UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

FirstEnergy Corporation Docket No. EL06-58-000

ORDER GRANTING PETITION FOR DECLARATORY ORDER

(Issued May 30, 2006)

1. On March 9, 2006, FirstEnergy Corporation (FirstEnergy) filed a petition for a declaratory order requesting the Commission find that the payment of dividends out of paid-in capital by Cleveland Electric Illuminating Company (CEI), Jersey Central Power & Light Company (JCP&L), Metropolitan Edison Company (MetEd), Ohio Edison Company (OE), Pennsylvania Electric Company (Penelec), Pennsylvania Power Company (Penn Power),[1] and Toledo Edison Company (Toledo Edison) (collectively, the Operating Companies) will not violate section 305(a) of the Federal Power Act (FPA).[2] For the reasons stated below, we will grant FirstEnergy's petition for a declaratory order and, as requested, authorize the payment of dividends out of paid-in capital so long as the Operating Companies' equity ratios (without consideration of any retained earnings that may exist on its books) are and will remain above 35 percent, as discussed herein.[3]

---

[1] Penn Power is a wholly-owned subsidiary of OE. The other companies are wholly-owned subsidiaries of FirstEnergy Corporation.

[2] 16 U.S.C. § 825d(a) (2000).

[3] FirstEnergy briefly suggests that as an alternative the Operating Companies may use paid-in capital to redeem common stock that has been issued and is outstanding. Because we find that the payment of dividends out of paid-in capital, as described herein, will not violate section 305(a) of the FPA, we need not address FirstEnergy's alternative use of paid-in capital to redeem common stock outstanding.

Background

2. FirstEnergy is a holding company as defined in the Public Utility Holding Company Act of 2005 (PUHCA 2005).[4] CEI, OE, and Toledo Edison provide retail electric service in Ohio; MetEd, Penelec, and Penn Power provide retail electric service in Pennsylvania; and JCP&L provides retail electric service in New Jersey. FirstEnergy's principal source of revenue for the payment of dividends to FirstEnergy's shareholders and for other expenses including payment of its debt costs is the payment of dividends by its direct and indirect, wholly-owned subsidiaries, including the Operating Companies.

3. FirstEnergy requests authorization for the Operating Companies to pay dividends out of paid-in capital for several reasons. First, according to FirstEnergy, issuing dividends out of paid-in capital will enable the Operating Companies to realign their capital structures, and to establish and maintain consistent and rational capitalization practices. FirstEnergy argues that mergers and associated accounting policies, sales and transfers of utility assets, recent corporate restructurings, and capital contributions have resulted in inconsistent capital structures among the Operating Companies.[5] FirstEnergy explains that, as a result of these activities, OE, Penn Power, Toledo Edison, MetEd and Penelec have equity that is far in excess of their long-term debt and is higher than these companies need to retain investor confidence and attract new capital.

4. In addition, according to FirstEnergy, while many of the Operating Companies have more equity than is currently needed to support their regulated operations, FirstEnergy itself has approximately $4.3 billion in unsecured debt outstanding, including $1 billion of Senior Notes due November 15, 2006.[6] FirstEnergy maintains that its principal source of revenue is dividends from its subsidiaries; however, the amount of retained earnings held by the Operating Companies is insufficient to provide the funds FirstEnergy needs to retire its debt due in November 2006.[7]

5. FirstEnergy also indicates that the ability to pay dividends out of paid-in capital will enable it and the Operating Companies to achieve several important objectives, in the

[4] Pub. L. No. 109-58, §§ 1261-77, 119 Stat. 594, 972-78 (2005) (to be codified at 42 U.S.C. §§ 16451-63).

[5] Attachment A of the petition describes some of the recent changes in equity capitalization of each of the Operating Companies, including differences among the companies reflecting the issuance of par value vs. no-par value common stock, capital contributions by corporate parents, and the effect of merger accounting practices on paid-in capital amounts.

[6] Petition at 3.

[7] *Id.* at 4.

public interest, including optimization of the Operating Companies' capital structures, consistency in capital structures and repayment of FirstEnergy's debt. FirstEnergy maintains that creditors prefer to hold debt issued by revenue-producing entities, rather than their corporate parents, and that the use of funds of the Operating Companies to retire FirstEnergy's debt will help to reduce overall debt costs and reduce the impact of debt service on ratepayers.[8]

6. FirstEnergy argues that the payment of dividends by each of the operating companies out of paid-in equity capital, subject to the conditions set forth in the petition, detailed below, is consistent with prior Commission precedent and permissible under section 305(a) of the FPA.

7. First, FirstEnergy states that the source of the dividends will be clearly identified. FirstEnergy indicates that the dividends will be paid from paid-in equity as identified on the books and records of the each Operating Company that has paid-in equity capital in excess of its needs, and that depending on the accounting policies of a particular Operating Company, the issuance of dividends may be reflected in a reduction in either Account 207 – Premium on Capital Stock, or Accounts 208-211 – Other Paid-In Capital.[9]

8. Second, FirstEnergy asserts that the dividends that will be paid from the capital accounts will not be excessive, stating that each of the Operating Companies will only pay dividends out of paid-in capital so long as its equity ratio (without consideration of any retained earning that may exist on its books) is and will remain above 35 percent.[10] FirstEnergy expects that by limiting the opportunity to pay dividends out of paid-in capital in this manner, each of the Operating Companies will maintain an investment grade credit rating for its long-term debt.

9. Third, FirstEnergy maintains that shareholders will not be harmed by the proposed issuance of dividends from capital accounts because each of the Operating Companies will refrain from paying dividends out of paid-in capital if doing so would reduce its equity ratio to less than 35 percent. In addition, FirstEnergy states that shareholders will have the same ownership interests in the Operating Companies before and after the payment of dividends.[11]

---

[8] *Id.* at 5.

[9] *Id.* at 7.

[10] *Id.* at 8.

[11] *Id*. at 10.

Notice of Filing

10. Notice of FirstEnergy's filing was published in the *Federal Register*, 71 Fed. Reg. 15,403 (2006), with interventions or protests due on or before April 10, 2006. None was filed.

Discussion

11. We will grant FirstEnergy's petition because the concerns underlying section 305(a) of the FPA are not present in the circumstances of this transaction.

12. Section 305(a) provides that:

> It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital accounts.[12]

13. The concerns underlying the enactment of section 305(a) included "that sources from which cash dividends were paid were not clearly identified and that holding companies had been paying out excessive dividends on the securities of their operating companies. A key concern, thus, was corporate officials raiding corporate coffers for their personal financial benefit."[13]

14. The concerns underlying section 305(a) are not present in this proceeding. FirstEnergy has clearly identified the source from which payment will be made; each Operating Company that has paid-in capital in excess of its needs will pay dividends from Account 207 or Accounts 208 to 211,[14] depending on each company's accounting policies. In addition, there is nothing to indicate that any dividends paid will be excessive; each of the Operating Companies will only pay dividends out of paid-in capital so long as its equity ratio (without consideration of any retained earnings that may

---

[12] 16 U.S.C. § 825d(a) (2000).

[13] *Exelon Generation Co., LLC*, 114 FERC ¶61,317 at P 13 (2006); *Entergy Louisiana Inc.*, 114 FERC ¶ 61,060 at P 12 (2006); *Exelon Corp.*, 109 FERC ¶ 61,172 at P 8 (2004); *ALLETE, Inc.*, 107 FERC ¶ 61,041 at P 10 (2004).

[14] *See* 18 C.F.R. Part 101, Account Nos. 207-11 (2005).

exist on its books) is and will remain above 35 percent.[15] Finally, the proposed dividends will not have an adverse effect on the value of shareholders interests. The shareholders of the Operating Companies will have the same percentage ownership interests in the Operating Companies following the payment of dividends.[16]

15. For these reasons, and under the circumstances of this case, we will grant the petition and find that section 305(a) of the FPA is not a bar to the payment of dividends from paid-in capital as described above.

The Commission orders:

(A) FirstEnergy's petition for declaratory order is hereby granted, as discussed in the body of this order.

(B) FirstEnergy must inform the Commission of any change in circumstances that would reflect a departure from the facts the Commission relied upon in granting the petition.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

---

[15] *Cf. Entergy Louisiana, Inc.*, 114 FERC ¶ 61,060 at P 7, 13 (2005) (in granting petition, noting that applicant would not let proprietary capital ratio fall below 30 per cent).

[16] *See id.* at P 13.