial condition.~~ FINANCIAL RISKS A downgrade of our credit ratings could materially and adversely affect our business, financial condition, and results of operations. Our current ratings are set forth in " Liquidity and Capital Resources — Credit Ratings " in Item 7. We cannot be sure that any of our current ratings will remain in effect for any given period of time or that a rating will not be lowered or withdrawn entirely by a rating agency if, in its judgment, circumstances in the future so warrant. Any downgrade or withdrawal could adversely affect the market price of Pinnacle West' s and APS' s securities, limit our access to capital and increase our borrowing costs, which would adversely impact our financial results. We could be required to pay a higher interest rate for future financings, and our potential pool of investors and funding sources could decrease. In addition, borrowing costs under our existing credit facilities depend on our credit ratings. A downgrade could also require us to provide additional support in the form of letters of credit or cash or other collateral to various counterparties. If our short- term ratings were to be lowered, it could severely limit access to the commercial paper market. We note that the ratings from rating agencies are not recommendations to buy, sell or hold our securities and that each rating should be evaluated independently of any other rating. Investment performance, changing interest rates, new rules or regulations and other economic, social, and political factors could decrease the value of our benefit plan assets, nuclear decommissioning trust funds and other special use funds or increase the valuation of our related obligations, resulting in significant additional funding requirements. We are also subject to risks related to the provision of employee healthcare benefits and healthcare reform legislation. Any inability to fully recover these costs in our utility rates would negatively impact our financial condition. We have significant pension plan and other postretirement benefits plan obligations to our employees and retirees, and legal obligations to fund our pension trust and nuclear decommissioning trusts for Palo Verde. We hold and invest substantial assets in these trusts that are designed to provide funds to pay for certain of these obligations as they arise. Declines in market values of the fixed income and equity securities held in these trusts may increase our funding requirements ~~into~~ **for** the related trusts. Additionally, the valuation of liabilities related to our pension plan and other postretirement benefit plans are impacted by a discount rate, which is the interest rate used to discount future pension and other postretirement benefit obligations. ~~Declining~~ **Changes in** interest rates ~~decrease~~ **impact** the discount rate **and** ~~, increase the~~ valuation of the plan liabilities, and may result in increases in pension and other postretirement benefit costs, cash contributions, regulatory assets, and charges to OCI. Changes in demographics, including increased number of retirements or changes in life expectancy and changes in other actuarial assumptions, may also result in similar impacts. The minimum contributions required under these plans are impacted by federal legislation and related regulations. Increasing liabilities or otherwise increasing funding requirements under these plans, resulting from adverse changes in legislation or otherwise, could result in significant cash funding obligations that could have a material impact on our financial ~~position~~ **condition** , results of operations, or cash flows. We recover most of the pension and other postretirement benefit expense and all of the currently estimated nuclear decommissioning costs in our regulated rates. Any inability to fully recover these costs in a timely manner could have a material negative impact on our financial condition, results of operations, or cash flows. Pending or future federal or state legislative or regulatory activity or court proceedings could increase **the** costs of providing medical insurance for our employees and retirees. Any potential changes and resulting cost impacts cannot be determined with certainty at this time. Our cash flow depends on the performance of APS and its ability to make distributions. We derive essentially all of our revenues and earnings from our wholly- owned subsidiary, APS. Accordingly, our cash flow and our ability to pay dividends on our common stock is dependent upon the earnings and cash flows of APS and its distributions to us. APS is a separate and distinct legal entity and has no obligation to make distributions to us. APS' s financing agreements may restrict its ability to pay dividends, make distributions or otherwise transfer funds to us. In addition, an ACC financing order requires APS to maintain a common equity ratio of at least 40 % and does not allow APS to pay common dividends if the payment would reduce its common equity below that threshold. The common equity ratio, as defined in the ACC order, is total shareholder equity divided by the sum of total shareholder equity and long- term debt, including current maturities of long- term debt. Pinnacle West' s ability to meet its debt service obligations could be adversely affected because its debt securities are structurally subordinated to the debt securities and other obligations of its subsidiaries.

Because Pinnacle West is structured as a holding company, all existing and future debt and other liabilities of its subsidiaries will be effectively senior in right of payment to its own debt securities. The assets and cash flows of our subsidiaries will be available, in the first instance, to service their own debt and other obligations. Our ability to have the benefit of their cash flows, particularly in the case of any insolvency or financial distress affecting our subsidiaries, would arise only through our equity ownership interests in our subsidiaries and only after their creditors have been satisfied. The use of derivative contracts in the normal course of our business could result in financial losses that negatively impact our results of operations. APS' s operations include managing market risks related to commodity prices. APS is exposed to the impact of market fluctuations in the price and transportation costs of electricity, natural gas, and coal to the extent that unhedged positions exist. We have established procedures to manage risks associated with these market fluctuations by utilizing various commodity derivatives, including exchange traded futures and over- the- counter (" OTC ") forwards, options, and swaps. As part of our overall risk management program, we enter into derivative transactions to hedge purchases and sales of electricity and natural gas. The changes in market value of such contracts have a high correlation to price changes in the hedged commodity. To the extent that commodity markets are illiquid, we may not be able to execute our risk management strategies, which could result in greater unhedged positions than we would prefer at a given time and financial losses that negatively impact our results of operations. The Dodd-Frank Wall Street Reform and Consumer Protection Act (" Dodd- Frank Act ") contains measures aimed at increasing the transparency and stability of the over- the- counter derivative markets and preventing excessive speculation. The Dodd- Frank Act could restrict, among other things, trading positions in the energy futures markets, require different collateral or settlement positions, or increase regulatory reporting over derivative positions. Based on the provisions included in the Dodd- Frank Act and the implementation of regulations, these changes could, among other things, impact our ability to hedge commodity price and interest rate risk or increase the costs associated with our hedging programs. We are exposed to losses in the event of nonperformance or nonpayment by counterparties. We use a risk management process to assess and monitor the financial exposure of all counterparties. Despite the fact that the majority of APS' s trading counterparties are rated as investment grade by the rating agencies, there is still a possibility that one or more of these companies could default, which could result in a material adverse impact on our earnings for a given period. GENERAL RISKS Proposals to change policy in Arizona or other states made through ballot initiatives or referenda may increase the Company' s cost of operations or impact its business plans. In Arizona and other states, a person or organization may file a ballot initiative or referendum with the Arizona Secretary of State or other applicable state agency and, if a sufficient number of verifiable signatures are presented, the initiative or referendum may be placed on the ballot for the public to vote on the matter. Ballot initiatives and referenda may relate to any matter, including policy and regulation related to the electric industry, and may change statutes or the state constitution in ways that could impact Arizona utility customers, the Arizona economy, and the Company. Some ballot initiatives and referenda are drafted in an unclear manner and their potential industry and economic impact can be subject to varied and conflicting interpretations. We may oppose certain initiatives or referenda (including those that could result in negative impacts to our customers, the state, or the Company) via the electoral process, litigation, traditional legislative mechanisms, agency rulemaking or otherwise, which could result in significant costs to the Company. The passage of certain initiatives or referenda could result in laws and regulations that impact our business plans and have a material adverse impact on our financial condition, results of operations, or cash flows. General economic conditions could materially affect our business, financial condition, and results of operations. General economic factors that are beyond the Company' s control impact the Company' s forecasts and actual performance. These factors include interest rates; recession; inflation; stagflation; deflation; supply chain constraints; unemployment trends; sanctions, trade restrictions, military interventions and the threat or possibility of war; terrorism or other global or national unrest; and political or financial instability. In particular, ~~during~~ **from** 2021 ~~and~~ **to** ~~2022~~ **2023** , the United States' economy has experienced a substantial rise in the inflation rate. There is increased uncertainty as to whether the rise in inflation will continue and for how long. Increases in inflation raise the Company' s costs for commodities, labor, materials and services. Additionally, ~~COVID- 19 severely impacted~~ global supply chains **have been impacted** , resulting in equipment delays and increased costs. A failure to recover the increased costs caused by increased inflation and supply chain constraints through our rates could have a material adverse impact on our financial condition, results of operations, or cash flows. The market price of our common stock may be volatile. The market price of our common stock could be subject to significant fluctuations in response to factors such as the following, some of which are beyond our control: • variations in our quarterly operating results; • operating results that vary from the expectations of management, securities analysts, and investors; • changes in expectations as to future financial performance, including financial estimates by securities analysts and investors; • developments generally affecting industries in which we operate; • announcements by us or our competitors of significant contracts, acquisitions, joint marketing relationships, joint ventures, or capital commitments; • announcements by third parties of significant claims or proceedings against us; • favorable or adverse regulatory or legislative developments; • our dividend policy; • change in our management; • future sales by the Company of equity or equity- linked securities; and • general domestic and international economic conditions. In addition, the stock market in general has experienced volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations may adversely affect the market price of our common stock. Financial market disruptions or new rules or regulations may increase our financing costs or limit our access to various financial markets, which may adversely affect our liquidity and our ability to implement our financial strategy. Pinnacle West and APS rely on access to credit markets as a significant source of liquidity and the capital markets for capital requirements not satisfied by cash flow from our operations. We believe that we will maintain sufficient access to these financial markets. However, certain market disruptions or revisions to rules or regulations may cause our cost of borrowing to increase generally, and / or otherwise adversely affect our ability to access these financial markets. In addition, the credit commitments of our lenders under our bank facilities may not be satisfied or continued beyond current commitment periods for a variety of reasons, including new rules and regulations, changes to the internal policies of our lenders, periods of financial distress or liquidity issues affecting our lenders or financial markets, which could materially adversely affect the adequacy of our liquidity sources and / or the cost of maintaining these sources. Changes in economic conditions, monetary policy, fiscal policy, financial regulation, rating agency treatment and / or other factors could result in higher interest rates, which would increase interest expense on our existing variable rate debt and new debt we expect to issue in the future, and thus increase the cost and / or reduce the amount of funds available to us for our current plans. Additionally, an increase in our leverage, whether as a result of these factors or otherwise, could adversely affect us by: • causing a downgrade of our credit ratings; • increasing the cost of future debt financing and refinancing; • increasing our vulnerability to adverse economic and industry conditions; and • requiring us to dedicate an increased portion of our cash flow from operations to payments on our debt, which would reduce funds available to us for operations, future investment in our business or other purposes. Certain provisions of our articles of incorporation and bylaws and of Arizona law make it difficult for shareholders to change the composition of our board and may discourage takeover attempts. These provisions, which could preclude our shareholders from receiving a change of control premium, include the following: • restrictions on our ability to engage in a wide range of " business combination " transactions with an " interested shareholder " (generally, any person who beneficially owns 10 % or more of our outstanding voting power, or any of our affiliates or associates who beneficially owned 10 % or more of our outstanding voting power at any time during the prior three years) or any affiliate or associate of an interested shareholder, unless specific conditions are met; • anti-greenmail provisions of Arizona law and our bylaws that prohibit us from purchasing shares of our voting stock from beneficial owners of more than 5 % of our outstanding shares unless specified conditions are satisfied; • the ability of the Board of Directors to increase the size of and fill vacancies on the Board of Directors, whether resulting from such increase, or from death, resignation, disqualification or otherwise; • the ability of our Board of Directors to issue additional shares of common stock and shares of preferred stock and to determine the price and, with respect to preferred stock, the other terms, including preferences and voting rights, of those shares without shareholder approval; • restrictions that limit the rights of our shareholders to call a special meeting of shareholders; and • restrictions regarding the rights of our shareholders to nominate directors or to submit proposals to be considered at shareholder meetings. While these provisions may have the effect of encouraging persons seeking to acquire control of us to negotiate with our Board of Directors, they could enable the Board of Directors to hinder or frustrate a transaction that some, or a majority, of our shareholders might believe to be in their best interests and, in that case, may prevent or discourage attempts to remove and replace incumbent directors.