Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company Credit Standards November 10, 2011

INTRODUCTION

Before retail competition, Pennsylvania utilities generated or bought electricity and delivered it to their customers. Now, customers have the ability to choose the supplier to provide their electricity, which the local Pennsylvania utility delivers. The registration and coordination services are set forth under a utility's electric generation supplier coordination tariff ("Supplier Tariff"). The Supplier Tariff establishes the basic requirements for interactions and coordination between the electric distribution company ("EDC") and electric generation supplier ("EGS") necessary for ensuring the delivery of competitive energy supply from EGSs to their customers.

Under the Supplier Tariff, an EGS must satisfy the EDC's creditworthiness requirements. The EDC's creditworthiness requirements are in place to ensure that the EGS is, and will continue to be, a viable entity, protecting the EDC and customers from unnecessary risk due to an event of EGS default. In calculating the credit risk exposure to the EDC under the Supplier Tariff, the exposure calculation must take into consideration the scope of operations of each EGS, as well as changes to the scope of the EGS's operations over time. The purpose of this document is to outline the risk that the EDC is exposed due to default of an EGS under the present Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), Pennsylvania Power Company ("Penn Power") and West Penn Power Company ("West Penn") Supplier Tariffs.[1]

Summary of EDC Creditworthiness Standards:

Section 4.14 of the current Met-Ed, Penelec and Penn Power ("the Companies") Supplier Tariffs discloses the current credit requirements for an EGS serving these territories. On a nondiscriminatory and consistent basis, the EDC uses reasonable financial standards to assess an EGS's creditworthiness. The Companies will grant an unsecured credit limit of 5% of a supplier's net worth if its senior unsecured rating from the major rating agencies is considered investment grade. The Companies make reasonable alternative credit arrangements with an EGS if it does not meet the aforementioned investment grade criteria. The alternative credit arrangements may be in the form of:

- Parent guaranty from an investment grade parent;
- An Irrevocable Letter of Credit; or
- A cash deposit

An initial credit amount of $250,000 is required, which amount is adjusted commensurate with the

[1] West Penn Power anticipates proposing modifications to its credit requirements in order to align West Penn Power's credit standards with those set forth in the Companies' Supplier Tariffs.

financial risks placed on the Companies.

EDC Credit Risk Exposure:

This document outlines the credit requirements that are deemed necessary to protect EDCs, as they are ultimately responsible for providing default service. The following credit requirements and procedures are in place to protect the EDC and its default service customers from identifiable risks that an EDC will incur in the event of an EGS's default.

1. Compensation to the EDC for the costs associated with the return of customers to default service in the event of an EGS default:

An EGS may serve customers from either its generation (local production) or purchase generation from the market; however, EDCs procure power through methods approved by the Pennsylvania Public Utility Commission ("PUC" or "Commission"). Currently, the Companies procure power through a mix of mechanisms including but not limited to:

(1) EDC as the load serving entity ("LSE") for the industrial class through acquisition of products from members of PJM Interconnection, LLC ("PJM") or through contracts for full requirements tranches executed as a result of a Commission-approved default service auction;
(2) Bilateral contracts for full requirements tranches executed as a result of Commission-approved default service auctions for the commercial class; and
(3) A mix of bilateral contracts for full requirements tranches executed as a result of a Commission-approved default service auction and bilateral contracts for forward block products executed as a result of a Commission-approved procurement process mixed with the acquisition of products from PJM members.

Should an EGS default, the load obligation immediately shifts to the EDC for default service until new energy supplier relationships are arranged. Establishing energy supplier relationships to replace the power may take several days and subject the EDC and its default service customers to large swings in both market prices as well as load obligation. The credit requirements outlined above are in place to protect the EDC and its default service customers from price and load volatility for periods where the EDC may be unprotected in the marketplace under the following scenarios:

1. The default of an EGS serving a large swath of residential customers will impact both the EDC and the default service supplier ("DS Supplier"). Under the current default service plans for the Companies, the EDC is the LSE for 25% of the load (served from block and spot) and DS Supplier(s) are responsible for the remaining 75% of load (short and long-term contracts).
2. A default of an EGS serving the industrial class load impacts the LSE for default service, which could be both the EDC and DS Supplier(s).
3. The default of an EGS serving commercial load results in the load coming back to the LSEs, which today are the DS Suppliers.
4. The default of an EGS could have a cascading effect that would result in the default of a DS Supplier, leaving the EDC to serve the entire load directly.

In default situations, the credit posted to the EDC provides protection to its customers from market exposure to real time prices while new energy supplier relationships are obtained.

An additional EGS default exposure faced by the EDC is the PJM member default allocation. A PJM member default is the failure of a member to perform its obligations under the PJM Operating Agreement or otherwise fails to meet its financial or other obligations to another member, a PJM settlement, or PJM itself. PJM credit requirements are in place to keep PJM solvent and capable of making payments to market participants in the event of a default by a market participant. In the event that collateral held by PJM is insufficient to cover the default exposure of a member, all PJM members have the obligation to pay PJM the shortfall amount, similar to a financial exchange.

In summary, the EDC is exposed to short-term purchases to cover the load obligation of the defaulting member EGS. This is accomplished by either purchasing power through PJM or contracting directly with another supplier. It should also be noted that not only is the EDC liable for the purchased power cost, but also may incur working capital costs associated with collateral requirements either through PJM or under a purchase power agreement. As discussed earlier, an EDC's cost of purchasing power is ultimately recovered through the EDC's respective Commission-approved Price to Compare Default Service Rate Rider, which is then passed on to customers. By imposing the outlined credit requirements, the EDC's effectively protect their default service customers from incurring these costs.

Below is an example of an EDC's method of calculation of EGS credit exposure for procuring short term load due to supplier default:

EGS Credit Exposure Formula

$$\left[\left[\sum_{n-12}^{n} Peak_n\right] \div n\right] * LMP_{max} * LMP_{CF} * DAY_{CF}$$

Where,		
n	month count where **n > 0 with greater weight given to most current month**	
Peak	each months aggregated load maximum peak; non-coincident with the local control area peak	
LMP_{max}	Previous 12 calendar months' maximum single hour total LMP (includes marginal loss and marginal congestion components)	
LMP_{CF}	Critical Factor multiplier for LMP_{max}. Represents potential for future price exposure to be greater than previous 12 months' LMP.	
DAY_{CF}	Critical Factor multiplier for the number of days may occur for future months duration of potential exposure	
	Currently the Critical Factors are set to the following:	
LMP_{CF}	3	300% of previous 12 months' LMP
DAY_{CF}	5	5 Days of potential duration of exposure

EGS Supplier	
Monthly Peak (kw)	
Month	**Monthly Peak (KW)**
Sep-08	15,576
Oct-08	15,087
Nov-08	17,473
Dec-08	21,567
Jan-09	19,379
Feb-09	17,871
Mar-09	17,201
Apr-09	17,454
May-09	19,209
Jun-09	32,950
Jul-09	26,347
Aug-09	30,847

Weighted Average Monthly Peak = 29,327

2. Compensate the EDC for payment of the EGS's Gross Receipts Tax liability if the EGS fails to pay Gross Receipts Tax:

EDCs are liable under sections of the Public Utility Code for the Pennsylvania Gross Receipts Taxes not paid by an EGS. When an EGS is qualified by the PUC to serve customers in Pennsylvania, the EGS posts a $250,000 bond with the PUC to compensate for any expenses incurred due to nonpayment of taxes or other expenses. The Gross Receipts tax return is filed every March, using the EGS's previous year's revenue. Because an EGS may serve customers in multiple EDC service territories, it is possible that the bond posted would not be sufficient to cover an EGS's Gross Receipts tax due. In the event this occurs, the shortfall is picked up by the EDC. As long as the EDC is responsible for any shortfall in Gross Receipts tax due, it is reasonable for the EDC to require an EGS post security as part of the credit requirement.

Below is an example of an EDC's method of calculating exposure to GRT liablity:

Gross Receipt Tax (GRT) Exposure is:

1.25 x Projected Annual Revenue X 5.9% - Amount of Security Bond the EGS has with the PaPUC

The amount of the security bond with the PUC is currently $250,000, which will be used to cover all EDC territories across the Commonwealth. For credit purposes, the Companies assume only ¼ of this bond (or $62,500) will be available to any one EDC for recovery of these costs.

The 1.25 multiplier is used to account for the exposure to an EDC of new EGSs entering the market without having established their tax requirement until March of the following year.

3. Cost for Noncompliance (Section 12.3 of the Companies' Supplier Tariffs)

As stated in the Companies' Supplier Tariffs, an EGS that withdraws from retail service and fails to provide at least ninety days' written notice shall reimburse the EDC for:

- Mailings by the EDC to the EGS's customers to inform them of the EGS's withdrawal of service;
- Non-standard/manual bill calculation and production performed by the EDC;
- EGS data transfer responsibilities that must be performed by the EDC; and
- Charges or penalties imposed on the EDC by PJM or other third parties resulting from EGS non-performance.

These charges incurred by the EDC are not recoverable through the Companies' Price to Compare Default Service Rate Rider, therefore the Companies would utilize the posted credit to cover these costs, as well.

4. EGS Consolidated Billing Option

Met-Ed, Penelec, and Penn Power's current Commission-approved Supplier Tariffs do not cover or mention EGS consolidated billing. If the Commission were to order changes in Supplier Tariffs to permit EGS consolidated billing, in essence allowing an EGS to bill and collect amounts from customers that must be passed on to the EDC, then the EDC would be exposed to nonpayment of collected distribution charges, as well as additional lag time in the settlement cycle. It is the opinion of Met-Ed, Penelec, Penn Power and West Penn that an additional collateral requirement would be necessary to cover the risk of late and or nonpayment of the distribution charges. Collateral requirements needed to cover the additional exposure could be two months worth of each customer's distribution billings plus 50%.