PENNSYLVANIA POWER COMPANY

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

GLOSSARY OF TERMS

The following abbreviations and acronyms may be used in these financial statements to identify Pennsylvania Power Company and its current and former affiliated companies:

ATSI	American Transmission Systems, Incorporated, formerly a direct subsidiary of FE that became a subsidiary of FET in April 2012, which owns and operates transmission facilities
CEI	The Cleveland Electric Illuminating Company, an Ohio electric utility operating affiliated company
FE	FirstEnergy Corp., a public utility holding company
FE Board	The Board of Directors of FirstEnergy Corp.
FENOC	Energy Harbor Nuclear Corp. (formerly known as FirstEnergy Nuclear Operating Company), a subsidiary of EH, which operates NG's nuclear generating facilities
FES	Energy Harbor LLC. (formerly known as FirstEnergy Solutions Corp.), a subsidiary of EH, which provides energy-related products and services
FESC	FirstEnergy Service Company, which provides legal, financial and other corporate support services
FET	FirstEnergy Transmission, LLC, formerly known as Allegheny Energy Transmission, LLC, which is the parent of ATSI, KATCo, MAIT and TrAIL and has a joint venture in PATH
FirstEnergy	FirstEnergy Corp., together with its consolidated subsidiaries
JCP&L	Jersey Central Power & Light Company, a New Jersey electric utility operating affiliated company
KATCo	Keystone Appalachian Transmission Company, a subsidiary of FET
MAIT	Mid-Atlantic Interstate Transmission, LLC, a subsidiary of FET, which owns and operates transmission facilities
ME	Metropolitan Edison Company, a Pennsylvania electric utility operating affiliated company
MP	Monongahela Power Company, a West Virginia electric utility operating affiliated company
OE	Ohio Edison Company, an Ohio electric utility operating company
PE	The Potomac Edison Company, a Maryland and West Virginia electric utility operating affiliated company
Penn	Pennsylvania Power Company, a Pennsylvania electric utility operating subsidiary of OE
Pennsylvania Companies	ME, PN, Penn and WP
PN	Pennsylvania Electric Company, a Pennsylvania electric utility operating affiliated company
TrAIL	Trans-Allegheny Interstate Line Company, a subsidiary of FET, which owns and operates transmission facilities
TE	The Toledo Edison Company, an Ohio electric utility operating affiliated company
Transmission Companies	ATSI, MAIT and TrAIL
Utilities	OE, CEI, TE, Penn, JCP&L, ME, PN, MP, PE and WP
WP	West Penn Power Company, a Pennsylvania electric utility operating affiliated company

The following abbreviations and acronyms may be used to identify frequently used terms in these financial statements:

ADITs	Accumulated Deferred Income Taxes
AMT	Alternative Minimum Tax
AOCI	Accumulated Other Comprehensive Income (Loss)
ASU	Accounting Standards Update
COVID-19	Coronavirus disease 2019
CSR	Conservative Support Rider
DSIC	Distribution System Improvement Charge
DSP	Default Service Plan
EDC	Electric Distribution Company
EE&C	Energy Efficiency and Conservation
EGS	Electric Generation Supplier
ERO	Electric Reliability Organization
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FMB	First Mortgage Bond

FPA	Federal Power Act
GAAP	Accounting Principles Generally Accepted in the United States of America
HB 6	House Bill 6, as passed by Ohio's 133rd General Assembly
IRS	Internal Revenue Service
LIBOR	London Interbank Offered Rate
LOC	Letter of Credit
LTIIPs	Long-Term Infrastructure Improvement Plans
MW	Megawatt
MWH	Megawatt-hour
NERC	North American Electric Reliability Corporation
N.D. Ohio	Northern District of Ohio
NOL	Net Operating Loss
OAG	Ohio Attorney General
OCA	Office of Consumer Advocate
OPEB	Other Post-Employment Benefits
POLR	Provider of Last Resort
POR	Purchase of Receivables
PPUC	Pennsylvania Public Utility Commission
PUCO	Public Utilities Commission of Ohio
R&D	Research and Development
RFC	Reliability*First* Corporation
RFP	Request for Proposal
ROE	Return on Equity
S.D. Ohio	Southern District of Ohio
SEC	United States Securities and Exchange Commission
SREC	Solar Renewable Energy Credit
Tax Act	Tax Cuts and Jobs Act adopted December 22, 2017

Report of Independent Auditors

To Management and the Board of Directors
of Pennsylvania Power Company

We have audited the accompanying financial statements of Pennsylvania Power Company (the “Company”), which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of income, of comprehensive income, of common stockholder’s equity, and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors’ Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pennsylvania Power Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP
Cleveland, Ohio
March 18, 2021

PENNSYLVANIA POWER COMPANY
STATEMENTS OF INCOME

(In millions)	For the Years Ended December 31, 2020	2019
REVENUES:		
Electric sales	$ 231	$ 228
Gross receipts tax collections	14	14
Total revenues	245	242
OPERATING EXPENSES:		
Purchased power from affiliates	—	11
Purchased power from non-affiliates	97	92
Other operating expenses	53	52
Provision for depreciation	24	22
Amortization of regulatory liabilities, net	(3)	(10)
General taxes	16	16
Total operating expenses	187	183
OPERATING INCOME	58	59
OTHER INCOME (EXPENSE):		
Miscellaneous income, net	8	6
Pension and OPEB mark-to-market adjustment	(7)	(14)
Interest expense	(12)	(12)
Capitalized financing costs	1	1
Total other expense	(10)	(19)
INCOME BEFORE INCOME TAXES	48	40
INCOME TAXES	10	8
NET INCOME	$ 38	$ 32
STATEMENTS OF COMPREHENSIVE INCOME		
NET INCOME	$ 38	$ 32
OTHER COMPREHENSIVE LOSS:		
Pension and OPEB prior service costs	—	(1)
Other comprehensive loss	—	(1)
Income tax benefits on other comprehensive loss	—	—
Other comprehensive loss, net of tax	—	(1)
COMPREHENSIVE INCOME	$ 38	$ 31

The accompanying Notes to Financial Statements are an integral part of these financial statements.

PENNSYLVANIA POWER COMPANY
BALANCE SHEETS

(In millions, except share amounts)	December 31, 2020	December 31, 2019
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 50	$ —
Receivables-		
Customers	42	35
Less — Allowance for uncollectible customer receivables	6	2
	36	33
Affiliated companies	7	9
Other	5	4
Prepaid taxes and other	5	7
	103	53
UTILITY PLANT:		
In service	839	804
Less — Accumulated provision for depreciation	231	220
	608	584
Construction work in progress	15	14
	623	598
OTHER PROPERTY AND INVESTMENTS:		
Investments in employee benefit trusts	11	11
Other	8	7
	19	18
	$ 745	$ 669
LIABILITIES AND CAPITALIZATION		
CURRENT LIABILITIES:		
Currently payable long-term debt	$ 1	$ 1
Short-term borrowings -		
Affiliated companies	32	12
Other	50	—
Accounts payable-		
Affiliated companies	—	1
Other	16	17
Accrued taxes	2	1
Other	19	18
	120	50
CAPITALIZATION:		
Common stockholder's equity-		
Common stock, $30 par value, authorized 6,500,000 shares - 3,110,836 shares outstanding	93	93
Other paid-in capital	32	32
Retained earnings	74	66
Total common stockholder's equity	199	191
Long-term debt and other long-term obligations	199	200
	398	391
NONCURRENT LIABILITIES:		
Accumulated deferred income taxes	111	105
Retirement benefits	38	39
Regulatory liabilities	32	41
Other	46	43
	227	228
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
	$ 745	$ 669

The accompanying Notes to Financial Statements are an integral part of these financial statements.

PENNSYLVANIA POWER COMPANY
STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

(In millions, except share amounts)	Common Stock: Number of Shares	Common Stock: Carrying Value	Other Paid-in Capital	Retained Earnings	Total Stockholder's Equity
Balance, January 1, 2019	3,110,836	$ 93	$ 31	$ 69	$ 193
Net income				32	32
Stock-based compensation			1		1
Cash dividends declared on common stock				(35)	(35)
Balance, December 31, 2019	3,110,836	$ 93	$ 32	$ 66	$ 191
Net income				38	38
Cash dividends declared on common stock				(30)	(30)
Balance, December 31, 2020	3,110,836	$ 93	$ 32	$ 74	$ 199

The accompanying Notes to Financial Statements are an integral part of these financial statements.

PENNSYLVANIA POWER COMPANY
STATEMENTS OF CASH FLOWS

(In millions)	For the Years Ended December 31, 2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 38	$ 32
Adjustments to reconcile net income to net cash from operating activities-		
Depreciation and amortization	21	13
Deferred income taxes	—	6
Pension trust contributions	—	(8)
Pension and OPEB mark-to-market adjustment	7	14
Retirement benefits, net of payments	(8)	(6)
Change in current assets and liabilities-		
Receivables	(2)	5
Prepaid taxes and other current assets	2	(2)
Accounts payable	(2)	(1)
Accrued taxes	1	—
Other current liabilities	1	1
Net cash provided from operating activities	58	54
CASH FLOWS FROM FINANCING ACTIVITIES:		
New financing-		
Short-term borrowings-		
Affiliated companies, net	20	12
Other, net	50	—
Redemptions and repayments-		
Long-term debt	—	(1)
Common stock dividend payments	(30)	(35)
Other	(1)	(1)
Net cash provided from (used for) financing activities	39	(25)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(43)	(48)
Loans to affiliated companies, net	—	24
Asset removal costs	(5)	(5)
Other	1	—
Net cash used for investing activities	(47)	(29)
Net change in cash, cash equivalents, and restricted cash	50	—
Cash, cash equivalents, and restricted cash at beginning of period	—	—
Cash, cash equivalents, and restricted cash at end of period	$ 50	$ —
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year -		
Interest (net of amounts capitalized)	$ 11	$ 11
Income taxes, net of refunds	$ 4	$ 10

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

PENNSYLVANIA POWER COMPANY
NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Unless otherwise indicated, defined terms and abbreviations used herein have the meanings set forth in the accompanying Glossary of Terms.

Penn is a wholly owned subsidiary of OE, which is a wholly owned subsidiary of FE. Penn operates an electric transmission and distribution system in Pennsylvania. Penn is subject to regulation by the PPUC and FERC.

Penn follows GAAP and complies with the regulations, orders, policies and practices prescribed by FERC and the PPUC. The preparation of financial statements in conformity with GAAP requires management to make periodic estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates. The reported results of operations are not necessarily indicative of results of operations for any future period. Penn has evaluated events and transactions for potential recognition or disclosure through March 18, 2021, the date the financial statements were issued.

Certain prior year amounts have been reclassified to conform to the current year presentation.

COVID-19

The outbreak of COVID-19 has become a global pandemic. Penn is continuously evaluating the global pandemic and taking steps to mitigate known risks. The full impact on Penn's business from the pandemic, including the governmental and regulatory responses, is unknown at this time and difficult to predict. Penn provides a critical and essential service to its customers and the health and safety of its employees and customers is its first priority. Penn is continuously monitoring its supply chain and is working closely with essential vendors to understand the continued impact of COVID-19 to its business and does not currently expect service disruptions or any material impact on its capital spending plan.

Currently, Penn is effectively managing operations during the pandemic in order to continue to provide critical service to customers, however, the situation remains fluid and future impacts to Penn that are presently unknown or unanticipated may occur. Furthermore, the likelihood of an impact to Penn, and the severity of any impact that does occur, could increase the longer the global pandemic persists.

RECEIVABLES

Penn's principal business is providing electric service to customers in Pennsylvania. Penn's retail customers are metered on a cycle basis. Electric revenues are recorded based on energy delivered through the end of the calendar month. An estimate of unbilled revenues is calculated to recognize electric service provided from the last meter reading through the end of the month. This estimate includes many factors, among which are historical customer usage, load profiles, estimated weather impacts, customer shopping activity and prices in effect for each class of customer. In each accounting period, Penn accrues the estimated unbilled amount as revenue and reverses the related prior period estimate. Billed (net of uncollectibles) and unbilled customer receivables were $21 million and $15 million, respectively, as of December 31, 2020, and were $19 million and $14 million, respectively, as of December 31, 2019. Receivables from customers include retail electric sales and distribution deliveries to residential, commercial and industrial customers.

The allowance for uncollectible customer receivables is based on historical loss information comprised of a rolling 36-month average net write-off percentage of revenues, in conjunction with a qualitative assessment of elements that impact the collectability of receivables to determine if allowances for uncollectible accounts should be further adjusted in accordance with the accounting guidance for credit losses. Management contemplates available current information such as changes in economic factors, regulatory matters, industry trends, customer credit factors, amount of receivable balances that are past-due, payment options and programs available to customers, and the methods that the Utilities are able to utilize to ensure payment.

FirstEnergy reviews its allowance for uncollectible customer receivables utilizing a quantitative and qualitative assessment, which includes consideration of the outbreak of COVID-19 and the impact on customer receivable balances outstanding and the ability of customers to continue payment since the pandemic began. The impact of COVID-19 on customers' ability to pay for service, along with the actions FirstEnergy has taken in response to the pandemic, is expected to result in an increase in customer receivable write-offs as compared to historically incurred losses. In order to estimate the additional losses and impacts expected, FirstEnergy analyzed the likelihood of loss based on increases in customer accounts in arrears since the pandemic began in mid-March 2020 as well as what collection methods are or were suspended, and that have historically been utilized to ensure payment. Based on this assessment, and consideration of other qualitative factors described above, Penn recognized incremental uncollectible expense of $5 million in the year 2020, of which $3 million was deferred for future recovery.

In Pennsylvania, the PPUC has authorized the Pennsylvania Companies to track all prudently incurred incremental costs arising from COVID-19, and to create a regulatory asset for future recovery of incremental uncollectible expenses incurred as a result of COVID-19 above what is included in the Pennsylvania Companies existing rates. On October 13, 2020, the PPUC entered an order that permits the Pennsylvania Companies to create a regulatory asset for incremental expenses associated with lifting the service termination moratorium, as further discussed below.

Activity associated with customer receivables is as follows:

(In millions)	2020	2019
Customer Receivables		
Beginning of year balance	$ 2	$ 2
Charged to income [(1)]	6	3
Charged to other accounts [(2)]	1	1
Write-offs	(3)	(4)
End of year balance	$ 6	$ 2

[(1)] Customer receivable amounts charged to income include approximately $3 million associated with incremental uncollectible expense, discussed above, which was deferred for future recovery for the year ended December 31, 2020.
[(2)] Represents recoveries and reinstatements of accounts previously written off for uncollectible accounts.

ACCOUNTING FOR THE EFFECTS OF REGULATION

Regulatory assets represent incurred costs that have been deferred because of their probable future recovery from customers through regulated rates. Regulatory liabilities represent amounts that are expected to be credited to customers through future regulated rates or amounts collected from customers for costs not yet incurred. Penn nets its regulatory assets and liabilities based on federal and state jurisdictions. Penn considers the entire regulatory asset balance as the unit of account for the purposes of balance sheet classification rather than the next years recovery and as such net regulatory assets and liabilities are presented in the non-current section on the Penn Balance Sheets.

Management assesses the probability of recovery of regulatory assets at each balance sheet date and whenever new events occur. Factors that may affect probability relate to changes in the regulatory environment, issuance of a regulatory commission order or passage of new legislation. Management applies judgment in evaluating the evidence available to assess the probability of recovery of regulatory assets from customers, including, but not limited to evaluating evidence related to precedent for similar items at Penn and information on comparable companies within similar jurisdictions, as well as assessing progress of communications between Penn and regulators.

The following table provides information about the composition of net regulatory assets and liabilities as of December 31, 2020 and December 31, 2019, and the changes during the year ended December 31, 2020:

Net Regulatory Assets (Liabilities) by Source	**December 31, 2020**	**December 31, 2019**	**Change**
		(In millions)	
Customer payables for future income taxes	$ (51)	$ (58)	$ 7
Deferred transmission costs	(1)	(8)	7
Deferred generation costs	(6)	(1)	(5)
Deferred distribution costs	3	5	(2)
Storm-related costs	19	16	3
Uncollectible and COVID-19 related costs	3	—	3
Other	1	5	(4)
Net Regulatory Liabilities included on the Balance Sheets	$ (32)	$ (41)	$ 9

The following is a description of the regulatory assets and liabilities described above:

Customer payables for future income taxes - Reflects amounts to be recovered or refunded through future rates to pay income taxes that become payable when rate revenue is provided to recover items such as AFUDC-equity and depreciation of property, plant and equipment for which deferred income taxes were not recognized for ratemaking purposes, including amounts attributable to tax rate changes such as the Tax Act These amounts are being amortized over the period in which the related deferred tax assets reverse, which is generally over the expected life of the underlying asset.

Deferred transmission costs - Primarily relates to the recovery of non-market based costs or fees imposed on or charged to Penn by various regulatory bodies including FERC and regional transmission organizations. These costs can include PJM charges and credits for service including, but not limited to, procuring transmission services and transmission enhancement.

Deferred generation costs - Relates to the costs to provide energy and capacity services to customers who take default services including non market based transmission and ancillary services.

Deferred distribution costs - Primarily relates to the recovery of legacy meters that were replaced with smart meters.

Storm-related costs - Relates to the recovery of storm costs, of which approximately $14 million and $16 million are currently being recovered through rates as of December 31, 2020 and 2019, respectively.

Uncollectible and COVID-19 related costs - Includes the deferral of prudently incurred incremental costs arising from COVID-19, including uncollectible expenses.

The following table provides information about the composition of net regulatory assets that do not earn a current return as of December 31, 2020 and 2019, of which $14 million and $17 million are currently being recovered through rates, respectively:

Regulatory Assets by Source Not Earning a Current Return	December 31, 2020	December 31, 2019	Change
		(In millions)	
Storm-related costs	$ 19	$ 16	$ 3
Uncollectible and COVID-19 related costs	3	—	3
Other	—	1	(1)
Regulatory Assets Not Earning a Current Return	$ 22	$ 17	$ 5

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment reflects original cost (net of any impairments recognized), including payroll and related costs such as taxes, employee benefits, administrative and general costs, and interest costs incurred to place the assets in service. The costs of normal maintenance, repairs and minor replacements are expensed as incurred. Penn recognizes liabilities for planned major maintenance projects as they are incurred.

Penn provides for depreciation on a straight-line basis at various rates over the estimated lives of property included in plant in service. Depreciation expense was approximately 2.9% and 2.8% of average depreciable property in 2020 and 2019, respectively.

Capitalized financing costs on Penn's Statement of Income include $1 million of allowance for equity funds used during construction for the years ended December 31, 2020 and 2019.

Penn evaluates long-lived assets classified as held and used for impairment when events or changes in circumstances indicate the carrying value of the long-lived assets may not be recoverable. First, the estimated undiscounted future cash flows attributable to the assets is compared with the carrying value of the assets. If the carrying value is greater than the undiscounted future cash flows, an impairment charge is recognized equal to the amount the carrying value of the assets exceeds its estimated fair value.

INVESTMENTS

All temporary cash investments purchased with an initial maturity of three months or less are reported as cash equivalents on the Balance Sheets at cost, which approximates their fair market value.

NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Pronouncements

ASU 2016-13, "*Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*" (Issued June 2016 and subsequently updated): ASU 2016-13 removes all recognition thresholds and will require companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. Prior to adoption, FirstEnergy analyzed its financial instruments within the scope of this guidance, primarily trade receivables and AFS debt securities. The adoption of this standard upon January 1, 2020 did not have a material impact to the financial statements and required additional disclosures within. Please see above for additional information on the allowance for uncollectible receivables.

ASU 2018-15, "*Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*" (Issued August 2018): ASU 2018-15 allows implementation costs incurred by customers in cloud computing arrangements to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customers in a software licensing arrangement. This standard was adopted as of January 1, 2020, with no material impact to the financial statements.

ASU 2020-04, "*Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting"* (Issued March 2020): ASU 2020-04 provides temporary optional expedients and exceptions to the current guidance on contract modifications to ease the financial reporting burdens related to the expected market transition from LIBOR and other interbank offered rates to alternative reference rates. FirstEnergy's $3.5 billion Revolving Credit Facility bears interest at fluctuating interest rates based on LIBOR and contains provisions (requiring an amendment) in the event that LIBOR can no longer be used. As of December 31, 2020, none of the expedients discussed within this ASU have been utilized.

Recently Issued Pronouncements - The following new authoritative accounting guidance issued by the FASB has not yet been adopted. Unless otherwise indicated, Penn is currently assessing the impact such guidance may have on its financial statements and disclosures, as well as the potential to early adopt where applicable. Penn has assessed other FASB issuances of new standards not described below and has not included these standards based upon the current expectation that such new standards will not significantly impact Penn's financing reporting.

ASU 2019-12, "Simplifying the Accounting for Income Taxes" (Issued in December 2019): ASU 2019-12 enhances and simplifies various aspects of the income tax accounting guidance including the elimination of certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences. The new guidance also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. FirstEnergy continues to evaluate the new guidance, but currently does not expect a material impact upon adopting this standard.

2. REVENUE

Penn accounts for revenues from contracts with customers under ASC 606, Revenue from Contracts with Customers. Revenue from leases, financial instruments, other contractual rights or obligations and other revenues that are not from contracts with customers are outside the scope of the standard and accounted for under other existing GAAP. Penn has elected to exclude sales taxes and other similar taxes collected on behalf of third parties from revenue as prescribed in the new standard. As a result, tax collections and remittances within the scope of this election are excluded from recognition in the income statement and instead recorded through the balance sheet. Gross receipts taxes that are assessed on Penn are not subject to the election and are included in revenue. Penn has elected the optional invoice practical expedient for most of its revenues and utilizes the optional short-term contract exemption for transmission revenues due to the annual establishment of revenue requirements, which eliminates the need to provide certain revenue disclosures regarding unsatisfied performance obligations.

Penn's principal business is providing electric service to customers in Pennsylvania. Penn's distribution customers are metered on a cycle basis. An estimate of unbilled revenues is calculated to recognize electric service provided from the last meter reading through the end of the month. This estimate includes many factors, among which are historical customer usage, load profiles, estimated weather impacts and prices in effect for each class of customer. In each accounting period, Penn accrues the estimated unbilled amount as revenue and reverses the related prior period estimate. Customer payments are generally due within 30 days. Retail generation sales relate to generation sales in Pennsylvania that are regulated by the PPUC.

Distribution services revenue relates to the distribution of electricity. Penn earns revenue from state-regulated rate tariffs under which it provides distribution services to residential, commercial and industrial customers in its service territory. Penn is obligated under the regulated construct to deliver power to customers reliably, as it is needed, which creates an implied monthly contract with the end-use customer. See Note 9, "Regulatory Matters," for additional information on rate recovery mechanisms. Distribution and electric revenues are recognized over time as electricity is distributed and delivered to the customer and the customers consume the electricity immediately as delivery occurs.

Retail generation sales relate to SOS requirements in Pennsylvania. Penn has default service obligations to provide power to non- shopping customers who have elected to continue to receive service under regulated retail tariffs. The volume of these sales varies depending on the level of shopping that occurs. Supply plans vary by state and by service territory. Default service for Penn are provided through a competitive procurement process approved by the state commission. Retail generation revenues are recognized over time as electricity is delivered and consumed immediately by the customer.

The following table represents a disaggregation of revenue from contracts with customers for the years ended December 31, 2020 and 2019, by type of service:

Revenues by Type of Service	For the Year Ended December 31, 2020	2019
	(In millions)	
Distribution services	$ 132	$ 129
Retail generation	108	108
Other	3	3
Total revenues from contracts with customers	$ 243	$ 240
Other non-customer revenue	2	2
Total revenues	$ 245	$ 242

The following table represents a disaggregation of Penn's revenue from contracts with distribution service and retail generation customers for the years ended December 31, 2020 and 2019, by class:

Revenues by Customer Class	For the Years Ended December 31, 2020	2019
	(In millions)	
Residential	$ 188	$ 182
Commercial	33	36
Industrial	18	17
Other	1	2
Total Revenues	$ 240	$ 237

3. PENSION AND OTHER POSTEMPLOYMENT BENEFITS

FirstEnergy provides noncontributory qualified defined benefit pension plans that cover substantially all of its employees and non-qualified pension plans that cover certain employees, including employees of Penn. The plans provide defined benefits based on years of service and compensation levels. Under the cash-balance portion of the Pension Plan (for employees hired on or after January 1, 2014), FirstEnergy makes contributions to eligible employee retirement accounts based on a pay credit and an interest credit. In addition, FirstEnergy provides a minimum amount of noncontributory life insurance to retired employees in addition to optional contributory insurance. Health care benefits, which include certain employee contributions, deductibles and co-payments, are also available upon retirement to certain employees, their dependents and, under certain circumstances, their survivors. Penn recognizes its allocated portion of the expected cost of providing pension and OPEB to employees and their beneficiaries and covered dependents from the time employees are hired until they become eligible to receive those benefits. Penn also recognizes its allocated portion of obligations to former or inactive employees after employment, but before retirement, for disability-related benefits.

FirstEnergy recognizes a pension and OPEB mark-to-market adjustment for the change in the fair value of plan assets and net actuarial gains and losses annually in the fourth quarter of each fiscal year and whenever a plan is determined to qualify for a remeasurement. The remaining components of pension and OPEB expense, primarily service costs, interest on obligations, assumed return on assets and prior service costs, are recorded on a monthly basis.

Under the approved bankruptcy settlement agreement, upon emergence, FES and FENOC employees ceased earning years of service under the FirstEnergy pension and OPEB plans. The emergence on February 27, 2020, triggered a remeasurement of the affected pension and OPEB plans and as a result, FirstEnergy recognized a non-cash, pre-tax pension and OPEB mark-to-market adjustment of approximately $423 million ($7 million at Penn) in the first quarter of 2020 The first quarter 2020 pension and OPEB mark-to-market adjustment primarily reflects a 38 bps decrease in the discount rate used to measure benefit obligations from December 31, 2019, partially offset by a slightly higher than expected return on assets. Penn's pension and OPEB mark-to-market adjustments for the years ended December 31, 2020 and 2019, were $7 million and $14 million, respectively. The fourth quarter 2020 pension and OPEB mark-to-market adjustment primarily reflects a 29 bps decrease in the discount rate used to measure benefit obligations from February 27, 2020, partially offset by higher than expected return on assets.

FirstEnergy’s pension and OPEB funding policy is based on actuarial computations using the projected unit credit method. On February 1, 2019, FirstEnergy made a $500 million ($8 million at Penn) voluntary cash contribution to the qualified pension plan. As a result of this contribution, FirstEnergy expects no required contributions until 2022.

Pension and OPEB costs are affected by employee demographics (including age, compensation levels and employment periods), the level of contributions made to the plans and earnings on plan assets. Pension and OPEB costs may also be affected by changes in key assumptions, including anticipated rates of return on plan assets, the discount rates and health care trend rates used in determining the projected benefit obligations for pension and OPEB costs. FirstEnergy uses a December 31 measurement date for its pension and OPEB plans. The fair value of the plan assets represents the actual market value as of the measurement date.

FirstEnergy’s assumed rate of return on pension plan assets considers historical market returns and economic forecasts for the types of investments held by the pension trusts. In 2020, FirstEnergy’s qualified pension and OPEB plan assets experienced gains of $1,225 million or 14.7%, compared to gains of $1,492 million, or 20.2% in 2019. An assumed 7.50% rate of return in 2020 and 2019 generated $651 million and $569 million of expected return on plan assets, respectively. The expected return on pension and OPEB assets is based on the trusts’ asset allocation targets and the historical performance of risk-based and fixed income securities. The gains or losses generated as a result of the difference between expected and actual returns on plan assets will decrease or increase future net periodic pension and OPEB cost as the difference is recognized annually in the fourth quarter of each fiscal year or whenever a plan is determined to qualify for remeasurement.

During 2020, the Society of Actuaries published new mortality tables that include more current data than the RP-2014 tables as well as new improvement scales. An analysis of FirstEnergy pension and OPEB plan mortality data indicated the use of the Pri-2012 mortality table with projection scale MP-2020 was most appropriate. As such, the Pri-2012 mortality table with projection scale MP-2020 was utilized to determine the 2020 benefit cost and obligation as of December 31, 2020 for the FirstEnergy pension and OPEB plans. The impact of using the Pri-2012 mortality table with projection scale MP-2020 resulted in a decrease to the projected benefit obligation of approximately $74 million and $2 million for the pension and OPEB plans, respectively, and was included in the 2020 pension and OPEB mark-to-market adjustment.

Effective in 2019, FirstEnergy changed the approach utilized to estimate the service cost and interest cost components of net periodic benefit cost for pension and OPEB plans. Historically, FirstEnergy estimated these components utilizing a single, weighted average discount rate derived from the yield curve used to measure the benefit obligation. FirstEnergy has elected to use a spot rate approach in the estimation of the components of benefit cost by applying specific spot rates along the full yield curve to the relevant projected cash flows, as this provides a better estimate of service and interest costs by improving the correlation between projected benefit cash flows to the corresponding spot yield curve rates. This election was considered a change in estimate and, accordingly, accounted for prospectively, and did not have a material impact on FirstEnergy's financial statements.

Service costs, net of capitalization, are reported within Other operating expenses on the Statements of Income. Non-service costs, other than the pension and OPEB mark-to-market adjustment, which is separately shown, are reported within Miscellaneous income, net, within Other Income (Expense) on the Statements of Income.

The following is a summary of the plan status:

	Pension		**OPEB**	
As of December 31,	**2020**	**2019**	**2020**	**2019**
		(In millions)		
FirstEnergy benefit obligation	$ 11,935	$ 11,050	$ 676	$ 654
FirstEnergy fair value of plan assets	8,968	8,395	502	458
FirstEnergy funded status	$ (2,967)	$ (2,655)	$ (174)	$ (196)
FirstEnergy accumulated benefit obligation	$ 11,376	$ 10,439	$ —	$ —
FirstEnergy net periodic costs (credits) [(1)]	$ 346	$ 703	$ (46)	$ (20)
Penn's share of net periodic costs (credits) [(1)]	$ (1)	$ 9	$ (1)	$ (1)
Penn's share of net liability [(2)]	$ 35	$ 35	$ 1	$ —

(1) Includes pension and OPEB mark-to-market adjustment.
(2) Excludes $36 million and $33 million as of December 31, 2020 and 2019, respectively, of affiliated non-current liabilities related to pension and OPEB mark-to-market costs allocated to Penn.

	Pension		OPEB	
	2020	2019	2020	2019
Assumptions Used to Determine Benefit Obligations (as of December 31)				
Discount rate	2.67 %	3.34 %	2.45 %	3.18 %
Rate of compensation increase	4.10 %	4.10 %	N/A	N/A
Cash balance weighted average interest crediting rate	2.57 %	2.57 %	N/A	N/A
Assumed Health Care Cost Trend Rates (as of December 31)				
Health care cost trend rate assumed (pre/post-Medicare)	N/A	N/A	6.0-5.5%	6.0-5.5%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	N/A	N/A	4.50 %	4.50 %
Year that the rate reaches the ultimate trend rate	N/A	N/A	2028	2028
Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31 (1)				
Service cost weighted-average discount rate (2)	3.60%/3.24%	4.66 %	3.63%/3.29%	4.67 %
Interest cost weighted-average discount rate (3)	3.27%/2.90%	4.37 %	2.71%/2.30%	3.89 %
Expected long-term return on plan assets	7.50 %	7.50 %	7.50 %	7.50 %
Rate of compensation increase	4.10 %	4.10 %	N/A	N/A

(1) Excludes impact of pension and OPEB mark-to-market adjustment.

(2) Weighted-average discount rates in effect from January 1, 2020, through February 26, 2020, were 3.60% and 3.63% for pension and OPEB service cost, respectively. Discount rates were 3.24% and 3.29% for pension and OPEB service cost, respectively, for the period February 27, 2020 through December 31, 2020.

(3) Weighted-average discount rates in effect from January 1, 2020, through February 26, 2020, were 3.27% and 2.71% for pension and OPEB interest cost, respectively. Discount rates were 2.90% and 2.30% for pension and OPEB interest cost, respectively, for the period February 27, 2020, through December 31, 2020.

In selecting an assumed discount rate, FirstEnergy considers currently available rates of return on high-quality fixed income investments expected to be available during the period to maturity of the pension and OPEB obligations. The assumed rates of return on plan assets consider historical market returns and economic forecasts for the types of investments held by FirstEnergy's pension and OPEB trusts. The long-term rate of return is developed considering the portfolio's asset allocation strategy.

4. TAXES

Penn records income taxes in accordance with the liability method of accounting. Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts recognized for tax purposes. Investment tax credits, which were deferred when utilized, are being amortized over the recovery period of the related property. Deferred income tax liabilities related to temporary tax and accounting basis differences and tax credit carryforward items are recognized at the statutory income tax rates in effect when the liabilities are expected to be paid. Deferred tax assets are recognized based on income tax rates expected to be in effect when they are settled.

Penn is party to an intercompany income tax allocation agreement with FE that provides for the allocation of consolidated tax liabilities. Net tax benefits attributable to FirstEnergy, excluding any tax benefits derived from interest expense associated with acquisition indebtedness from the merger with GPU, are reallocated to the subsidiaries of FirstEnergy that have taxable income. That allocation is accounted for as a capital contribution to the company receiving the tax benefit.

On March 27, 2020, President Trump signed into law the CARES Act, an economic stimulus package in response to the COVID-19 pandemic containing several corporate income tax provisions, including making remaining AMT credits immediately refundable; providing a 5-year carryback of NOLs generated in tax years 2018, 2019, and 2020, and removing the 80% taxable income limitation on utilization of those NOLs if carried back to prior tax years or utilized in tax years beginning before 2021; and temporarily liberalizing the interest deductibility rules under Section 163(j) of the Tax Act, by raising the adjusted taxable income limitation from 30% to 50% for tax years 2019 and 2020 and giving taxpayers the election of using 2019 adjusted taxable income for purposes of computing 2020 interest deductibility. Penn does not currently expect the provisions of the CARES Act to have a material effect on current income tax expense or the realizability of deferred income tax assets.

On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act, 2021, an additional stimulus package providing financial relief for individuals and small businesses. The Appropriations Act contains a variety of tax provisions, including full expensing of business meals in 2021 and 2022, extensions of various energy tax incentives (including the Investment Tax Credit), and expansion of the employee retention tax credit. Penn does not currently expect the Appropriations Act to have a material tax impact.

On July 28, 2020, the IRS issued final regulations implementing interest expense deduction limitation rules under section 163(j) of the Internal Revenue Code. The final regulations changed certain rules on the computation of interest expense and limitation amount, as well as rules relevant to status as a regulated utility business and the allocation of consolidated group interest expense between utility and non-utility businesses. On January 6, 2021, the IRS released an additional set of final regulations under Section 163(j) primarily addressing partnership, real estate, and certain controlled foreign corporation issues, which do not materially impact Penn.

	For the Years Ended December 31,	
INCOME TAXES:	**2020**	**2019**
	(In millions)	
Currently payable-		
Federal	$ 8	$ 2
State	2	—
	10	2
Deferred, net-		
Federal	—	4
State	—	2
	—	6
Total income taxes	$ 10	$ 8

Penn's tax rates are affected by permanent items, such as AFUDC equity and other flow-through items, as well as discrete items that may occur in any given period, but are not consistent from period to period. The following table provides a reconciliation of federal income tax expense at the federal statutory rate to the total income taxes for the years ended December 31, 2020 and 2019:

	For the Years Ended December 31,	
(In millions)	**2020**	**2019**
Book income before income taxes	$ 48	$ 40
Federal income tax expense at statutory rate	$ 10	$ 8
Increases (reductions) in taxes resulting from-		
State income taxes, net of federal tax benefit	4	3
AFUDC equity and other flow-through items	(3)	(2)
Excess deferred tax amortization due to the Tax Act	(1)	(2)
Other, net	—	1
Total income taxes	$ 10	$ 8
Effective income tax rate	20.8 %	20.0 %

Penn's effective tax rate on pre-tax income in 2020 and 2019 was 20.8% and 20.0%, respectively.

Accumulated deferred income taxes as of December 31, 2020 and 2019 are as follows:

	As of December 31,	
(In millions)	**2020**	**2019**
Property basis differences	$ 126	$ 122
Regulatory asset/liability	3	2
Pension and OPEB	(21)	(20)
Other	3	1
Net accumulated deferred income tax liabilities	$ 111	$ 105

Penn records as deferred income tax assets the effect of Federal NOLs and tax credits that will more likely than not be realized through future operations and through the reversal of existing temporary differences. As of December 31, 2020 and 2019, Penn's deferred income tax assets attributable to loss carryforwards and tax credits were immaterial.

Penn accounts for uncertainty in income taxes recognized in its financial statements. A recognition threshold and measurement attribute are utilized for financial statement recognition and measurement of tax positions taken or expected to be taken on a company's tax return. For the years ended December 31, 2020 and 2019, Penn did not record any unrecognized income tax benefits, nor does Penn have a reserve for any unrecognized tax benefits.

Penn recognizes interest expense or income and penalties related to uncertain tax positions in income taxes. That amount is computed by applying the applicable statutory interest rate to the difference between the tax position recognized and the amount previously taken or expected to be taken on the federal income tax return. During 2020 and 2019, Penn did not record any interest related to uncertain tax positions, nor did Penn have cumulative net interest payable recorded on its balance sheet.

For federal income tax purposes, Penn files as a member of the FE consolidated group. Tax years 2018 and 2019 are currently under review by the IRS. Penn has tax returns under review by state taxing authorities at the audit or appeals level for tax years 2017-2019.

General Taxes

Details of general taxes for the years ended December 31, 2020 and 2019 are shown below:

(In millions)	**2020**	**2019**
Gross receipts	$ 14	$ 14
Social security and unemployment	2	2
Total general taxes	$ 16	$ 16

5. LEASES

Penn primarily leases vehicles as well as building space, office equipment, and other property and equipment under cancelable and noncancelable leases.

In addition, ATSI has a ground lease with Penn under an operating lease agreement. Land use is rented to ATSI under the terms and conditions of a ground lease. Penn reserve the right to use (and to permit authorized others to use) the land for any purpose that does not cause a violation of electrical safety code or applicable law, or does not impair ATSI's ability to satisfy its service obligations. Additional uses of such land for ATSI's facilities requires prior written approval from the applicable operating company. ATSI purchases directly any new property acquired for transmission use. ATSI makes fixed quarterly lease payments to Penn through December 31, 2049, unless terminated prior to maturity, or extended by ATSI for up to 10 additional successive periods of 50 years each. Revenue associated with this agreement was approximately $1 million for 2020 and 2019.

Penn adopted ASU 2016-02, *"Leases (Topic 842)*" on January 1, 2019, and elected a number of transitional practical expedients provided within the standard. These included a "package of three" expedients that must be taken together and allowed entities to (1) not reassess whether existing contracts contain leases, (2) carryforward the existing lease classification, and (3) not reassess initial direct costs associated with existing leases. In addition, Penn elected the option to apply the requirements of the standard in the period of adoption (January 1, 2019) with no restatement of prior periods. Adoption of the standard on January 1, 2019, did not result in a material cumulative effect adjustment upon adoption. Penn did not evaluate land easements under the new guidance as they were not previously accounted for as leases. Penn also elected not to separate lease components from non-lease components as non-lease components were not material.

Leases with an initial term of 12 months or less are recognized as lease expense on a straight-line basis over the lease term and not recorded on the balance sheet. Most leases include one or more, options to renew and certain leases include options to terminate. The exercise of lease renewal options is at Penn's sole discretion. Renewal options are included within the lease liability if they are reasonably certain based on various factors relative to the contract. Certain leases also include options to purchase the leased property. The depreciable life of leased assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise.

For vehicles leased under master lease agreements, the lessor is guaranteed a residual value up to a stated percentage of the equipment cost at the end of the lease term. As of December 31, 2020, the maximum potential loss for these lease agreements at the end of the lease term is less than $1 million.

Finance leases for assets used in regulated operations are recognized in Penn's Statement of Income such that amortization of the right-of-use asset and interest on lease liabilities equals the expense allowed for ratemaking purposes. All operating lease expenses are recognized in Other operating expense. The components of lease expense were as follows:

(In millions)	December 31, 2020	December 31, 2019
Operating lease costs [(1)]	$ 1	$ 1
Finance lease costs:		
Amortization of right-of-use assets	1	1
Total finance lease cost	1	1
Total lease cost	$ 2	$ 2

[(1)] Includes $1 million of short-term lease costs as of December 31, 2020.

Supplemental balance sheet information related to leases was as follows:

(In millions)	Financial Statement Line Item	As of December 31, 2020	As of December 31, 2019
Assets			
Operating lease assets [(1)]	Deferred charges and other assets	$ 4	$ 3
Finance lease assets [(2)]	Property, plant and equipment	1	2
Total leased assets		$ 5	$ 5
Liabilities			
Current:			
Operating	Other current liabilities	$ 1	$ 1
Finance	Currently payable long-term debt	—	1
Noncurrent:			
Operating	Other noncurrent liabilities	3	2
Finance	Long-term debt and other long-term obligations	1	1
Total leased liabilities		$ 5	$ 5

[(1)] Operating lease assets are recorded net of accumulated amortization of $1 million and an immaterial amount as of December 31, 2020 and 2019, respectively.
[(2)] Finance lease assets are recorded net of accumulated amortization of $4 million and $3 million as of December 31, 2020 and 2019, respectively.

Lease terms and discount rates were as follows:

	As of December 31, 2020	As of December 31, 2019
Weighted-average remaining lease terms (years)		
Operating leases	6.08	6.20
Finance leases	2.47	3.37
Weighted-average discount rate [(1)]		
Operating leases	2.99 %	3.37 %
Finance leases	3.42 %	3.37 %

[(1)] When an implicit rate is not readily determinable, an incremental borrowing rate is utilized, determining the present value of lease payments. The rate is determined based on expected term and information available at the commencement date.

Supplemental cash flow information related to leases was as follows:

	For the Years Ended,	
(In millions)	**December 31, 2020**	**December 31, 2019**
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	$ 1	$ —
Operating cash flows from finance leases	—	—
Finance cash flows from finance leases	1	1
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases	$ 2	$ 2
Finance leases	—	—

Maturities of lease liabilities as of December 31, 2020, were as follows:

(In millions)	**Operating Leases**	**Finance Leases**	**Total**
2021	$ 1	$ 1	$ 2
2022	1	—	1
2023	1	—	1
2024	1	—	1
2025	—	—	—
Thereafter	1	—	1
Total lease payments	5	1	6
Less imputed interest	(1)	—	(1)
Total net present value	$ 4	$ 1	$ 5

As of December 31, 2020, additional operating leases agreements, primarily for vehicles, that have not yet commenced are $1 million. These leases are expected to commence within the next 18 months with lease terms of 5 to 10 years.

6. FAIR VALUE MEASUREMENTS

All borrowings with initial maturities of less than one year are defined as short-term financial instruments under GAAP and are reported as Short-term borrowings on the Balance Sheets at cost. Since these borrowings are short-term in nature, Penn believes that their costs approximate their fair market value. The following table provides the approximate fair value and related carrying amounts of long-term debt, which excludes finance lease obligations and net unamortized debt issuance costs and discounts:

	December 31, 2020		December 31, 2019	
(In millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Long-term debt	$ 200	$ 217	$ 200	$ 219

The fair values of long-term debt and other long-term obligations reflect the present value of the cash outflows relating to those securities based on the current call price, the yield to maturity or the yield to call, as deemed appropriate at the end of each respective period. The yields assumed were based on securities with similar characteristics offered by corporations with credit ratings similar to those of Penn, which results in short-term borrowings, long-term debt and other long-term obligations being classified as Level 2 in the fair value hierarchy as of December 31, 2020 and December 31, 2019.

7. CAPITALIZATION

COMMON STOCK

In addition to paying dividends from retained earnings, Penn has authorization from the FERC to pay cash dividends to FirstEnergy from paid-in capital accounts, as long as its FERC-defined equity-to-total-capitalization ratio remains above 35%.

PREFERRED STOCK

Penn is authorized to issue 1,200,000 shares preferred stock, $100 par value, as of December 31, 2020. As of December 31, 2020 and 2019, there were no preferred shares outstanding.

LONG-TERM DEBT AND OTHER LONG-TERM OBLIGATIONS

The following table presents outstanding long-term debt and finance lease obligations for Penn as of December 31, 2020 and 2019:

	As of December 31, 2020		As of December 31,	
(Dollar amounts in millions)	Maturity Date	Interest Rate	2020	2019
FMBs	2022 - 2056	4.240% - 6.090%	$ 200	$ 200
Finance lease obligations			1	2
Unamortized debt discounts			—	(1)
Unamortized debt issuance costs			(1)	—
Currently payable long-term debt			(1)	(1)
Total long-term debt and other long-term obligations			$ 199	$ 200

The following table presents scheduled debt repayments for outstanding long-term debt, excluding finance leases and unamortized debt discounts and premiums, for the next five years as of December 31, 2020.

Year	Penn
	(In millions)
2021	$ —
2022	100
2023	—
2024	—
2025	—

Other Long-term Debt

Penn has a first mortgage indenture under which it can issue FMBs secured by a direct first mortgage lien on substantially all of its property and franchises, other than specifically excepted property.

Debt Covenant Default Provisions

Penn has various debt covenants under certain financing arrangements, including its revolving credit facility. The most restrictive of the debt covenants relate to the nonpayment of interest and/or principal on such debt and the maintenance of certain financial ratios. The failure by Penn to comply with the covenants contained in any of its financing arrangements could result in an event of default, which may have an adverse effect on Penn's financial condition.

Additionally, there are cross-default provisions in certain financing arrangements of FE and its subsidiaries, including Penn. These provisions generally trigger a default in the applicable financing arrangement of an entity if it or any of its significant subsidiaries default under another financing arrangement in excess of a certain principal amount, typically $100 million. Although such defaults by Penn would generally cross-default FE financing arrangements containing these provisions, defaults by FE would generally not cross-default applicable Penn financing arrangements.

As of December 31, 2020, Penn was in compliance with all debt covenant default provisions.

8. SHORT-TERM BORROWINGS AND BANK LINES OF CREDIT

Penn had $82 million and $12 million of outstanding short-term borrowings as of December 31, 2020 and 2019, respectively.

Revolving Credit Facility

FE and the Utilities, including Penn, participate in a five-year syndicated revolving credit facility, which was amended on October 19, 2018, providing for aggregate commitments of $2.5 billion (Facility), which are available through December 6, 2022. Under the amended Facility, FE and the Utilities may use borrowings under their respective facility for working capital and other general corporate purposes, including intercompany loans and advances by a borrower to any of its subsidiaries. Generally, borrowings under the Facility are available to each borrower separately and mature on the earlier of 364 days from the date of borrowing or the commitment termination date, as the same may be extended. The Facility contains financial covenants requiring each borrower to maintain a consolidated debt-to-total-capitalization ratio (as defined under the Facility) of no more than 65% measured at the end of each fiscal quarter.

On November 17, 2020, FE and the Utilities entered into an amendment to the FE credit facility. The amendment provides for modifications and/or waivers of: (i) certain representations and warranties, and (ii) certain affirmative and negative covenants, contained therein, which allowed FirstEnergy to regain compliance with such provisions.

On November 23, 2020, FE and its regulated distribution subsidiaries, JCP&L, ME, Penn, TE, and WP, borrowed $950 million in the aggregate under the FE Revolving Facility, $50 million at Penn. The outstanding principal balance under the FE Revolving Facility is $1.2 billion, with $1.3 billion of remaining availability under the FE Revolving Facility. Borrowings were increased under the Revolving Facility as a proactive measure to increase the respective cash position and preserve financial flexibility.

Under the Facility, Penn may borrow up to its sub-limit of $100 million, all of which was available to Penn as of December 31, 2020. Penn has regulatory and other short-term debt limitations of $100 million which includes amounts that may be borrowed under the regulated companies' money pool.

The Facility does not contain provisions that restrict the ability to borrow or accelerate payment of outstanding advances in the event of any change in credit ratings of the borrowers. Pricing is defined in “pricing grids,” whereby the cost of funds borrowed under the Facility is related to the credit ratings of the company borrowing the funds. Additionally, borrowings under the Facility are subject to the usual and customary provisions for acceleration upon the occurrence of events of default, including a cross-default for other indebtedness in excess of $100 million.

FirstEnergy Money Pool

FE’s utility and transmission operating subsidiary companies, including Penn, also have the ability to borrow from each other and the holding company to meet their short-term working capital requirements. FESC administers this money pool and tracks surplus funds of FE and the respective regulated subsidiaries, as well as proceeds available from bank borrowings. Companies receiving a loan under the money pool agreement must repay the principal amount of the loan, together with accrued interest, within 364 days of borrowing the funds. The rate of interest is the same for each company receiving a loan from the regulated pool and is based on the average cost of funds available through the pool. The average interest rate for borrowings in 2020 was 0.89% per annum.

9. REGULATORY MATTERS

STATE REGULATION

Penn's retail rates, conditions of service, issuance of securities and other matters are subject to regulation in Pennsylvania by the PPUC. The key terms of Penn's current rate orders for distribution customer billings, which have been effective since January 2017, include an allowed debt/equity ratio of 49.9%/50.1% (reflecting the filed debt/equity as final settlement/orders do not specifically include capital structure). The PPUC-approved settlement agreement for such rates did not disclose ROE.

PENNSYLVANIA

The Pennsylvania Companies operate under rates approved by the PPUC, effective as of January 27, 2017. These rates were adjusted for the net impact of the Tax Act, effective March 15, 2018. The net impact of the Tax Act for the period January 1, 2018 through March 14, 2018 was separately tracked and its treatment will be addressed in a future rate proceeding. The Pennsylvania Companies operate under DSPs for the June 1, 2019 through May 31, 2023 delivery period, which provide for the competitive procurement of generation supply for customers who do not choose an alternative EGS or for customers of alternative EGSs that fail to provide the contracted service. Under the 2019-2023 DSPs, supply will be provided by wholesale suppliers through a mix of 3, 12 and 24-month energy contracts, as well as two RFPs for 2-year SREC contracts for ME, PN and Penn.

Pursuant to Pennsylvania Act 129 of 2008 and PPUC orders, Pennsylvania EDCs implement energy efficiency and peak demand reduction programs. The Pennsylvania Companies’ Phase III EE&C plans for the June 2016 through May 2021 period, which were approved in March 2016, with expected costs up to $390 million, are designed to achieve the targets established in the PPUC’s Phase III Final Implementation Order with full recovery through the reconcilable EE&C riders. On June 18, 2020, the PPUC entered a Final Implementation Order for a Phase IV EE&C Plan, operating from June 2021 through May 2026. The Final Implementation Order set demand reduction targets, relative to 2007 to 2008 peak demands at 2.0% MW for Penn; and energy consumption reduction targets, as a percentage of the Pennsylvania Companies’ historic 2009 to 2010 reference load at 2.7% MWH for Penn. The Pennsylvania Companies' Phase IV plans were filed November 30, 2020. A settlement has been reached in this matter, and a joint petition seeking approval of that settlement by the parties was filed on February 16, 2021. A PPUC decision on the settlement is expected in March 2021.

Pennsylvania EDCs may file with the PPUC for approval of an LTIIP for infrastructure improvements and costs related to highway relocation projects, after which a DSIC may be approved to recover LTIIP costs. On August 30, 2019, the Pennsylvania Companies filed Petitions for approval of new LTIIPs for the five-year period beginning January 1, 2020 and ending December 31, 2024 for a total capital investment of approximately $572 million for certain infrastructure improvement initiatives. On January 16, 2020, the PPUC approved the LTIIPs without modification. The Pennsylvania Companies' approved DSIC riders for quarterly cost recovery went into effect July 1, 2016. On August 30, 2019, Penn filed a Petition seeking approval of a waiver of the statutory DSIC cap of 5% of distribution rate revenue and approval to increase the maximum allowable DSIC to 11.81% of distribution rate revenue for the five-year period of its proposed LTIIP. On March 12, 2020, an order was entered approving a settlement by all parties to that case which provides for a temporary increase in the recoverability cap from 5% to 7.5%, to expire on the earlier of the effective date of new base rates following Penn's next base rate case or the expiration of its LTIIP II program.

Following the Pennsylvania Companies' 2016 base rate proceedings, the PPUC ruled in a separate proceeding related to the DSIC mechanisms that the Pennsylvania Companies were not required to reflect federal and state income tax deductions related to DSIC-eligible property in DSIC rates, which decision was appealed by the Pennsylvania OCA to the Pennsylvania Commonwealth Court. The Commonwealth Court reversed the PPUC's decision and remanded the matter to require the Pennsylvania Companies to revise their tariffs and DSIC calculations to include ADIT and state income taxes. On April 7, 2020, the Pennsylvania Supreme Court issued an order granting Petitions for Allowance of Appeal by both the PPUC and the Pennsylvania Companies of the Commonwealth Court's Opinion and Order. Briefs and Reply Briefs of the parties were filed, and oral argument before the Supreme Court was held on October 21, 2020. An adverse ruling by the Pennsylvania Supreme Court is not expected to result in a material impact to Penn.

The PPUC issued an order on March 13, 2020, forbidding utilities from terminating service for non-payment for the duration of the COVID-19 pandemic. On May 13, 2020, the PPUC issued a Secretarial letter directing utilities to track all prudently incurred incremental costs arising from the COVID-19 pandemic, and to create a regulatory asset for future recovery of incremental uncollectibles incurred as a result of the COVID-19 pandemic and termination moratorium. On October 13, 2020, the PPUC entered an order lifting the service termination moratorium effective November 9, 2020, subject to certain additional notification, payment procedures and exceptions, and permits the Pennsylvania Companies to create a regulatory asset for all incremental expenses associated with their compliance with the order.

FERC REGULATORY MATTERS

Under the FPA, FERC regulates rates for interstate wholesale sales, accounting and other matters. With respect to its wholesale services and rates, Penn is subject to regulation by FERC. FERC regulates the sale of power for resale in interstate commerce in part by granting authority to public utilities to sell wholesale power at market-based rates upon showing that the seller cannot exert market power in generation or transmission or erect barriers to entry into markets. Penn has been authorized by FERC to sell wholesale power in interstate commerce at market-based rates and have a market-based rate tariff on file with FERC, although major wholesale purchases remain subject to review and regulation by the PPUC.

Federally-enforceable mandatory reliability standards apply to the bulk electric system and impose certain operating, record-keeping and reporting requirements on Penn. NERC is the Electric Reliability Organization designated by FERC to establish and enforce these reliability standards, although NERC has delegated day-to-day implementation and enforcement of these reliability standards to six regional entities, including RFC. All of the facilities that FirstEnergy operates, including those of Penn, are located within the RFC region. FirstEnergy actively participates in the NERC and RFC stakeholder processes, and otherwise monitors and manages its companies, including Penn, in response to the ongoing development, implementation and enforcement of the reliability standards implemented and enforced by RFC.

FirstEnergy, including Penn, believes that it is in material compliance with all currently-effective and enforceable reliability standards. Nevertheless, in the course of operating its extensive electric utility systems and facilities, FirstEnergy, including Penn, occasionally learns of isolated facts or circumstances that could be interpreted as excursions from the reliability standards. If and when such occurrences are found, FirstEnergy, including Penn, develops information about the occurrence and develops a remedial response to the specific circumstances, including in appropriate cases "self-reporting" an occurrence to RFC. Moreover, it is clear that NERC, RFC and FERC will continue to refine existing reliability standards as well as to develop and adopt new reliability standards. Any inability on FirstEnergy's, including Penn's, part to comply with the reliability standards for its bulk electric system could result in the imposition of financial penalties, or obligations to upgrade or build electric facilities that could have a material adverse effect on Penn's financial condition, results of operations and cash flows.

10. COMMITMENTS AND CONTINGENCIES

ENVIRONMENTAL MATTERS

Various federal, state and local authorities regulate Penn with regard to air and water quality, hazardous and solid waste disposal, and other environmental matters. While Penn's environmental policies and procedures are designed to achieve compliance with applicable environmental laws and regulations, such laws and regulations are subject to periodic review and potential revision by the implementing agencies. Penn cannot predict the timing or ultimate outcome of any of these reviews or how any future actions taken as a result thereof may materially impact its business, results of operations, cash flows and financial condition.

OTHER LEGAL PROCEEDINGS

United States v. Larry Householder, et al.

On July 21, 2020, a complaint and supporting affidavit containing federal criminal allegations were unsealed against the now former Ohio House Speaker Larry Householder and other individuals and entities allegedly affiliated with Mr. Householder. Also, on July 21, 2020, and in connection with the investigation, FirstEnergy received subpoenas for records from the U.S. Attorney's Office for the S.D. Ohio. FirstEnergy was not aware of the criminal allegations, affidavit or subpoenas before July 21, 2020. No contingency has been reflected in FirstEnergy's consolidated financial statements as a loss is neither probable, nor is a loss or range of a loss reasonably estimable.

Legal Proceedings Relating to United States v. Larry Householder, et al.

In addition to the subpoenas referenced above under "—United States v. Larry Householder, et. al.", certain FE stockholders and FirstEnergy customers filed several lawsuits against FirstEnergy and certain current and former directors, officers and other employees, and the complaints in each of these suits is related to allegations in the complaint and supporting affidavit relating to HB 6 and the now former Ohio House Speaker Larry Householder and other individuals and entities allegedly affiliated with Mr. Householder.

- *Owens v. FirstEnergy Corp. et al.* and *Frand v. FirstEnergy Corp. et al.* (Federal District Court, S.D. Ohio); on July 28, 2020 and August 21, 2020, purported stockholders of FE filed putative class action lawsuits against FE and certain FE officers, purportedly on behalf of all purchasers of FE common stock from February 21, 2017 through July 21, 2020, asserting claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, alleging misrepresentations or omissions by FirstEnergy concerning its business and results of operations. These actions have been consolidated and a lead plaintiff has been appointed by the court. A Consolidated Complaint was filed on February 26, 2021.
- *Gendrich v. Anderson, et al. and Sloan v. Anderson, et al.* (Common Pleas Court, Summit County, OH); on July 26, 2020 and July 31, 2020, respectively, purported stockholders of FE filed shareholder derivative action lawsuits against certain FE directors and officers, alleging, among other things, breaches of fiduciary duty. These actions have been consolidated.
- *Miller v. Anderson, et al.* (Federal District Court, N.D. Ohio); *Bloom, et al. v. Anderson, et al.; Employees Retirement System of the City of St. Louis v. Jones, et al.; Electrical Workers Pension Fund, Local 103, I.B.E.W. v. Anderson et al.; Massachusetts Laborers Pension Fund v. Anderson et al.; The City of Philadelphia Board of Pensions and Retirement v. Anderson et al.; Atherton v. Dowling et al; Behar v. Anderson, et al.* (U.S. District Court, S.D. Ohio, all actions have been consolidated); beginning on August 7, 2020, purported stockholders of FE filed shareholder derivative actions alleging the board and officers breached their fiduciary duties and committed violations of Section 14(a) of the Securities Exchange Act of 1934. The cases in the S.D. Ohio have been consolidated and co-lead plaintiffs have been appointed by the court.
- *Smith v. FirstEnergy Corp. et al., Buldas v. FirstEnergy Corp. et al., and Hudock and Cameo Countertops, Inc. v. FirstEnergy Corp. et al.* (Federal District Court, S.D. Ohio); on July 27, 2020, July 31, 2020, and August 5, 2020, respectively, purported customers of FirstEnergy filed putative class action lawsuits against FE and FESC, as well as certain current and former FirstEnergy officers, alleging civil Racketeer Influenced and Corrupt Organizations Act violations and related state law claims. These actions have been consolidated.
- *State of Ohio ex rel. Dave Yost, Ohio Attorney General v. FirstEnergy Corp., et al. and City of Cincinnati and City of Columbus v. FirstEnergy Corp.* (Common Pleas Court, Franklin County, OH); on September 23, 2020 and October 27, 2020, the OAG and the cities of Cincinnati and Columbus, respectively, filed complaints against several parties including FE, each alleging civil violations of the Ohio Corrupt Activity Act in connection with the passage of HB 6. The OAG sought a preliminary injunction to prevent each of the defendants, including FE, through the end of 2020, from: (i) contributing to any groups whose purpose is to keep or modify HB 6; (ii) making any public statements for or against any repeal or modification legislation concerning HB 6; (iii) lobbying, consulting, or advising on these matters; or (iv) contributing to any Ohio legislative candidates. The court denied the OAG's request for preliminary injunctive relief on October 2, 2020. On January 13, 2021, the OAG filed a motion for a temporary restraining order and preliminary injunction against FirstEnergy seeking to enjoin FirstEnergy from collecting the Ohio Companies' decoupling rider. On January 31, 2021, FE reached a partial settlement with the OAG and the cities of Cincinnati and Columbus with respect to the temporary restraining order and preliminary injunction request and related issues. In connection with the partial settlement, the Ohio Companies filed an application on February 1, 2021, with the PUCO to set their respective decoupling riders (CSR) to zero. On February 2, 2021, the PUCO approved the application of the Ohio Companies setting the rider to zero and no additional customer bills will include new decoupling rider charges after February 8, 2021. The cities of Dayton and Toledo have also been added as plaintiffs to the action. These actions have been consolidated.
- *Emmons v. FirstEnergy Corp. et al.* (Common Pleas Court, Cuyahoga County, OH); on August 4, 2020, a purported customer of FirstEnergy filed a putative class action lawsuit against FE, FESC, OE, TE and CEI, along with FES, alleging several causes of action, including negligence and/or gross negligence, breach of contract, unjust enrichment, and unfair or deceptive consumer acts or practices. On October 1, 2020, plaintiffs filed a First Amended Complaint,

adding as a plaintiff a purported customer of FirstEnergy and alleging a civil violation of the Ohio Corrupt Activity Act and civil conspiracy against FE, FESC and FES.

The plaintiffs in each of the above cases, seek, among other things, to recover an unspecified amount of damages (unless otherwise noted). In addition, on August 10, 2020, the SEC, through its Division of Enforcement, issued an order directing an investigation of possible securities laws violations by FE, and on September 1, 2020, issued subpoenas to FE and certain FE officers. Further, in letters dated January 26 and February 22, 2021, staff of FERC's Division of Investigations notified FirstEnergy that the Division is conducting an investigation of FirstEnergy's lobbying and governmental affairs activities concerning HB 6, and staff directed FirstEnergy to preserve and maintain all documents and information related to the same as such have been developed as part of an ongoing audit that is being conducted by FERC's Division of Audits and Accounting. The outcome of any of these lawsuits, investigations and audit are uncertain and could have a material adverse effect on FE’s or its subsidiaries’ financial condition, results of operations and cash flows. No contingency has been reflected in FirstEnergy’s consolidated financial statements as a loss is neither probable, nor is a loss or range of a loss reasonably estimable.

Internal Investigation Relating to United States v. Larry Householder, et al.

As previously disclosed, a committee of independent members of the FE Board is directing an internal investigation related to ongoing government investigations. In connection with FirstEnergy’s internal investigation, such committee determined on October 29, 2020, to terminate FirstEnergy’s Chief Executive Officer, Charles E. Jones, together with two other executives: Dennis M. Chack, Senior Vice President of Product Development, Marketing, and Branding; and Michael J. Dowling, Senior Vice President of External Affairs. Each of these terminated executives violated certain FirstEnergy policies and its code of conduct. These executives were terminated as of October 29, 2020. Such former members of senior management did not maintain and promote a control environment with an appropriate tone of compliance in certain areas of FirstEnergy’s business, nor sufficiently promote, monitor or enforce adherence to certain FirstEnergy policies and its code of conduct. Furthermore, certain former members of senior management did not reasonably ensure that relevant information was communicated within our organization and not withheld from our independent directors, our Audit Committee, and our independent auditor. Among the matters considered with respect to the determination by the committee of independent members of the FE Board that certain former members of senior management violated certain FirstEnergy policies and its code of conduct related to a payment of approximately $4 million made in early 2019 in connection with the termination of a purported consulting agreement, as amended, which had been in place since 2013. The counterparty to such agreement was an entity associated with an individual who subsequently was appointed to a full-time role as an Ohio government official directly involved in regulating the Ohio Companies, including with respect to distribution rates. FirstEnergy believes that payments under the consulting agreement may have been for purposes other than those represented within the consulting agreement. Immediately following these terminations, the independent members of its Board appointed Mr. Steven E. Strah to the position of Acting Chief Executive Officer and Mr. Christopher D. Pappas, a current member of the Board, to the temporary position of Executive Director, each effective as of October 29, 2020. Mr. Donald T. Misheff will continue to serve as Non-Executive Chairman of the Board. Additionally, on November 8, 2020, Robert P. Reffner, Senior Vice President and Chief Legal Officer, and Ebony L. Yeboah-Amankwah, Vice President, General Counsel, and Chief Ethics Officer, were separated from FirstEnergy due to inaction and conduct that the Board determined was influenced by the improper tone at the top. The matter is a subject of the ongoing internal investigation as it relates to the government investigations. Additionally, on February 17, 2021, the FE Board appointed Mr. John Somerhalder to the positions of Vice Chairperson of the FE Board and Executive Director of FE, each effective as of March 1, 2021. Mr. Misheff will continue to serve as Non-Executive Chairman of the FE Board and Mr. Pappas will continue to serve on the FE Board as an independent director. Mr. Somerhalder will help lead efforts to enhance FirstEnergy’s reputation. On March 7, 2021, the FE Board appointed Mr. Steven E. Strah to the position of Chief Executive Officer of FirstEnergy, effective as of March 8, 2021. On March 7, 2021, at the recommendation of the FirstEnergy Corporate Governance and Corporate Responsibility Committee, the FE Board also elected Mr. Strah as a Director of FirstEnergy, effective as of March 8, 2021, increasing the size of the FE Board from 11 to 12 members. Mr. Strah has been elected to the FE Board to serve for a term expiring at the FirstEnergy's 2021 Annual Meeting of Shareholders and until his successor shall have been elected. Also, in connection with the internal investigation, FirstEnergy recently identified certain transactions, which, in some instances, extended back ten years or more, including vendor services, that were either improperly classified, misallocated to certain of the Utilities and Transmission Companies, or lacked proper supporting documentation. These transactions resulted in amounts collected from customers that were immaterial to FirstEnergy and Penn. The Utilities and Transmission Companies will be working with the appropriate regulatory agencies to address these amounts.

Other Legal Matters

There are various lawsuits, claims (including claims for asbestos exposure) and proceedings related to Penn's normal business operations pending against Penn. The loss or range of loss in these matters is not expected to be material to Penn. The other potentially material items not otherwise discussed above are described under Note 9, "Regulatory Matters."

Penn accrues legal liabilities only when it concludes that it is probable that it has an obligation for such costs and can reasonably estimate the amount of such costs. In cases where Penn determines that it is not probable, but reasonably possible that it has a material obligation, it discloses such obligations and the possible loss or range of loss if such estimate can be made. If it were ultimately determined that Penn has legal liability or is otherwise made subject to liability based on any of the matters referenced above, it could have a material adverse effect on Penn's financial condition, results of operations and cash flows.

11. TRANSACTIONS WITH AFFILIATED COMPANIES

Penn's operating revenues, operating expenses and interest expenses include transactions with affiliated companies. These affiliated company transactions include affiliated company power sales agreements, support service billings, interest on affiliated company notes including the money pool and other transactions.

The primary affiliated company transactions for Penn during the years ended December 31, 2020 and 2019 were as follows:

	For the Years Ended December 31,	
	2020	2019
	(In millions)	
Revenues[1]	$ 1	$ 1
Expenses:		
Purchased power from affiliates[2]	—	11
Support services	15	15
Miscellaneous Income	—	1

[1] Includes ground lease revenues from ATSI. See Note 5, "Leases" for additional information.
[2] Primarily related to purchases from FES prior to emergence.

FirstEnergy does not bill directly or allocate any of its costs to any subsidiary company. Costs are allocated from FESC, a subsidiary of FE. The majority of costs are directly billed or assigned at no more than cost. The remaining costs are for services that are provided on behalf of more than one company, or costs that cannot be precisely identified and are allocated using formulas developed by FESC. The current allocation or assignment formulas used and their bases include multiple factor formulas: each company's proportionate amount of FirstEnergy's aggregate direct payroll, number of employees, asset balances, revenues, number of customers, other factors and specific departmental charge ratios. Intercompany transactions with FirstEnergy and its other subsidiaries are generally settled under commercial terms within thirty days.

Affiliate accounts receivable and accounts payable balances relate to intercompany transactions that have not yet settled through the FirstEnergy money pool (see Note 8, "Short-Term Borrowings and Bank Lines of Credit").

Penn and FirstEnergy's other subsidiaries are parties to an intercompany income tax allocation agreement with FE and its other subsidiaries that provides for the allocation of consolidated tax liabilities. Net tax benefits attributable to FE are generally reallocated to the subsidiaries of FirstEnergy that have taxable income. That allocation is accounted for as a capital contribution to the company receiving the tax benefit (see Note 4, "Taxes").

Additionally, Penn purchases power to meet a portion of its POLR and default service requirements and provide power to certain facilities.