

## SECURITIES AND EXCHANGE COMMISSION

(Release No. 35-27991;70-10286)

**Pepco Holdings, Inc. *et al***

**June 30, 2005**

Pepco Holdings, Inc. (“PHI”), Washington, District of Columbia, a registered public utility holding company, PHI’s direct and indirect electric and gas public utility subsidiaries: Potomac Electric Power Company (“Pepco”), Washington, District of Columbia, Atlantic City Electric Company (“ACE”) and Delmarva Power and Light Company (“DPL”), Wilmington, Delaware; PHI’s registered public utility holding company subsidiary, Conectiv, Wilmington, Delaware; PHI’s direct and indirect nonutility subsidiary holding companies Potomac Capital Investment Corporation (“PCIC”), Washington, District of Columbia, Pepco Energy Services, Inc. (“PES”), Arlington, Virginia, PHI Service Company (“PHISCo”) and Conectiv Energy Holding Company (“Conectiv Holding”), Wilmington, Delaware and PHI’s other direct and indirect nonutility subsidiaries<sup>1</sup> (“Nonutility Subsidiaries,” and together, “Applicants”) have filed an application-declaration (“Application”) with the Securities and Exchange Commission (“Commission”) under sections 6(a), 7, 9(a), 10, 12(b), 12(c), 12(f) and 13(b) of the Public Utility Holding Company Act of 1935, as amended (“Act”), and rules 43, 45, 46, 54, 90 and 91 under the Act. The Commission issued a notice of the Application on June 2, 2005 (HCAR No. 27981).

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<sup>1</sup> See S.E.C. File No. 70-10286 for a complete list of the companies listed as “Applicants” to this transaction.

## I. Background

On August 1, 2002, Pepco and Conectiv were involved in merger transactions that resulted in the formation of PHI (“Merger”). Conectiv was a registered holding company under the Act prior to the Merger and continues as such. By order dated July 31, 2002 (HCAR No. 27557) (“Financing Order”), the Commission authorized PHI and certain of its subsidiaries, among other things, to perform financing activities through the period ending June 30, 2005.

In this Application Applicants request authorization to engage in various transactions described below through June 30, 2008 (“Authorization Period”).

## II. Description of the Parties

### A. PHI

The principal direct subsidiaries of PHI are:

1. Pepco, a public utility company engaged in the transmission and distribution of electricity in Washington, D.C. and major portions of Prince George’s and Montgomery counties in suburban Maryland;
2. PCIC, a company which manages a portfolio of financial investments, primarily energy leveraged leases;
3. PES, a competitive energy business providing non-regulated generation, marketing and supply of electricity and gas and related energy management services;
4. PHISCo, a service company established in accordance with section 13(b) of the Act and
5. Conectiv, a registered holding company under the Act.

The principal direct subsidiaries of Conectiv are:

- a) ACE, a public utility company engaged in the generation, transmission and distribution of electricity in southern New Jersey;
- b) DPL, a public utility company engaged in the transmission and distribution of electricity in Delaware and portions of Maryland and Virginia and the distribution of gas in northern Delaware and
- c) Conectiv Energy Holding Company, an intermediate holding company that holds interests in nonutilities involved in energy and related projects (including exempt projects) or that engage in energy trading activities.

Pepco, ACE and DPL are referred to as the “Utility Subsidiaries.” PHI subsidiaries, other than the Utility Subsidiaries, are referred to as the “Nonutility Subsidiaries.” The Utility Subsidiaries and the Nonutility Subsidiaries are collectively referred to as the “Subsidiaries.”

### III. Use of Proceeds

The proceeds from the sale of securities will be used for general corporate purposes, including the financing, in part, of the capital expenditures and working capital requirements of PHI and the Subsidiaries, for the acquisition, retirement or redemption of securities previously issued by PHI or the Subsidiaries, for investments in companies organized in accordance with rule 58 under the Act (“Rule 58 Subsidiaries”), exempt wholesale generators (“EWGs”), as defined in section 32 of the Act, foreign utility companies (“FUCOs”), as defined in section 33 of the Act, exempt telecommunications companies (“ETCs”), as defined in section 34 of the Act, and for other lawful purposes.

Proceeds of any borrowings by the Nonutility Subsidiaries may be used by each Nonutility Subsidiary: (a) for the interim financing of its construction and capital expenditure programs, (b) for its working capital needs, (c) for the repayment, redemption or refinancing of its debt and equity, (d) to meet unexpected contingencies, payment and timing differences, and cash requirements and (e) to otherwise finance its own business and for other lawful general corporate purposes. The use of proceeds from the financings will be limited to use in the operations of the respective businesses in which Subsidiaries are already authorized to engage.

#### IV. Financing Parameters

Applicants request authorization to engage in certain financing transactions during the Authorization Period. All securities issued by PHI and the Subsidiaries will be subject to the financing parameters (“Financing Parameters”) below.

##### A. Effective Cost of Money

Applicants state that the effective cost of capital on long-term debt, short-term debt, preferred securities and equity-linked securities will not exceed competitive market rates available at the time of issuance for securities having the same or reasonably similar terms and conditions issued by similar companies of reasonably comparable quality; provided that in no event will the effective cost of capital on (a) any long-term debt security exceed 500 basis points over comparable term U.S. Treasury securities (“Treasury Securities”) or (b) any short-term debt security exceed 300 basis points over the comparable London Interbank Offered Rate (“LIBOR”). The dividend and distribution rate on any series of preferred securities or equity-linked securities will not exceed at the time of issuance 700 basis points over a Treasury Security.

#### B. Maturity of Debt and Final Redemption on Preferred Securities

The maturity of long-term debt securities will not exceed 50 years. Preferred securities and equity-linked securities will be redeemed no later than 50 years after issuance except for preferred securities that are perpetual in duration.

#### C. Issuance Expenses

The underwriting fees, commissions or other similar remuneration paid in connection with the non-competitive issue, sale or distribution of a security under this Application (not including any original issue discount) will not exceed the greater of: (a) 5% of the principal or total amount of the securities being issued or (b) issuance expenses that are generally paid at the time of the pricing for sales of the particular issuance, having the same or reasonably similar terms and conditions issued by similar companies of reasonably comparable credit quality.

#### D. Financial Condition

PHI states that PHI, Conectiv and the Utility Subsidiaries are financially sound and each has investment-grade ratings from major national rating agencies. PHI and Conectiv commit that each will maintain a common equity ratio (common equity divided by consolidated capitalization (“Common Equity Ratio”)) during the Authorization Period of at least 30%.<sup>2</sup> Further, Pepco and DPL each commits that it will maintain a Common Equity Ratio of at least 30% and at least investment-grade senior unsecured and senior secured debt ratings by at least one nationally recognized rating agency.

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<sup>2</sup> Applicants state that consolidated capitalization includes, where applicable, all common stock equity (comprised of common stock, additional paid in capital, retained earnings, accumulated other comprehensive income or loss, and/or treasury stock), minority interests, preferred securities, equity-linked securities, long-term debt, short-term debt and current maturities.

Applicants state that below are the Common Equity Ratios for PHI, Conectiv and the Utility Subsidiaries as of March 31, 2005:

	<u>Debt</u>	<u>Preferred Stock</u>	<u>Common Equity</u>
PHI	62.3%	0.6%	37.1%
Pepco	56.6%	1.1%	42.3%
DPL	51.3%	1.7%	47.0%
ACE <sup>3</sup>	65.7%	0.4%	33.9%
Conectiv	60.0%	0.6%	39.4%

Applicants state that the following are the long-term unsecured debt ratings for PHI, Conectiv and the Utility Subsidiaries as of April 30, 2005:

<u>Company</u>	<u>Moody's</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
PHI	Baa2	BBB	BBB
Conectiv	Baa2	BBB	BBB+
Pepco	Baa1	BBB	A-
ACE	Baa1	BBB	BBB+
DPL	Baa1	BBB	A-

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<sup>3</sup> By order dated October 28, 2002 (HCAR No. 27588), ACE is required to maintain a Common Equity Ratio of not less than 28% through December 31, 2005. After this date, Applicants state that ACE will maintain a Common Equity Ratio of at least 30% during the Authorization Period. ACE commits that it will maintain at least investment grade senior unsecured and senior secured debt ratings by at least one nationally recognized rating agency.

With respect to the securities issuance authority proposed in this Application:

(a) within four business days after the occurrence of a Ratings Event,<sup>4</sup> Applicants will notify the Commission of its occurrence (by means of a letter, via fax, email or overnight mail to the Office of Public Utility Regulation), and (b) within 30 days after the occurrence of a Ratings Event, Applicants will submit a post-effective amendment to this Application explaining the material facts and circumstances relating to that Ratings Event (including the basis on which, taking into account the interests of investors, consumers and the public as well as other applicable criteria under the Act, it remains appropriate for Applicant(s) to issue the securities for which authorization has been requested in this Application, so long as Applicant(s) continue to comply with the other applicable terms and conditions specified in the Commission's order authorizing the transactions requested in this Application). Furthermore, no securities authorized as a result of this Application will be issued following the 60th day after a Ratings Event (other than common stock and short-term debt) by any Applicant if a registered holding company has experienced a Ratings Event or by any individual Applicant that itself has experienced a Ratings Event. Applicants also request that the Commission reserve jurisdiction, through the remainder of the Authorization Period, over the issuance of any authorized securities in this

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<sup>4</sup> For these purposes, (a) a security will be deemed "investment grade" if it is rated investment grade by any of Moody's Investors Service, Standard & Poor's, Fitch Ratings or any other nationally recognized statistical rating agency (as defined by the Commission in rules adopted under the Securities Exchange Act of 1934, as amended) and (b) a "Ratings Event" will be deemed to have occurred if, during the Authorization Period, (i) any outstanding security of any Applicant(s) is/are downgraded below investment grade; (ii) any security issued by any Applicant upon original issuance is rated below investment grade or (iii) any outstanding security of the top-level registered holding company that is rated is downgraded below investment grade.

Application (other than common stock and short-term debt) the issuance of which is prohibited after the 60th day following a Ratings Event.

#### V. PHI Financing

PHI seeks authorization to issue equity and debt securities aggregating not more than \$6 billion (“PHI Financing Limit”) at any one time issued and outstanding during the Authorization Period. These securities could include, but would not necessarily be limited to, common stock, preferred securities, options, warrants, purchase contracts, units (consisting of one or more purchase contracts, warrants, debt securities, shares of preferred securities, shares of common stock or any combination of such securities), long-term debt, short-term debt (including commercial paper), subordinated debt, bank borrowings, securities with call or put options and securities convertible into any of these securities.<sup>5</sup>

##### A. Common Stock

PHI seeks authorization to issue and sell common stock during the Authorization Period. Common stock financings may be executed under underwriting agreements of a type generally standard in the industry. Public distributions may be under private negotiation with underwriters, dealers or agents as discussed below or effected through competitive bidding among underwriters. In addition, sales may be made through private placements or other non-public offerings to one or more persons. All common stock sales will be at rates or prices and under conditions negotiated or based upon, or otherwise determined by, competitive capital markets. Underwriters may resell common

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<sup>5</sup> Applicants state that any convertible or equity-linked securities would be convertible into or linked only to securities that PHI is otherwise authorized to issue directly or indirectly through a financing entity on behalf of PHI.

stock from time to time in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. If common stock is being sold in an underwritten offering, PHI may grant the underwriters thereof a “green shoe” option permitting the shares to be offered solely for the purpose of covering over-allotments.

PHI further requests authorization to issue and sell from time to time equity-linked securities, including, but not limited to, contracts obligating holders to purchase from PHI and/or PHI to sell to the holders, a number of shares specified directly or by formula at an aggregate offering price either fixed at the time the stock purchase contracts (“Stock Purchase Contracts”) are issued or determined by reference to a specific formula set forth in the Stock Purchase Contracts. The Stock Purchase Contracts may be issued separately or as part of units consisting of a stock purchase contract and debt and/or preferred securities of PHI and/or debt securities of nonaffiliates, including Treasury Securities, securing holders’ obligations to purchase the common stock of PHI under the Stock Purchase Contracts. The Stock Purchase Contracts may require holders to secure their obligations in a specified manner.

PHI also seeks authorization to issue common stock or equity linked securities in public or privately negotiated transactions as consideration for the equity securities or assets of other companies, provided that the acquisition of any equity securities or assets has been authorized by the Commission or is exempt under the Act or the rules thereunder. For purposes of calculating compliance with the PHI Financing Limit, common stock issued in negotiated transactions would be valued based upon the negotiated agreement between the buyer and the seller.

PHI proposes, from time to time during the Authorization Period, to issue and/or acquire in open market transactions or by some other method that complies with applicable law and Commission interpretations then in effect, shares of PHI common stock under PHI's dividend reinvestment plan, certain incentive compensation plans and other employee benefit plans currently existing or that may be adopted in the future in an amount not to exceed 20 million shares during the Authorization Period ("Common Stock Plan Limit"). PHI common stock issued under the Common Stock Plan Limit will not be included in the calculation of the PHI Financing Limit.

#### B. Preferred Securities

PHI may issue and sell preferred securities from time to time during the Authorization Period. Preferred securities of any series (a) will have a specified par or stated value or liquidation value per security, (b) will carry a right to periodic cash dividends and/or other distributions, subject among other things, to funds being legally available, (c) may be subject to optional and/or mandatory redemption, in whole or in part, at par or at various premiums above the par or stated liquidation value, (d) may be convertible or exchangeable into common stock of PHI and (e) may bear other further rights, including voting, preemptive or other rights, and other terms and conditions, as set forth in the applicable certificate of designation, purchase agreement and/or similar instruments governing the issuance and sale of the series of preferred securities.

The liquidation preference, dividend or distribution rates, redemption provisions, voting rights, conversion or exchange rights, and other terms and conditions of a particular series of preferred securities, as well as any associated placement, underwriting, structuring or selling agent fees, commissions and discounts, if any, will be

established by negotiation or competitive bidding and reflected in the applicable certificate of designation, purchase agreement or underwriting agreement, and other relevant instruments setting forth the terms.

### C. Long-Term Debt

Applicants request authority for PHI to issue long-term debt securities including notes, medium-term notes, or debentures, under one or more indentures or long-term indebtedness under agreements with banks or other institutional lenders. Long-term debt issued by PHI will be unsecured.

Any long-term debt security would have such designation, aggregate principal amount, maturity, interest rate(s) or methods of determining the same, terms of payment of interest, redemption provisions, sinking-fund terms and other terms and conditions as PHI may determine at the time of issuance. Any long-term debt (a) may be convertible into any other authorized securities of PHI, (b) will have maturities ranging from one to 50 years, (c) may be subject to optional and/or mandatory redemption, in whole or in part, at par or at various premiums above the principal amount thereof, (d) may be entitled to mandatory or optional sinking-fund provisions, (e) may provide for reset of the coupon under a remarketing arrangement, (f) may be subject to tender or the obligation of the issuer to repurchase at the election of the holder or upon the occurrence of a specified event, (g) may be called from existing investors by a third party and (h) may be entitled to the benefit of financial or other covenants.

Specific terms of any borrowings, such as maturity dates, interest rates, redemption and sinking fund provisions, tender or repurchase and conversion features, if any, with respect to the long-term securities of a particular series, will be determined by

PHI at the time of issuance and will comply in all regards with the Financing Parameters. Associated placement, underwriting or selling agent fees, commissions and discounts, if any, will be established by negotiation or competitive bidding.

#### D. Short-Term Debt

PHI seeks authority to issue short-term debt during the Authorization Period to refund short-term debt, refund maturing long-term debt, and for general corporate purposes, working capital requirements and temporary financing of Subsidiary capital expenditures until long-term financing can be obtained.

Types of short-term debt securities will include borrowings under one or more revolving credit facilities or bank loans, commercial paper, short-term notes and bid notes. Specific terms of any short-term borrowings will be determined by PHI at the time of issuance and will comply in all regards with the parameters for financing authorization set forth in the Financing Parameters. The maturity of any short-term debt issued will not exceed 364 days or, if the notional maturity is greater than 364 days, the debt security will include put options at appropriate points in time to cause the security to be accounted for as a current liability under United States generally accepted accounting principles (“GAAP”).

PHI may sell commercial paper, from time to time, in established domestic or European commercial paper markets. Commercial paper would be sold directly to investors or sold to dealers at the discount rate or the coupon rate per annum prevailing at the date of issuance for commercial paper of comparable quality and maturities sold to commercial paper dealers generally. Applicants expect that the dealers acquiring commercial paper from PHI will reoffer this paper at a discount to corporate, institutional

and, with respect to European commercial paper, individual investors. Institutional investors are expected to include commercial banks, insurance companies, pension funds, investment trusts, foundations, colleges and universities and finance companies.

PHI may engage in other types of short-term financing generally available to borrowers with comparable credit ratings as it may deem appropriate in light of its needs and market conditions at the time of issuance. Applicants state that any additional short-term financings will comply in all regards with the Financing Parameters.

#### E. Guarantees

PHI requests authority to enter into guarantees to third parties, obtain letters of credit, enter into support or expense agreements or liquidity support agreements or otherwise provide credit support with respect to the obligations of the Subsidiaries as may be appropriate to carry on in the ordinary course of their respective businesses in an aggregate amount not to exceed the \$3.5 billion during the Authorization Period (“PHI Guarantee Limit”). Included in this amount are guarantees previously entered into by PHI and on behalf of the Subsidiaries to the extent they remain outstanding during the Authorization Period. Excluded from the PHI Guarantee Limit are obligations exempt under rule 45. Applicants state that the issuance of any guarantees will be subject to the limitations of rule 53(c) or rule 58(a)(1), as applicable.

A portion of the guarantees proposed to be issued by PHI may be in connection with the business of Conectiv Energy Supply, Inc. (“CESI”), PES and PES’s subsidiaries. CESI conducts power marketing and trading operations. PES and its subsidiaries provide energy efficiency contracting, central plant and other equipment construction, operation and maintenance as well as conducting gas and electric marketing. PHI provides credit

support in connection with the trading positions of CESI and PES entered into in the ordinary course of CESI's and PES's energy marketing and trading businesses. In addition, PHI provides credit support for certain obligations of PES and its subsidiaries entered into in the ordinary course of their energy contracting business. The provision of parent guarantees by holding companies to affiliates in the generation, power marketing and energy contracting business is standard business practice. The portion of the PHI Guarantee Limit to be used on behalf of the trading activities of CESI and PES will be no more than half of the PHI Guarantee Limit at any time during the Authorization Period. A portion of the guarantees will be for intercompany obligations. PHI will guarantee all deposits in the Money Pool.

Certain of the guarantees may be in support of obligations that are not capable of exact quantification. In these cases, PHI will determine the exposure under a guarantee for purposes of measuring compliance with the PHI Guarantee Limit by appropriate means, including estimation of exposure based on loss experience or potential payment amounts. PHI states that these estimates will be made in accordance with GAAP if appropriate and this estimation will be reevaluated periodically.

PHI may charge each Subsidiary a fee for any guarantee provided on its behalf that is not greater than the cost, if any, of obtaining the liquidity necessary to perform the guarantee for the period of time the guarantee remains outstanding.

#### F. Interest Rate Risk Management

PHI requests authority to enter into, perform, purchase and sell financial instruments intended to reduce or manage the volatility of interest rates with respect to then existing or simultaneously created indebtedness, including interest rate swaps, caps,

floors, collars and forward agreements or any other similar agreements. Hedges may also include the issuance of structured notes (*i.e.*, a debt instrument in which the principal and/or interest payments are indirectly linked to the value of an underlying asset or index), or transactions involving the purchase or sale, including short sales, of U.S. Treasury or agency (*e.g.*, Federal National Mortgage Association) obligations or LIBOR based swap instruments (collectively, “Hedge Instruments”). PHI would employ Hedge Instruments as a means of prudently managing the risk associated with any of its outstanding debt by, in effect, synthetically: (a) converting variable-rate debt to fixed-rate debt, (b) converting fixed-rate debt to variable-rate debt, (c) limiting the impact of changes in interest rates resulting from variable-rate debt and (d) providing an option to enter into interest rate swap transactions in future periods for planned issuances of debt securities. In no case will the notional principal amount of any Hedge Instrument exceed that of the underlying debt instrument and related interest rate exposure. Thus, PHI will not engage in leveraged or speculative transactions. The underlying interest rate indices will closely correspond to the underlying interest rate indices of PHI’s debt to which the Hedge Instruments relates. PHI will only enter into agreements with counterparties whose senior debt ratings, as published by any one nationally recognized rating agency, are investment grade (“Approved Counterparties”).

In addition, PHI requests authorization to enter into interest rate Hedge Instruments with respect to anticipated debt offerings (“Anticipatory Hedges”), subject to certain limitations and restrictions. Anticipatory Hedges would only be entered into with Approved Counterparties, and would be utilized to fix and/or limit the interest rate risk associated with any new issuance through: (a) a forward sale of exchange-traded Hedge

Instruments (“Forward Sale”), (b) the purchase of put options on Hedge Instruments (“Put Options Purchase”), (c) a Put Options Purchase in combination with the sale of call options on Hedge Instruments (“Zero Cost Collar”), (d) transactions involving the purchase or sale, including short sales, of Hedge Instruments or (e) some combination of a Forward Sale, Put Options Purchase, Zero Cost Collar and/or other derivative or cash transactions, including, but not limited to, structured notes, caps and collars, appropriate for the Anticipatory Hedges.

Hedge Instruments may be executed on-exchange (“On-Exchange Trades”) with brokers through the opening of futures and/or options positions traded on the Chicago Board of Trade, the opening of over-the-counter positions with one or more counterparties (“Off-Exchange Trades”), or a combination of On-Exchange Trades and Off-Exchange Trades. PHI will determine the optimal structure of each Hedge instrument transaction at the time of execution.

PHI represents that it will comply with Statement of Accounting Standards 133 (“SFAS”), SFAS 138 or other standards relating to accounting for derivative transactions as are adopted and implemented by the Financial Accounting Standards Board (“FASB”). PHI states that Hedge Instruments and Anticipatory Hedges will qualify for hedge accounting treatment under the current FASB standard in effect and as determined at the date Hedge Instruments and/or Anticipatory Hedges are entered into; provided, that in the event the Hedge Instruments and/or Anticipatory Hedges do not so qualify, PHI requests that the Commission reserve jurisdiction over the entering into of these Hedge Instruments or Anticipatory Hedges.

## VI. Utility Subsidiary Financing

Applicants state that the District of Columbia Public Service Commission (“DC Commission”) regulates the, the issuance of long-term debt and equity securities for Pepco.<sup>6</sup> The New Jersey Board of Public Utilities (“NJBPU”) regulates issuance of short-term debt, long-term debt and equity securities for ACE. For DPL, the Delaware Public Service Commission (“DPSC”) regulates the issuance of long-term debt and equity securities and the issuance of short-term debt, long-term debt and equity securities is regulated by the VSCC.<sup>7</sup>

### A. Short-Term Debt

Pepco and DPL request authority to have outstanding short-term debt securities in amounts not to exceed \$500 million and \$275 million for Pepco and DPL, respectively, at any point in time during the Authorization Period. Pepco and DPL request authority to issue the same types of unsecured short-term debt securities under the same terms as requested for PHI above. In addition, Pepco and DPL may issue secured short-term debt securities. Pepco and DPL anticipate that the collateral for secured short-term debt securities would be limited to short-term assets such as the respective issuer’s inventory

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<sup>6</sup> Pepco is also regulated by the Virginia State Corporation Commission (“VSCC”) but the VSCC does not have jurisdiction over its securities issuances.

<sup>7</sup> Pepco currently has authorization from the DC Commission to issue up to \$1.1 billion of long-term debt and equity securities through May 16, 2006, with \$525 million in remaining authority outstanding. DPL currently has authorization from the VSCC to issue up to \$275 million in short-term debt through March 31, 2006 and up to \$150 million long-term debt and equity securities through December 31, 2006. DPL currently has authorization from the DPSC to issue up to \$150 million long-term debt and equity securities through December 31, 2006. ACE currently has NJBPU authorization to issue up to \$250 million of short-term debt through January 1, 2006. ACE currently has a pending request before the NJBPU to issue up to \$105 million of long-term debt securities through December 31, 2006.

and/or accounts receivable. Pepco and DPL may, without counting against the limit set forth above, maintain back-up lines of credit. Any outstanding short-term debt issued by Pepco or DPL will be included in the calculation of the PHI Financing Limit. Pepco and DPL also request authorization to participate in the Money Pool as more fully described below.

#### B. Long-Term Debt Securities and Preferred Securities

Authority is requested for Pepco to issue an aggregate of up to \$1.1 billion of long-term debt securities and preferred securities during the Authorization Period. Pepco requests authority to issue long-term debt securities and preferred securities under the same terms as requested for PHI above except that Pepco may issue secured as well as unsecured debt securities. Any long-term debt or preferred securities issued by Pepco will be included in the calculation of the PHI Financing Limit.

#### C. Guarantees

Applicants request authority for the Utility Subsidiaries to enter into guarantees (“Utility Guarantees”) during the Authorization Period in the same manner as set forth above for PHI in section V.E. above. The Utility Guarantees will be included in the calculation of the PHI Guarantee Limit. The issuance of any Utility Guarantees will be subject to the limitations of rule 53(c) or rule 58(a)(1), as applicable.

Certain of the Utility Guarantees may be in support of obligations that are not capable of exact quantification. In these cases, PHI will determine the exposure under a guarantee for purposes of measuring compliance with the PHI Guarantee Limit by appropriate means including estimation of exposure based on loss experience or potential

payment amounts. PHI states that these estimates will be made in accordance with GAAP, if appropriate and that this estimation will be reevaluated periodically.

The Utility Subsidiaries may charge associate companies a fee for each guarantee provided on their behalf determined in the same manner as specified above for guarantees issued by PHI in section V.E. above.

#### D. Interest Rate Risk Management

The Utility Subsidiaries request authority to enter into Hedge Instruments subject to the limitations and requirements applicable to PHI described in section V.F. above.

### VII. Nonutility Subsidiary Financings

#### A. Loans

In the limited circumstances where a Nonutility Subsidiary making a borrowing is not wholly owned, directly or indirectly, by PHI, Applicants request authority for PHI, Conectiv or a Nonutility Subsidiary, as the case may be, to make loans to Subsidiaries at interest rates and maturities designed to provide a return to the lending company of not less than its effective cost of capital. If these loans are made to a Nonutility Subsidiary, the Nonutility Subsidiary will not provide any services to any associate Nonutility Subsidiary except to a wholly or partially owned subsidiary that meets one of the following conditions: (a) a FUCO or an EWG that derives no part of its income, directly or indirectly, from the generation, transmission, or distribution of electric energy for sale within the United States, (b) an EWG that sells electricity at market-based rates that have been approved by the Federal Energy Regulatory Commission (“FERC”), provided that the purchaser of such electricity is not an associate public utility company, (c) a qualified facility (“QF”) within the meaning of the Public Utility Regulatory Policy Act

(“PURPA”), that sells electricity exclusively (i) at rates negotiated at arm's-length to one or more industrial or commercial customers purchasing such electricity for their own use and not for resale, and/or (ii) to an electric utility company (other than an associate utility company) at the purchaser's avoided cost as determined in accordance with FERC's regulations under PURPA, (d) a domestic EWG or QF that sells electricity at rates based upon its cost of service, as approved by FERC or any state public utility commission having jurisdiction, provided that the purchaser of such electricity is not an associate public utility company, or (e) a direct or indirect Rule 58 Subsidiary of PHI or any other nonutility company that (i) is partially owned by PHI, provided that the ultimate recipient of the services is not an associate public utility company, or (ii) is engaged solely in the business of developing, owning, operating, and/or providing services to Nonutility Subsidiaries described in clauses (a) through (e) immediately above, or (iii) does not derive, directly or indirectly, any material part of its income from sources within the United States and is not a public utility company operating within the United States. Any securities issued under this paragraph will be limited to \$300 million outstanding at any time during the Authorization Period and will comply in all regards with the Financing Parameters. Further, no Nonutility Subsidiary that is also a subsidiary of a Utility Subsidiary will issue securities under this paragraph.

#### B. Guarantees

The Nonutility Subsidiaries request authority to provide to other Nonutility Subsidiaries guarantees and other forms of credit support (“Nonutility Subsidiary Guarantees”). Nonutility Subsidiary Guarantees would be issued subject to the limitations and requirements applicable to PHI as set forth in section V.E., above. The

Nonutility Subsidiary Guarantees will be included in the calculation of the PHI Guarantee Limit. The issuance of any Nonutility Subsidiary Guarantees will be subject to the limitations of rule 53(c) or rule 58(a)(1), as applicable. The Nonutility Subsidiary providing the credit support may charge its associate company a fee for each guarantee provided on its behalf determined in the same manner as specified above in section V.E. above for guarantees issued by PHI.

#### VIII. Authorization and Operation of the PHI System Money Pool

PHI and the Subsidiaries hereby request authorization to continue operation of the Money Pool, and the Subsidiaries, to the extent not exempted by rule 52, also request authorization to make unsecured short-term borrowings from the Money Pool, to contribute surplus funds to the Money Pool and to lend and extend credit to (and acquire promissory notes from) one another through the Money Pool. PHI requests authorization to contribute surplus funds and to lend and extend credit to the Money Pool. Applicants state that EWGs, FUCOs and ETCs will not be eligible to participate in the Money Pool.

PHI and the Subsidiaries believe that the cost of the proposed borrowings through the Money Pool will generally be more favorable to the borrowing participants than the comparable cost of external short-term borrowings, and the yield to the participants contributing available funds to the Money Pool will generally be higher than the typical yield on short-term investments.

Under the terms of the Money Pool, short-term funds would be available from the following sources for short-term loans to the Subsidiaries from time to time: (a) surplus funds in the treasuries of Money Pool participants other than PHI, (b) surplus funds in the treasury of PHI ((a) and (b) comprise "Internal Funds") and (c) proceeds from the

issuance of short-term debt securities by Money Pool participants or by PHI for loan to the Money Pool (“External Funds”). Funds would be made available from such sources in such order as PHISCo, the administrator of the Money Pool, may determine would result in a lower cost of borrowing, consistent with the individual borrowing needs and financial standing of the companies providing funds to the pool. The determination of whether a Money Pool participant at any time has surplus funds to lend to the Money Pool or shall lend funds to the Money Pool would be made by the participant's chief financial officer or treasurer, or by a designee thereof, on the basis of cash flow projections and other relevant factors, in the participant's sole discretion.

No party would be required to effect a borrowing through the Money Pool if it is determined that it could (and had authority to) effect a borrowing at lower cost directly from other lenders. No loans through the Money Pool would be made to, and no borrowings through the Money Pool would be made by, PHI. In situations in which limited funds are available in the Money Pool for loans, Applicants state that the Utility Subsidiaries would have first priority for these funds.

The cost of compensating balances, if any, and fees paid to banks to maintain credit lines and accounts by Money Pool participants lending External Funds to the Money Pool would initially be paid by the participant maintaining the line. A portion of the costs, or all of the costs in the event a Money Pool participant establishes a line of credit solely for purposes of lending any External Funds obtained thereby into the Money Pool, would be retroactively allocated every month to the companies borrowing the External Funds through the Money Pool in proportion to their respective daily outstanding borrowings of the External Funds.

If only Internal Funds make up the funds available in the Money Pool, the interest rate applicable and payable to or by Subsidiaries for all loans of the Internal Funds will be the rates for high-grade unsecured 30-day commercial paper sold through dealers by major corporations as quoted in *The Wall Street Journal*.

If only External Funds comprise the funds available in the Money Pool, the interest rate applicable to loans of the External Funds would be equal to the lending company's weighted average of the cost for the External Funds (or, if more than one Money Pool participant had made available External Funds on that day, the applicable interest rate would be a composite rate equal to the weighted average of the cost incurred by the respective Money Pool participants for the External Funds).

In cases where both Internal Funds and External Funds are concurrently borrowed through the Money Pool, the rate applicable to all loans comprised of the “blended” funds would be a composite rate equal to the weighted average of the cost of all the External Funds.

Applicants state that funds not required by the Money Pool to make loans (with the exception of funds required to satisfy the Money Pool's liquidity requirements) would ordinarily be invested in one or more short-term investments, including: (a) interest-bearing accounts with banks, (b) obligations issued or guaranteed by the U.S. government and/or its agencies and instrumentalities, including obligations under repurchase agreements, (c) obligations issued or guaranteed by any state or political subdivision thereof, provided that such obligations are rated not less than “A” by a nationally recognized rating agency, (d) commercial paper rated not less than “A-1” or “P-1” or their equivalent by a nationally recognized rating agency, (e) money market mutual

funds, (f) bank certificates of deposit, (g) Eurodollar funds and (h) such other investments as are permitted by section 9(c) of the Act and rule 40 thereunder.

Applicants state that the interest income earned on investments in the Money Pool would be allocated among the participants in the Money Pool in accordance with the weighted average proportion each participant's contribution of funds bears to the total amount of funds in the Money Pool. Each Subsidiary receiving a loan through the Money Pool would be required to repay the principal amount of the loan, together with all interest accrued thereon, on demand and in any event not later than one year after the date of the loan. All loans made through the Money Pool may be prepaid by the borrower without premium or penalty.

Applicants propose that Pepco and DPL may have up to \$500 million and \$275 million, respectively, borrowed at any one time from the Money Pool. Amounts borrowed by Pepco and DPL from the Money Pool would count against the short-term borrowing authority for Pepco and DPL referred to in section VII.A., above.

Applicants state that the operation of the Money Pool, including record keeping and coordination of loans, will be handled by PHISCO, or its successor, under the authority of the appropriate officers of the participating companies and that the Money Pool will be administered on an "at cost" basis.

#### IX. Financing Entities

PHI and the Subsidiaries seek authorization to organize new corporations, trusts, partnerships or other entities ("Financing Entities") that will facilitate financings by issuing short-term debt, long-term debt, preferred securities, equity securities, or other securities to third parties and transfer the proceeds of these financings to PHI or their

respective parent Subsidiaries. To the extent not exempt under rule 52, the Financing Entities also request authorization to issue these securities to third parties. In connection with this method of financing, PHI and the Subsidiaries may: (a) issue debentures or other evidences of indebtedness to Financing Entities in return for the proceeds of the financing; (b) acquire voting interests or equity securities issued by the Financing Entities to establish ownership of the Financing Entities (the equity portion of the entity generally being created through a capital contribution or the purchase of equity securities, ranging from one to three percent of the capitalization of the Financing Entities) and (c) guarantee a Financing Entity's obligations in connection with a financing transaction. Any amounts issued by Financing Entities to a third party under this authorization will be included in the PHI Financing Limit. However, the underlying intrasystem mirror debt and parent guarantee will not be so included.<sup>8</sup>

PHI and the Subsidiaries also request authorization to enter into support or expense agreements ("Expense Agreements") with Financing Entities to pay the expenses of any Financing Entity. In cases where it is necessary or desirable to ensure legal separation for purposes of isolating a Financing Entity from its parent or another subsidiary for bankruptcy purposes, the ratings agencies require that any Expense Agreement whereby the parent or Financing Entity provides services related to the Financing Entity be at a price, not to exceed a market price, consistent with similar services for parties with comparable credit quality and terms entered into by other companies so that a successor service provider could assume the duties of the parent or

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<sup>8</sup> Specifically excluded from this limitation is the issuance of up to \$1.108 billion of securitization securities by Atlantic City Electric Transition Funding LLC ("ACETF"). The Commission has reserved jurisdiction over this issuance by ACETF by order dated November 19, 2003 (HCAR No. 27765).

Financing Entity in the event of the bankruptcy of the parent or Financing Entity Subsidiary without interruption or an increase of fees. Therefore, PHI seeks approval under section 13(b) of the Act and rules 87 and 90 to provide the services described in this paragraph at a charge not to exceed a market price but only for so long as the Expense Agreement established by the Financing Entity financing subsidiary is in place.

X. Changes in Capital Stock of Wholly Owned Subsidiaries

Applicants state that the portion of an individual Subsidiary's aggregate financing to be effected through the sale of stock to PHI or other immediate parent company during the Authorization Period under rule 52 and/or under an order issued under this Application cannot be ascertained at this time. It may happen that the proposed sale of capital securities (*i.e.*, common stock or preferred securities) may in some cases exceed the then-authorized capital stock of the Subsidiary. In addition, the Subsidiary may choose to use capital stock with no par value. As needed to accommodate these proposed transactions and to provide for future issues, Applicants request authority to change the terms of any wholly owned Subsidiary's authorized capital stock capitalization or other equity interests by an amount deemed appropriate by PHI or other intermediate parent company. The requested authorization is limited to PHI's wholly owned Subsidiaries and will not affect the aggregate limits or other conditions contained within this Application. A Subsidiary would be able to change the par value, or change between par value and no-par stock, without additional Commission approval. This action by a Utility Subsidiary would be subject to, and would only be taken upon, the receipt of any necessary approvals by the state commission in the state or states where the Utility Subsidiary is incorporated and doing business.

## XI. Investments in EWGs and FUCOs

Rule 53 provides that in determining whether to approve certain financing transactions for the purpose of investments in EWGs, the Commission will not make certain adverse findings if the conditions of rule 53(a) and (b) are met. rule 53(c) provides that, in connection with a proposal by a registered holding company to issue and sell securities to finance an investment in an EWG, or to guarantee the securities of an EWG, an applicant unable to satisfy the conditions of rule 53(a) and (b) must affirmatively demonstrate that the proposal (a) will not have a substantial adverse impact upon the financial integrity of the registered holding company system; and (b) will not have an adverse impact on any utility subsidiary of the registered holding company or its customers, or on the ability of state commissions to protect those subsidiaries or customers.

PHI currently does not meet the conditions of rule 53(a). At March 31, 2005, PHI's "aggregate investment," as defined in rule 53(a)(1) was 3,053.2 million. At March 31, 2005, PHI's "consolidated retained earnings" (also as defined in rule 53(a)(1)) were \$872.1 million. Accordingly, at March 31, 2005, PHI's aggregate investment exceeded 50% of its consolidated retained earnings, the "safe harbor" limitation contained in rule 53(a). However, under the Financing Order, the Commission authorized PHI to increase its aggregate investment to an amount equal to the sum of (a) 100% of consolidated retained earnings plus (b) \$3.5 billion. At March 31, 2005, based on the Financing Order, PHI could have had an aggregate investment of up to \$4,363.7 million. Therefore, although PHI's aggregate investment at such date exceeded the 50% "safe harbor" limitation of rule 53, it is well within the higher investment level granted by the

Financing Order. PHI now requests authorization to invest in EWGs and FUCOs up to \$4.5 billion ("PHI Exempt Project Limit") during the Authorization Period.

PHI currently complies with, and will comply with, the record-keeping requirements of rule 53(a)(2), the limitation under rule 53(a)(3) on the use of the PHI system's domestic public-utility company personnel to render services to EWGs and FUCOs, and the requirements of rule 53(a)(4) concerning the submission of copies of certain filings under the Act to retail regulatory commissions. None of the circumstances described in 53(b) have occurred, and rule 53(c) is inapplicable by its terms.

As further described below, PHI states that the requested authority "will not have a substantial adverse impact upon the financial integrity of the holding company system" and "will not have an adverse impact on any utility subsidiary of the registered company, or its customers, or on the ability of state commissions to protect such subsidiary or customers", as is required by subparts (1) and (2) of rule 53(c).

PHI represents that it is in compliance with all of the conditions established by subparts (a) and (b) of rule 53 except 53(a)(1). Particularly with respect to demonstrating the absence of any substantial adverse impact prohibited by rule 53(c)(1) upon the financial integrity of the registered holding company system, PHI establishes such absence as provided below.

#### A. Equity to Total Capitalization

PHI commits that common equity will comprise at least 30% of its consolidated capitalization throughout the Authorization Period. As of March 31, 2005, its common equity comprised 37.1% of PHI's consolidated capitalization.

## B. Credit Ratings

The senior debt of PHI carries an investment grade rating as determined by Moody's, Standard & Poor's and Fitch. PHI commits that during the authorization period it will maintain at least an investment grade corporate senior unsecured debt rating from at least one nationally recognized rating agency.

## C. Financial Performance

PHI states that its existing investments in EWGs and FUCOs make a positive contribution to revenues and earnings. PHI states that it has suffered none of the adverse conditions specified by rule 53(b), including no bankruptcy of a subsidiary having assets with book value exceeding 10% of PHI's consolidated retained earnings, no decrease by more than 10% in average consolidated retained earnings for the last four quarters compared to the prior four quarters, and no operating losses in EWGs or FUCOs in excess of 5% of consolidated retained earnings. PHI states that it will notify the Commission by post-effective amendment in this matter should any of those circumstances occur.

## D. Risk Management and Project Review Process

PHI states that every potential investment in EWGs and FUCOs undergoes a series of reviews by project managers responsible for identifying business opportunities, and in some cases senior management and the Board of Directors of PHI and/or senior management and the Board of Directors of PHI.

Potential investments are evaluated against a number of investment criteria including (a) economic viability of the project, (b) political and regulatory risk, (c) availability of non-recourse financing on reasonable terms and (d) strategic fit within the

PHI System. Analysis of the economic viability of the project includes an analysis of the overall industry environment (*e.g.* progress towards restructuring) in which the project will operate. The analysis also includes review of permitting and environmental risks as well as legal risk associated with the ability to enforce contracts relating to the project and its financing.

PHI asserts that its principal investments under its business plan are in well-established, growing, and fundamentally stable energy markets. PHI states that it is particularly sensitive to ensuring that its independent energy investments contribute to its overall strategic growth plan building upon PHI's strengths and resources to achieve broad corporate objectives within budgeting and expenditure guidelines. Each potential investment must be reviewed and approved by a number of managers within the PHI system who will focus their review not only on the questions of whether a particular project satisfies PHI's investment criteria and is reasonably anticipated to generate earnings commensurate with risk, but also on the question of whether the project is likely to aid in achieving PHI's long-term overall strategic objectives.

Particularly with respect to demonstrating the absence of any adverse impact upon the Utility Subsidiaries, their customers or the ability of state commissions to protect those subsidiaries and their customers, PHI states that:

1. All EWG and FUCO projects will be structurally separate from the operations of the Utility Subsidiaries in that they are permanently owned by corporations, limited liability companies, or partnerships that are held in corporate chains of ownership independent of the Utility Subsidiaries.

2. The Utility Subsidiaries will not indemnify or guarantee the obligations of EWG or FUCO projects.

3. Each of the Utility Subsidiaries maintains investment grade corporate credit ratings and debt ratings as determined by at least one nationally recognized rating agency, that each is able to finance its operations principally from internally generated funds, and the proposed investment authority will not restrict the availability of capital for their operations. Each commits that the common equity will constitute at least 30% of its respective consolidated capitalization.<sup>9</sup>

4. The Utility Subsidiaries operate in states with state public service commissions that exercise general supervision authority, including authority over rate and public utility cost of service matters. These commissions have the authority to establish rates for regulated public utility company service based upon a rate of return determined to be fair by the state commission.

5. The Utility Subsidiaries will not seek recovery in rates to their regulated customers to compensate for any losses or inadequate returns that may be sustained on PHI 's investments in EWGs or FUCOs.

## XII. Payment of Dividends by Nonutility Subsidiaries Out of Capital or Unearned Surplus

Applicants propose that Nonutility Subsidiaries be permitted to pay dividends, from time to time through the Authorization Period, out of capital and unearned surplus, to the extent permitted under applicable corporate law and state and national law applicable in the jurisdiction where each company is organized, and any applicable financing covenants and, in addition, will not declare or pay any dividend out of capital

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<sup>9</sup> *But see* Note 3.

or unearned surplus unless it: (a) has received excess cash as a result of the sale of some or all of its assets, (b) has engaged in a restructuring or reorganization and/or (c) is returning capital to an associate company.

### XIII. Intermediate Subsidiaries

PHI proposes to acquire, directly or indirectly, the securities of one or more entities (“Intermediate Subsidiaries”), which would be organized exclusively for the purpose of acquiring, holding and/or financing the acquisition of the securities of or other interest in one or more EWGs, FUCOs, Rule 58 Subsidiaries, ETCs or other non-exempt nonutility subsidiaries (as authorized in this proceeding or in a separate proceeding), provided that Intermediate Subsidiaries may also engage in administrative activities (“Administrative Activities”) and development activities (“Development Activities”), as these terms are defined below, relating to those subsidiaries.

Administrative Activities include ongoing personnel, accounting, engineering, legal, financial and other support activities necessary to manage PHI’s investments in nonutility subsidiaries. Development Activities will be limited to due diligence and design review, market studies, preliminary engineering, site inspection, preparation of bid proposals, including, in connection therewith, posting of bid bonds, application for required permits and/or regulatory approvals, acquisitions of site options and options on other necessary rights, negotiation and execution of contractual commitments with owners of existing facilities, equipment vendors, construction firms and other project contractors, negotiation of financing commitments with lenders and other third-party investors, and other preliminary activities as may be required in connection with the

purchase, acquisition, financing or construction of facilities or the acquisition of securities of or interest in new businesses.

An Intermediate Subsidiary , among other things, may be organized: (a) to facilitate the making of bids or proposals to develop or acquire an interest in any EWG, FUCO, Rule 58 Subsidiary, ETC or other nonutility subsidiary, (b) to facilitate closing on the purchase or financing of the acquired company after the awarding of a bid, (c) at any time subsequent to the consummation of an acquisition of an interest in the company to, among other things, effect an adjustment in the respective ownership interests in the business held by PHI and nonaffiliated investors, (d) to facilitate the sale of ownership interests in one or more acquired nonutility companies, (e) to comply with applicable laws of foreign jurisdictions limiting or otherwise relating to the ownership of domestic companies by foreign nationals, (f) as a part of tax planning in order to limit PHI's exposure to taxes, (g) to further insulate PHI and the Utility Subsidiaries from operational or other business risks that may be associated with investments in nonutility companies or (h) for other lawful purposes.

Applicants state that investments in Intermediate Subsidiaries may take the form of any combination of the following: (a) purchases of capital shares, partnership interests, member interests in limited liability companies, trust certificates or other forms of equity interests, (b) capital contributions, (c) open account advances with or without interest, (d) loans and (e) guarantees issued, provided or arranged in respect of the securities or other obligations of any Intermediate Subsidiaries. Funds for any direct or indirect investment in any Intermediate Subsidiary will be derived from: (a) financings authorized in this proceeding, (b) any appropriate future debt or equity securities issuance

authorization obtained by PHI from the Commission and (c) other available cash resources, including proceeds of securities sales by Nonutility Subsidiaries under rule 52. To the extent that PHI provides funds or guarantees directly or indirectly to an Intermediate Subsidiary that are used for the purpose of making an investment in any EWG, FUCO or Rule 58 Subsidiary, Applicants state that the amount of funds or guarantees will be included in PHI's "aggregate investment" in these entities, as calculated in accordance with rule 53 or rule 58, as applicable.

PHI requests authorization to make expenditures on Development Activities, as defined above, in an aggregate amount up to \$200 million. PHI proposes a "revolving fund" concept for permitted expenditures on Development Activities. Thus, to the extent a Nonutility Subsidiary in respect of which Development Activities were made subsequently becomes an EWG, FUCO or qualifies as an "energy-related company" under rule 58, the amount so expended will cease to be considered an expenditure for Development Activities, but will instead be considered as part of the "aggregate investment" in the entity under rule 53 or rule 58, as applicable.

#### XIV. Nonutility Reorganizations

PHI requests authorization to consolidate or otherwise reorganize all or any part of its direct or indirect ownership interests in Nonutility Subsidiaries, and the activities and functions related to these investments. To effect any consolidation or other reorganization, PHI may wish to merge or contribute the equity securities of one Nonutility Subsidiary to another Nonutility Subsidiary (including a newly formed Intermediate Subsidiary) or sell (or cause a Nonutility Subsidiary to sell) the equity securities or all or part of the assets of one Nonutility Subsidiary to another one. To the

extent that these transactions are not otherwise exempt under the Act or the rules thereunder, PHI hereby requests authorization under the Act to consolidate or otherwise reorganize under one or more direct or indirect Intermediate Subsidiaries, PHI's ownership in existing and future Nonutility Subsidiaries. Applicants state that transactions may take the form of a Nonutility Subsidiary selling, contributing or transferring the equity securities of a subsidiary or all or part of the subsidiary's assets as a dividend to an Intermediate Subsidiary or to another Nonutility Subsidiary, and the acquisition, directly or indirectly, of the equity securities or assets of the subsidiary, either by purchase or by receipt of a dividend. The purchasing Nonutility Subsidiary in any transaction structured as an intrasystem sale of equity securities or assets may execute and deliver its promissory note evidencing all or a portion of the consideration given. Each transaction would be carried out in compliance with all applicable laws and accounting requirements.<sup>10</sup>

#### XV. Exemption of Certain Transactions from At-Cost Requirements

PHI requests authority for the Nonutility Subsidiaries to provide certain services in the ordinary course of their business to each other, in certain circumstances described below, including but not limited to cost or fair market prices, and they request an exemption under section 13(b) from the "at cost requirement" of rules 90 and 91 to the extent that a price other than "cost" is charged. Any services provided by the Nonutility Subsidiaries to the Utility Subsidiaries will continue to be provided at "cost" consistent with rules 90 and 91. A Nonutility Subsidiary will not provide services at other than cost

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<sup>10</sup> PHI states that in the event that proxy solicitations are necessary with respect to internal corporate reorganizations, PHI will seek the necessary Commission approvals under sections 6(a)(2) and 12(e) of the Act through the appropriate filing of a declaration.

to any other Nonutility Subsidiary that, in turn, provides the services, directly or indirectly, to any other associate company that is not a Nonutility Subsidiary, except under the requirements of the Commission's rules and regulations under section 13(b) or an exemption from those rules and regulations obtained under a separate filing.

Accordingly, PHI requests authority for the Nonutility Subsidiaries to provide services to each other at other than cost in any case where the Nonutility Subsidiary receiving the services is: (a) a FUCO or an EWG that derives no part of its income, directly or indirectly, from the generation, transmission, or distribution of electric energy for sale within the United States, (b) an EWG that sells electricity at market-based rates that have been approved by the FERC, provided that the purchaser of such electricity is not an associate public utility company, (c) a QF within the meaning of PURPA, that sells electricity exclusively (i) at rates negotiated at arm's-length to one or more industrial or commercial customers purchasing electricity for their own use and not for resale, and/or (ii) to an electric utility company (other than an associate utility company) at the purchaser's avoided cost as determined in accordance with FERC's regulations under PURPA, (d) a domestic EWG or QF that sells electricity at rates based upon its cost of service, as approved by FERC or any state public utility commission having jurisdiction, provided that the purchaser of the electricity is not an associate public utility company or (e) a direct or indirect Rule 58 Subsidiary of PHI or any other nonutility company that (i) is partially owned by PHI, provided that the ultimate recipient of the services is not an associate public utility company, or (ii) is engaged solely in the business of developing, owning, operating, and/or providing services to Nonutility Subsidiaries described in clauses (a) through (e) immediately above or (iii) does not derive, directly or indirectly,

any material part of its income from sources within the United States and is not a public utility company operating within the United States.

XVI. Authorization to Engage in Energy-Related Activities Outside of the United States

PHI, on behalf of any current or future Nonutility Subsidiaries, requests authority for Nonutility Subsidiaries to engage in certain “energy-related” activities outside the United States during the Authorization Period.

Applicants state that activities may include:

1. the brokering of electricity, natural gas and other energy commodities (“Energy Marketing”),
2. energy management services (“Energy Management Services”), including the marketing, sale, installation, operation and maintenance of various products and services related to energy management and demand side management, including energy and efficiency audits; facility design and process control and enhancements; construction, installation, testing, sales and maintenance of (and training client personnel to operate), energy conservation equipment; design, implementation, monitoring and evaluation of energy conservation programs; development and review of architectural, structural and engineering drawings for energy efficiencies, design and specification of energy consuming equipment and general advice on programs; the design, construction, installation, testing, sales and maintenance of new and retrofit heating, ventilating and air conditioning, electrical and power systems, alarm and warning systems, and related structures, in connection with energy-related structures, in connection with energy-related needs; and the provision of services and products designed to prevent, control or mitigate adverse effects of power disturbances on a customer’s electrical systems and

3. engineering, consulting and other technical support services (“Consulting Services”) with respect to energy-related businesses, as well as for individuals.

Consulting Services would include technology assessments, power factor correction and harmonics mitigation analysis, meter reading and repair, rate schedule design and analysis, environmental services, engineering services, billing services (including consolidation billing and bill disaggregation tools), risk management services, communications systems, information systems/data processing, system planning, finance, feasibility studies, and other similar services.

Applicants request that the Commission: (a) authorize Nonutility Subsidiaries to engage in Energy Marketing activities in Canada and Mexico and reserve jurisdiction over Energy Marketing Services anywhere outside of Canada and Mexico pending completion of the record in this proceeding, (b) authorize Nonutility Subsidiaries to provide Energy Management Services and Consulting Services anywhere outside the United States and (c) reserve jurisdiction over other activities of Nonutility Subsidiaries outside the United States pending completion of the record.

#### K. Filing of Certificates of Notification

It is proposed that, with respect to PHI, the reporting systems of the 1933 Act and the Securities Exchange Act of 1934, as amended (“1934 Act”) be integrated with the reporting system under the Act. This would eliminate duplication of filings with the Commission that cover essentially the same subject matters, resulting in a reduction of expense for both the Commission and PHI. To effect such integration, the portion of the 1933 Act and 1934 Act reports containing or reflecting disclosures of transactions occurring pursuant to the authorizations granted in this proceeding would be incorporated

by reference into this proceeding through rule 24 certificates of notification. The certificates would also contain all other information required by rule 24, including the certification that each transaction being reported on had been carried out in accordance with the terms and conditions of and for the purposes represented in this Application. Such certificates of notification would be filed within 60 days after the end of the first three calendar quarters and 90 days after the end of the last calendar quarter.

The rule 24 certificates will contain the following information:

1. The sales, if any, during the quarter of common stock by PHI, the purchase price per share and the market price per share at the date of the agreement of sale and the aggregate amount of common stock issued during the Authorization Period;
2. The total number of shares of PHI common stock issued or issuable pursuant to options granted during the quarter under employee benefit plans and dividend reinvestment plans including any employee benefit plans or dividend reinvestment plans hereafter adopted and the total number of shares of PHI stock issued or issuable pursuant to options outstanding during the period;
3. If PHI common stock has been transferred to a seller of securities of a company being acquired, the number of shares so issued, the value per share and whether the shares are restricted in the hands of the acquirer;
4. If a guarantee is issued during the quarter, the name of the guarantor, the name of the beneficiary of the guarantee and the amount terms and purpose of the guarantee and the total amount of guarantees issued and outstanding during the Authorization Period;

5. The amount and terms of any PHI indebtedness issued during the quarter and the total amount of PHI indebtedness issued and outstanding during the Authorization Period;
6. The amount and terms of any indebtedness issued by any Utility Subsidiary or Nonutility Subsidiary during the quarter that is not exempt under rule 52 and the total amount of Utility Subsidiary and Nonutility Subsidiary indebtedness issued and outstanding during the Authorization Period;
7. The notional amount and principal terms of any Hedge Instruments or Anticipatory Hedges entered into during the quarter and the identity of the other parties thereto;
8. If any Subsidiaries are Variable Interest Entities (“VIEs”) as that term is used in FASB Interpretation 46R, Consolidation of Variable Interest Entities, provide a description of any financing transactions conducted during the reporting period that were used to fund VIEs;
9. If any proceeds are used for VIEs, a description of the accounting for the transaction under FASB 46R;
10. A list of U-6B-2 forms filed with the Commission during the quarter, including the name of the filing entity and the date of filing;
11. Consolidated balance sheets as of the end of the quarter and separate balance sheets as of the end of the quarter for each company, including PHI, that has engaged in jurisdictional financing transactions during the quarter;

12. A table showing, as of the end of the quarter, the dollar and percentage components of the capital structure of PHI on a consolidated basis and the capital structure of each of the Utility Subsidiaries;
13. A retained earnings analysis of PHI on a consolidated basis and the Utility Subsidiaries detailing gross earnings, goodwill amortization, dividends paid out of capital surplus and the resulting capital account balances at the end of the quarter;
14. Future registration statements filed under the 1933 Act with respect to securities that are subject of the Application will be filed or incorporated by reference as exhibits to the next certificate filed under rule 24;
15. Identification of any investment in new EWGs or FUCOs during the quarter and the aggregate amount of investment in EWGs and FUCOs as of the end of the quarter and
16. Consolidated capitalization ratios of PHI and the Utility Subsidiaries as of the end of the quarter.

Applicants state that fees, commissions and miscellaneous expenses to be incurred in connection with this Application total \$15,000. The estimated fees and expenses do not include underwriting fees and other expenses incurred in completing specific financial transactions or other transactions covered in this file. Applicants state that the fees and expenses incurred for specific financings will not exceed 5% of the proceeds of those financings.

Applicants state that aside from the statements in section VI and footnotes 6 and 7, above, no other state or federal commission besides the Commission has jurisdiction over the activities contemplated in this Application.

Due notice of the filing of this Application has been given in the manner prescribed in rule 23 under the Act, and no hearing has been requested or ordered by the Commission. Based on the facts in the record, the Commission finds that, except as to those matters over which jurisdiction has been reserved, the applicable standards of the Act and rules are satisfied and that no adverse findings are necessary.

IT IS ORDERED, under the applicable provisions of the Act and the rules under the Act, that, except as to those matters over which jurisdiction has been reserved, the Application, as amended, be granted and permitted to become effective immediately, subject to the terms and conditions prescribed in rule 24, including the provisions under rule 24(c)(2), under the Act.

IT IS FURTHER ORDERED, that jurisdiction is reserved, pending completion of the record, over: (a) the issuance of any authorized securities in this Application (other than common stock and short-term debt) the issuance of which is prohibited after the 60th day following a Ratings Event, (b) the entering into of these Hedge Instruments or Anticipatory Hedges that do not qualify for hedge accounting treatment under the current FASB standard in effect, (c) engagement in Energy Marketing Services anywhere outside of Canada and Mexico and (d) other activities of Nonutility Subsidiaries outside the United States pending completion of the record in this proceeding.

For the Commission by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland  
Deputy Secretary