



Agenda Date: 9/18/13
Agenda Item: 2D

STATE OF NEW JERSEY
Board of Public Utilities
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ENERGY

IN THE MATTER OF THE PROVISION OF BASIC)	DECISION AND ORDER
GENERATION SERVICE PURSUANT TO THE)	
ELECTRIC DISCOUNT AND ENERGY)	
COMPETITITON ACT, N.J.S.A. 48:3-49 ET SEQ.)	DOCKET NO. EX01110754
IN THE MATTER OF THE PROVISION OF BASIC)	
GENERATION SERVICE ("BGS") PURSUANT TO)	
THE ELECTRIC DISCOUNT AND ENERGY)	
COMPETITITON ACT—DETERMINATION ON)	
CREDITWORTHINESS REQUIREMENTS FOR)	
JERSEY CENTRAL POWER & LIGHT COMPANY)	DOCKET NO. EO13080721

Parties of Record:

Gregory Eisenstark, Esq., Morgan, Lewis & Bockius LLP, for Petitioner
Stefanie A. Brand, Esq., Director, New Jersey Division of Rate Counsel

BY THE BOARD:

This Order supplements the Board of Public Utilities' ("Board") December 4, 2002 Order in In re the Provision of Basic Generation Service in Docket No. EX01110754 ("2002 Order") and modifies the appropriate measures to be taken to protect the integrity of the Board-authorized auction process for the procurement of Basic Generation Service ("BGS") in the event of a credit rating downgrading of Jersey Central Power & Light Company ("JCP&L") or its parent holding company, FirstEnergy Corp ("FirstEnergy") by Standard & Poor's Ratings Services ("S&P"), Moody's Investor Service ("Moody's") or Fitch Ratings ("Fitch").

BACKGROUND

On August 5, 2013, JCP&L notified the Board of a credit rating downgrade by Fitch Ratings of parent company FirstEnergy's and utility JCP&L's senior unsecured debt to below investment grade and offered a mitigation plan for the Board's consideration. The downgrade triggered a requirement set forth in the 2002 Order that the affected utility notify the Board of such downgrade and supply a mitigation plan within five business days of the downgrade. The 2002 Order also required that the Board request comments and hold a public hearing on the mitigation plan within 10 business days of its receipt and issue an Order on the matter within 30

days of the downgrade. However, the Order issued in March 2010¹ following an S&P downgrade affirmed the adequacy of the Company's mitigation plan, almost identical to the one submitted in the current case, and also discussed 2007 changes to the BGS contracts that greatly ameliorated BGS supplier credit concerns with JCP&L by automatically requiring twice per month payments of an electric distribution company's ("EDC's") credit rating drops below investment grade.²

PROCEDURAL HISTORY

By letter dated August 5, 2013, JCP&L notified the Board that Fitch Ratings had lowered both its Issuer Default Rating ("IDR") and senior unsecured debt credit rating on JCP&L's parent company FirstEnergy from BBB- to BB+. Fitch also lowered its IDR on the utility JCP&L from BBB to BBB-, and lowered JCP&L's senior unsecured debt credit rating from BBB+ to BBB while revising JCP&L's Rating Outlook to Stable from Negative. By that same letter, posted with this Notice and the July 31, 2013 Fitch Ratings report, JCP&L submitted its plan for mitigating any possible effects of this credit downgrade as required under the terms of the 2002 Order.

A public notice was posted on the Board's website on August 12, 2013, requesting that comments on the matter be submitted to the Board Secretary either by mail or electronically to a dedicated mailbox by August 19, 2013. The posting included the subject Fitch Ratings Report and JCP&L's Mitigation Plan. The notice and other documents were also distributed electronically to a BGS service list supplied by JCP&L. The notice advised that the Board would review comments and then determine whether a public hearing or other action would be appropriate.

Prior Rating Action 12/23/03 – The provisions of the 2002 Order were triggered twice before. First, on December 23, 2003, S&P lowered FirstEnergy's senior unsecured credit rating from BBB- to BB+. At that time, only the rating of senior unsecured debt fell to "speculative grade" and FirstEnergy's S&P corporate credit rating remained investment grade at BBB-. JCP&L filed a mitigation plan on December 19, 2003, and five affected BGS suppliers reviewed the plan and submitted recommendations which the Board took into consideration in its January 30, 2004 Order, wherein the Board ordered JCP&L to automatically begin twice-a-month payments to BGS suppliers in the event of a JCP&L credit downgrade below investment grade and directed JCP&L to "take preliminary steps to enable it to expeditiously put into place a trust/escrow structure...that would only be activated upon further Board Order in the event that JCP&L's corporate credit rating from any major rating agency fell below investment grade." JCP&L drafted such a trust agreement and submitted it to the Board on March 31, 2004. No credit downgrade event has ever occurred to necessitate use of the trust mechanism. Subsequently, the BGS contracts, the BGS-FP and BGS-CEIP Supplier Master Agreements, were modified to incorporate in Article 9: Billing and Payment paragraph 9.1 (d) the twice-per-month payment mechanism ordered by the Board in 2004. The presence of the payment remedy embedded within the BGS contractual agreement obviates the need to develop a separate mechanism for each downgrade situation under a Board Order.

¹ In re the Provision of Basic Generation Service ("BGS") Pursuant to the Electric Discount and Energy Competition Act—Determination on Creditworthiness Requirements for Jersey Central Power & Light Company, Docket No. EO10020125 (Order dated March 17, 2010).

² In re the Provision of Basic Generation Service for the Period Beginning June 1, 2007, Docket No. EO06020119 (Order dated Dec. 22, 2006) ("2007 BGS Order").

Prior Rating Action 2/17/10 - The second instance occurred on February 17, 2010, when JCP&L notified the Board of a credit rating downgrade by S&P of parent company FirstEnergy's senior unsecured debt to below investment grade while Moody's Investors Service and Fitch Ratings affirmed their existing investment grade ratings for both FirstEnergy and JCP&L. In its mitigation plan, JCP&L provided its assessment of its present and future sources of liquidity and asserts that this plan "demonstrates that JCP&L has ample resources available to it to assure continued payments for the basic generation service supply for its customers" and the utility argued that no additional Board action was required. The Board received comments from Rate Counsel only and no parties other than JCP&L and Rate Counsel asked to be heard at the March 1, 2010 hearing. During the hearing, FirstEnergy Vice President and Treasurer James Pearson stated that the negative rating actions were a conclusion of only one of three rating agencies and suggested that in order to prevent this divergent decision by S&P from having a distorting impact, any consideration of S&P's actions must be balanced by an assessment of the opinions of Moody's and Fitch. Pearson stated that this proper balancing is already built into the structure of the BGS Supplier Master Agreements, which provide that in the case of split ratings, the two higher ratings should be controlling for purposes of assessing the credit for either suppliers or utilities.

Also testifying in 2010, Rate Counsel expressed concern that the downgrading of FirstEnergy's credit rating by S&P could negatively impact JCP&L's ratepayers as a BGS bidder might perceive that it faces additional payment default risks due to JCP&L's parent company's credit rating, and then increases its bid price for serving JCP&L customers. Rate Counsel reserved its right to argue that any such additional costs incurred by JCP&L due to the downgrading of FirstEnergy should be paid by shareholders, and not JCP&L ratepayers in any future proceeding.

POSITIONS OF THE PARTIES - Current Rating Action 7/31/13

JCP&L

In the current case of the July 31, 2013 downgrade, JCP&L put forth its mitigation plan on August 5, 2013 asserting that:

- FirstEnergy and JCP&L have sufficient existing sources of liquidity in that FirstEnergy and certain of its utility subsidiaries, including JCP&L, participate in a \$2.5 billion multi-year syndicated revolving credit facility while revolving credit facilities totaling \$3.55 billion are in place for certain other FirstEnergy Corp. subsidiaries yielding total revolving credit facilities in place for the FirstEnergy of \$6.05 billion. As of July 31, 2013, \$3.245 billion had been drawn down and \$8 million in letters of credit had been issued under these facilities, leaving \$2.797 billion of available credit from these facilities. Additionally, as of July 31, 2013, the FirstEnergy companies had \$189 million in cash investments resulting in available liquidity of \$2.986 billion. Further, FirstEnergy may borrow from an unregulated money pool.³ These sources of liquidity provide ample support to assure payments to the BGS suppliers.
- FirstEnergy will have funds from operations after purchased power and BGS costs of between \$3.15 billion and \$3.35 billion for 2013 including JCP&L's funds from operations.

³ JCP&L is currently following a Board Order to reduce its short-term borrowing from the utility money pool from a high of \$850 million down to \$600 million because the Board authorized borrowing of up to \$750 in long term debt in February 2013.

- Through June 30, 2013, FirstEnergy and certain of its subsidiaries issued \$2.245 billion of new long-term debt in 2013.

JCP&L concludes that its Mitigation Plan demonstrates that it has ample resources available to assure continued payments for BGS supply for its customers.

Rate Counsel

Pursuant to the Board's request for comments on the July 2013 credit downgrade, only Rate Counsel submitted comments and observed that despite the adverse FitchRatings report, JCP&L's corporate and senior unsecured credit ratings from all three credit rating agencies remain investment grade, and also acknowledged that JCP&L "has access to adequate levels and sources of liquidity, such that payment for basic generation service supply for its customers is not an immediate issue."⁴ However, Rate Counsel expressed concerns that JCP&L's credit ratings are subpar compared with other major New Jersey utilities. Rate Counsel argued that credit rating reports make clear that JCP&L's credit ratings cannot be explained by the utility's inherent business risk profile which S&P characterizes as "Excellent;" nor by the Board's regulatory treatment that is generally viewed as "supportive" by credit rating agencies. JCP&L's strong service territory also supplies no reason for subpar ratings according to Rate Counsel. Rate Counsel argued that at least part of the problem is JCP&L's affiliation with FirstEnergy, "a company heavily dependent for its income stream on risky coal-fired merchant generation" and asserted that "[t]here is little doubt that this weakens JCP&L's credit ratings since JCP&L is controlled by and is financially integrated with its FirstEnergy parent."⁵ Rate Counsel then referred to its efforts in the pending JCP&L rate case to urge that JCP&L promptly conduct and submit "ring fencing" feasibility study to the Board to determine the costs and benefits of potential ring fencing measures that could protect its credit rating. Rate Counsel concluded that this should be the first step in an appropriate mitigation plan for JCP&L.

Secondly, Rate Counsel asserted that as a fundamental issue, JCP&L appears to be undercapitalized which undermines the utility's credit metrics. Rate Counsel notes that JCP&L appears to have a strong capital structure with a 54 percent equity ratio (excluding securitization and short-term debt) according to its rate case filing,⁶ but Rate Counsel stated that fully \$1.8 billion of its roughly \$2.3 billion common equity is merely a "goodwill" accounting entry on its balance sheet. Rate Counsel pointed out that this non-cash write-up to equity "was created as a result of the 'acquisition premium' paid by FirstEnergy for GPU at the time of that merger and does not reflect in any way JCP&L's net plant and equipment or other assets that comprise its utility rate base and, therefore, earn a cash return." Rate Counsel noted that absent this "goodwill" accounting entry, JCP&L's balance sheet quite weak. Rate Counsel argued that FirstEnergy has an obligation to utility customers to ensure that JCP&L is adequately capitalized and not excessively leveraged and further argued that goodwill does not represent real utility assets and cannot provide the basis for financially sound, prudent operations.

⁴ Comments of the Division of Rate Counsel in response to the Notice dated August 12, 2013 submitted August 19, 2013, at 2.

⁵ Ibid.

⁶ See, In re the Verified Petition of Jersey Central Power & Light Company for Review and Approval of Increases in and Other Adjustments to Its Rates and charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in connection Therewith; and for Approval of an Accelerated Reliability Enhancement Program ("2012" Base Rate Filing), BPU Docket No. ER12111052, Exhibit JC-5, Direct Testimony of Steven R. Staub.

DISCUSSION AND FINDINGS

The Board has considered JCP&L's Mitigation Plan and Rate Counsel's comments as well as the factors that drove the adoption of the creditworthiness review process detailed in the 2002 Order to balance the goal of providing reasonable assurances to BGS suppliers and minimizing the costs to ratepayers.

In the 2007 BGS Order, the Board noted that as a result of discussions between the EDCs and suppliers, the EDCs agreed to provide for accelerated payments in the event that an EDC's credit rating drops below investment grade during the term of the Supplier Master Agreements ("SMA"). As a result of this agreement, all FP- and CEIP-Supplier Master Agreements provide for twice-per-month payments if an EDC's credit rating drops below investment grade. Current BGS-FP and BGS-CEIP SMAs each reflect this provision under Article 9: Billing and Payment, paragraph 9.1 (d), which specifically set forth the twice-per-month payment mechanism ordered by the Board in 2004. Accordingly, no further action is needed in the instant case with regard to BGS payments as the procedures embedded in the contractual agreements, JCP&L's continuing investment grade rating on all its secured and unsecured debt from the three rating agencies, and the sufficiency of JCP&L's Mitigation Plan ensure that payments to BGS Suppliers will not be compromised and JCP&L has sufficient liquidity to meet its BGS supplier obligations. None of the BGS Suppliers submitted comments in response to this event, as was the case in 2010, which leads the Board to conclude that the changes made to BGS contract language have negated the need for additional Board actions. Most significantly, the terms of the BGS agreements continue to provide for twice-per-month payments in the event JCP&L's debt were to be downgraded below investment grade which addresses the BGS Suppliers' original concerns that were the genesis for the credit review process implemented in 2002. With the payment provisions embedded in the contractual agreements, as also noted in 2010, the Board again **FINDS** there is no need to develop a separate payment mechanism in response to the July 31, 2013 credit downgrade at this time.

When the BGS process was first established, BGS suppliers expressed concerns with respect to utility creditworthiness and the Board established an expedited process to provide assurances to BGS suppliers that their payments from the EDCs would 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 it recognized that the EDC's credit status is inevitably linked to that of its parent. While that Order recognized that the downgrade of an EDC's parent company could have a negative effect on the EDC's financial stability, it left the final determination as to the consequences of that downgrade to the Board. The process of requiring a Mitigation Plan and soliciting comments continues to have validity now just as it did in when crafted in 2002 and when triggered in 2004 and 2010; however, since BGS contracts have been amended directly⁷ to incorporate the provision of accelerated payments to BGS suppliers in the event an EDC's credit rating drops below investment grade during the term of the contract, there is less need for the Board to hold a hearing on the credit event and issue an Order. The Board **FINDS** that it is appropriate to modify the process originally set forth in 2002 to review the impact of credit downgrades on the ability of utilities to pay BGS suppliers in light of the fact that BGS contracts have been amended directly to ensure timely payments and BGS Suppliers have ceased responding to the

⁷ Current BGS-FP and BGS-CEIP SM reflect this provision under Article 9 Billing and Payment, section 91 (d), which substantially mirrors the twice-per month payment mechanism that the Board directed the Company to develop in 2004.

Board's request for comments, indicating comfort with contractual assurances that were not in place when the creditworthiness protocol was established in 2002.


The Board **FINDS** no immediate concerns with JCP&L's liquidity position, the primary subject of this proceeding. In the event that JCP&L's bonds were to be downgraded below investment grade, FirstEnergy could infuse additional equity into JCP&L or reduce or eliminate JCP&L's payment of dividends to the parent.

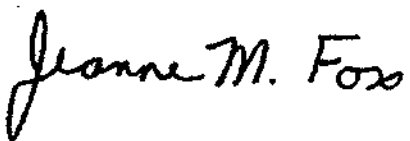
In response to Rate Counsel's comments, the Board **FINDS** that the study of potential ring-fencing measures is a reasonable proposal that would be best pursued in the context of the Company's pending base rate case or other relevant proceeding. With regard to Rate Counsel's assertions about goodwill and capitalization of JCP&L, the Board **FINDS** that these issues also appropriately belong in the Company's base rate case.

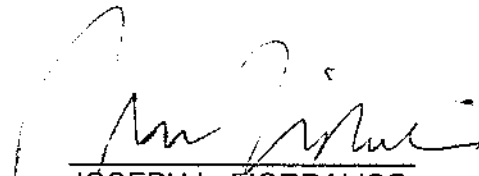
Therefore, the Board **FINDS** that there is no need to develop a separate payment mechanism to provide assurance to these suppliers in the event that JCP&L's credit rating falls below the "Required Rating" as defined in section 9.1(c) of the SMAs. The Board **FINDS** that there is no need for JCP&L to modify its payment schedules, post security or take any other remedial actions at this time. The Board **DIRECTS** JCP&L to continue to provide timely notice to the Board of any further changes to its or FirstEnergy's credit ratings as required under the 2002 Order and the Board's rules at N.J.A.C. 14:4-4.6(d). The Board **ORDERS** that going forward, when a triggering credit downgrade occurs, JCP&L will submit a Mitigation Plan and the Board will solicit comments; however, the Board may hold a hearing and/or issue an Order as the Board deems necessary.

DATED: 9/19/13

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BY:


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JEANNE M. FOX
COMMISSIONER

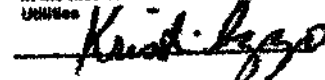

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SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities



**IN THE MATTER OF THE PROVISION OF BASIC GENERATION SERVICE ("BGS") PURSUANT
TO THE ELECTRIC DISCOUNT AND ENERGY COMPETITION ACT—DETERMINATION ON
CREDITWORTHINESS REQUIREMENTS FOR JERSEY CENTRAL POWER AND LIGHT COMPANY
BPU DOCKET NO. EO13080721**

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**IN THE MATTER OF THE PROVISION OF BASIC GENERATION SERVICE ("BGS") PURSUANT
TO THE ELECTRIC DISCOUNT AND ENERGY COMPETITION ACT—DETERMINATION ON
REDITWORTHINESS REQUIREMENTS FOR JERSEY CENTRAL POWER AND LIGHT COMPANY
BPU DOCKET NO. EO13080721**

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