AMERICAN TRANSMISSION SYSTEMS, INCORPORATED

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

GLOSSARY OF TERMS

The following abbreviations and acronyms may be used in these financial statements to identify American Transmission Systems, Incorporated and its current and former affiliated companies:

ATSI	American Transmission Systems, Incorporated, formerly a direct subsidiary of FE that became a subsidiary of FET in April 2012, which owns and operates transmission facilities
CEI	The Cleveland Electric Illuminating Company, an Ohio electric utility operating affiliated company
FE	FirstEnergy Corp., a public utility holding company
FESC	FirstEnergy Service Company, which provides legal, financial and other corporate support services
FET	FirstEnergy Transmission, LLC, formerly known as Allegheny Energy Transmission, LLC, which is the parent of ATSI, MAIT and TrAIL and has a joint venture in PATH
FirstEnergy	FirstEnergy Corp., together with its consolidated subsidiaries
GPU	GPU, Inc., former parent of JCP&L, ME and PN, that merged with FE on November 7, 2001
JCP&L	Jersey Central Power & Light Company, a New Jersey electric utility operating affiliated company
MAIT	Mid-Atlantic Interstate Transmission, LLC, a subsidiary of FET, formed to own and operate transmission facilities
ME	Metropolitan Edison Company, a Pennsylvania electric utility operating affiliated company
OE	Ohio Edison Company, an Ohio electric utility operating affiliated company
Ohio Companies	CEI, OE and TE
PATH	Potomac-Appalachian Transmission Highline, LLC, a joint venture between FE and a subsidiary of AEP
PE	The Potomac Edison Company, a Maryland and West Virginia electric utility operating affiliated company
Penn	Pennsylvania Power Company, a Pennsylvania electric utility operating subsidiary of OE
TE	The Toledo Edison Company, an Ohio electric utility operating affiliated company
TrAIL	Trans-Allegheny Interstate Line Company, a subsidiary of FET, which owns and operates transmission facilities

The following abbreviations and acronyms may be used to identify frequently used terms in these financial statements:

AEP	American Electric Power Company, Inc.
AFUDC	Allowance for Funds Used During Construction
AMT	Alternative Minimum Tax
ARO	Asset Retirement Obligation
ASU	Accounting Standards Update
ERO	Electric Reliability Organization
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
GAAP	Accounting Principles Generally Accepted in the United States of America
IRS	Internal Revenue Service
kV	Kilovolt
LOC	Letter of Credit
MISO	Midcontinent Independent System Operator, Inc.
MVP	Multi-value Project
NERC	North American Electric Reliability Corporation
NOL	Net Operating Loss
OPEB	Other Post-Employment Benefits
PJM	PJM Interconnection, L.L.C.
PJM Region	The aggregate of the zones within PJM
PJM Tariff	PJM Open Access Transmission Tariff
PPUC	Pennsylvania Public Utility Commission
RFC	Reliability*First* Corporation
RTEP	Regional Transmission Expansion Plan
RTO	Regional Transmission Organization
Seventh Circuit	United States Court of Appeals for the Seventh Circuit

Sixth Circuit	United States Court of Appeals for the Sixth Circuit
Tax Act	Tax Cuts and Jobs Act adopted December 22, 2017
TO	Transmission Owner
U.S. Court of Appeals for the D.C. Circuit	United States Court of Appeals for the District of Columbia Circuit

Report of Independent Auditors

To Management and the Board of Directors
Of American Transmission Systems, Incorporated

We have audited the accompanying financial statements of American Transmission Systems, Incorporated, which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, of common stockholder's equity, and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of American Transmission Systems, Incorporated as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP (signed)

Cleveland, Ohio
March 9, 2018

AMERICAN TRANSMISSION SYSTEMS, INCORPORATED
STATEMENTS OF INCOME

(In millions)	For the Years Ended December 31 2017	2016
STATEMENTS OF INCOME		
REVENUES	$ 657	$ 540
OPERATING EXPENSES:		
Other operating expenses	97	78
Provision for depreciation	103	87
Amortization of regulatory assets/liabilities, net	7	—
General taxes	154	134
Total operating expenses	361	299
OPERATING INCOME	296	241
OTHER INCOME (EXPENSE):		
Miscellaneous income	1	1
Interest expense	(52)	(53)
Capitalized financing costs	11	15
Total other expense	(40)	(37)
INCOME BEFORE INCOME TAXES	256	204
INCOME TAXES	91	70
NET INCOME	$ 165	$ 134

The accompanying Notes to Financial Statements are an integral part of these financial statements.

AMERICAN TRANSMISSION SYSTEMS, INCORPORATED
BALANCE SHEETS

(In millions)	December 31, 2017	December 31, 2016
ASSETS		
CURRENT ASSETS:		
Receivables-		
Affiliated companies	$ 33	$ 22
Other	29	25
Notes receivable from affiliated companies	—	62
Prepaid taxes and other	3	2
	65	111
UTILITY PLANT:		
In service	4,284	3,882
Less — Accumulated provision for depreciation	933	889
	3,351	2,993
Construction work in progress	160	100
	3,511	3,093
DEFERRED CHARGES AND OTHER ASSETS:		
Regulatory assets	—	13
Property taxes	177	156
Other	7	7
	184	176
	$ 3,760	$ 3,380
LIABILITIES AND CAPITALIZATION		
CURRENT LIABILITIES:		
Accounts payable - affiliated companies	$ 15	$ 5
Short-term borrowings - affiliated companies	113	—
Accrued taxes	155	136
Accrued interest	20	18
	303	159
CAPITALIZATION:		
Common stockholder's equity-		
Common stock, no par value, 850 shares authorized - 1 share outstanding	1,166	1,166
Retained earnings	348	318
Total common stockholder's equity	1,514	1,484
Long-term debt and other long-term obligations	1,090	940
	2,604	2,424
NONCURRENT LIABILITIES:		
Accumulated deferred income taxes	368	604
Property taxes	177	156
Regulatory liabilities	271	—
Other	37	37
	853	797
COMMITMENTS AND CONTINGENCIES (NOTE 8)		
	$ 3,760	$ 3,380

The accompanying Notes to Financial Statements are an integral part of these financial statements.

AMERICAN TRANSMISSION SYSTEMS, INCORPORATED
STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

	Common Stock		
(In millions, except share amounts)	Number of Shares	Carrying Value	Retained Earnings
Balance, January 1, 2016	1	$ 1,101	$ 209
Net income			134
Equity contribution from parent		65	
Cash dividends declared on common stock			(25)
Balance, December 31, 2016	1	$ 1,166	$ 318
Net income			165
Cash dividends declared on common stock			(135)
Balance, December 31, 2017	1	$ 1,166	$ 348

The accompanying Notes to Financial Statements are an integral part of these financial statements.

AMERICAN TRANSMISSION SYSTEMS, INCORPORATED
STATEMENTS OF CASH FLOWS

	For the Years Ended December 31	
(In millions)	**2017**	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 165	$ 134
Adjustments to reconcile net income to net cash from operating activities-		
Depreciation and amortization of regulatory assets/liabilities, net	110	87
Deferred income taxes and investment tax credits, net	131	137
Transmission revenue collections, net	(68)	12
Allowance for funds used during construction - equity	(8)	(11)
Changes in current assets and liabilities-		
Receivables	(15)	84
Accounts payable	10	(1)
Accrued taxes	19	50
Accrued interest	2	—
Other	(8)	(3)
Net cash provided from operating activities	338	489
CASH FLOWS FROM FINANCING ACTIVITIES:		
New financing -		
Long-term debt	150	—
Short-term borrowings, net	113	—
Equity contribution from parent	—	65
Common stock dividend payments	(135)	(25)
Other	(1)	(1)
Net cash provided from financing activities	127	39
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(478)	(443)
Loans to affiliated companies, net	62	(49)
Asset removal costs	(49)	(36)
Net cash used for investing activities	(465)	(528)
Net change in cash and cash equivalents	—	—
Cash and cash equivalents at beginning of period	—	—
Cash and cash equivalents at end of period	$ —	$ —
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid (received) during the year -		
Interest (net of amounts capitalized)	$ 47	$ 49
Income taxes received, net of payments	$ (37)	$ (159)

The accompanying Notes to Financial Statements are an integral part of these financial statements.

AMERICAN TRANSMISSION SYSTEMS, INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Unless otherwise indicated, defined terms and abbreviations used herein have the meanings set forth in the accompanying Glossary of Terms.

ATSI is a wholly owned subsidiary of FET. ATSI owns high-voltage transmission facilities consisting of approximately 7,500 pole miles of transmission lines with nominal voltages of 345 kV, 138 kV and 69 kV. Effective October 1, 2003, ATSI transferred operational control of its transmission facilities to MISO. On December 17, 2009, FERC authorized ATSI to transfer operational control of its facilities to PJM. On June 1, 2011, ATSI successfully integrated into PJM. ATSI plans, operates, and maintains its transmission system in accordance with NERC reliability standards, and other applicable regulatory requirements. On December 8, 2016, ATSI was approved by the PPUC to operate as a public utility in Pennsylvania in an area coextensive with the PJM ATSI Zone. In addition, ATSI follows GAAP and complies with the regulations, orders, policies and practices prescribed by FERC and applicable state regulatory authorities, including the PPUC and the PUCO.

The preparation of financial statements in conformity with GAAP requires management to make periodic estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from these estimates. The reported results of operations are not necessarily indicative of results of operations for any future period. ATSI has evaluated events and transactions for potential recognition or disclosure through March 9, 2018, the date the financial statements were issued.

Certain prior year amounts have been reclassified to conform to the current year presentation.

REVENUES AND RECEIVABLES

Under a formula rate mechanism approved by the FERC, ATSI makes annual filings in order to recover incurred costs and an allowed return. An initial rate filing is made for each calendar year using estimated costs, which is used to determine the initial billings to customers. All prudently incurred allowable operation and maintenance costs, a return earned on rate base and an income tax allowance are recovered or refunded through a subsequent true-up mechanism. As such, ATSI recognizes revenue as it incurs recoverable costs and earns the allowed return. Any differences between revenues earned based on actual costs and the amounts billed based on estimated costs are recognized as a regulatory asset or liability and will be recovered or refunded, respectively, in subsequent periods.

ACCOUNTING FOR THE EFFECTS OF REGULATION

ATSI accounts for the effects of regulation through the application of regulatory accounting since its rates are established by a third-party regulator with the authority to set rates that bind customers, are cost-based and can be charged to and collected from customers.

ATSI records regulatory assets and liabilities that result from the regulated rate-making process that would not be recorded under GAAP for non-regulated entities. These assets and liabilities are amortized in the Statements of Income concurrent with the recovery or refund through customer rates. ATSI believes that it is probable that its regulatory assets and liabilities will be recovered and settled, respectively, through future rates. ATSI nets its regulatory assets and liabilities based on federal and state jurisdictions.

As a result of the Tax Act, FirstEnergy, including ATSI, adjusted its net deferred tax liabilities at December 31, 2017, for the reduction in the corporate income tax rate from 35% to 21%. The impact of reducing the net deferred tax liabilities was offset with a regulatory liability, as appropriate, for amounts expected to be refunded to rate payers in future rates, with the remainder recorded to deferred income tax expense.

The following table provides information about the composition of net regulatory assets and liabilities as of December 31, 2017 and December 31, 2016, and the changes during the year ended December 31, 2017:

Net Regulatory Assets (Liabilities) by Source	December 31, 2017	December 31, 2016	Increase (Decrease)
		(In millions)	
MISO exit fee deferral [(1)]	$ 65	$ 60	$ 5
Customer receivables (payables) for future income taxes	(315)	52	(367)
Asset removal costs	(55)	(65)	10
Deferred transmission costs	31	(37)	68
Other	3	3	—
Net Regulatory Assets (Liabilities) included on the Balance Sheets	$ (271)	$ 13	$ (284)

(1) Comprised of MISO exit fees, which are not earning a return. Recovery is subject to a current regulatory proceeding (see Note 8, "Regulatory Matters").

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment reflects original cost, including payroll and related costs such as taxes, employee benefits, administrative and general costs, and interest costs incurred to place the assets in service. The costs of normal maintenance, repairs and minor replacements are expensed as incurred. ATSI recognizes liabilities for planned major maintenance projects as they are incurred.

ATSI provides for depreciation on a straight-line basis at various rates over the estimated lives of property included in plant in service. The annual composite rates for ATSI's transmission facilities were 2.5% and 2.4% in 2017 and 2016, respectively.

For the years ended December 31, 2017 and 2016, capitalized financing costs on ATSI's Statements of Income include $8 million and $11 million, respectively, of allowance for equity funds used during construction and $3 million and $4 million, respectively, of capitalized interest.

ATSI evaluates long-lived assets classified as held and used for impairment when events or changes in circumstances indicate the carrying value of the long-lived assets may not be recoverable. First, the estimated undiscounted future cash flows attributable to the assets is compared with the carrying value of the assets. If the carrying value is greater than the undiscounted future cash flows, an impairment charge is recognized equal to the amount the carrying value of the assets exceeds its estimated fair value.

INVESTMENTS

All temporary cash investments purchased with an initial maturity of three months or less are reported as cash equivalents on the Balance Sheets, at cost, which approximates their fair market value. Investments other than cash and cash equivalents include notes receivable.

NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Pronouncements

ASU 2016-15, "*Classification of Certain Cash Receipts and Cash Payments*" (Issued August 2016): The standard is intended to eliminate diversity in practice in how certain cash receipts and cash payments are presented and classified in the Statements of Cash Flows, including the presentation of debt prepayment or debt extinguishment costs, all of which will be classified as financing activities. ASU 2016-15 is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2017. ATSI early adopted this ASU as of January 1, 2017. There was no impact to prior periods.

Recently Issued Pronouncements - The following new authoritative accounting guidance issued by the FASB was not adopted in 2017. Unless otherwise indicated, ATSI is currently assessing the impact such guidance may have on its financial statements and disclosures, as well as the potential to early adopt where applicable. ATSI has assessed other FASB issuances of new standards not described below and has not included these standards based upon the current expectation that such new standards will not significantly impact ATSI's financial reporting.

ASU 2014-09, *"Revenue from Contracts with Customers"* (Issued May 2014 and subsequently updated to address implementation questions): The new revenue recognition guidance: establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. ATSI has evaluated its revenues and the new guidance will have limited impacts to current revenue recognition practices upon adoption on January 1, 2018. As part of the adoption, ATSI elected to apply the new guidance on a modified retrospective basis. ATSI will not record a cumulative adjustment to retained earnings for initially applying the new guidance as no revenue recognition differences were identified in the timing or amount of revenue. In addition,upon adoption, certain immaterial financial statement presentation changes will be implemented. ATSI expects to disaggregate revenue by type of service in future revenue disclosures.

ASU 2016-02, *"Leases (Topic 842)"* (Issued February 2016) and ASU 2018-01, *"Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842"* (Issued January 2018): ASU 2016-02 will require organizations that lease assets with lease terms of more than 12 months to recognize assets and liabilities for the rights and obligations created by those leases on their balance sheets. In addition, new qualitative and quantitative disclosures of the amounts, timing, and uncertainty of cash flows arising from leases will be required. The ASU will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. ASU 2018-01 (same effective date and transition requirements as ASU 2016-02) provides an optional transition practical expedient that, if elected, would not require an entity to reconsider its accounting for existing land easements that are not currently accounted for under the old leases standard. FirstEnergy does not plan to adopt these standards early. Lessors and lessees will be required to apply a modified retrospective transition approach, which requires adjusting the accounting for any leases existing at the beginning of the earliest comparative period presented in the adoption-period financial statements. Any leases that expire before the initial application date will not require any accounting adjustment. ATSI expects an increase in assets and liabilities, however, it is currently assessing the impact on its Financial Statements. This assessment includes monitoring utility industry implementation guidance. FirstEnergy is in the process of conducting outreach activities across its business units and analyzing its lease population. In addition, it has begun implementation of a third-party software tool that will assist with the initial adoption and ongoing compliance.

ASU 2017-01, "*Business Combinations: Clarifying the Definition of a Business*" (Issued January 2017): ASU 2017-01 assists entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2017. The ASU will be applied prospectively to any transactions occurring within the period of adoption. ATSI will not early adopt this standard.

ASU 2017-07, "*Compensation-Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*" (Issued March 2017): ASU 2017-07 requires entities to retrospectively (1) disaggregate the current-service-cost component from the other components of net benefit cost (the “other components”) and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations if such a subtotal is presented. In addition, ASU 2017-07 requires service costs to be capitalized as appropriate and non-service costs to be charged to earnings. ATSI will present non-service costs in the caption “Miscellaneous Income” with the exception of the annual mark-to-market adjustment which will be disclosed separately.

2. TAXES

ATSI records income taxes in accordance with the liability method of accounting. Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts recognized for tax purposes. Investment tax credits, which were deferred when utilized, are being amortized over the recovery period of the related property. Deferred income tax liabilities related to temporary tax and accounting basis differences and tax credit carryforward items are recognized at the statutory income tax rates in effect when the liabilities are expected to be paid. Deferred tax assets are recognized based on income tax rates expected to be in effect when they are settled.

ATSI is party to an intercompany income tax allocation agreement with FE that provides for the allocation of consolidated tax liabilities. Net tax benefits attributable to FirstEnergy, excluding any tax benefits derived from interest expense associated with acquisition indebtedness from the merger with GPU, are reallocated to the subsidiaries of FirstEnergy that have taxable income. That allocation is accounted for as a capital contribution to the company receiving the tax benefit.

On December 22, 2017, the President signed into law the Tax Act. Substantially all of the provisions of the Tax Act are effective for taxable years beginning after December 31, 2017. The Tax Act includes significant changes to the Internal Revenue Code of 1986 (as amended, the Code), including amendments which significantly change the taxation of business entities and includes specific provisions related to regulated public utilities including ATSI. The more significant changes that impact ATSI included in the Tax Act are the following:

- Reduction of the corporate federal income tax rate from 35% to 21%, effective in 2018;
- Elimination of 50% bonus depreciation of qualified property for rate regulated utilities, as of September 27, 2017;
- Limitation of the utilization of federal NOLs arising after December 31, 2017 to 80% of taxable income with an indefinite carryforward;
- Repeal of the corporate AMT and allowing taxpayers to claim a refund on any AMT credit carryovers.

The most significant change that impacts ATSI in the current year is the reduction of the corporate federal income tax rate. Other provisions are not expected to have a significant impact on the financial statements, but may impact the effective tax rate in future years. Under US GAAP, specifically ASC Topic 740, Income Taxes, the tax effects of changes in tax laws must be recognized in the period in which the law is enacted, or December 22, 2017, for the Tax Act. ASC 740 also requires deferred tax assets and liabilities to be measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. Thus, at the date of enactment, ATSI’s deferred taxes were re-measured based upon the new tax rate, which resulted in a material decrease to ATSI’s net deferred income tax liabilities. ATSI recorded a corresponding net regulatory liability to the extent the change in deferred taxes would result in amounts previously collected from utility customers to be subject to refunds to such customers, generally through reductions in future rates. All other amounts were recorded as an adjustment to ATSI’s deferred income tax provision.

ATSI has completed its assessment of the accounting for certain effects of the provisions in the Tax Act, and as allowed under SEC Staff Accounting Bulletin 118 (SAB 118), has recorded provisional income tax amounts as of December 31, 2017 related to depreciation for which the impacts of the Tax Act could not be finalized, but for which a reasonable estimate could be determined.

Under the new law, property acquired and placed into service after September 27, 2017, will no longer qualify for fifty percent bonus depreciation. As a result, ATSI will need to evaluate the contractual terms of its capital expenditures to determine if capital additions are still eligible for fifty percent bonus depreciation under the prior tax law. As of December 31, 2017, ATSI has not yet completed this analysis, but has recorded a reasonable estimate of the effects of these changes based on capital costs incurred prior to year-end. In addition, SAB 118 allows for a measurement period for companies to finalize the provisional amounts recorded as of December 31, 2017. ATSI expects to record any final adjustments to the provisional amounts by the fourth quarter of 2018, which could result in a material impact to ATSI’s income tax provision or financial position.

ATSI's assessment of accounting for the Tax Act are based upon management's current understanding of the Tax Act. However, it is expected that further guidance will be issued during 2018, which may result in adjustments that could have a material impact to ATSI's future results of operations, cash flows, or financial position.

As a result of the Tax Act, ATSI recognized an immaterial non-cash charge to income tax expense and resulted in excess deferred taxes of $278 million, of which the revenue impact was recorded as a regulatory liability. These adjustments had no impact on our 2017 cash flows.

INCOME TAXES:	**2017**	**2016**
	(In millions)	
Currently receivable-		
Federal	$ (40)	$ (67)
State	—	—
	(40)	(67)
Deferred, net-		
Federal	125	133
State	6	4
	131	137
Total income taxes	$ 91	$ 70

ATSI's tax rates are affected by permanent items, such as AFUDC equity and other flow-through items, as well as discrete items that may occur in any given period, but are not consistent from period to period. The following table provides a reconciliation of federal income tax expense at the federal statutory rate to the total income taxes for the years ended December 31:

(In millions)	**2017**	**2016**
Book income before income taxes	$ 256	$ 204
Federal income tax expense at statutory rate (35%)	$ 90	$ 71
Increases (reductions) in taxes resulting from-		
State income taxes, net of federal income tax benefit	4	3
AFUDC	(2)	(3)
Other, net	(1)	(1)
Total income taxes	$ 91	$ 70
Effective income tax rate	35.5%	34.3%

ATSI's effective tax rate on pre-tax income for 2017 and 2016 was 35.5% and 34.3%, respectively. The increase in the effective tax rate was primarily due to a decrease in the benefit for AFUDC equity and other state flow-through.

Accumulated deferred income taxes as of December 31, 2017 and 2016, are as follows:

(In millions)	**2017**	**2016**
Property basis differences	$ 416	$ 707
Regulatory asset/liability	28	9
Pension and OPEB	(7)	(11)
Loss carryforwards and AMT credits	(68)	(100)
All other	(1)	(1)
Net accumulated deferred income tax liabilities	$ 368	$ 604

ATSI has recorded as deferred income tax assets the effect of NOLs and tax credits that will more likely than not be realized through future operations and through the reversal of existing temporary differences. As of December 31, 2017, ATSI's loss carryforwards consisted of approximately $262 million ($55 million, tax-effected) of Federal NOL carryforwards that begin to expire in 2031 and approximately $806 million ($13 million, tax-effected) of state and local NOL carryforwards that will begin to expire in 2018.

ATSI accounts for uncertainty in income taxes recognized in its financial statements. A recognition threshold and measurement attribute are utilized for financial statement recognition and measurement of tax positions taken or expected to be taken on a company's tax return. For the years ended December 31, 2017 and 2016, ATSI did not record any unrecognized tax benefits, nor does ATSI have a reserve for any uncertain tax positions.

ATSI recognizes interest expense or income and penalties related to uncertain tax positions in income taxes. That amount is computed by applying the applicable statutory interest rate to the difference between the tax position recognized and the amount previously taken or expected to be taken on the federal income tax return. During 2017 and 2016, ATSI did not record any interest related to uncertain tax positions, nor did ATSI have cumulative net interest payable recorded on its balance sheets.

For federal income tax purposes, ATSI files as a member of the FE consolidated group. In February 2017, the IRS completed its examination of FE's 2015 federal income tax return and issued a Full Acceptance Letter with no changes or adjustments to ATSI's taxable income. In August 2017, the IRS substantially completed its examination of FE’s 2016 federal income tax return and, on January 18, 2018, issued a Full Acceptance Letter with no changes or adjustments to ATSI’s taxable income. ATSI has tax returns under review by state taxing authorities at the audit or appeals level for tax years 2010 and 2014-2016.

General Taxes

Details of general taxes for the years ended December 31, 2017 and 2016, are shown below:

(In millions)	**2017**	**2016**
Real and personal property	$ 154	$ 134
Total general taxes	$ 154	$ 134

3. LEASES

ATSI leases fee-owned land, easements, franchises, and other land use rights from OE, Penn, CEI and TE under an operating lease agreement. Land use is rented to ATSI under the terms and conditions of a ground lease approved by FERC. ATSI, OE, Penn, CEI, and TE reserve the right to use (and to permit authorized others to use) the land for any purpose that does not cause a violation of electrical safety code or applicable law, or does not impair ATSI's ability to satisfy its service obligations. Additional uses of such land for ATSI's facilities requires prior written approval from the applicable operating companies. ATSI purchases directly any new property acquired for transmission use. ATSI makes fixed quarterly lease payments of approximately $5 million through December 31, 2049, unless terminated prior to maturity, or extended by ATSI for up to 10 additional successive periods of 50 years each.

4. FAIR VALUE MEASUREMENTS

All borrowings with initial maturities of less than one year are defined as short-term financial instruments under GAAP and are reported as Short-term borrowings on the Balance Sheets at cost. Since these borrowings are short-term in nature, ATSI believes that their costs should approximate their fair market value. The following table provides the approximate fair value and related carrying value of long-term debt, which excludes net unamortized debt issuance costs and discounts:

	December 31, 2017		**December 31, 2016**	
(In millions)	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Long-term debt	$ 1,100	$ 1,208	$ 950	$ 1,022

The fair values of long-term debt reflect the present value of the cash outflows relating to those securities based on the current call price, the yield to maturity or the yield to call, as deemed appropriate at the end of each respective period. The yields assumed were based on securities with similar characteristics offered by corporations with credit ratings similar to those of ATSI. ATSI classified short-term borrowings, long-term debt as Level 2 in the fair value hierarchy as of December 31, 2017 and December 31, 2016.

5. CAPITALIZATION

COMMON STOCK

In addition to paying dividends from retained earnings, ATSI has authorization from the FERC to pay cash dividends to FirstEnergy from paid-in capital accounts, as long as its FERC-defined equity-to-total-capitalization ratio remains above 35%.

LONG-TERM DEBT AND OTHER LONG-TERM OBLIGATIONS

The following table presents outstanding long-term debt for ATSI as of December 31, 2017 and 2016:

	As of December 31, 2017		As of December 31,	
(Dollar amounts in millions)	**Maturity Date**	**Interest Rate**	**2017**	**2016**
Unsecured notes - fixed rate	2022 - 2045	3.660% - 5.250%	$ 1,100	$ 950
Unamortized debt discounts			(4)	(4)
Unamortized debt issuance costs			(6)	(6)
Total long-term debt and other long-term obligations			$ 1,090	$ 940

On August 31, 2017, ATSI issued $150 million of 3.66% senior unsecured notes maturing in 2032. Proceeds from the issuance of the notes were used: (i) to repay short-term borrowings, (ii) to fund capital expenditures and (iii) for working capital needs and other general business purposes.

As of December 31, 2017, ATSI has a $400 million scheduled debt repayment in 2022.

Debt Covenant Default Provisions

ATSI has various debt covenants under certain financing arrangements, including its revolving credit facility. The most restrictive of the debt covenants relate to the nonpayment of interest and/or principal on such debt and the maintenance of certain financial ratios. The failure by ATSI to comply with the covenants contained in any of its financing arrangements could result in an event of default, which may have an adverse effect on ATSI's financial condition.

Additionally, there are cross-default provisions in certain financing arrangements of FE and its subsidiaries, including ATSI. These provisions generally trigger a default in the applicable financing arrangement of an entity if it or any of its significant subsidiaries default under another financing arrangement in excess of a certain principal amount, typically $100 million. Although such defaults by ATSI would generally cross-default FE financing arrangements containing these provisions, defaults by FE would generally not cross-default applicable ATSI financing arrangements.

As of December 31, 2017, ATSI was in compliance with all debt covenant provisions.

6. SHORT-TERM BORROWINGS AND BANK LINES OF CREDIT

ATSI had $113 million of outstanding short-term borrowings as of December 31, 2017 and no outstanding short-term borrowings as of December 31, 2016.

Revolving Credit Facility

FET and its subsidiaries, including ATSI, participate in two separate five-year syndicated revolving credit facilities with aggregate commitments of $5.0 billion (Facilities), which are available through December 6, 2021. FET and its subsidiaries may use borrowings under their Facilities for working capital and other general corporate purposes, including intercompany loans and advances by a borrower to any of its subsidiaries. Generally, borrowings under each of the Facilities are available to each borrower separately and mature on the earlier of 364 days from the date of borrowing or the commitment termination date, as the same may be extended. Each of the Facilities contains financial covenants requiring each borrower to maintain a consolidated debt-to-total-capitalization ratio (as defined under each of the Facilities) of no more than 65%, and 75% for FET, measured at the end of each fiscal quarter.

Under this Facility, ATSI may borrow up to its sub-limit of $500 million, all of which was available to ATSI as of January 31, 2018. ATSI has regulatory and other short-term debt limitations of $500 million which includes amounts that may be borrowed under the regulated companies' money pool.

The Facility does not contain provisions that restrict the ability to borrow or accelerate payment of outstanding advances in the event of any change in credit ratings of the borrowers. Pricing is defined in “pricing grids,” whereby the cost of funds borrowed under the Facility is related to the credit ratings of the company borrowing the funds, other than the FET facility, which is based on its subsidiaries' credit ratings. Additionally, borrowings under the Facility are subject to the usual and customary provisions for acceleration upon the occurrence of events of default, including a cross-default for other indebtedness in excess of $100 million.

FirstEnergy Money Pools

FE's regulated companies, including ATSI, also have the ability to borrow from each other and the holding company to meet their short-term working capital requirements. FESC administers this money pool and tracks surplus funds of FE and the respective regulated subsidiaries, as well as proceeds available from bank borrowings. Companies receiving a loan under the money pool agreement must repay the principal amount of the loan, together with accrued interest, within 364 days of borrowing the funds. The rate of interest is the same for each company receiving a loan from the regulated pool and is based on the average cost of funds available through the pool. The average interest rate for borrowings in 2017 was 1.48% per annum.

7. REGULATORY MATTERS

FEDERAL REGULATION

With respect to its transmission services and rates, ATSI is subject to regulation by FERC. Under the FPA, FERC regulates rates for transmission of electric power, accounting and other matters. FERC regulations require ATSI to provide open access transmission service at FERC-approved rates, terms and conditions. ATSI's transmission facilities are subject to functional control by PJM, and transmission service using ATSI's transmission facilities is provided by PJM under the PJM Tariff. See "FERC Matters" below.

To date, FERC has yet to issue guidance to address how to reflect the impacts resulting from the Tax Act in customer rates. Management continues to monitor and investigate the impact of changes to federal regulation resulting from the Tax Act.

RELIABILITY MATTERS

Federally-enforceable mandatory reliability standards apply to the bulk electric system and impose certain operating, record-keeping and reporting requirements on ATSI. NERC is the ERO designated by FERC to establish and enforce these reliability standards, although NERC has delegated day-to-day implementation and enforcement of these reliability standards to eight regional entities, including RFC. All of FirstEnergy's facilities, including those of ATSI, are located within the RFC region. FirstEnergy actively participates in the NERC and RFC stakeholder processes, and otherwise monitors and manages its companies, including ATSI, in response to the ongoing development, implementation and enforcement of the reliability standards implemented and enforced by RFC.

FirstEnergy, including ATSI, believes that it is in compliance with all currently-effective and enforceable reliability standards. Nevertheless, in the course of operating its extensive electric utility systems and facilities, FirstEnergy, including ATSI, occasionally learns of isolated facts or circumstances that could be interpreted as excursions from the reliability standards. If and when such occurrences are found, FirstEnergy, including ATSI, develops information about the occurrence and develops a remedial response to the specific circumstances, including in appropriate cases "self-reporting" an occurrence to RFC. Moreover, it is clear that NERC, RFC and FERC will continue to refine existing reliability standards as well as to develop and adopt new reliability standards. Any inability on FirstEnergy's, including ATSI's, part to comply with the reliability standards for its bulk electric system could result in the imposition of financial penalties, and obligations to upgrade or build transmission facilities, that could have a material adverse effect on ATSI's financial condition, results of operations and cash flows.

FERC MATTERS

PJM Transmission Rates

PJM and its stakeholders have been debating the proper method to allocate costs for certain transmission facilities. While FirstEnergy and other parties advocate for a traditional "beneficiary pays" (or usage based) approach, others advocate for "socializing" the costs on a load-ratio share basis, where each customer in the zone would pay based on its total usage of energy within PJM. This question has been the subject of extensive litigation before FERC and the appellate courts, including before the Seventh Circuit. On June 25, 2014, a divided three-judge panel of the Seventh Circuit ruled that FERC had not quantified the benefits that western PJM utilities would derive from certain new 500 kV or higher lines and thus had not adequately supported its decision to socialize the costs of these lines. The majority found that eastern PJM utilities are the primary beneficiaries of the lines, while western PJM utilities are only incidental beneficiaries, and that, while incidental beneficiaries should pay some share of the costs of the lines, that share should be proportionate to the benefit they derive from the lines, and not on load-ratio share in PJM as a whole. The court remanded the case to FERC, which issued an order setting the issue of cost allocation for hearing and settlement proceedings. On June 15, 2016, various parties, including ATSI, filed a settlement agreement at FERC agreeing to apply a combined usage based/socialization approach to cost allocation for charges to transmission customers in the PJM Region for transmission projects operating at or above 500 kV. Certain other parties in the proceeding did not agree to the settlement and filed protests to the settlement seeking, among other issues, to strike certain of the evidence advanced by FirstEnergy and certain of the other settling parties in support of the settlement, as well as provided further comments in opposition to the settlement. FirstEnergy and certain of the other parties responded to such opposition. On October 20, 2017, the settling and non-opposing parties requested expedited action by FERC. The settlement is pending before FERC.

The outcome of this proceeding and its impact, if any, on ATSI cannot be predicted at this time.

RTO Realignment

On June 1, 2011, ATSI and the ATSI zone transferred from MISO to PJM. While many of the matters involved with the move have been resolved, FERC denied recovery under ATSI's transmission rate for certain charges that collectively can be described as "exit fees" and certain other transmission cost allocation charges totaling approximately $78.8 million until such time as ATSI submits a cost/benefit analysis demonstrating net benefits to customers from the transfer to PJM. Subsequently, FERC rejected a proposed settlement agreement to resolve the exit fee and transmission cost allocation issues, stating that its action is without prejudice to ATSI submitting a cost/benefit analysis demonstrating that the benefits of the RTO realignment decisions outweigh the exit fee and transmission cost allocation charges. On March 17, 2016, FERC denied FirstEnergy's request for rehearing of FERC's earlier order rejecting the settlement agreement and affirmed its prior ruling that ATSI must submit the cost/benefit analysis.

Separately, ATSI resolved a dispute regarding responsibility for certain costs for the “Michigan Thumb” transmission project. Potential responsibility arises under the MISO MVP tariff, which has been litigated in complex proceedings before FERC and certain U.S. appellate courts. On October 29, 2015, FERC issued an order finding that ATSI and the ATSI zone do not have to pay MISO MVP charges for the Michigan Thumb transmission project. MISO and the MISO TOs filed a request for rehearing, which FERC denied on May 19, 2016. The MISO TOs subsequently filed an appeal of FERC's orders with the Sixth Circuit. FirstEnergy intervened and participated in the proceedings on behalf of ATSI, the Ohio Companies and Penn. On June 21, 2017, the Sixth Circuit issued its decision denying the MISO TOs' appeal request. MISO and the MISO TOs did not seek review by the U.S. Supreme Court, effectively resolving the dispute over the "Michigan Thumb" transmission project. On a related issue, FirstEnergy joined certain other PJM TOs in a protest of MISO's proposal to allocate MVP costs to energy transactions that cross MISO's borders into the PJM Region. On July 13, 2016, FERC issued its order finding it appropriate for MISO to assess an MVP usage charge for transmission exports from MISO to PJM. Various parties, including FirstEnergy and the PJM TOs, requested rehearing or clarification of FERC’s order. The requests for rehearing remain pending before FERC.

In addition, in a May 31, 2011 order, FERC ruled that the costs for certain "legacy RTEP" transmission projects in PJM approved before ATSI joined PJM could be charged to transmission customers in the ATSI zone. The amount to be paid, and the question of derived benefits, is pending before FERC as a result of the Seventh Circuit's June 25, 2014 order described above under "PJM Transmission Rates."

The outcome of the proceedings that address the remaining open issues related to MVP costs and "legacy RTEP" transmission projects cannot be predicted at this time.

STATE REGULATORY MATTERS

In response to a June 2013 request by Penn to locate and construct a 200-foot transmission line in Western Pennsylvania to tap a 138 kV line to serve a nearby customer at transmission voltage, the PPUC in September 2013 approved the request, but questioned whether ATSI should be considered a "public utility" under the Pennsylvania Public Utility Code and directed the filing of a petition for declaratory order or an application for a certificate of public convenience in order for the PPUC to address the issue. On October 15, 2013, ATSI filed a Petition for Declaratory Order with the PPUC outlining why it is not a "public utility" under the Pennsylvania Public Utility Code. On August 11, 2016, the PPUC denied ATSI’s Petition and directed ATSI to file an Application for public utility status in Pennsylvania. ATSI filed such Application on September 16, 2016, and the Application was approved by the PPUC on December 8, 2016, authorizing ATSI to operate as a public utility in Pennsylvania in an area coextensive with the PJM ATSI Zone.

8. COMMITMENTS AND CONTINGENCIES

ENVIRONMENTAL MATTERS

Various federal, state and local authorities regulate ATSI with regard to air and water quality and other environmental matters. Pursuant to a March 28, 2017 executive order, the EPA and other federal agencies are to review existing regulations that potentially burden the development or use of domestically produced energy resources and appropriately suspend, revise or rescind those that unduly burden the development of domestic energy resources beyond the degree necessary to protect the public interest or otherwise comply with the law. ATSI cannot predict the timing or ultimate outcome of any of these reviews or how any future actions taken as a result thereof, in particular with respect to existing environmental regulations, may impact its business, results of operations, cash flows and financial condition.

Compliance with environmental regulations could have a material adverse effect on ATSI's earnings and competitive position to the extent that ATSI competes with companies that are not subject to such regulations and, therefore, do not bear the risk of costs associated with compliance, or failure to comply, with such regulations.

OTHER LEGAL PROCEEDINGS

Other Legal Matters

There are various lawsuits, claims (including claims for asbestos exposure) and proceedings related to ATSI's normal business operations pending against ATSI. The loss or range of loss in these matters is not expected to be material to ATSI. The other potentially material items not otherwise discussed above are described under Note 7, "Regulatory Matters" of the Notes to Financial Statements.

ATSI accrues legal liabilities only when it concludes that it is probable that it has an obligation for such costs and can reasonably estimate the amount of such costs. In cases where ATSI determines that it is not probable, but reasonably possible that it has a material obligation, it discloses such obligations and the possible loss or range of loss if such estimate can be made. If it were ultimately determined that ATSI has legal liability or is otherwise made subject to liability, based on any of the matters referenced above, it could have a material adverse effect on ATSI's financial condition, results of operations and cash flows.

9. TRANSACTIONS WITH AFFILIATED COMPANIES

In addition to the intercompany income tax allocation and short-term borrowing arrangement, ATSI has other operating expense, miscellaneous income and interest expense transactions with affiliated companies, primarily OE, CEI, TE, Penn and FESC. The primary affiliated-company transactions, including the effects of the transmission arrangements with OE, CEI, TE and Penn, during the years ended December 31, 2017 and 2016 are as follows:

	2017	2016
	(in millions)	
Revenues	$ 5	$ 6
Operating Costs:		
Ground lease expense	22	22
Support services	70	58
Miscellaneous income	2	—
Interest expense to affiliates	1	2

FirstEnergy does not bill directly or allocate any of its costs to any subsidiary company. Costs are allocated from FESC. The majority of costs are directly billed or assigned at no more than cost. The remaining costs are for services that are provided on behalf of more than one company, or costs that cannot be precisely identified and are allocated using formulas developed by FESC. The current allocation or assignment formulas used and their bases include multiple factor formulas: each company's proportionate amount of FirstEnergy's aggregate direct payroll, number of employees, asset balances, revenues, number of customers, other factors and specific departmental charge ratios. Intercompany transactions with FirstEnergy and its other subsidiaries are generally settled under commercial terms within thirty days.

As of December 31, 2017 and 2016, ATSI has $29 million of affiliated non-current liabilities related to pension and OPEB mark-to-market costs allocated to ATSI.

ATSI and FirstEnergy's other subsidiaries are parties to an intercompany income tax allocation agreement with FE and its other subsidiaries that provides for the allocation of consolidated tax liabilities. Net tax benefits attributable to FE are generally reallocated to the subsidiaries of FirstEnergy that have taxable income. That allocation is accounted for as a capital contribution to the company receiving the tax benefit (see Note 2, "Taxes").