

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
AUDITED CONSOLIDATED 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 The Cleveland Electric Illuminating Company and its current and former subsidiaries and affiliated companies:

CEI	The Cleveland Electric Illuminating Company, an Ohio electric utility operating 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
GPU	GPU, Inc., former parent of JCP&L, ME and PN, that merged with FE on November 7, 2001
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 affiliated company
Ohio Companies	CEI, OE and TE
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
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
CO ₂	Carbon Dioxide
DCR	Delivery Capital Recovery
DMR	Distribution Modernization Rider
ERO	Electric Reliability Organization
ESP IV	Electric Security Plan IV
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
KWH	Kilowatt-hour
NERC	North American Electric Reliability Corporation
NOL	Net Operating Loss
OCC	Ohio Consumers' Counsel
OPEB	Other Post-Employment Benefits
PJM	PJM Interconnection, L.L.C.
PJM Region	The aggregate of the zones within PJM

GLOSSARY OF TERMS, *Continued*

PJM Tariff	PJM Open Access Transmission Tariff
POLR	Provider of Last Resort
PUCO	Public Utilities Commission of Ohio
RFC	Reliability <i>First</i> Corporation
RFP	Request for Proposal
ROE	Return on Equity
SPE	Special Purpose Entity
Tax Act	Tax Cuts and Jobs Act adopted December 22, 2017
VIE	Variable Interest Entity

Report of Independent Auditors

To Management and the Board of Directors
Of The Cleveland Electric Illuminating Company

We have audited the accompanying consolidated financial statements of The Cleveland Electric Illuminating Company and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated 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 Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Cleveland Electric Illuminating Company and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their 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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

<i>(In millions)</i>	For the Years Ended December 31,	
	2019	2018
REVENUES:		
Electric sales	\$ 962	\$ 995
Excise and gross receipts tax collections	64	67
Total revenues	1,026	1,062
OPERATING EXPENSES:		
Purchased power from affiliates	14	25
Purchased power from non-affiliates	96	91
Other operating expenses	383	331
Provision for depreciation	108	102
Amortization of regulatory liabilities, net	(42)	(1)
General taxes	189	187
Total operating expenses	748	735
OPERATING INCOME	278	327
OTHER INCOME (EXPENSE):		
Miscellaneous income, net	9	16
Pension and OPEB mark-to-market adjustment	(55)	(1)
Interest expense	(70)	(80)
Total other expense	(116)	(65)
INCOME BEFORE INCOME TAXES	162	262
INCOME TAXES	25	54
NET INCOME	\$ 137	\$ 208
<u>STATEMENTS OF COMPREHENSIVE INCOME</u>		
NET INCOME	\$ 137	\$ 208
OTHER COMPREHENSIVE LOSS:		
Pension and OPEB prior service costs	—	(3)
Other comprehensive loss	—	(3)
Income tax benefits on other comprehensive loss	—	(1)
Other comprehensive loss, net of tax	—	(2)
COMPREHENSIVE INCOME	\$ 137	\$ 206

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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<i>(In millions, except share amounts)</i>	December 31, 2019	December 31, 2018
ASSETS		
CURRENT ASSETS:		
Restricted cash	\$ 13	\$ 13
Receivables-		
Customers, net of allowance for uncollectible accounts of \$6 in 2019 and \$7 in 2018	97	113
Affiliated companies	39	25
Other	15	26
Prepaid taxes and other	2	3
	<u>166</u>	<u>180</u>
UTILITY PLANT:		
In service	3,358	3,260
Less — Accumulated provision for depreciation	<u>1,353</u>	<u>1,295</u>
	2,005	1,965
Construction work in progress	73	52
	<u>2,078</u>	<u>2,017</u>
DEFERRED CHARGES AND OTHER ASSETS:		
Goodwill	1,689	1,689
Property taxes	129	122
Other	37	23
	<u>1,855</u>	<u>1,834</u>
	<u>\$ 4,099</u>	<u>\$ 4,031</u>
LIABILITIES AND CAPITALIZATION		
CURRENT LIABILITIES:		
Currently payable long-term debt	\$ 21	\$ 22
Short-term borrowings - affiliated companies	85	12
Accounts payable-		
Affiliated companies	38	30
Other	10	9
Accrued taxes	125	122
Accrued interest	13	14
Other	42	43
	<u>334</u>	<u>252</u>
CAPITALIZATION:		
Common stockholder's equity-		
Common stock, without par value, authorized 105,000,000 shares - 67,930,743 shares outstanding	1,240	1,234
Accumulated other comprehensive loss	(3)	(3)
Retained earnings	<u>298</u>	<u>321</u>
Total common stockholder's equity	1,535	1,552
Long-term debt and other long-term obligations	<u>1,342</u>	<u>1,362</u>
	<u>2,877</u>	<u>2,914</u>
NONCURRENT LIABILITIES:		
Accumulated deferred income taxes	291	289
Retirement benefits	113	93
Regulatory liabilities	143	183
Property taxes	129	122
Other	212	178
	<u>888</u>	<u>865</u>
COMMITMENTS AND CONTINGENCIES (Note 12)		
	<u>\$ 4,099</u>	<u>\$ 4,031</u>

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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

<i>(In millions, except share amounts)</i>	Common Stock		AOCL	Retained Earnings	Total Stockholder's Equity
	Number of Shares	Carrying Value			
Balance, January 1, 2018	67,930,743	\$ 1,228	\$ (1)	\$ 314	\$ 1,541
Net income				208	208
Other comprehensive loss, net of tax			(2)		(2)
Stock-based compensation		3			3
Consolidated tax benefit allocation		3			3
Impact of adopting ASU 2018-02 ⁽¹⁾				(1)	(1)
Cash dividends declared on common stock				(200)	(200)
Balance, December 31, 2018	67,930,743	\$ 1,234	\$ (3)	\$ 321	\$ 1,552
Net income				137	137
Stock-based compensation		3			3
Consolidated tax benefit allocation		3			3
Cash dividends declared on common stock				(160)	(160)
Balance, December 31, 2019	67,930,743	\$ 1,240	\$ (3)	\$ 298	\$ 1,535

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

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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(In millions)</i>	For the Years Ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 137	\$ 208
Adjustments to reconcile net income to net cash from operating activities-		
Depreciation and amortization	73	112
Deferred income taxes and investment tax credits, net	(13)	(4)
Pension trust contributions	(10)	(31)
Retirement benefits, net of payments	(10)	(12)
Pension and OPEB mark-to-market adjustment	55	1
Change in current assets and liabilities-		
Receivables	17	8
Prepaid taxes and other current assets	1	—
Accounts payable	7	(6)
Accrued taxes	3	4
Accrued interest	(1)	(1)
Other current liabilities	(4)	5
Other	4	6
Net cash provided from operating activities	259	290
CASH FLOWS FROM FINANCING ACTIVITIES:		
New financing-		
Long-term debt	—	300
Short-term borrowings - affiliated companies, net	73	10
Redemptions and repayments-		
Long-term debt	(19)	(319)
Common stock dividend payments	(160)	(200)
Other	(3)	(5)
Net cash used for financing activities	(109)	(214)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(135)	(128)
Proceeds from asset sale	1	—
Loans to affiliated companies, net	—	19
Asset removal costs	(16)	(17)
Net cash used for investing activities	(150)	(126)
Net change in cash, cash equivalents, and restricted cash		
	—	(50)
Cash, cash equivalents, and restricted cash at beginning of period	13	63
Cash, cash equivalents, and restricted cash at end of period	\$ 13	\$ 13
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year-		
Interest (net of amounts capitalized)	\$ 67	\$ 79
Income taxes, net of refunds	\$ 43	\$ 48

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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

CEI, together with its consolidated subsidiary is a wholly owned subsidiary of FE, and is incorporated in Ohio. CEI operates an electric distribution system in Ohio. CEI is subject to regulation by the PUCO and FERC.

CEI follows GAAP and complies with the regulations, orders, policies and practices prescribed by FERC and the PUCO. 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. CEI has evaluated events and transactions for potential recognition or disclosure through March 4, 2020, the date the financial statements were issued.

CUSTOMER RECEIVABLES

CEI's principal business is providing electric service to customers in Ohio. CEI'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, CEI accrues the estimated unbilled amount as revenue and reverses the related prior period estimate.

Receivables from customers include distribution and retail electric sales 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 \$48 million and \$49 million, respectively, as of December 31, 2019, and were \$59 million and \$54 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 CEI'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. CEI nets its regulatory assets and liabilities based on federal and state jurisdictions. CEI 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 CEI 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 CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Net Regulatory Assets (Liabilities) by Source	December 31, 2019	December 31, 2018	Change
	<i>(In millions)</i>		
Customer payables for future income taxes	\$ (263)	\$ (270)	\$ 7
Asset removal costs	(100)	(90)	(10)
Deferred transmission costs	40	(3)	43
Deferred generation costs	95	115	(20)
Deferred distribution costs	42	45	(3)
Storm-related costs	64	43	21
Other	(21)	(23)	2
Net Regulatory Liabilities included on the Consolidated Balance Sheets	<u>\$ (143)</u>	<u>\$ (183)</u>	<u>\$ 40</u>

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 5, "Taxes" for further discussion on the Tax Act.

Asset removal costs - Primarily represents the rates charged to customers that include a provision for the cost of future activities to remove assets, including obligations for which an asset retirement obligation has been recognized, that are expected to be incurred at the time of retirement.

Deferred Transmission Costs - Primarily relates to the recovery of non-market based costs or fees imposed on or charged to CEI by various regulatory bodies including FERC, the state of Ohio 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 - Primarily relates to regulatory assets associated with the securitized recovery of certain electric customer heating discounts, fuel and purchased power regulatory costs that are amortized through 2034.

Deferred distribution costs - Primarily relates to the deferral of certain expenses resulting from distribution and reliability related expenditures, including interest, and are amortized through 2036.

Storm-related costs - Relates to the recovery of storm costs, none of which are currently being recovered through rates.

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. CEI recognizes liabilities for planned major maintenance projects as they are incurred.

CEI 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 3.2% of average depreciable property in 2019 and 2018.

CEI evaluates long-lived assets classified as held and used for impairment when events or changes in circumstances indicate the carrying value of such 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.

GOODWILL

In a business combination, the excess of the purchase price over the estimated fair values of the assets acquired and liabilities assumed is recognized as goodwill. CEI evaluates goodwill for impairment annually on July 31 and more frequently if indicators of impairment arise. In evaluating goodwill for impairment, CEI assesses qualitative factors to determine whether it is more likely than not (that is, likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying value (including goodwill). If CEI concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then no further testing is required. However, if CEI concludes that it is more likely than not that the fair value of a reporting unit is less than its

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

carrying value or bypasses the qualitative assessment, then the quantitative goodwill impairment test is performed to identify a potential goodwill impairment and measure the amount of impairment to be recognized, if any.

No impairment of goodwill was indicated as a result of testing in 2019 and 2018. In 2019 and 2018, CEI performed a qualitative assessment, assessing economic, industry and market considerations in addition to CEI's overall financial performance. It was determined that the fair value was, more likely than not, greater than its carrying value and a quantitative analysis was not necessary.

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. CEI implemented a third-party software tool that assisted with the initial adoption and will assist with ongoing compliance. CEI 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, CEI increased assets and liabilities by \$12 million, with no impact to results of operations or cash flows. See Note 6, "Leases," for additional information on CEI's leases.

Recently Issued Pronouncements - The following new authoritative accounting guidance issued by the FASB has not yet been adopted. Unless otherwise indicated, CEI 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. CEI 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 CEI'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. CEI 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. CEI 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

CEI 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. CEI 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 CEI are not subject to the election and are included in revenue. CEI 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.

CEI's principal business is providing electric service to customers in Ohio. CEI'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, CEI 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 Ohio that are regulated by the PUCO.

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Distribution services revenue relates to the distribution of electricity. CEI earns revenue from state-regulated rate tariffs under which it provides distribution services to residential, commercial and industrial customers in its service territory. CEI 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 11, "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 the Ohio Companies are provided through a competitive procurement process approved by each state's respective 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:

Revenues by Type of Service	For the Year Ended December 31,	
	2019	2018
	<i>(In millions)</i>	
Distribution services	\$ 802	\$ 802
Retail generation	114	128
Other	31	27
Total revenues from contracts with customers ⁽¹⁾	947	957
ARP ⁽²⁾	64	90
Other non-customer revenue	15	15
Total revenues	<u>\$ 1,026</u>	<u>\$ 1,062</u>

⁽¹⁾ Includes \$6 million and \$22 million in reductions to revenue related to amounts subject to refund resulting from the Tax Act for both the years ended December 31, 2019 and 2018, respectively.

⁽²⁾ Please see Note 11, "Regulatory Matters" for additional information on Rider DMR.

Other revenue primarily includes \$23 million related to amounts collected from customers to repay bonds associated with the Ohio Securitization (See Note 7, "Variable Interest Entities") for the year ended December 31, 2019 and 2018, respectively.

The following table represents a disaggregation of CEI's revenue from contracts with distribution service and retail generation customers for the years ended December 31, 2019 and 2018, by class:

Revenues by Customer Class	For the Years Ended December 31,	
	2019	2018
	<i>(In millions)</i>	
Residential	\$ 415	\$ 436
Commercial	391	383
Industrial	92	93
Other	18	18
Total Revenues	<u>\$ 916</u>	<u>\$ 930</u>

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in AOCI, net of tax, for the years ended December 31, 2019 and 2018 for CEI are shown in the following tables:

	Defined Benefit Pension & OPEB Plans <i>(In millions)</i>
AOCL Balance, January 1, 2018	\$ (1)
Amounts reclassified from AOCI	(3)
Other comprehensive loss	(3)
Income tax benefits on other comprehensive loss	(1)
Net other comprehensive loss	(2)
AOCL Balance, December 31, 2018	\$ (3)
Amounts reclassified from AOCI	—
Other comprehensive loss	—
Income tax benefits on other comprehensive loss	—
Net other comprehensive loss	—
AOCL Balance, December 31, 2019	\$ (3)

The following amounts were reclassified from AOCI for CEI in the years ended December 31, 2019 and 2018:

Reclassifications out of AOCI ⁽¹⁾	For the Years Ended December 31,		Affected Line Item in the Consolidated Statements of Income
	2019	2018 ⁽²⁾	
	<i>(In millions)</i>		
Defined Benefit Pension and OPEB Plans			
Prior-service costs	\$ —	\$ (3) ⁽³⁾	
	—	1	Income taxes
	\$ —	\$ (2)	Net of tax

⁽¹⁾ Amounts in parenthesis represent credits to the Consolidated Statements of Income from AOCI.

⁽²⁾ Includes stranded tax amounts reclassified from AOCI in connection with the adoption of ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income."

⁽³⁾ These AOCI components are included in the computation of net periodic pension cost. See Note 4, "Pension and Other Postemployment Benefits," for additional details.

4. 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 CEI. 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. CEI 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. CEI 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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

primarily reflects a 110 bps decrease in the discount rate used to measure benefit obligations and higher than expected asset returns. CEI's pension and OPEB mark-to-market adjustments for the years ended December 31, 2019 and 2018, were \$55 million and \$1 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 (\$31 million at CEI). On February 1, 2019, FirstEnergy made a \$500 million (\$10 million at CEI) voluntary cash contribution to the qualified pension plan. 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 CEI Consolidated 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:

For the Years Ended	Pension		OPEB	
	2019	2018	2019	2018
	<i>(In millions)</i>			
FirstEnergy benefit obligation	\$ 11,050	\$ 9,462	\$ 654	\$ 608
FirstEnergy fair value of plan assets	8,395	6,984	458	408
FirstEnergy funded status	<u>(2,655)</u>	<u>(2,478)</u>	<u>(196)</u>	<u>(200)</u>
FirstEnergy accumulated benefit obligation	10,439	8,951	—	—
FirstEnergy net periodic costs (credits) ⁽¹⁾	703	287	(20)	(156)
CEI's share of net liability ⁽²⁾	74	57	36	32
CEI's share of net periodic costs (credits) ⁽¹⁾	33	11	3	(13)

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

⁽²⁾ Excludes \$171 million and \$148 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 CEI.

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	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.

5. TAXES

CEI 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.

CEI 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.

<u>INCOME TAXES:</u>	For the Years Ended December 31,	
	2019	2018
	<i>(In millions)</i>	
Currently payable-		
Federal	\$ 35	\$ 53
State	3	5
	38	58
Deferred, net-		
Federal	(14)	(5)
State	1	1
	(13)	(4)
Total income taxes	\$ 25	\$ 54

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

CEI's tax rates are affected by permanent 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:

<i>(In millions)</i>	For the Years Ended December 31,	
	2019	2018
Book income before income taxes	\$ 162	\$ 262
Federal income tax expense at statutory rate	\$ 34	\$ 55
Increases (reductions) in taxes resulting from-		
State income taxes, net of federal tax benefit	2	4
Excess deferred tax amortization due to the Tax Act	(11)	(7)
Other	—	2
Total income taxes	<u>\$ 25</u>	<u>\$ 54</u>
Effective income tax rate	15.4%	20.6%

CEI's effective tax rate on pre-tax income for 2019 and 2018 was 15.4% and 20.6%, respectively. The decrease in the effective tax rate was primarily due to an increase in the tax benefit associated with the amortization of net excess deferred income taxes as compared to 2018 (See Note 11 "Regulatory Matters" for additional detail).

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

<i>(In millions)</i>	As of December 31,	
	2019	2018
Property basis differences	\$ 285	\$ 287
Regulatory assets/liability	45	38
Pension and OPEB	(63)	(52)
Valuation allowance on municipal property DTAs	20	20
Other	4	(4)
Net accumulated deferred income tax liabilities	<u>\$ 291</u>	<u>\$ 289</u>

CEI records as deferred income tax assets the effect of 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, CEI's deferred income tax assets attributable to loss carryforwards and credits were immaterial.

CEI accounts for uncertainty in income taxes recognized in its financial statements. Accounting guidance prescribes a recognition threshold and measurement attribute 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, CEI did not record any unrecognized tax benefits, nor does CEI have a reserve for any uncertain tax positions.

CEI 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 tax return. During 2019 and 2018, CEI did not record any interest related to uncertain tax positions, nor does CEI have a cumulative net interest payable recorded on its balance sheet.

For federal income tax purposes, CEI 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 CEI's taxable income. Tax year 2018 is currently under review by the IRS. CEI has tax returns under review by state taxing authorities at the audit or appeals level for tax years 2016-2018.

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

General Taxes

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

<i>(In millions)</i>	2019	2018
KWH excise	\$ 61	\$ 64
State gross receipts	3	3
Real and personal property	118	113
Social security and unemployment	7	7
Total general taxes	<u>\$ 189</u>	<u>\$ 187</u>

6. LEASES

CEI 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 CEI under an operating lease agreement. Land use is rented to ATSI under the terms and conditions of a ground lease. CEI 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 CEI 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 \$7 million for 2019 and 2018.

CEI 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, CEI 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. CEI did not evaluate land easements under the new guidance as they were not previously accounted for as leases. CEI 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 CEI'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, 2019, the maximum potential loss for these lease agreements at the end of the lease term is approximately \$2 million.

Finance leases for assets used in regulated operations are recognized in CEI'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:

<i>(In millions)</i>	
Operating lease costs ⁽¹⁾	\$ 2
Finance lease costs:	
Amortization of right-of-use assets	2
Interest on lease liabilities	2
Total finance lease cost	<u>4</u>
Total lease cost	<u>\$ 6</u>

⁽¹⁾ Includes \$1 million of short-term lease costs.

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Supplemental balance sheet information related to leases was as follows:

<i>(In millions)</i>	Financial Statement Line Item	As of December 31, 2019
Assets		
Operating lease assets, net of accumulated amortization of \$1 million	Deferred charges and other assets	\$ 16
Finance lease assets, net of accumulated amortization of \$14 million	Property, plant and equipment	15
Total leased assets		\$ 31
Liabilities		
<i>Current:</i>		
Operating	Other current liabilities	\$ 3
Finance	Currently payable long-term debt	3
<i>Noncurrent:</i>		
Operating	Other noncurrent liabilities	12
Finance	Long-term debt and other long-term obligations	12
Total leased liabilities		\$ 30

Lease terms and discount rates were as follows:

<i>(In millions)</i>	As of December 31, 2019
<i>Weighted-average remaining lease terms (years)</i>	
Operating leases	6.69
Finance leases	5.99
<i>Weighted-average discount rate ⁽¹⁾</i>	
Operating leases	3.19%
Finance leases	16.43%

⁽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:

<i>(In millions)</i>	For the Year Ended December 31, 2019
<i>Cash paid for amounts included in the measurement of lease liabilities</i>	
Operating cash flows from operating leases	\$ 2
Operating cash flows from finance leases	2
Finance cash flows from finance leases	2
<i>Right-of-use assets obtained in exchange for lease obligations:</i>	
Operating leases	\$ 5
Finance leases	—

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

<i>(In millions)</i>	Operating Leases	Finance Leases	Total
2020	\$ 3	\$ 4	\$ 7
2021	2	4	6
2022	2	4	6
2023	2	2	4
2024	2	2	4
Thereafter	5	9	14
<i>Total lease payments</i>	16	25	41
Less imputed interest	(1)	(10)	(11)
<i>Total net present value</i>	<u>\$ 15</u>	<u>\$ 15</u>	<u>\$ 30</u>

As of December 31, 2019, additional operating leases agreements, primarily for vehicles, that have not yet commenced are \$2 million. These leases are expected to commence within the next 18 months with lease terms of 3 to 10 years.

ASC 840, "Leases" Disclosures

CEI'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:

<i>(In millions)</i>	2019	2020	2021	2022	2023	Thereafter	Total	Less: amount representing interest and fees	Present value of net minimum capital lease payments
Capital leases	\$ 4	\$ 4	\$ 4	\$ 4	\$ 3	\$ 7	\$ 26	\$ 9	\$ 17
Operating leases	\$ 3	\$ 2	\$ 2	\$ 1	\$ 1	\$ 5	\$ 14	N/A	N/A

Operating lease expense under ASC 840 "Leases" for the year ended December 31, 2018 was \$5 million.

7. VARIABLE INTEREST ENTITIES

CEI performs qualitative analyses based on control and economics to determine whether a variable interest classifies CEI as the primary beneficiary (a controlling financial interest) of a VIE. An enterprise has a controlling financial interest if it has both power and economic control, such that an entity has (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (ii) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. CEI consolidates a VIE when it is determined that it is the primary beneficiary.

Consolidated VIEs

VIEs in which CEI is the primary beneficiary included in CEI's consolidated financial statements include CEI Funding LLC. In September 2012, CEI formed CEI Funding LLC as a separate, wholly-owned limited liability SPE. The phase-in recovery bonds issued by the SPE are payable only from, and secured by, phase-in recovery property owned by the SPE (i.e. the right to impose, charge and collect irrevocable non-bypassable usage-based charges payable by retail electric customers in the service territories of CEI) and the bondholder has no recourse to the general credit of FirstEnergy or CEI. CEI, as servicer of the SPE, manages and administers the phase-in recovery property including the billing, collection and remittance of usage-based charges payable by retail electric customers. CEI is entitled to annual servicing fees of \$232 thousand that are recoverable through the usage-based charges. The SPE is considered a VIE and is consolidated into the financial statements of CEI. As of December 31, 2019 and 2018, \$108 million and \$127 million of the phase-in recovery bonds were outstanding, respectively.

Unconsolidated VIEs

CEI does not have any unconsolidated VIEs.

8. FAIR VALUE MEASUREMENTS

INVESTMENTS

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

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

LONG-TERM DEBT AND OTHER LONG-TERM OBLIGATIONS

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 Consolidated Balance Sheets at cost. Since these borrowings are short-term in nature, CEI believes that their costs approximate their fair market value. The following table provides the approximate fair value and related carrying value of long-term debt, which excludes finance lease obligations and net unamortized debt issuance costs and discounts:

<i>(In millions)</i>	December 31, 2019		December 31, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt	\$ 1,358	\$ 1,539	\$ 1,377	\$ 1,457

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 CEI, which results in long-term debt being classified as Level 2 in the fair value hierarchy as of December 31, 2019 and 2018.

9. CAPITALIZATION

COMMON STOCK

In addition to paying dividends from retained earnings, CEI 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 AND PREFERENCE STOCK

CEI is authorized to issue preferred stock and preference stock as of December 31, 2019, as follows:

Preferred Stock		Preference Stock	
Shares Authorized	Par Value	Shares Authorized	Par Value
4,000,000	no par	3,000,000	no par

As of December 31, 2019, and 2018, there were no preferred or preference shares outstanding.

LONG-TERM DEBT AND OTHER LONG-TERM OBLIGATIONS

The following table presents outstanding long-term debt and finance lease obligations for CEI as of December 31, 2019 and 2018:

<i>(Dollar amounts in millions)</i>	As of December 31, 2019		As of December 31,	
	Maturity Date	Interest Rate	2019	2018
FMBs	2024	5.5%	\$ 300	\$ 300
Secured notes - fixed rate	2020-2034	1.726% - 3.450%	108	127
Unsecured notes - fixed rate	2028-2036	3.500% - 5.950%	950	950
Finance lease obligations			15	17
Unamortized debt discounts			(2)	(2)
Unamortized debt issuance costs			(8)	(8)
Currently payable long-term debt			(21)	(22)
Total long-term debt and other long-term obligations			<u>\$ 1,342</u>	<u>\$ 1,362</u>

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2019.

Year	CEI
	<i>(In millions)</i>
2020	\$ 19
2021	19
2022	5
2023	5
2024	305

Phase-In Recovery Bonds

In June 2013, the SPEs formed by the Ohio Companies issued pass-through trust certificates supported by phase-in recovery bonds to securitize the recovery of certain all electric customer heating discounts, fuel and purchased power regulatory assets (CEI - \$232 million). As of December 31, 2019 and 2018, \$108 million and \$127 million of the phase-in recovery bonds were outstanding at CEI, respectively.

See Note 7, "Variable Interest Entities," for additional information on securitized bonds.

Other Long-term Debt

CEI 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

CEI 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 CEI 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 CEI's financial condition.

Additionally, there are cross-default provisions in certain financing arrangements of FE and its subsidiaries, including CEI. 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 CEI would generally cross-default FE financing arrangements containing these provisions, defaults by FE would generally not cross-default applicable CEI financing arrangements.

As of December 31, 2019, CEI was in compliance with all debt covenant default provisions.

10. SHORT-TERM BORROWINGS AND BANK LINES OF CREDIT

CEI had \$85 million and \$12 million of outstanding short-term borrowings as of December 31, 2019 and 2018, respectively.

Revolving Credit Facility

FE and the Utilities, including CEI, 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, CEI may borrow up to its sub-limit of \$500 million, all of which was available to CEI as of December 31, 2019. CEI has regulatory and other short-term debt limitations of \$500 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.

THE CLEVELAND ELECTRIC ILLUMINATING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FirstEnergy Money Pool

FE's utility and transmission operating subsidiary companies, including CEI, 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.

11. REGULATORY MATTERS

STATE REGULATION

CEI's retail rates, conditions of service, issuance of securities and other matters are subject to regulation in Ohio by the PUCO. In addition, under Ohio law, municipalities may regulate rates of a public utility, subject to appeal to the PUCO if not acceptable to the utility. The key terms of CEI's current rate orders for distribution customer billings, which have been effective since May 2009, include an allowed debt/equity ratio of 51%/49% and an allowed ROE of 10.5%.

OHIO

The Ohio Companies currently operate under base distribution rates approved by the PUCO effective in 2009. The Ohio Companies' residential and commercial base distribution revenues are decoupled, through a mechanism that took effect on February 1, 2020, to the base distribution revenue and lost distribution revenue associated with energy efficiency and peak demand reduction programs recovered as of the twelve-month period ending on December 31, 2018. The Ohio Companies currently operate under ESP IV effective June 1, 2016, and continuing through May 31, 2024, that continues the supply of power to non-shopping customers at a market-based price set through an auction process. ESP IV also continues Rider DCR, which supports continued investment related to the distribution system for the benefit of customers, with increased revenue caps of \$20 million per year from June 1, 2019 through May 31, 2022; and \$15 million per year from June 1, 2022 through May 31, 2024. In addition, ESP IV includes: (1) continuation of a base distribution rate freeze through May 31, 2024; (2) the collection of lost distribution revenues associated with energy efficiency and peak demand reduction programs; (3) a goal across FirstEnergy to reduce CO₂ emissions by 90% below 2005 levels by 2045; and (4) contributions, totaling \$51 million to: (a) fund energy conservation programs, economic development and job retention in the Ohio Companies' service territories; (b) establish a fuel-fund in each of the Ohio Companies' service territories to assist low-income customers; and (c) establish a Customer Advisory Council to ensure preservation and growth of the competitive market in Ohio.

ESP IV further provided for the Ohio Companies to collect through Rider DMR \$132.5 million annually for three years beginning in 2017, grossed up for federal income taxes, resulting in an approved amount of approximately \$168 million annually in 2018 and 2019. Revenues from Rider DMR are excluded from the significantly excessive earnings test. On appeal, the SCOH, on June 19, 2019, reversed the PUCO's determination that Rider DMR is lawful, and remanded the matter to the PUCO with instructions to remove Rider DMR from ESP IV. On August 20, 2019, the SCOH denied the Ohio Companies' motion for reconsideration. The PUCO entered an Order directing the Ohio Companies to cease further collection through Rider DMR, credit back to customers a refund of Rider DMR funds collected since July 2, 2019, and remove Rider DMR from ESP IV. On October 1, 2019, the Ohio Companies implemented PUCO approved tariffs to refund approximately \$28 million to customers, including Rider DMR revenues billed from July 2, 2019 through August 31, 2019.

On July 15, 2019, OCC filed a Notice of Appeal with the SCOH, challenging the PUCO's exclusion of Rider DMR revenues from the determination of the existence of significantly excessive earnings under ESP IV for calendar year 2017 and claiming a \$42 million refund is due to OE customers. The Ohio Companies are contesting this appeal but are unable to predict the outcome of this matter.

Under Ohio law, the Ohio Companies are required to implement energy efficiency programs that achieve certain annual energy savings and total peak demand reductions. The Ohio Companies' 2017-2019 plan includes a portfolio of energy efficiency programs targeted to a variety of customer segments. The Ohio Companies anticipate the cost of the plan will be approximately \$268 million over the life of the plan and such costs are expected to be recovered through the Ohio Companies' existing rate mechanisms. On November 21, 2017, the PUCO issued an order that approved the proposed plan with several modifications, including a cap on the Ohio Companies' collection of program costs and shared savings set at 4% of the Ohio Companies' total sales to customers. On October 15, 2019, the SCOH reversed the PUCO's decision to impose the 4% cost-recovery cap and remanded the matter to the PUCO for approval of the portfolio plans without the cost-recovery cap.

On July 23, 2019, Ohio enacted legislation establishing support for nuclear energy supply in Ohio. In addition to the provisions supporting nuclear energy, the legislation included a provision implementing a decoupling mechanism for Ohio electric utilities. The legislation also is ending current energy efficiency program mandates on December 31, 2020, provided statewide energy efficiency mandates are achieved as determined by the PUCO. On October 23, 2019, the PUCO solicited comments on whether the PUCO should terminate the energy efficiency programs once the statewide energy efficiency mandates are achieved. Opponents to the

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legislation sought to submit it to a statewide referendum and stay its effect unless and until approved by a majority of Ohio voters. Petitioners filed a lawsuit in the U.S. District Court for the Southern District of Ohio seeking additional time to gather signatures in support of a referendum. Petitioners failed to file the necessary number of petition signatures, and the legislation took effect on October 22, 2019. On October 23, 2019, the U.S. District Court denied petitioners' request for more time, and certified questions of state law to the SCOH to answer. Petitioners appealed the U.S. District Court's decision to the U.S. Court of Appeals for the Sixth Circuit. The Petitioners ended their challenge to the legislation voluntarily at the end of January 2020 causing the dismissal of the appeal, the lawsuit before the U.S District Court, and the proceedings before the SCOH.

On November 21, 2019, the Ohio Companies applied to the PUCO for approval of a decoupling mechanism, which would set residential and commercial base distribution related revenues at the levels collected in 2018. As such, those base distribution revenues would no longer be based on electric consumption, which allows continued support of energy efficiency initiatives while also providing revenue certainty to the Ohio Companies. On January 15, 2020, the PUCO approved the Ohio Companies' decoupling application, and the decoupling mechanism took effect on February 1, 2020.

In February 2016, the Ohio Companies filed a Grid Modernization Business Plan for PUCO consideration and approval, as required by the terms of ESP IV. On December 1, 2017, the Ohio Companies filed an application with the PUCO for approval of a DPM Plan, a portfolio of distribution platform investment projects, which are designed to modernize the Ohio Companies' distribution grid, prepare it for further grid modernization projects, and provide customers with immediate reliability benefits. Also, on January 10, 2018, the PUCO opened a case to consider the impacts of the Tax Act on Ohio utilities' rates and determine the appropriate course of action to pass benefits on to customers. On November 9, 2018, the Ohio Companies filed a settlement agreement that provides for the implementation of the first phase of grid modernization plans, including the investment of \$516 million over three years to modernize the Ohio Companies' electric distribution system, and for all tax savings associated with the Tax Act to flow back to customers. As part of the agreement, the Ohio Companies also filed an application for approval of a rider to return the remaining tax savings to customers following PUCO approval of the settlement. On January 25, 2019, the Ohio Companies filed a supplemental settlement agreement that keeps intact the provisions of the settlement described above and adds further customer benefits and protections, which broadened support for the settlement. The settlement had broad support, including PUCO Staff, the OCC, representatives of industrial and commercial customers, a low-income advocate, environmental advocates, hospitals, competitive generation suppliers and other parties. On July 17, 2019, the PUCO approved the settlement agreement with no material modifications. On September 11, 2019, the PUCO denied the application for rehearing of environmental advocates who were not parties to the settlement.

The Ohio Companies' Rider NMB is designed to recover NMB transmission-related costs imposed on or charged to the Ohio Companies by FERC or PJM. On December 14, 2018, the Ohio Companies filed an application for a review of their 2019 Rider NMB, including recovery of future Legacy RTEP costs and previously absorbed Legacy RTEP costs, net of refunds received from PJM. On February 27, 2018, the PUCO issued an order directing the Ohio Companies to file revised final tariffs recovering Legacy RTEP costs incurred since May 31, 2018, but excluding recovery of approximately \$95 million in Legacy RTEP costs incurred prior to May 31, 2018, net of refunds received from PJM. The PUCO solicited comments on whether the Ohio Companies should be permitted to recover the Legacy RTEP charges incurred prior to May 31, 2018. On October 9, 2019, the PUCO approved the recovery of the \$95 million of previously excluded Legacy RTEP charges.

FERC REGULATORY MATTERS

With respect to its wholesale services and rates, CEI is subject to regulation by FERC. Under the FPA, FERC regulates rates for interstate wholesale sales, accounting and other matters.

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. CEI 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 relevant state commissions.

Federally-enforceable mandatory reliability standards apply to the bulk electric system and impose certain operating, record-keeping and reporting requirements on CEI. 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 CEI, are located within the RFC region. FirstEnergy actively participates in the NERC and RFC stakeholder processes, and otherwise monitors and manages its companies, including CEI, in response to the ongoing development, implementation and enforcement of the reliability standards implemented and enforced by RFC.

FirstEnergy, including CEI, 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 CEI, 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 CEI, 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

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inability on FirstEnergy's, including CEI'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 CEI's financial condition, results of operations and cash flows.

12. COMMITMENTS AND CONTINGENCIES

ENVIRONMENTAL MATTERS

Various federal, state and local authorities regulate CEI with regard to air and water quality and other environmental matters. While CEI'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. CEI 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

Other Legal Matters

There are various lawsuits, claims (including claims for asbestos exposure) and proceedings related to CEI's normal business operations pending against CEI or its subsidiaries. The loss or range of loss in these matters is not expected to be material to CEI or its subsidiaries. The other potentially material items not otherwise discussed above are described under Note 11, "Regulatory Matters."

CEI 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 CEI 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 CEI or its subsidiaries have legal liability or are otherwise made subject to liability based on any of the matters referenced above, it could have a material adverse effect on CEI's or its subsidiaries' financial condition, results of operations and cash flows.

13. TRANSACTIONS WITH AFFILIATED COMPANIES

CEI's operating revenues, operating expenses, miscellaneous income and interest expenses include transactions with affiliated companies. These affiliated company transactions include affiliated company power sales agreements between FirstEnergy's competitive and regulated companies, support service billings, interest on affiliated company notes including the money pools and other transactions.

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

	For The Years Ended December 31,	
	2019	2018
	<i>(In millions)</i>	
Revenues ⁽¹⁾	\$ 9	\$ 9
Expenses:		
Purchased power from FES	14	25
Support services	63	76
Miscellaneous Income	1	3
Interest expense to affiliates	1	—

⁽¹⁾ Includes ground lease revenues from ATSI. Please see Note 6, "Leases" for additional information.

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 10, "Short-Term Borrowings and Bank Lines of Credit").

CEI and FirstEnergy's other subsidiaries, including FES and FENOC, are parties to an intercompany income tax allocation agreement

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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 5, "Taxes").

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