



STATE OF NEW JERSEY

Board of Public Utilities

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ENERGY

IN THE MATTER OF THE PROVISION OF BASIC)
GENERATION SERVICE PURSUANT TO THE)
ELECTRIC DISCOUNT AND ENERGY)
COMPETITION ACT, N.J.S.A 48:3-49 ET SEQ.)

DECISION AND ORDER

DOCKET NO. EX01110754

IN THE MATTER OF THE BOARD'S)
DETERMINATION ON INCREASED)
CREDITWORTHINESS REQUIREMENTS FOR)
JERSEY CENTRAL POWER AND LIGHT COMPANY)

DOCKET NO. EF04010042

(Service List Attached)

BY THE BOARD:

This Order is intended to supplement the Board of Public Utilities' ("Board") December 4, 2002 Order in this Docket and addresses the appropriate measures to be taken to protect the integrity of the Board-authorized auction process for the procurement of Basic Generation Service ("BGS"), as a result of the downgrading of Jersey Central Power & Light Company's ("JCP&L") parent holding company, FirstEnergy Corp. ("FirstEnergy") by Standard & Poor's Ratings Services ("S&P").

PROCEDURAL HISTORY

By Order dated December 4, 2002, the Board approved, with modifications, the Electric Distribution Companies' ("EDCs") BGS Supplier Master Agreement released on November 13, 2002, for the procurement of supply to meet the full electricity requirements of BGS customers for the period August 1, 2002 through July 31, 2003. I/M/O The Provision of Basic Generation Service Pursuant to the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq., BPU Docket No. EX01110754. ("2002 Order") While the 2002 Order did not provide for reciprocal credit assurances as had been requested by BGS suppliers, the 2002 Order established an expedited process for dealing with a utility credit impairment, as it affects the BGS suppliers.

OFFICIAL FILE

ILL. C. C. DOCKET NO. 06-0800

Dynegy Cross Exhibit No. 1

Witness _____

Date 4/24/07 Reporter CB

The 2002 Order, at page 4, describes the process as follows:

If one of the "nationally recognized statistical rating organizations" (Fitch, Standard and Poor's, or Moody's) issues a report indicating a prospect of downgrading a rating of an EDC or its parent holding company below investment grade, the EDC shall, within 3 business days, file with the Board a plan to mitigate or remove the threat of such downgrade. Included therein should be an assessment of its present and future sources of liquidity necessary to assure continued payments for the BGS supply for its customers. The Board, within 10 days after such filing, shall hold a public hearing to review the plan and consider the available options, including assurances to the BGS suppliers of the affected EDC that their payments will continue. The affected suppliers may present their recommendations to the Board at this time by filing their positions no later than three business days prior to such hearing.

No later than 30 days after the public issuance of the negative report of the rating agency, the Board shall issue an Order, which shall include assurances, in such form as shall be determined by the Board, to the suppliers of BGS to the affected EDC that their payments will continue in a prompt and timely manner.

On December 23, 2003, Standard & Poor's Ratings Services ("S&P") announced that it had lowered its corporate credit rating on JCP&L's parent holding company, FirstEnergy, from BBB to BBB- and its senior unsecured credit rating on FirstEnergy from BBB- to BB+. Although, FirstEnergy's S&P corporate credit rating remains at investment grade, its S&P senior unsecured credit rating is now "speculative grade."

In accordance with the 2002 Order, on December 29, 2003, JCP&L filed a "Mitigation Plan" with the Board. The affected BGS suppliers were given the opportunity to review JCP&L's mitigation plan and present written recommendations to the Board. On January 5, 2004, the following five BGS suppliers submitted written comments:

- J. Aron & Company ("J. Aron")
- PPL EnergyPlus ("PPL")
- Morgan Stanley Capital Group ("Morgan Stanley")
- Constellation Power Source ("Constellation"); and
- Conectiv Energy Supply ("CESI").

On January 7, 2004, JCP&L filed reply comments to the submissions of the five BGS suppliers.

A public legislative-type hearing was held in the matter before Commissioner Frederick F. Butler on January 8, 2004. Thomas C. Navin, Treasurer of JCP&L and FirstEnergy testified in support of JCP&L's proposed mitigation measures, responded to informational questions from Commissioner Butler and Board Staff, and provided comments on the statements by the BGS suppliers. The five BGS suppliers submitting written comments, as well as any interested parties, were permitted to make oral statements. Constellation, J. Aron, PPL, and CESI provided additional oral comments in the record, while Morgan Stanley indicated that it would rely upon its written submission. The Ratepayer Advocate ("RPA") attended the hearing, but did not offer oral or written comments.

In response to information requests from Board Staff, and consistent with the 2002 Order, on January 15, 2004, JCP&L submitted an outline of the various mechanisms by which credit

assurances proposed by various BGS suppliers in their comments could be implemented, and provided cost estimates associated with each option. The BGS suppliers were afforded the opportunity to comment on JCP&L's submission. On January 20, 2004, Constellation submitted a response to the JCP&L outline. On January 23, 2004, J. Aron also submitted supplemental comments.

POSITIONS OF THE PARTIES

JCP&L

JCP&L does not believe that any particular action by the Board is necessary at this time. It asserts that its credit ratings remain investment grade and that JCP&L has ample liquidity resources available to it to assure continued payments for the BGS supply for its customers. Its Mitigation Plan details several initiatives and options that FirstEnergy/JCP&L are pursuing to improve FirstEnergy's financial situation while ensuring liquidity for JCP&L, including:

- continuing to work to return First Energy's Davis-Besse nuclear facility to safe and reliable operation as expeditiously as possible;
- the sale of common stock;
- the ability to issue additional common stock, debt securities or share purchase contracts and related share purchase units under an existing shelf registration statement;
- additional receivables financing facilities for the Pennsylvania operating companies (Pennsylvania Electric, Metropolitan Edison and Pennsylvania Power)
- continuation of ongoing discussions with the rating agencies;
- the issuance of new long-term debt securities by JCP&L;
- continuation of the existing FirstEnergy revolving credit facilities, and the related maintenance of regulated and unregulated money pools;
- maintenance of existing cash flow from operations;
- an aggressive debt reduction program.

In its reply comments, JCP&L also cites the fact that the credit analysis provisions of the current BGS Supplier Master Agreements focus exclusively on the credit rating of the supplier itself, not its parent holding company (unless the parent itself is a formal guarantor for a non-creditworthy supplier) as further support for the position that inclusion in the 2002 Order of a parent company downgrade as a triggering incident for a proceeding is not, by itself, a reason to impose credit worthiness standards on JCP&L for FirstEnergy's downgrade. Additionally, JCP&L contends that none of the commenting BGS suppliers provide any explanation as to why the FirstEnergy downgrade by only one of the three rating agencies materially increases their risk of payment from the investment grade JCP&L.

Finally, JCP&L estimates that were it required to post reciprocal security to the BGS suppliers, as much as \$300 million of security would be needed, depending on market prices and when the calculation is made. Not only would this increase costs to customers, but it would use

up a substantial amount of the credit and liquidity resources available to JCP&L and FirstEnergy and potentially cause a relatively minor temporary financial downgrade to become a much more serious and costly financial matter.

J. Aron & Company

J. Aron contends that the mitigation plan submitted by JCP&L does not comply with the Board's 2002 Order, in that it does not include assurances to J. Aron that payments to J. Aron will continue. Although generally supporting the mitigation plan's strategy for improving FirstEnergy's financial situation, J. Aron's concern centers around its belief that the plan does not provide concrete assurances that BGS suppliers will continue to be paid. It recommends that JCP&L be required to post margin in amounts commensurate with those required of the BGS Suppliers pursuant to the Independent Credit Requirement per tranche ("ICRT") and Independent Credit Threshold ("ICT") provisions set out in the Supplier Master Agreement for the duration of the downgrade. By way of example, J. Aron asserts that JCP&L is required to purchase seven 10-month tranches from J. Aron at 5.042 cents/kWh. Adequate assurances would be calculated by multiplying seven tranches by \$1.2 million per tranche, or \$8.4 million. J. Aron also contends that JCP&L should have to meet the Mark-to-Market exposure requirements applicable to the BGS Suppliers.

Should the Board reject J. Aron's recommendation that JCP&L be required to post reciprocal credit assurances, in the alternative, J. Aron proposes that JCP&L segregate the monies recovered from ratepayers for the benefit of BGS Suppliers into separate trust accounts for each supplier, pursuant to a Board Order clearly stating that these funds are not the property or property rights of JCP&L. However, it notes that although the trust would potentially protect the BGS suppliers in the event of a JCP&L bankruptcy or default, the insulation of these funds from a bankruptcy proceeding is not a legal certainty.

If the Board fails to provide necessary assurances to suppliers, J. Aron asserts that prospective bidders in the upcoming 2004 BGS Auction may: (1) not bid on JCP&L load; or (2) increase the price of electricity to JCP&L by application of additional risk factors for this load, resulting in higher costs to JCP&L customers. Additionally, J. Aron asserts that no immediate action by the Board could lead prospective bidders to factor the increased credit risk of transacting with other New Jersey EDCs into their future bids, leading to a higher cost of power to all EDCs, and, in turn, to all customers within the State.

PPL

PPL recommends that the Board require JCP&L to create a binding mechanism which would provide BGS suppliers with the right to request performance assurances, in the form of cash or a letter of credit from an institution acceptable to the suppliers, in an amount equal to the amount of the supplier's receivables from JCP&L at any one time, typically 60 days worth of energy deliveries; plus the positive difference, if any, between the "mark" for each billing month (set at the date the auction is completed) and the current forward market price.¹ To effect this recommendation, PPL, like J. Aron, proposes that the credit protection provisions set forth in the

¹ As PPL notes, this constitutes the inverse of the "Mark-to-Market Credit Exposure Methodology" set forth in Section 6.5 of the Master Supplier Agreements.

Master Supplier Agreements be made reciprocal, including, without limitation, the credit threshold matrices and the 1.15 adjustment factor set forth therein.

Alternatively, PPL recommends that the Board require JCP&L to make advance weekly payments to BGS suppliers for energy delivered under the Master Supplier Agreements for the immediately following week. Additionally, similar to J. Aron, PPL also recommends establishing a mechanism in which JCP&L customer receipts are placed in a separate escrow account (to be administered by a third party), from which PPL and other BGS suppliers would be entitled to withdraw the funds necessary to cover energy supply costs incurred by JCP&L under the Master Supply Agreements.

Morgan Stanley and CESI²

Similar to the other commenting suppliers, Morgan Stanley and CESI recommend that JCP&L be ordered to meet the bilateral credit and collateral provisions of the BGS Master Agreements. Additionally, CESI generally and Morgan Stanley specifically renew their recommendations from prior proceedings that the Board replace the mitigation plan process established by the 2002 Order with bilateral credit and collateral terms in the BGS Master Agreements going forward. They contend that the mitigation plan process contains uncertainties because suppliers do not know when and how the Board will act on a downgraded EDC's mitigation plan. Moreover, once a Board Order is issued, it is unclear whether the EDC could delay compliance, pending a request for rehearing and/or an appeal.

In further support of their position, Morgan Stanley and CESI assert that the EEI Master Power Purchase and Sale Agreement and other standard wholesale power supply agreements provide for the posting of collateral by either party in the event of a downgrade, in addition to maintaining the requirement of prompt payments of amounts due and owing.

Constellation

Constellation, like Morgan Stanley, contends that JCP&L's mitigation plan does not provide for the type of assurances that are customary in the industry when a counter party's credit is downgraded below investment grade. Constellation joins the other commenting suppliers in advocating that the Board require JCP&L to provide collateral consistent with the collateral requirements to which below investment grade BGS suppliers are subject, including the mark-to-market exposure calculations applicable to BGS suppliers pursuant to the Master FP Agreements and the security calculations applicable to BGS suppliers pursuant to the Master CIEP Agreements for the duration of the credit downgrade. Constellation also recommends that the Board clarify that credit rating downgrades to any of the other New Jersey EDCs would cause those entities to become subject to these same remedies. It asserts that such a clarification at this time would save the Board, the EDCs and the BGS suppliers the time and expense of another proceeding.

Constellation further recommends that the Board direct JCP&L to accelerate its payments to BGS suppliers from monthly payments to weekly payments in order to reduce the costs that JCP&L will incur to provide the necessary credit support. It argues for the adoption of this

² Because the comments provided by Morgan Stanley and CESI are so similar, they have been summarized together.

measure, even without the imposition of credit and collateral requirements, in order to mitigate some of the substantial risk faced by the BGS suppliers.

Constellation, on a bilateral basis with all BGS suppliers, would also be amenable to granting JCP&L a certain level of unsecured credit at both its parent company's current senior unsecured credit rating of BB+ and below this level, in the amounts of \$15 million for BB+, \$10 million for BB, an \$5 million for BB-. It contends that this would help reduce the amount of potential JCP&L collateral posting to BGS suppliers and would give a reasonable amount of unsecured credit at the BB+ and BB level on a bilateral basis. Constellation agrees with the other BGS suppliers that a properly established trust/escrow could be a suitable mechanism to mitigate the settlement exposure that BGS suppliers face.

DISCUSSION AND FINDINGS

The Board has carefully considered and appreciates the comments of all the parties. In evaluating the competing positions advocated in this proceeding, the Board's role is to balance the competing interests with the goal of providing reasonable assurances to BGS suppliers, while, at the same time, minimizing the costs to ratepayers. The Board developed the process detailed in its December 4, 2002 Order in light of the concerns with respect to creditworthiness reciprocity which were raised by BGS suppliers. The Board determined, at that time, that it was neither necessary nor appropriate to adopt a reciprocal credit requirement, but instead developed an expedited process to deal with the effects of a potential deterioration of the credit ratings of an EDC or its parent to below investment grade. The purpose of the expedited process was to provide assurances to BGS suppliers that their payments from the EDCs will continue in a prompt and timely manner.

In the 2002 Order, the Board specifically included a rating downgrade of an EDC's parent holding company as a trigger for the expedited review process because, in its experience, the EDC's credit status is inevitably linked, although not always in a direct or immediate manner, to that of its parent. While that Order recognizes that a downgrade of an EDC's parent company could have a negative effect on the EDC's financial stability, it also leaves the final determination as to the consequence of a rating agency downgrade to the Board. This latitude is necessary in order to allow the Board to properly consider the specific circumstances of the case, including the action of the rating agency, the circumstances behind the rating agency's action, the prospects for corrective action on the part of the EDC and/or its parent company and ultimately, the ability of the EDC to continue to pay BGS suppliers in a timely manner.

JCP&L continues to have an investment grade rating on its senior unsecured credit from the three rating agencies. S&P and Moody's provide JCP&L with an investment grade corporate credit rating. On August 14, 2003, Moody's placed FirstEnergy and its subsidiaries, including JCP&L, under review for possible downgrade. S&P still categorizes its outlook for FirstEnergy and JCP&L as stable. Looking at the overall credit picture for JCP&L and FirstEnergy, and based upon the record which was developed in this proceeding, there is nothing to suggest to the Board that JCP&L is in imminent danger of missing or delaying a payment to BGS suppliers.

After considering all of JCP&L and FirstEnergy's ratings, and after reviewing the record in this proceeding, the Board FINDS that JCP&L continues to be rated at investment grade and has a stable outlook from S&P and Fitch. Moody's rating is on review, but JCP&L is at an "A" rating, which is several notches higher than the S&P and Fitch ratings. Accordingly, and recognizing that the remedial steps proposed by the BGS suppliers could be costly and could impose additional burdens on JCP&L and its ratepayers, the Board FINDS that there is no

immediate need for JCP&L to modify its payment schedules, post security or take any of the other remedial actions proposed by suppliers.

However, since any further negative action by a credit rating agency toward FirstEnergy could negatively impact the rating of JCP&L, and in order to provide meaningful risk relief to BGS suppliers, the Board FINDS that certain preliminary steps below should be taken by JCP&L immediately, and that certain measures should be implemented without further Board Order in the event of a downgrade of JCP&L to speculative grade.

Specifically, based on the record and the Board's experience, the Board recognizes that BGS suppliers have some risk with respect to the lag between their delivery of energy and payment by JCP&L. Some suppliers have proposed a weekly payment schedule to reduce their risk. The Board recognizes, as well, that there is a lag between the time that energy is delivered to customers by the EDC and when customer payments are received, and that an accelerated payment schedule to the BGS suppliers would create additional costs to the EDC, and ultimately to customers. Recognizing these competing concerns, and in order to balance the equities in a cost-efficient manner, the Board believes that in the event that JCP&L's corporate credit rating from any major rating agency falls below investment grade, a twice-a-month payment process should provide significant benefit to suppliers and represents the least costly mechanism to assuage supplier concerns. Therefore, the Board HEREBY ORDERS JCP&L to automatically begin twice-a-month payment to the BGS suppliers without further proceedings or hearings in the event that JCP&L's corporate credit rating from any major rating agency falls below investment grade. The Board DIRECTS JCP&L to work with Staff to develop the processes necessary to implement twice-a-month supplier payments within forty-five days of this Order.

The Board also believes that the separate trust accounts proposed by J. Aron and Constellation may be a reasonable additional step for JCP&L to take if JCP&L is downgraded to speculative grade. However, such a trust arrangement may require significant time and expense to develop in order to provide for a meaningful segregation of BGS revenues that would be protected in the event of a bankruptcy proceeding. While the Board is not inclined to require that such a trust be set up at this time, the Board finds it appropriate and HEREBY DIRECTS JCP&L to take preliminary steps to enable it to expeditiously put into place a trust/escrow structure, as described in its January 15, 2004 submission to the Board, that would only be activated upon further Board Order in the event that JCP&L's corporate credit rating from any major rating agency falls below investment grade. In this way, the Board would have this option readily available to it should it believe it necessary to provide additional protection upon the occurrence of an event that it believes places BGS suppliers and/or customers at additional risk. The Board FURTHER DIRECTS JCP&L to keep Staff updated on its progress in this area and to provide Staff with written quarterly updates beginning March 31, 2004, on the progress of its work in developing a trust/escrow mechanism.

Should JCP&L be rated below investment grade by one or more rating agencies, the Board will determine whether, in addition to the automatic twice-a-month payment process, a trust/escrow structure should be implemented. As part of that review, the Board will afford the Ratepayer Advocate and the affected BGS suppliers the opportunity to be heard on this issue.

The Board emphasizes that this Order is meant to address the particular facts and circumstances of this case only, and is not meant to supercede the process for expedited review set forth in the Board's 2002 Order in the event of a downgrade of any other EDC or its parent.

DATED: 1/30/04

BOARD OF PUBLIC UTILITIES
BY:

SIGNED

JEANNE M. FOX
PRESIDENT

SIGNED

FREDERICK F. BUTLER
COMMISSIONER

SIGNED

CAROL J. MURPHY
COMMISSIONER

SIGNED

CONNIE O. HUGHES
COMMISSIONER

SIGNED

JACK ALTER
COMMISSIONER

ATTEST:

SIGNED

KRISTI IZZO
SECRETARY