PENNSYLVANIA POWER COMPANY

AUDITED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

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:

CEI	The Cleveland Electric Illuminating Company, an Ohio electric utility operating affiliated company
FE	FirstEnergy Corp., a public utility holding company
FES	FirstEnergy Solutions Corp., together with its consolidated subsidiaries, which provides energy-related products and services. On March 31, 2018, FES filed voluntary petitions under Chapter 11 of the United States Bankruptcy Code with the Bankruptcy Court. FES was deconsolidated from FirstEnergy's consolidated financial statements as of March 31, 2018.
FESC	FirstEnergy Service Company, which provides legal, financial and other corporate support services
FirstEnergy	FirstEnergy Corp., together with its consolidated subsidiaries
JCP&L	Jersey Central Power & Light Company, a New Jersey electric utility operating affiliated company
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
TE	The Toledo Edison Company, an Ohio electric utility operating affiliated company
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:

AOCI	Accumulated Other Comprehensive Income
AOCL	Accumulated Other Comprehensive Loss
ASU	Accounting Standards Update
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
IRS	Internal Revenue Service
LTIIPs	Long-Term Infrastructure Improvement Plans
NERC	North American Electric Reliability Corporation
NOL	Net Operating Loss
OPEB	Other Post-Employment Benefits
POLR	Provider of Last Resort
POR	Purchase of Receivables
PPUC	Pennsylvania Public Utility Commission

GLOSSARY OF TERMS, *Continued*

RFC	Reliability*First* Corporation
RFP	Request for Proposal
ROE	Return on Equity
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, 2019 and 2018, and the related statements of income and 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, 2019 and 2018, 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 4, 2020

PENNSYLVANIA POWER COMPANY
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands)	For the Years Ended December 31, 2019	2018
REVENUES:		
Electric sales	$ 227,737	$ 241,626
Gross receipts tax collections	13,830	14,910
Total revenues	241,567	256,536
OPERATING EXPENSES:		
Purchased power from affiliates	10,799	23,225
Purchased power from non-affiliates	91,669	81,812
Other operating expenses	51,947	48,084
Provision for depreciation	22,282	20,994
Deferral (amortization) of regulatory liabilities, net	(10,045)	3,102
General taxes	15,898	16,999
Total operating expenses	182,550	194,216
OPERATING INCOME	59,017	62,320
OTHER INCOME (EXPENSE):		
Miscellaneous income, net	5,530	6,150
Pension and OPEB mark-to-market adjustment	(14,380)	(11,749)
Interest expense	(12,028)	(10,516)
Capitalized financing costs	1,030	703
Total other expense	(19,848)	(15,412)
INCOME BEFORE INCOME TAXES	39,169	46,908
INCOME TAXES	7,518	10,267
NET INCOME	$ 31,651	$ 36,641
STATEMENTS OF COMPREHENSIVE INCOME		
NET INCOME	$ 31,651	$ 36,641
OTHER COMPREHENSIVE LOSS:		
Pension and OPEB prior service costs	(534)	(1,495)
Other comprehensive loss	(534)	(1,495)
Income tax benefits on other comprehensive loss	(154)	(912)
Other comprehensive loss, net of tax	(380)	(583)
COMPREHENSIVE INCOME	$ 31,271	$ 36,058

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

PENNSYLVANIA POWER COMPANY
BALANCE SHEETS

(In thousands, except share amounts)		December 31, 2019		December 31, 2018
ASSETS				
CURRENT ASSETS:				
Receivables-				
Customers, net of allowance for uncollectible accounts of $1,558 in 2019 and $1,621 in 2018	$	33,311	$	38,745
Affiliated companies		9,061		4,894
Other		3,699		7,070
Notes receivable from affiliated companies		—		24,343
Prepaid taxes and other		6,486		4,155
		52,557		79,207
UTILITY PLANT:				
In service		803,551		762,894
Less — Accumulated provision for depreciation		219,597		207,431
		583,954		555,463
Construction work in progress		14,294		11,327
		598,248		566,790
OTHER PROPERTY AND INVESTMENTS:				
Investments in employee benefit trusts		10,698		10,393
Other		7,141		3,777
		17,839		14,170
	$	668,644	$	660,167
LIABILITIES AND CAPITALIZATION				
CURRENT LIABILITIES:				
Currently payable long-term debt	$	512	$	1,559
Short-term borrowings - affiliated companies		11,999		—
Accounts payable-				
Affiliated companies		773		3,162
Other		17,047		15,113
Accrued taxes		570		847
Other		19,403		18,306
		50,304		38,987
CAPITALIZATION:				
Common stockholder's equity-				
Common stock, $30 par value, authorized 6,500,000 shares - 3,110,836 shares outstanding		93,325		93,325
Other paid-in capital		31,489		30,574
Accumulated other comprehensive income (loss)		(191)		189
Retained earnings		65,950		69,299
Total common stockholder's equity		190,573		193,387
Long-term debt and other long-term obligations		199,688		200,176
		390,261		393,563
NONCURRENT LIABILITIES:				
Accumulated deferred income taxes		104,608		94,487
Retirement benefits		39,248		40,816
Regulatory liabilities		40,750		57,759
Other		43,473		34,555
		228,079		227,617
COMMITMENTS AND CONTINGENCIES (NOTE 10)				
	$	668,644	$	660,167

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

PENNSYLVANIA POWER COMPANY
STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

(In thousands, except share amounts)	Common Stock Number of Shares	Common Stock Carrying Value	Other Paid-in Capital	AOCI (AOCL)	Retained Earnings	Total Stockholder's Equity
Balance, January 1, 2018	3,110,836	$ 93,325	$ 29,862	$ 772	$ 53,137	$ 177,096
Net income					36,641	36,641
Other comprehensive loss, net of tax				(583)		(583)
Stock-based compensation			602			602
Consolidated tax benefit allocation			110			110
Impact of adopting ASU 2018-02 [1]					(479)	(479)
Cash dividends declared on common stock					(20,000)	(20,000)
Balance, December 31, 2018	3,110,836	$ 93,325	$ 30,574	$ 189	$ 69,299	$ 193,387
Net income					31,651	31,651
Other comprehensive loss, net of tax				(380)		(380)
Stock-based compensation			628			628
Consolidated tax benefit allocation			287			287
Cash dividends declared on common stock					(35,000)	(35,000)
Balance, December 31, 2019	3,110,836	$ 93,325	$ 31,489	$ (191)	$ 65,950	$ 190,573

[1] Penn early adopted ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" during the first quarter of 2018. Upon adoption, Penn recorded a cumulative effect adjustment for stranded tax effects, such as pension and OPEB prior service costs to retained earnings.

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

PENNSYLVANIA POWER COMPANY
STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
(In thousands)	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 31,651	$ 36,641
Adjustments to reconcile net income to net cash from operating activities-		
Depreciation and amortization	12,652	24,656
Deferred income taxes, net	5,500	7,055
Pension trust contributions	(8,000)	(12,000)
Retirement benefits, net of payments	(5,463)	(7,343)
Pension and OPEB mark-to-market adjustment	14,380	11,749
Change in current assets and liabilities-		
Receivables	4,924	(628)
Prepaid taxes and other current assets	(2,331)	1,104
Accounts payable	(762)	(3,216)
Accrued taxes	(277)	(1,773)
Other current liabilities	531	(1,103)
Other	726	894
Net cash provided from operating activities	53,531	56,036
CASH FLOWS FROM FINANCING ACTIVITIES:		
New financing-		
Long-term debt	—	50,000
Short-term borrowings - affiliated companies, net	11,999	—
Redemptions and repayments-		
Long-term debt	(1,007)	(974)
Short-term borrowings - affiliated companies, net	—	(8,860)
Common stock dividend payments	(35,000)	(20,000)
Other	(552)	(1,111)
Net cash provided from (used for) financing activities	(24,560)	19,055
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(47,884)	(45,645)
Loans to affiliated companies, net	24,343	(24,343)
Asset removal costs	(5,205)	(5,183)
Other	(225)	79
Net cash used for investing activities	(28,971)	(75,092)
Net change in cash, cash equivalents, and restricted cash	—	(1)
Cash, cash equivalents, and restricted cash at beginning of period	—	1
Cash, cash equivalents, and restricted cash at end of period	$ —	$ —
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year-		
Interest (net of amounts capitalized)	$ 10,932	$ 12,022
Income taxes, net of refunds	$ 9,528	$ 4,150

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 4, 2020, the date the financial statements were issued.

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

CUSTOMER 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.

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. Billed and unbilled customer receivables were $19 million and $14 million, respectively, as of December 31, 2019, and were $24 million and $15 million, respectively, as of December 31, 2018. There was no material concentration of receivables as of December 31, 2019 and 2018, with respect to any particular segment of Penn's customers.

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. Similarly, Management records regulatory liabilities when a determination is made that a refund is probable or when ordered by a commission. Factors that may affect probability include changes in the regulatory environment, issuance of a regulatory commission order or passage of new legislation. If recovery of a regulatory asset is no longer probable, that regulatory asset is written off as a charge against earnings. 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 the Company and information on comparable companies within similar jurisdictions, as well as assessing progress of communications between the Company and regulators.

The following table provides information about the composition of net regulatory assets and liabilities as of December 31, 2019 and December 31, 2018, and the changes during the year ended December 31, 2019:

Net Regulatory Assets (Liabilities) by Source	December 31, 2019	December 31, 2018	Change
		(In millions)	
Customer payables for future income taxes	$ (58)	$ (63)	$ 5
Deferred transmission costs	(8)	(11)	3
Deferred generation costs	(1)	(5)	4
Deferred distribution costs	5	7	(2)
Storm-related costs	16	13	3
Other	5	1	4
Net Regulatory Liabilities included on the Balance Sheets	$ (41)	$ (58)	$ 17

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 asset reverse, which is generally over the expected life of the underlying asset. See Note 4, "Taxes" for further discussion on the Tax Act.

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, the state of Pennsylvania 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. Amounts are amortized through 2020.

Storm-related costs - Relates to the recovery of storm costs, of which approximately $16 million and $13 million are currently being recovered through rates as of December 31, 2019 and 2018, respectively.

The following table provides information about the composition of net regulatory assets that do not earn a current return as of December 31, 2019 and 2018, all of which are currently being recovered through rates over varying periods depending on the nature of the deferral and the jurisdiction:

Regulatory Assets by Source Not Earning a Current Return	December 31, 2019	December 31, 2018	Change
Storm-related costs	$ 16	$ 13	$ 3
Other	1	1	—
Regulatory Assets Not Earning a Current Return	$ 17	$ 14	$ 3

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 2.8% of average depreciable property in 2019 and 2018.

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, 2019 and 2018.

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.

NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Pronouncements

ASU 2016-02, *"Leases (Topic 842)"* (Issued February 2016 and subsequently updated to address implementation questions): The new guidance requires organizations that lease assets with lease terms of more than 12 months to recognize assets and liabilities for the rights and obligations created by those leases on their balance sheets as well as new qualitative and quantitative disclosures. Penn implemented a third-party software tool that assisted with the initial adoption and will assist with ongoing compliance. Penn chose to apply the requirements of the standard in the period of adoption (January 1, 2019) with no restatement of prior periods. Upon adoption, on January 1, 2019, Penn increased assets and liabilities by $2 million, with no impact to results of operations or cash flows. See Note 5, "Leases," for additional information on Penn's leases.

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 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. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Penn has analyzed its financial instruments within the scope of this guidance, primarily trade receivables, and does not expect a material impact to its financial statements upon adoption in 2020.

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 requires 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. The guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Penn does not expect a material impact to its financial statements upon adoption in 2020.

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.

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 new 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, 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 default service requirements in Ohio. Certain of the Utilities have 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 is 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, 2019 and 2018, by type of service:

	For the Year Ended December 31,	
Revenues by Type of Service	**2019**	**2018**
	(In millions)	
Distribution services	$ 129	$ 130
Retail generation	108	121
Other	3	3
Total revenues from contracts with customers [1]	240	254
Other non-customer revenue	2	3
Total revenues	$ 242	$ 257

[1] Includes $3 million in reductions to revenue related to amounts subject to refund resulting from the Tax Act for the year ended December 31, 2018. Amounts were immaterial for the year ended December 31, 2019.

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, 2019 and 2018, by class:

	For the Years Ended December 31,	
Revenues by Customer Class	**2019**	**2018**
	(In millions)	
Residential	$ 182	$ 191
Commercial	36	51
Industrial	17	8
Other	2	1
Total Revenues	$ 237	$ 251

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. In 2019, the pension and OPEB mark-to-market adjustment primarily reflects a 110 bps decrease in the discount rate used to measure benefit obligations and higher than expected asset returns. Penn's pension and OPEB mark-to-market adjustments for the years ended December 31,2019 and 2018, were $14 million and $12 million, respectively.

FirstEnergy's pension and OPEB funding policy is based on actuarial computations using the projected unit credit method. In January 2018, FirstEnergy satisfied its minimum required funding obligations to its qualified pension plan of $500 million and addressed anticipated required funding obligations through 2020 to its pension plan with an additional contribution of $750 million ($12 million at Penn). On February 1, 2019, FirstEnergy made a $500 million voluntary cash contribution to the qualified pension plan ($8 million at Penn). FirstEnergy expects no required contributions through 2021.

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 2019, FirstEnergy's pension and OPEB plan assets experienced gains of $1,492 million, or 20.2%, compared to losses of $371 million, or (4.0)%, in 2018, and assumed a 7.5% rate of return for 2019 and 2018 which generated $569 million and $605 million of expected returns 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 2019, 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-2019 was most appropriate. As such, the Pri-2012 mortality table with projection scale MP-2019 was utilized to determine the 2019 benefit cost and obligation as of December 31, 2019 for the FirstEnergy pension and OPEB plans. The impact of using the Pri-2012 mortality table with projection scale MP-2019 resulted in a decrease to the projected benefit obligation approximately $29 million and $3 million for the pension and OPEB plans, respectively, and was included in the 2019 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 is considered a change in estimate and, accordingly, accounted for prospectively, and did not have a material impact on FirstEnergy's financial statements.

Following adoption of ASU 2017-07, "*Compensation-Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*" in 2018, service costs, net of capitalization, continue to be reported within Other operating expenses on the Penn Statements of Income. Non-service costs are reported within Miscellaneous income, net, within Other Income (Expense).

The following is a summary of the plan status:

	Pension		OPEB	
As of December 31,	**2019**	**2018**	**2019**	**2018**
		(In millions)		
FirstEnergy benefit obligation	$ 11,050	$ 9,462	$ 654	$ 608
FirstEnergy fair value of plan assets	8,395	6,984	458	408
FirstEnergy funded status	(2,655)	(2,478)	(196)	(200)
FirstEnergy accumulated benefit obligation	10,439	8,951	—	—
FirstEnergy net periodic costs (credits) [(1)]	703	287	(20)	(156)
Penn's share of net periodic costs (credits) [(1)]	9	12	(1)	(3)
Penn's share of net liability [(2)]	35	36	—	1

(1) Includes annual pension and OPEB mark-to-market adjustment.

(2) Excludes $33 million and $29 million as of December 31, 2019 and 2018, respectively, of affiliated non-current liabilities related to pension and OPEB mark-to-market costs allocated to Penn.

	Pension		OPEB	
	2019	2018	2019	2018
Assumptions Used to Determine Benefit Obligations				
(as of December 31)				
Discount rate	3.34%	4.44%	3.18%	4.30%
Rate of compensation increase	4.10%	4.10%	N/A	N/A
Cash balance weighted average interest crediting rate	2.57%	3.34%	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	4.5%	4.5%
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				
Weighted-average discount rate	4.44%	3.75%	4.30%	3.50%
Expected long-term return on plan assets	7.50%	7.50%	7.50%	7.50%
Rate of compensation increase	4.10%	4.20%	N/A	N/A

*Excludes impact of pension and OPEB mark-to-market adjustment.

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 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.

	For the Years Ended December 31,	
INCOME TAXES:	**2019**	**2018**
	(In millions)	
Currently payable-		
Federal	$ 2	$ 2
State	—	1
	2	3
Deferred, net-		
Federal	4	6
State	2	1
	6	7
Total income taxes	$ 8	$ 10

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, 2019 and 2018:

	For the Years Ended December 31,	
(In millions)	**2019**	**2018**
Book income before income taxes	$ 39	$ 47
Federal income tax expense at statutory rate	$ 8	$ 10
Increases (reductions) in taxes resulting from-		
State income taxes, net of federal tax benefit	3	4
AFUDC equity and other flow-through items	(2)	(2)
Excess deferred tax amortization due to the Tax Act	(2)	(1)
Other, net	1	(1)
Total income taxes	$ 8	$ 10
Effective income tax rate	20.5%	21.3%

Penn's effective tax rate on pre-tax income in 2019 and 2018 was 20.5% and 21.3%, respectively.

Accumulated deferred income taxes as of December 31, 2019 and 2018 are as follows:

	As of December 31,	
(In millions)	**2019**	**2018**
Property basis differences	$ 122	$ 115
Regulatory asset/liability	2	(1)
Pension and OPEB	(20)	(19)
Other	1	(1)
Net accumulated deferred income tax liabilities	$ 105	$ 94

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, 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, 2019 and 2018, 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 2019 and 2018, 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. In June 2019, the IRS completed its examination of FirstEnergy's 2017 federal income tax return and issued a Full Acceptance Letter with no changes or adjustments to Penn's taxable income. Tax year 2018 is 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 2016-2018.

General Taxes

Details of general taxes for the years ended December 31, 2019 and 2018 are shown below:

(In millions)	**2019**	**2018**
Gross receipts	$ 14	$ 15
Social security and unemployment	2	2
Total general taxes	$ 16	$ 17

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 reserves 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 companies. 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 in 2019 and 2018.

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.

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 for the year ended December 31, 2019, were as follows:

(In millions)	
Operating lease costs	$ 1
Finance lease costs:	
Amortization of right-of-use assets	1
Interest on lease liabilities	—
Total finance lease cost	1
Total lease cost	$ 2

Supplemental balance sheet information related to leases was as follows:

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

Lease terms and discount rates were as follows:

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

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

Maturities of lease liabilities as of December 31, 2019, were as follows:

(In millions)	Operating Leases	Finance Leases	Total
2020	$ 1	$ 1	$ 2
2021	1	1	2
2022	1	—	1
2023	—	—	—
2024	—	—	—
Thereafter	1	—	1
Total lease payments	4	2	6
Less imputed interest	(1)	—	(1)
Total net present value	$ 3	$ 2	$ 5

ASC 840, "Leases" Disclosures

Penn's estimated future minimum lease payments for capital and operating leases as of December 31, 2018, as reported in the 2018 financial statements under ASC 840, with initial or remaining lease terms in excess of one year are as follows:

(In millions)	2019	2020	2021	2022	2023	Thereafter	Total	Less: amount representing interest and fees	Present value of net minimum capital lease payments
Capital leases	$ 1	$ 1	$ —	$ —	$ —	$ —	$ 2	$ —	$ 2
Operating leases	$ 1	$ —	$ —	$ —	$ —	$ 1	$ 2	N/A	N/A

Operating lease expense under ASC 840 "*Leases*" for the year ended December 31, 2018 was $1 million.

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:

	December 31, 2019		December 31, 2018	
(In millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	$ 200	$ 219	$ 201	$ 197

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, 2019 and December 31, 2018.

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, 2019. As of December 31, 2019 and 2018, 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, 2019 and 2018:

	As of December 31, 2019		As of December 31,	
(Dollar amounts in millions)	**Maturity Date**	**Interest Rate**	**2019**	**2018**
FMBs	2022 - 2056	4.24% - 6.09%	$ 200	$ 201
Finance lease obligations			2	2
Unamortized debt discounts			(1)	(1)
Currently payable long-term debt			(1)	(2)
Total long-term debt and other long-term obligations			$ 200	$ 200

The following table presents scheduled debt repayments for outstanding long-term debt, excluding finance leases, fair value purchase accounting adjustments and unamortized debt discounts and premiums, for the next five years as of December 31, 2019.

Year	Penn
	(In millions)
2020	$ —
2021	—
2022	100
2023	—
2024	—

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, 2019, Penn was in compliance with all debt covenant default provisions.

8. SHORT-TERM BORROWINGS AND BANK LINES OF CREDIT

Penn had $12 million of outstanding short-term borrowings as of December 31, 2019 and no outstanding short-term borrowings as of December 31, 2018.

Revolving Credit Facility

FE and the Utilities, including Penn, participate in a five-year syndicated revolving credit facility providing for aggregate commitments of $2.5 billion (Facility), which are available through December 6, 2022. Under the 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.

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, 2019. 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 2019 was 2.27% 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 must also be separately tracked for treatment 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. The 2019-2023 DSPs also include modifications to the Pennsylvania Companies’ POR programs in order to continue their clawback pilot program as a long-term, permanent program term, modifications to the Pennsylvania Companies’ customer class definitions to allow for the introduction of hourly priced default service to customers at or above 100kW, customer assistance program shopping limitations, and script modifications related to the Pennsylvania Companies' customer referral programs.

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.

Pennsylvania EDCs may establish a DSIC to recover costs of infrastructure improvements and costs related to highway relocation projects with PPUC approval. LTIIPs outlining infrastructure improvement plans for PPUC review and approval must be filed prior to approval of a DSIC. The PPUC approved modified LTIIPs for ME, PN and Penn for the remaining years of 2017 through 2020 to provide additional support for reliability and infrastructure investments. Following a periodic review of the LTIIPs in 2018 as required by regulation once every five years, the PPUC entered an Order concluding that the Pennsylvania Companies have substantially adhered to the schedules and expenditures outlined in their LTIIPs, but that changes to the LTIIPs as designed are necessary to maintain and improve reliability and directed the Pennsylvania Companies to file modified or new LTIIPs. On May 23, 2019, the PPUC approved the Pennsylvania Companies’ Modified LTIIPs that revised LTIIP spending in 2019 of approximately $26 million by Penn, and terminating at the end of 2019. On August 30, 2019, the Pennsylvania Companies filed Petitions for approval of proposed 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, as well as directed the Pennsylvania Companies to submit corrective action plans by March 16, 2020, which outline how they will reduce their pole replacement backlogs over a five-year period to a rolling two-year backlog.

The Pennsylvania Companies' approved DSIC riders for quarterly cost recovery went into effect July 1, 2016, subject to hearings and refund or reallocation among customer classes. In the January 19, 2017 order approving the Pennsylvania Companies’ general rate cases, the PPUC added an additional issue to the DSIC proceeding to include whether ADIT should be included in DSIC calculations. The parties to the DSIC proceeding submitted a Joint Settlement that resolved the issues that were pending from the order issued on June 9, 2016, and the PPUC approved the Joint Settlement without modification and reversed the ALJ's previous decision that would have required the Pennsylvania Companies to reflect all federal and state income tax deductions related to

DSIC-eligible property in currently effective DSIC rates. The Pennsylvania OCA filed an appeal with the Pennsylvania Commonwealth Court of the PPUC's decision, and the Pennsylvania Companies contested the appeal. The Commonwealth Court reversed the PPUC’s decision of April 19, 2018 and remanded the matter to the PPUC to require the Pennsylvania Companies to revise their tariffs and DSIC calculations to include ADIT and state income taxes. The Commonwealth Court denied Applications for Reargument in the Court’s July 11, 2019 Opinion and Order filed by the PPUC and the Pennsylvania Companies. On October 7, 2019, the PPUC and the Pennsylvania Companies filed separate Petitions for Allowance of Appeal of the Commonwealth Court’s Opinion and Order to the Pennsylvania Supreme Court.

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. The Pennsylvania Office of Small Business Advocate, the PPUC’s Bureau of Investigation, and the Pennsylvania OCA opposed Penn’s Petition. On January 17, 2020, the parties filed a petition seeking approval of settlement that provides for a temporary increase in the recoverability cap from 5% to 7.5%, which will 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. On February 11, 2020, a Recommended Decision was issued by the presiding officer, recommending that the PPUC approve the settlement without modifications.

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 has a market-based rate tariff on file with FERC, although major wholesale purchases remain subject to 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 ERO 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 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, and 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 and other environmental matters. While Penn's environmental policies and procedures are designed to achieve compliance with applicable environmental laws and regulation, 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, in particular with respect to existing environmental regulations, may materially impact its business, results of operations, cash flows and financial condition.

OTHER LEGAL PROCEEDINGS

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 pools and other transactions.

The primary affiliated company transactions for Penn during the years ended December 31, 2019 and 2018 were as follows:

	For the Years Ended December 31,	
	2019	2018
	(In millions)	
Revenues [(1)]	$ 1	$ 1
Expenses:		
Purchased power from FES [(2)]	11	23
Support services	15	17
Miscellaneous Income	1	1

(1) Includes ground lease revenues from ATSI. Please see Note 5, "Leases" for additional information.
(2) Penn purchases power from FES to meet a portion of its POLR and default service requirements and provide power to certain facilities.

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, including FES and FENOC, 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").