

***Sustainable Energy Fund
Of Central Eastern Pennsylvania
(As established by the PUC-PP&L Utilities
Settlement Agreement)***

**Annual Report
To the
Pennsylvania Public Utility Commission
And to the
Joint Petitioners**

**For the Period
July 1, 2000 - June 30, 2001**

October 16, 2001

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Thomas J. Tuffey, Ph.D.
Executive Director

Our mission is to promote, research and invest in clean and renewable energy technologies, energy conservation, energy efficiency and sustainable energy enterprises that provide opportunities and benefits for PPL ratepayers.

1.0 OVERVIEW

This is the Sustainable Energy Fund of Central Eastern Pennsylvania's (SEF) first annual report to the Pennsylvania Public Utility Commission and to the joint petitioners in the PPL Utilities restructuring proceeding. It discusses the progress that the SEF has made in the period from July 1, 2000 through June 30, 2001

The SEF Board of Directors chose to develop a new organization through which to manage its funds and accomplish its mission. By doing so, they also chose to be actively involved in the conduct of the SEF.

Consequently the first six-month period was characterized by the start-up activities that took the Fund to a fully functioning operation. The SEF constructed governance, administrative, marketing, and financial management systems while still reserving time to do some real business. The second half of the year was characterized by more networking activities and our increased focus on program related investments (PRI's). By the end of the fiscal year, June 30, 2001, the SEF made commitments to \$2,365,000.00 in grants and PRI's, almost twice the first year goal.

The current and future SEF focus, is to move beyond the capacity to merely meet obligations. We intend to improve the systems, alliances, and behaviors so that we, and our partners, may together excel.

2.0 ACCOMPLISHMENTS

Some of this period's accomplishments follow:

2.1 Governance

The PUC approved the SEF by-laws at the end of June 2000 and the SEF began official operations July 1, 2000. The period prior to operation was an active one, during which the Board met eleven times to plan the organization and prepare its affairs to be ready for start-up operations. The Directors also contracted with a consultant ¹ to provide staff to carry out its activities and to assist them in forming

¹ Winsor Associates, Philadelphia, PA

a common vision. It further retained Dechert, Price & Rhoads for legal counsel and to prepare its by-laws. Start-up costs prior to by-laws approval were either directly paid by PPL or were paid through funds advanced to SEF by PPL. During this early period, the Board was able to accomplish several critical tasks as follow:

- The decision to develop its own organization rather than contract the funds to be administered by an existing entity. Accompanying this decision was the design for structure and governance of the new organization.
- The By-Laws were prepared and submitted to the PUC for approval.
- The Investment Policy was developed and approved. Asset management firms and accountants were solicited and selected.
- An open search process for an Executive Director was conducted. The finalist, Mr. Thomas J. Tuffey was selected from 126 candidates and retained in May 2000 as a consultant to further plan for start-up upon approval of the by-laws.

The Executive Director officially started on July 1, 2000, immediately upon PUC approval of the by-laws. There have been six formal meetings of the Board since retaining the Executive Director, including a one and one half day planning retreat to develop the scope of the Annual Plan. Additionally, all of our Directors attended the two-day "Partners Retreat" of the regional funds at Lake Wallenpaupack. A majority of the Board also attended the Directors Training Program at the Rittenhouse Hotel, Philadelphia, PA. The Board approved the Plan and budget, made \$2,365,000.00 in grants and investment commitments, and directed the operations. The Board Committees: Administration/Finance (A/F), and Program Related Investments (PRI), are regularly engaged in issues or considering PRI opportunities, often by e-mail or telephone, and in face to face meetings. SEF staff consults and meets with individual Directors several times a week. Director referrals of PRI opportunities occur regularly. This is a very involved Board.

To avoid market confusion, the Board approved the use of a fictitious name in business dealings. The SEF does business as the Sustainable Energy Fund of Central Eastern Pennsylvania.

During the second half of the year, the U.S. Internal Revenue Service (IRS) approved our status as a 501c3 non-profit foundation, supporting organization. The SEF is neither subject to federal taxation, nor does the SEF have a tax motivation obligation to make grants. The Board still chose to assign 5-10% of the disbursement budget to grants.

The SEF has actively participated in the design and start-up of the Pennsylvania Sustainable Energy Board (PASEB). This organization is intended to provide both support and oversight to the regional funds. SEF considers it to be a critical success factor and it is committed to its early and effective implementation.

2.2 Asset Management

Funds were held since January 1, 1999 by PPL in an interest bearing account until the SEF was prepared to accept them. On July 10, 2000 the SEF received a transfer of \$4,863,251.99.²

Additional funds are transferred monthly from PPL to the SEF account with First Union National Bank. SEF management retains funds for operations and PRI disbursements, and transfers investment assets to custodian accounts at Charles Schwab Inc. All transactions are in accordance with SEF operating practices and are carefully monitored.

The Finance Committee prepared the Statement of Investment Policy that was adopted by the Board. Our investment policy is environmentally responsible and attempts to support our energy mission. Based on this policy, RFP's were issued for two asset managers and one custodial account manager. In July 2000, Berkshire Asset Management, Inc., and Dearden, Maguire, Weaver and Barrett, Inc. were both retained as asset managers, each to manage one half of the allocated investment funds. Both were instructed to employ 70% equity and 30% fixed income securities portfolio allocation. Charles Schwab, Inc. was appointed as the Custodian and First Union National Bank was approved for the working capital accounts. The asset managers will report performance quarterly and may be replaced at any time.

We disbursed \$4,700,000.00 to the Asset Managers in July 2000. An additional \$1,750,000.00 was disbursed throughout the year.

The period reported on was a very difficult one for the equity markets, however, through a combination of cautious entry of the equities market, exceptional equity selections, a strong preference for large capitalization companies with strong earnings growth available for reasonable price, and solid performance of the cash and fixed assets portfolios, the asset accounts net of fees grew by \$76,852, just over 1% (one percent). Certainly less than the planned 8% (eight percent) of our Plan, but considering the market conditions, when the S&P was down 14.32% (7/31/00 – 7/31/01) during the same period, our Asset Managers did a fine job.

² Funds are collected by PPL from the ratepayer in accordance with the Joint Petitioners for the settlement of PP&L restructuring plan, as approved by the PUC, which established the Sustainable Energy Fund.

Although our investment performance fell short of the plan, it was offset by higher ratepayer income due to an exceptionally cold winter, a lag in cash disbursements after PRI commitments by the Board (due to legal document preparations and negotiations), and a budget surplus from SEF operations.

The SEF completed the year with the asset accounts at \$6,526,852.00, and an operating cash position of \$1,084,581.00. (The latter is consciously high to meet an October disbursement requirement of \$1,150,000.00).

All taken into account, The SEF completed the year with a Fund balance of \$7,589,000 versus a plan of \$6,972,000, a \$617,000 positive variance.

Hence, we judge our Balance Sheet position to be essentially on plan and strong. We remain cautious relative to the equity markets, but believe we are well positioned.

2.3 Operations

The operational strategy during this period was to establish a foundation organization and to solicit and make our first Program Related Investments. This approach recognized the importance of initiating marketing for deal flow and that operating experience is the best determinant of ultimate organizational design.

Considerable staff time and attention was devoted to start up; as of the end of the first fiscal year, the SEF was fully functional.

Accomplishments include:

- Selected office location, furniture, equipment and supplies
- Recruited staff (full time Executive Director, Associate and part time Financial Comptroller)
- Established asset transaction systems and procedures
- Retained accountant and auditor, Campbell, Rappold & Yurasits, and attorneys, Hourigan, Kluger & Quinn
- Established payroll, insurance, and vendor contracts through a critical selection process
- Established financial accounting & reporting systems and procedures
- Developed PRI Tracking & Reporting System
- Developed standard business forms and contracts
- Completed and Submitted approval of tax status to IRS
- Completed of Annual Plan and Budget
- Completed and submitted Semi-Annual Report to PUC
- Established Personnel & Benefits Policy
- Completed marketing brochure
- Initiated an extensive market/alliance networking program

2.4 Program Related Investments

A broad range of marketing, network and alliance building activities were conducted. As a result, the SEF received and considered over 110 inquiries and requests. Each was considered by staff to determine mission fit in accordance with the criteria established in the Annual Plan. Most were also discussed with the Chairman of the Investment Committee to keep him informed and to seek guidance.

The Board of Directors made the following commitments, totaling \$2,365,000:

- **Grant \$165,000**
 - \$20,000 Allentown technology demonstration micro turbines generating power for sewage treatment plant digester gas
 - \$50,000 to Pennsylvania Sustainable Energy Board
 - \$10,000 to MAREC (Mid Atlantic Renewable Energy Coalition) to support consumer education/awareness advertising
 - \$10,000 to Clean Energy Fund Network (CEFN) to support common initiatives across the seven northeast states' clean energy funds
 - \$75,000 to the SEF Program to place windmills for demonstration and curriculum purposes at Environmental Education Centers

- **Program Related Investments \$2,225,000**
 - \$100,000 *Loan* to Energy Unlimited to support wind energy development projects in PPL territory
 - \$500,000 *Subordinated Debt with Warrants* to PowerWeb, an energy load management software company, co-invested with SDF
 - \$150,000 *Loan/Royalty payments* to Community Energy, Inc. to market renewable/wind energy in the PPL territory
 - \$25,000 *Loan* AFC First Financial to aid in the development of the business plan for the FANNIE MAE Energy Loan Program for owner occupied residential properties
 - \$300,000 *Loan* to Masonic Homes for new energy efficient heating system incorporating micro turbines. (Subsequently declined for more advantageous bond financing by MH)
 - \$1,150,000 *Loan* to Somerset Wind for 9 MW wind project, co-invested with other regional PA Funds

There is a lag time between Board Commitments and cash disbursements as the legal documents are drafted and further negotiations are conducted. Additionally, a recipient may choose to cancel/delay a project or finance it through other channels.

Funds disbursed by June 30, 2001 totaled \$360,000.

3.0 FINANCIAL REPORT

As discussed, the SEF received \$4,863,252 (includes interest \$199,929) from PPL on July 10, 2000. Monthly fund transfers from PPL through the period were:

July	\$266,721
August	\$261,021
September	\$268,303
October	\$243,883
November	\$250,670
December	\$292,013
January	\$340,942
February	\$343,146
March	\$294,772
April	\$270,017
May	\$251,792
June	\$250,230

As of year-end, a total of \$8,196,792 has been received.

During the first fiscal year, the SEF received Grants totaling \$47,300 from the following:³

- \$10,000 PA DEP – Allentown technology demonstration, micro turbines
- \$10,000 PA DEP – Windmills/wind education for environmental education centers
- \$10,000 PPL, Inc. – Windmills/wind education for environmental education centers
- \$ 7,300 PA Environmental Council – Partner’s Retreat
- \$ 5,000 GPU Berks – Venture Capital for PA Funds
- \$ 5,000 GPU West Penn – Venture Capital for PA Funds

\$6,450,000 has been transferred to the Schwab custodian accountants for investment by the two asset managers. As of year-end, the assets invested after fees and market fluctuations totaled \$6,526,852

Operating expenses for the fiscal year, July 2000 to June 2001 totaled \$258,122 9.2% under the approved budget, additionally, start-up expenses were \$103,332.

At end of year, cash totaled \$812,041.

The SEF completed the year with Net Assets of \$7,589,000.

³ NOTE: Cash is not received until all grant milestones are fulfilled.

The year-end audited financial statements may be found in Appendix A.

4.0 NEXT STEPS

The SEF focus going forward is to concentrate on building the marketing infrastructure and alliances that will produce solid deal flow into the future. The flexibility to stay sensitive to the market opportunities and to adjust operations to capitalize on those opportunities will be key. The second year plan will be available on October 16, 2001 upon approval by the Board and presented at the Annual Meeting on that date.

Further attention will be devoted to fine tuning the systems and practices established during the first six-month period.

5.0 CONCLUSION

The Sustainable Energy Fund has made satisfactory progress during this initial formative period. The SEF looks forward to further progress in fulfilling its mission to develop a sustainable energy environment via market leadership and sustainable program related investments.

6.0 BOARD MEMBERSHIP

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