
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarter ended March 31, 2012

Commission File Number	Exact Name of Registrant as specified in its Charter, State or Other Jurisdiction of Incorporation, Address of Principal Executive Offices, Zip Code and Telephone Number (Including Area Code)	I.R.S. Employer Identification Number
001-31403	PEPCO HOLDINGS, INC. (Pepco Holdings or PHH), a Delaware corporation 701 Ninth Street, N.W. Washington, D.C. 20068 Telephone: (202)872-2000	52-2297449
001-01072	POTOMAC ELECTRIC POWER COMPANY (Pepco), a District of Columbia and Virginia corporation 701 Ninth Street, N.W. Washington, D.C. 20068 Telephone: (202)872-2000	53-0127880
001-01405	DELMARVA POWER & LIGHT COMPANY (DPL), a Delaware and Virginia corporation 500 North Wakefield Drive Newark, DE 19702 Telephone: (202)872-2000	51-0084283
001-03559	ATLANTIC CITY ELECTRIC COMPANY (ACE), a New Jersey corporation 500 North Wakefield Drive Newark, DE 19702 Telephone: (202)872-2000	21-0398280

Indicate by check mark whether each registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.

Pepco Holdings	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>	Pepco	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
DPL	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>	ACE	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Pepco Holdings	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>	Pepco	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
DPL	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>	ACE	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

	<u>Large Accelerated Filer</u>	<u>Accelerated Filer</u>	<u>Non- Accelerated Filer</u>	<u>Smaller Reporting Company</u>
Pepco Holdings	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pepco	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
DPL	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
ACE	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Pepco Holdings	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>	Pepco	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
DPL	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>	ACE	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Pepco, DPL, and ACE meet the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and are therefore filing this Form 10-Q with reduced disclosure format specified in General Instruction H(2) of Form 10-Q.

<u>Registrant</u>	<u>Number of Shares of Common Stock of the Registrant Outstanding at April 25, 2012</u>
Pepco Holdings	228,280,444 (\$.01 par value)
Pepco	100 (\$.01 par value) (a)
DPL	1,000 (\$2.25 par value) (b)
ACE	8,546,017 (\$3.00 par value) (b)

- (a) All voting and non-voting common equity is owned by Pepco Holdings.
- (b) All voting and non-voting common equity is owned by Conectiv, LLC, a wholly owned subsidiary of Pepco Holdings.

THIS COMBINED FORM 10-Q IS SEPARATELY FILED BY PEPSCO HOLDINGS, PEPSCO, DPL, AND ACE. INFORMATION CONTAINED HEREIN RELATING TO ANY INDIVIDUAL REGISTRANT IS FILED BY SUCH REGISTRANT ON ITS OWN BEHALF. EACH REGISTRANT MAKES NO REPRESENTATION AS TO INFORMATION RELATING TO THE OTHER REGISTRANTS.

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GLOSSARY OF TERMS

<u>Term</u>	<u>Definition</u>
2011 Form 10-K	The Annual Report on Form 10-K for the year ended December 31, 2011, as amended, for each Reporting Company, as applicable
ACE	Atlantic City Electric Company
ACE Funding	Atlantic City Electric Transition Funding LLC
AMI	Advanced metering infrastructure
AOCL	Accumulated Other Comprehensive Loss
ASC	Accounting Standards Codification
BGS	Basic Generation Service (the supply of electricity by ACE to retail customers in New Jersey who have not elected to purchase electricity from a competitive supplier)
Bondable Transition Property	The principal and interest payments on the Transition Bonds and related taxes, expenses and fees
BSA	Bill Stabilization Adjustment
Calpine	Calpine Corporation
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act of 1980
Conectiv	Conectiv, LLC, a wholly owned subsidiary of PHI and the parent of DPL and ACE
CSA	Credit Support Annex
DCPSC	District of Columbia Public Service Commission
DDOE	District of Columbia Department of the Environment
DEDA	Delaware Economic Development Authority
Default Electricity Supply	The supply of electricity by PHI's electric utility subsidiaries at regulated rates to retail customers who do not elect to purchase electricity from a competitive supplier, and which, depending on the jurisdiction, is also known as Standard Offer Service or BGS
Default Electricity Supply Revenue	Revenue primarily from Default Electricity Supply
DOE	U.S. Department of Energy
DPL	Delmarva Power & Light Company
DPSC	Delaware Public Service Commission
EDCs	Electric distribution companies
EmPower Maryland	A Maryland demand-side management program for Pepco and DPL
Energy Services	Energy savings performance contracting services provided principally to federal, state and local government customers, and designing, constructing and operating combined heat and power, and central energy plants by Pepco Energy Services
EPA	U.S Environmental Protection Agency
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GAAP	Accounting principles generally accepted in the United States of America
GCR	Gas Cost Rate
GWh	Gigawatt hour
IIP	ACE's Infrastructure Investment Program
IRS	Internal Revenue Service
ISDA	International Swaps and Derivatives Association
ISRA	New Jersey's Industrial Site Recovery Act
MAPP	Mid-Atlantic Power Pathway
Market Transition Charge Tax	Revenue ACE receives and pays to ACE Funding to recover income taxes associated with Transition Bond Charge revenue
MDC	MDC Industries, Inc.
MFVRD	Modified fixed variable rate design
Mirant	Mirant Corporation
MMBtu	One Million British Thermal Units
MPSC	Maryland Public Service Commission

<u>Term</u>	<u>Definition</u>
MWh	Megawatt hour
NJBPU	New Jersey Board of Public Utilities
NPL	National Priorities List, which, among other things, serves as a guide to EPA in determining which sites warrant further investigation to assess the nature and extent of the human health and environmental risks associated with a site
NUGs	Non-utility generators
NYMEX	New York Mercantile Exchange
PCI	Potomac Capital Investment Corporation and its subsidiaries
Pepco	Potomac Electric Power Company
Pepco Energy Services	Pepco Energy Services, Inc. and its subsidiaries
Pepco Holdings or PHI	Pepco Holdings, Inc.
PHI Retirement Plan	PHI's noncontributory retirement plan
PJM	PJM Interconnection, LLC
PJM RTO	PJM regional transmission organization
Power Delivery	PHI's Power Delivery Business
PPA	Power purchase agreement
PRP	Potentially responsible party
PUHCA 2005	Public Utility Holding Company Act of 2005
RECs	Renewable energy credits
Regulated T&D Electric Revenue	Revenue from the transmission and the distribution of electricity to PHI's customers within its service territories at regulated rates
Reporting Company	PHI, Pepco, DPL or ACE
RI/FS	Remedial investigation and feasibility study
RIM	Reliability investment recovery mechanism
ROE	Return on equity
RPS	Renewable Energy Portfolio Standards
SEC	Securities and Exchange Commission
SOCAs	Standard Offer Capacity Agreements required to be entered into by ACE pursuant to a New Jersey law enacted to promote the construction of qualified electric generation facilities in New Jersey
SOS	Standard Offer Service, how Default Electricity Supply is referred to in Delaware, the District of Columbia and Maryland
SRECs	Solar renewable energy credits
SPCC	Spill Prevention, Control, and Countermeasure plans, required pursuant to federal regulations requiring plans for facilities using oil-containing equipment in proximity to surface waters
Transition Bond Charge	Revenue ACE receives, and pays to ACE Funding, to fund the principal and interest payments on Transition Bonds and related taxes, expenses and fees
Transition Bonds	Transition Bonds issued by ACE Funding
VADEQ	Virginia Department of Environmental Quality
VaR	Value at Risk

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Quarterly Report on Form 10-Q with respect to Pepco Holdings, Inc. (PHI or Pepco Holdings), Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (DPL) and Atlantic City Electric Company (ACE), including each of their respective subsidiaries, are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the Securities Act of 1933, as amended, and are subject to the safe harbor created thereby and by the Private Securities Litigation Reform Act of 1995. These statements include declarations regarding the intents, beliefs, estimates and current expectations of one or more of PHI, Pepco, DPL or ACE (each a Reporting Company) or their subsidiaries. In some cases, you can identify forward-looking statements by terminology such as “may,” “might,” “will,” “should,” “could,” “expects,” “intends,” “assumes,” “seeks to,” “plans,” “anticipates,” “believes,” “projects,” “estimates,” “predicts,” “potential,” “future,” “goal,” “objective,” or “continue” or the negative of such terms or other variations thereof or comparable terminology, or by discussions of strategy that involve risks and uncertainties. Forward-looking statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that may cause one or more Reporting Company’s or their subsidiaries’ actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Therefore, forward-looking statements are not guarantees or assurances of future performance, and actual results could differ materially from those indicated by the forward-looking statements.

The forward-looking statements contained herein are qualified in their entirety by reference to the following important factors, which are difficult to predict, contain uncertainties, are beyond each Reporting Company’s or their subsidiaries’ control and may cause actual results to differ materially from those contained in forward-looking statements:

- Changes in governmental policies and regulatory actions affecting the energy industry, including allowed rates of return, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of transmission and distribution facilities and the recovery of purchased power expenses;
- The outcome of pending and future rate cases, including the possible disallowance of costs and expenses;
- The expenditures necessary to comply with regulatory requirements, including regulatory orders, and to implement reliability enhancement, emergency response and customer service improvement programs;
- Possible fines, penalties or other sanctions assessed by regulatory authorities against PHI’s regulated utilities;
- Weather conditions affecting usage and emergency restoration costs;
- Population growth rates and changes in demographic patterns;
- Changes in customer energy demand due to conservation measures and the use of more energy-efficient products;
- General economic conditions, including the impact of an economic downturn or recession on energy usage;
- Changes in and compliance with environmental and safety laws and policies;
- Changes in tax rates or policies;
- Changes in rates of inflation;
- Changes in accounting standards or practices;
- Unanticipated changes in operating expenses and capital expenditures;

- Rules and regulations imposed by, and decisions of, federal and/or state regulatory commissions, PJM Interconnection, LLC (PJM), the North American Electric Reliability Corporation (NERC) and other applicable electric reliability organizations;
- Legal and administrative proceedings (whether civil or criminal) and settlements that affect a Reporting Company's or their subsidiaries' business and profitability;
- Pace of entry into new markets;
- Interest rate fluctuations and the impact of credit and capital market conditions on the ability to obtain funding on favorable terms; and
- Effects of geopolitical events, including the threat of domestic terrorism or cyber attacks.

These forward-looking statements are also qualified by, and should be read together with, the risk factors included in "Part I, Item 1A. Risk Factors" and other statements in each Reporting Company's annual report on Form 10-K for the year ended December 31, 2011, as amended to include the executive compensation and other information required by Part III of Form 10-K (which information originally had been omitted as permitted by that form), (2011 Form 10-K), as filed with the Securities and Exchange Commission (SEC), and in this Form 10-Q, and investors should refer to such risk factors and other statements in evaluating the forward-looking statements contained in this Form 10-Q.

Any forward-looking statements speak only as to the date of this Quarterly Report on Form 10-Q for each Reporting Company and none of the Reporting Companies undertakes an obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statements are made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for a Reporting Company to predict all such factors, nor can the impact of any such factor be assessed on such Reporting Company's or its subsidiaries' business (viewed independently or together with the business or businesses of some or all of the other Reporting Companies or their subsidiaries) or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. The foregoing factors should not be construed as exhaustive.

PART I FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Listed below is a table that sets forth, for each registrant, the page number where the information is contained herein.

<u>Item</u>	<u>Registrants</u>			
	<u>Pepco Holdings</u>	<u>Pepco*</u>	<u>DPL*</u>	<u>ACE</u>
Consolidated Statements of Income	4	49	67	88
Consolidated Statements of Comprehensive Income	5	N/A	N/A	N/A
Consolidated Balance Sheets	6	50	68	89
Consolidated Statements of Cash Flows	8	52	70	91
Consolidated Statement of Equity	9	53	71	92
Notes to Consolidated Financial Statements	10	54	72	93

* Pepco and DPL have no operating subsidiaries and, therefore, their financial statements are not consolidated.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars, except per share data)</i>	
Operating Revenue		
Power Delivery	\$ 1,055	\$ 1,249
Pepco Energy Services	228	373
Other	9	12
Total Operating Revenue	<u>1,292</u>	<u>1,634</u>
Operating Expenses		
Fuel and purchased energy	684	995
Other services cost of sales	45	43
Other operation and maintenance	225	234
Depreciation and amortization	110	105
Other taxes	104	111
Deferred electric service costs	(15)	(3)
Total Operating Expenses	<u>1,153</u>	<u>1,485</u>
Operating Income	<u>139</u>	<u>149</u>
Other Income (Expenses)		
Interest expense	(65)	(62)
Loss from equity investments	—	(1)
Other income	8	10
Total Other Expenses	<u>(57)</u>	<u>(53)</u>
Income from Continuing Operations Before Income Tax Expense	82	96
Income Tax Expense Related to Continuing Operations	<u>14</u>	<u>34</u>
Net Income from Continuing Operations	68	62
Income from Discontinued Operations, net of Income Taxes	<u>—</u>	<u>2</u>
Net Income	<u>\$ 68</u>	<u>\$ 64</u>
Basic and Diluted Earnings per Share Information		
Weighted average shares outstanding (millions)	<u>228</u>	<u>225</u>
Earnings per share of common stock from Continuing Operations	\$ 0.30	\$ 0.27
Earnings per share of common stock from Discontinued Operations	<u>—</u>	<u>0.01</u>
Basic and diluted earnings per share	<u>\$ 0.30</u>	<u>\$ 0.28</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Net Income	<u>\$ 68</u>	<u>\$ 64</u>
Other Comprehensive Income		
Gains (losses) on commodity derivatives designated as cash flow hedges:		
Losses arising during period	—	(1)
Amount of losses reclassified into income	13	27
Net gains on commodity derivatives	13	26
Amortization of gains for prior service costs	1	1
Other comprehensive income, before income taxes	14	27
Income tax expense related to other comprehensive income	6	11
Other comprehensive income, net of income taxes	8	16
Comprehensive Income	<u>\$ 76</u>	<u>\$ 80</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars)</i>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 64	\$ 109
Restricted cash equivalents	10	11
Accounts receivable, less allowance for uncollectible accounts of \$43 million and \$49 million, respectively	843	929
Inventories	129	132
Derivative assets	6	5
Prepayments of income taxes	131	74
Deferred income tax assets, net	43	59
Prepaid expenses and other	122	120
Total Current Assets	<u>1,348</u>	<u>1,439</u>
INVESTMENTS AND OTHER ASSETS		
Goodwill	1,407	1,407
Regulatory assets	2,215	2,196
Investment in finance leases held in trust	1,362	1,349
Income taxes receivable	217	84
Restricted cash equivalents	15	15
Assets and accrued interest related to uncertain tax positions	60	37
Other	165	163
Total Investments and Other Assets	<u>5,441</u>	<u>5,251</u>
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	13,080	12,855
Accumulated depreciation	(4,681)	(4,635)
Net Property, Plant and Equipment	<u>8,399</u>	<u>8,220</u>
TOTAL ASSETS	<u><u>\$15,188</u></u>	<u><u>\$ 14,910</u></u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars, except shares)</i>	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Short-term debt	\$ 986	\$ 732
Current portion of long-term debt and project funding	114	112
Accounts payable and accrued liabilities	522	549
Capital lease obligations due within one year	8	8
Taxes accrued	99	110
Interest accrued	79	47
Liabilities and accrued interest related to uncertain tax positions	3	3
Derivative liabilities	25	26
Other	259	274
Total Current Liabilities	<u>2,095</u>	<u>1,861</u>
DEFERRED CREDITS		
Regulatory liabilities	526	526
Deferred income taxes, net	3,119	2,863
Investment tax credits	22	22
Pension benefit obligation	232	424
Other postretirement benefit obligations	467	469
Liabilities and accrued interest related to uncertain tax positions	10	32
Derivative liabilities	2	6
Other	179	191
Total Deferred Credits	<u>4,557</u>	<u>4,533</u>
LONG-TERM LIABILITIES		
Long-term debt	3,794	3,794
Transition bonds issued by ACE Funding	285	295
Long-term project funding	13	13
Capital lease obligations	78	78
Total Long-Term Liabilities	<u>4,170</u>	<u>4,180</u>
COMMITMENTS AND CONTINGENCIES (NOTE 15)		
EQUITY		
Common stock, \$.01 par value, 400,000,000 shares authorized, 228,244,115 and 227,500,190 shares outstanding, respectively	2	2
Premium on stock and other capital contributions	3,340	3,325
Accumulated other comprehensive loss	(55)	(63)
Retained earnings	1,079	1,072
Total Equity	<u>4,366</u>	<u>4,336</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 15,188</u>	<u>\$ 14,910</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
OPERATING ACTIVITIES		
Net income	\$ 68	\$ 64
Income from discontinued operations	—	(2)
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	110	105
Non-cash rents from cross-border energy lease investments	(13)	(14)
Deferred income taxes	259	90
Other	(4)	(4)
Changes in:		
Accounts receivable	78	87
Inventories	3	10
Prepaid expenses	—	10
Regulatory assets and liabilities, net	(37)	11
Accounts payable and accrued liabilities	(60)	(126)
Pension contributions	(200)	(110)
Pension benefit obligation, excluding contributions	15	16
Cash collateral related to derivative activities	20	31
Taxes accrued	(247)	(49)
Interest accrued	33	31
Other assets and liabilities	(2)	16
Conectiv Energy net assets held for sale	—	31
Net Cash From Operating Activities	<u>23</u>	<u>197</u>
INVESTING ACTIVITIES		
Investment in property, plant and equipment	(291)	(171)
Department of Energy capital reimbursement awards received	7	9
Changes in restricted cash equivalents	1	(2)
Net other investing activities	2	—
Net Cash Used By Investing Activities	<u>(281)</u>	<u>(164)</u>
FINANCING ACTIVITIES		
Dividends paid on common stock	(61)	(61)
Common stock issued for the Dividend Reinvestment Plan and employee-related compensation	17	14
Redemption of preferred stock of subsidiaries	—	(6)
Reacquisitions of long-term debt	(9)	(9)
Issuances of short-term debt, net	253	33
Cost of issuances	(3)	—
Net other financing activities	16	(7)
Net Cash From (Used By) Financing Activities	<u>213</u>	<u>(36)</u>
Net Decrease in Cash and Cash Equivalents	(45)	(3)
Cash and Cash Equivalents at Beginning of Period	109	21
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 64</u>	<u>\$ 18</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for income taxes, net	\$ —	\$ 2

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EQUITY
(Unaudited)

<i>(millions of dollars, except shares)</i>	<u>Common Stock</u>		<u>Premium on Stock</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Par Value</u>				
BALANCE, DECEMBER 31, 2011	227,500,190	\$ 2	\$ 3,325	\$ (63)	\$ 1,072	\$4,336
Net income	—	—	—	—	68	68
Other comprehensive income	—	—	—	8	—	8
Dividends on common stock (\$0.27 per share)	—	—	—	—	(61)	(61)
Issuance of common stock:						
Original issue shares, net	319,037	—	9	—	—	9
Shareholder DRP original shares	424,888	—	8	—	—	8
Net activity related to stock-based awards	—	—	(2)	—	—	(2)
BALANCE, MARCH 31, 2012	<u>228,244,115</u>	<u>\$ 2</u>	<u>\$ 3,340</u>	<u>\$ (55)</u>	<u>\$ 1,079</u>	<u>\$4,366</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**PEPCO HOLDINGS, INC.****(1) ORGANIZATION**

Pepco Holdings, Inc. (PHI or Pepco Holdings), a Delaware corporation incorporated in 2001, is a holding company that, through the following regulated public utility subsidiaries, is engaged primarily in the transmission, distribution and default supply of electricity and, to the lesser extent, the distribution and supply of natural gas (Power Delivery):

- Potomac Electric Power Company (Pepco), which was incorporated in Washington, D.C. in 1896 and became a domestic Virginia corporation in 1949,
- Delmarva Power & Light Company (DPL), which was incorporated in Delaware in 1909 and became a domestic Virginia corporation in 1979, and
- Atlantic City Electric Company (ACE), which was incorporated in New Jersey in 1924.

Each of PHI, Pepco, DPL and ACE is also a Reporting Company under the Securities Exchange Act of 1934, as amended. Together, Pepco, DPL and ACE constitute the Power Delivery segment, for financial reporting purposes.

Through Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services), PHI provides energy savings performance contracting services, primarily to commercial, industrial and government customers. Pepco Energy Services is in the process of winding down its competitive electricity and natural gas retail supply business. Pepco Energy Services constitutes a separate segment for financial reporting purposes.

PHI Service Company, a subsidiary service company of PHI, provides a variety of support services, including legal, accounting, treasury, tax, purchasing and information technology services to PHI and its operating subsidiaries. These services are provided pursuant to a service agreement among PHI, PHI Service Company and the participating operating subsidiaries. The expenses of PHI Service Company are charged to PHI and the participating operating subsidiaries in accordance with cost allocation methodologies set forth in the service agreement.

Power Delivery

Each of Pepco, DPL and ACE is a regulated public utility in the jurisdictions that comprise its service territory. Each utility owns and operates a network of wires, substations and other equipment that is classified as transmission facilities, distribution facilities or common facilities (which are used for both transmission and distribution). Transmission facilities are high-voltage systems that carry wholesale electricity into, or across, the utility's service territory. Distribution facilities are low-voltage systems that carry electricity to end-use customers in the utility's service territory.

Each utility is responsible for the distribution of electricity, and in the case of DPL, natural gas, in its service territory for which it is paid tariff rates established by the applicable local public service commissions. Each utility also supplies electricity at regulated rates to retail customers in its service territory who do not elect to purchase electricity from a competitive energy supplier. The regulatory term for this supply service is Standard Offer Service in Delaware, the District of Columbia and Maryland, and Basic Generation Service in New Jersey. In these Notes to the consolidated financial statements, these supply service obligations are referred to generally as Default Electricity Supply.

Pepco Energy Services

Pepco Energy Services is engaged in the following businesses:

- providing energy efficiency services principally to federal, state and local government customers, and designing, constructing and operating combined heat and power and central energy plants,
- providing high voltage electric construction and maintenance services to customers throughout the United States and low voltage electric construction and maintenance services and streetlight construction and asset management services to utilities, municipalities and other customers in the Washington, D.C. metropolitan area, and
- providing retail customers electricity and natural gas under its remaining contractual obligations.

Pepco Energy Services also owns and operates two oil-fired generation facilities that are scheduled for deactivation in May 2012.

In December 2009, PHI announced the wind-down of the retail energy supply component of the Pepco Energy Services business. Pepco Energy Services is implementing this wind-down by not entering into any new supply contracts while continuing to perform under its existing supply contracts through their respective expiration dates, the last of which is June 1, 2014. The retail energy supply business has historically generated a substantial portion of the operating revenues and net income of the Pepco Energy Services segment. Operating revenues related to the retail energy supply business for the three months ended March 31, 2012 and 2011 were \$160 million and \$305 million, respectively, while operating income for the same periods was \$15 million and \$12 million, respectively.

In connection with the operation of the retail energy supply business, Pepco Energy Services provided letters of credit of \$1 million and posted cash collateral of \$92 million as of March 31, 2012. These collateral requirements, which are based on existing wholesale energy purchase and sale contracts and current market prices, will decrease as the contracts expire, with the collateral expected to be fully released by June 1, 2014. The energy services business will not be affected by the wind-down of the retail energy supply business.

Other Business Operations

Through its subsidiary Potomac Capital Investment Corporation (PCI), PHI maintains a portfolio of cross-border energy lease investments. This activity constitutes a third operating segment for financial reporting purposes, which is designated as “Other Non-Regulated.” For a discussion of PHI’s cross-border energy lease investments, see Note (8), “Leasing Activities,” and Note (15), “Commitments and Contingencies – PHI’s Cross-Border Energy Lease Investments.”

Discontinued Operations

In April 2010, the Board of Directors approved a plan for the disposition of PHI’s competitive wholesale power generation, marketing and supply business, which had been conducted through subsidiaries of Conectiv Energy Holding Company (collectively Conectiv Energy). On July 1, 2010, PHI completed the sale of Conectiv Energy’s wholesale power generation business to Calpine Corporation (Calpine) for \$1.64 billion. The disposition of all of Conectiv Energy’s remaining assets and businesses, consisting of its load service supply contracts, energy hedging portfolio, certain tolling agreements and other assets not included in the Calpine sale, is complete. The former operations of Conectiv Energy have been accounted for as a discontinued operation and no longer constitute a separate segment for financial reporting purposes.

(2) SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

Pepco Holdings' unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the Securities and Exchange Commission, certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been omitted. Therefore, these consolidated financial statements should be read along with the annual consolidated financial statements included in PHI's annual report on Form 10-K for the year ended December 31, 2011, as amended to include the executive compensation and other information required by Part III of Form 10-K (which information originally had been omitted as permitted by that form). In the opinion of PHI's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to state fairly Pepco Holdings' financial condition as of March 31, 2012, in accordance with GAAP. The year-end December 31, 2011 consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP. Interim results for the three months ended March 31, 2012 may not be indicative of PHI's results that will be realized for the full year ending December 31, 2012.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Although Pepco Holdings believes that its estimates and assumptions are reasonable, they are based upon information available to management at the time the estimates are made. Actual results may differ significantly from these estimates.

Significant matters that involve the use of estimates include the assessment of goodwill and long-lived assets for impairment, fair value calculations for derivative instruments, the costs of providing pension and other postretirement benefits, evaluation of the probability of recovery of regulatory assets, accrual of storm restoration costs, accrual of self-insurance reserves for general and auto liability claims, accrual of interest related to income taxes, accrual of unbilled revenue, recognition of changes in network service transmission rates for prior service year costs, and the recognition of income tax benefits for investments in finance leases held in trust associated with PHI's portfolio of cross-border energy lease investments. Additionally, PHI is subject to legal, regulatory and other proceedings and claims that arise in the ordinary course of its business. PHI records an estimated liability for these proceedings and claims, when it is probable that a loss has been incurred and the loss is reasonably estimable.

Consolidation of Variable Interest Entities

PHI assesses its contractual arrangements with variable interest entities to determine whether it is the primary beneficiary and thereby has to consolidate the entities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810. The guidance addresses conditions under which an entity should be consolidated based upon variable interests rather than voting interests. Subsidiaries of PHI have the following contractual arrangements to which the guidance applies.

ACE Power Purchase Agreements

PHI, through its ACE subsidiary, is a party to three power purchase agreements (PPAs) with unaffiliated, non-utility generators (NUGs) totaling 459 megawatts. One of the agreements ends in 2016 and the other two end in 2024. PHI was unable to obtain sufficient information to determine whether these three entities were variable interest entities or if ACE was the primary beneficiary. As a result, PHI applied the scope exemption from the consolidation guidance for enterprises that have not been able to obtain such information.

Net purchase activities with the NUGs for the three months ended March 31, 2012 and 2011 were approximately \$51 million and \$57 million, respectively, of which approximately \$50 million and \$53 million, respectively, consisted of power purchases under the PPAs. The power purchase costs are recoverable from ACE's customers through regulated rates.

DPL Renewable Energy Transactions

DPL is subject to Renewable Energy Portfolio Standards (RPS) in the state of Delaware that require it to obtain renewable energy credits (RECs) for energy delivered to its customers. DPL's costs associated with obtaining RECs to fulfill its RPS obligations are recoverable from its customers by law. PHI, through its DPL subsidiary, has entered into three land-based wind PPAs in the aggregate amount of 128 megawatts and one solar PPA with a 10 megawatt facility as of March 31, 2012. All of the facilities associated with these PPAs are operational, and DPL is obligated to purchase energy and RECs in amounts generated and delivered by the wind facilities and solar renewable energy credits (SRECs) from the solar facility at rates that are primarily fixed under these agreements. PHI has concluded that consolidation is not required for any of these agreements under the FASB guidance on the consolidation of variable interest entities.

DPL is obligated to purchase energy and RECs from one of the wind facilities through 2024 in amounts not to exceed 50 megawatts, the second of the wind facilities through 2031 in amounts not to exceed 40 megawatts, and the third facility through 2031 in amounts not to exceed 38 megawatts. DPL's purchases under the three wind PPAs totaled \$9 million and \$5 million for the three months ended March 31, 2012 and 2011, respectively. The term of the agreement with the solar facility is 20 years and DPL is obligated to purchase SRECs in an amount up to 70 percent of the energy output at a fixed price. DPL's purchases under the solar agreement were zero for the three months ended March 31, 2012.

On October 18, 2011, the Delaware Public Service Commission (DPSC) approved a tariff submitted by DPL in accordance with the requirements of the RPS specific to fuel cell facilities totaling 30 megawatts to be constructed by a qualified fuel cell provider. The tariff and the RPS establish that DPL would be an agent to collect payments in advance from its distribution customers and remit them to the qualified fuel cell provider for each megawatt hour of energy produced by the fuel cell facilities over 21 years. DPL would have no liability to the qualified fuel cell provider other than to remit payments collected from its distribution customers pursuant to the tariff. The RPS provides for a reduction in DPL's REC requirements based upon the actual energy output of the facilities. In June 2012, a 3 megawatt generation facility is expected to be placed into service under the tariff. A 27 megawatt generation facility is expected to be placed into service in 5 megawatt increments beginning in January 2013. PHI has concluded that DPL would account for this arrangement as an agency transaction.

Atlantic City Electric Transition Funding LLC

Atlantic City Electric Transition Funding LLC (ACE Funding) was established in 2001 by ACE solely for the purpose of securitizing authorized portions of ACE's recoverable stranded costs through the issuance and sale of bonds (Transition Bonds). The proceeds of the sale of each series of Transition Bonds have been transferred to ACE in exchange for the transfer by ACE to ACE Funding of the right to collect non-bypassable transition bond charges (the Transition Bond Charges) from ACE customers pursuant to bondable stranded costs rate orders issued by the New Jersey Board of Public Utilities (NJBP) in an amount sufficient to fund the principal and interest payments on the Transition Bonds and related taxes, expenses and fees (Bondable Transition Property). ACE collects the Transition Bond Charges from its customers on behalf of ACE Funding and the holders of the Transition Bonds. The assets of ACE Funding, including the Bondable Transition Property, and the Transition Bond Charges collected from ACE's customers, are not available to creditors of ACE. The holders of the Transition Bonds have recourse only to the assets of ACE Funding. ACE owns 100 percent of the equity of ACE Funding and PHI consolidates ACE Funding in its financial statements as ACE is the primary beneficiary of ACE Funding under the variable interest entity consolidation guidance.

ACE Standard Offer Capacity Agreements

In April 2011, ACE entered into three Standard Offer Capacity Agreements (SOCAs) by order of the NJBPU, each with a different generation company. The SOCAs were established under a New Jersey law enacted to promote the construction of qualified electric generation facilities in New Jersey. The SOCAs are 15-year, financially settled transactions approved by the NJBPU that allow generators to receive payments from, or make payments to, ACE based on the difference between the fixed price in the SOCAs and the price for capacity that clears PJM Interconnection, LLC (PJM). Each of the other electricity distribution companies (EDCs) in New Jersey has entered into SOCAs having the same terms with the same generation companies. The annual share of payments or receipts for ACE and the other EDCs is based upon each company's annual proportion of the total New Jersey load attributable to all EDCs. The NJBPU has approved full recovery from distribution customers of payments made by ACE and the other EDCs, and distribution customers would be entitled to any payments received by ACE and the other EDCs.

Currently, PHI believes that FASB guidance on derivative accounting and the accounting for regulated operations would apply to ACE's obligations under the SOCA once the related capacity has cleared a PJM auction. Once cleared, the gain (loss) associated with the fair value of a derivative would be offset by the recognition of a regulatory liability (asset). The next PJM capacity auction is scheduled for May 2012. PHI has concluded that consolidation is not required for the SOCAs under the FASB guidance on the consolidation of variable interest entities.

Goodwill

Goodwill represents the excess of the purchase price of an acquisition over the fair value of the net assets acquired at the acquisition date. Substantially all of Pepco Holdings' goodwill was generated by Pepco's acquisition of Conectiv (now Conectiv, LLC (Conectiv)) in 2002 and is allocated entirely to Power Delivery for purposes of impairment testing based on the aggregation of its components because its utilities have similar characteristics. Pepco Holdings tests its goodwill for impairment annually as of November 1 and whenever an event occurs or circumstances change in the interim that would more likely than not reduce the fair value of a reporting unit below the carrying amount of its net assets. Factors that may result in an interim impairment test include, but are not limited to: a change in the identified reporting units; an adverse change in business conditions; a protracted decline in PHI's stock price causing market capitalization to fall below book value; an adverse regulatory action; or an impairment of long-lived assets in the reporting unit. PHI concluded that an interim impairment test was not required during the three months ended March 31, 2012.

Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions

Taxes included in Pepco Holdings' gross revenues were \$92 million and \$96 million for the three months ended March 31, 2012 and 2011, respectively.

Reclassifications and Adjustments

Certain prior period amounts have been reclassified in order to conform to the current period presentation. The following adjustments have been recorded and are not considered material either individually or in the aggregate:

Pepco Energy Services Derivative Accounting Adjustments

During the first quarter of 2011, PHI recorded an adjustment associated with an increase in the value of certain derivatives from October 1, 2010 to December 31, 2010, which had been erroneously recorded in other comprehensive income at December 31, 2010. This adjustment resulted in an increase in revenue and pre-tax earnings of \$2 million for the three months ended March 31, 2011.

Income Tax Adjustments

During the first quarter of 2011, Pepco recorded an adjustment to correct certain income tax errors related to prior periods associated with interest on uncertain tax positions. The adjustment resulted in an increase in income tax expense of \$1 million for the three months ended March 31, 2011.

(3) NEWLY ADOPTED ACCOUNTING STANDARDS**Fair Value Measurements and Disclosures (ASC 820)**

The FASB issued new guidance on fair value measurement and disclosures that was effective beginning with PHI's March 31, 2012 consolidated financial statements. The new measurement guidance did not have a material impact on PHI's consolidated financial statements and the new disclosure requirements are in Note (14), "Fair Value Disclosures," of PHI's consolidated financial statements.

Comprehensive Income (ASC 220)

The FASB issued new disclosure requirements for reporting comprehensive income that were effective beginning with PHI's March 31, 2012 consolidated financial statements. PHI did not have to change the presentation of its comprehensive income because it had already reported comprehensive income in two separate but consecutive statements of income and comprehensive income. PHI also has provided the new required disclosures of the income tax effects of items in other comprehensive income or amounts reclassified from other comprehensive income to income on a quarterly basis in Note (16), "Accumulated Other Comprehensive Loss."

Goodwill (ASC 350)

The FASB issued new guidance that changes the annual and interim assessments of goodwill for impairment. The new guidance modifies the required annual impairment test by giving entities the option to perform a qualitative assessment of whether it is more likely than not that goodwill is impaired before performing a quantitative assessment. The new guidance also amends the events and circumstances that entities should assess to determine whether an interim quantitative impairment test is necessary. As of January 1, 2012, PHI has adopted the new guidance and concluded it did not have a material impact on its consolidated financial statements.

(4) RECENTLY ISSUED ACCOUNTING STANDARDS, NOT YET ADOPTED**Balance Sheet (ASC 210)**

In December 2011, the FASB issued new disclosure requirements for financial assets and liabilities, such as derivatives, that are subject to contractual netting arrangements. The new disclosures will include information about the gross exposures of the instruments and the net exposure of the instruments under contractual netting arrangements, how the exposures are presented in the financial statements, and the terms and conditions of the contractual netting arrangements. The new disclosures are effective beginning with PHI's March 31, 2013 consolidated financial statements. PHI is evaluating the impact of this new guidance on its consolidated financial statements.

(5) SEGMENT INFORMATION

Pepco Holdings' management has identified its operating segments at March 31, 2012 as Power Delivery, Pepco Energy Services and Other Non-Regulated. In the tables below, the Corporate and Other column is included to reconcile the segment data with consolidated data and includes unallocated Pepco Holdings' (parent company) capital costs, such as financing costs. Segment financial information for continuing operations for the three months ended March 31, 2012 and 2011 is as follows:

	Three Months Ended March 31, 2012				
	(millions of dollars)				
	Power Delivery	Pepco Energy Services	Other Non- Regulated	Corporate and Other (a)	PHI Consolidated
Operating Revenue	\$ 1,055	\$ 228	\$ 13	\$ (4)	\$ 1,292
Operating Expenses (b)	954	211	1	(13)	1,153
Operating Income	101	17	12	9	139
Interest Income	—	—	1	(1)	—
Interest Expense	53	1	3	8	65
Other Income (Expenses)	8	—	1	(1)	8
Preferred Stock Dividends	—	—	1	(1)	—
Income Tax Expense (Benefit)	9	6	—	(1)	14
Net Income from Continuing Operations	47	10	10	1	68
Total Assets	11,473	544	1,487	1,684	15,188
Construction Expenditures	\$ 280	\$ 5	\$ —	\$ 6	\$ 291

- (a) Total Assets in this column includes Pepco Holdings' goodwill balance of \$1.4 billion, all of which is allocated to Power Delivery for purposes of assessing impairment. Total assets also include capital expenditures related to certain hardware and software expenditures which primarily benefit Power Delivery. These expenditures are recorded as incurred in the Corporate and Other segment and are allocated to Power Delivery once the assets are placed in service. Corporate and Other includes intercompany amounts of \$(4) million for Operating Revenue, \$(6) million for Operating Expenses, \$(5) million for Interest Income, \$(5) million for Interest Expense and \$(1) million for Preferred Stock Dividends.
- (b) Includes depreciation and amortization expense of \$110 million, consisting of \$99 million for Power Delivery, \$6 million for Pepco Energy Services, \$1 million for Other Non-Regulated and \$4 million for Corporate and Other.

	Three Months Ended March 31, 2011				
	(millions of dollars)				
	Power Delivery	Pepco Energy Services	Other Non- Regulated	Corporate and Other (a)	PHI Consolidated
Operating Revenue	\$ 1,249	\$ 373	\$ 14	\$ (2)	\$ 1,634
Operating Expenses (b)	1,131	357	2	(5)	1,485
Operating Income	118	16	12	3	149
Interest Income	—	—	1	(1)	—
Interest Expense	50	1	3	8	62
Other Income (Expenses)	8	1	(1)	1	9
Preferred Stock Dividends	—	—	1	(1)	—
Income Tax Expense (Benefit)	29	6	2	(3)	34
Net Income (Loss) from Continuing Operations	47	10	6	(1)	62
Total Assets (excluding Assets Held For Sale)	10,667	613	1,645	1,295	14,220
Construction Expenditures	\$ 160	\$ 1	\$ —	\$ 10	\$ 171

- (a) Total Assets in this column includes Pepco Holdings' goodwill balance of \$1.4 billion, all of which is allocated to Power Delivery for purposes of assessing impairment. Total assets also include capital expenditures related to certain hardware and software expenditures which primarily benefit Power Delivery. These expenditures are recorded as incurred in the Corporate and Other segment and are allocated to Power Delivery once the assets are placed in service. Corporate and Other includes intercompany amounts of \$(2) million for Operating Revenue, \$(2) million for Operating Expenses, \$(5) million for Interest Income, \$(4) million for Interest Expense and \$(1) million for Preferred Stock Dividends.
- (b) Includes depreciation and amortization expense of \$105 million, consisting of \$97 million for Power Delivery, \$4 million for Pepco Energy Services and \$4 million for Corporate and Other.

(6) GOODWILL

PHI's goodwill balance of \$1.4 billion was unchanged during the three months ended March 31, 2012. Substantially all of PHI's goodwill balance was generated by Pepco's acquisition of Conectiv in 2002 and is allocated entirely to the Power Delivery reporting unit based on the aggregation of its regulated public utility company components for purposes of assessing impairment under FASB guidance on goodwill and other intangibles (ASC 350).

PHI's annual impairment test as of November 1, 2011 indicated that goodwill was not impaired. For the three months ended March 31, 2012, PHI concluded that there were no events requiring it to perform an interim goodwill impairment test. PHI will perform its next annual impairment test as of November 1, 2012.

(7) REGULATORY MATTERS**Rate Proceedings**

Over the last several years, PHI's utility subsidiaries have proposed in each of their respective jurisdictions the adoption of a mechanism to decouple retail distribution revenue from the amount of power delivered to retail customers. To date:

- A bill stabilization adjustment (BSA) has been approved and implemented for Pepco and DPL electric service in Maryland and for Pepco electric service in the District of Columbia. The Maryland Public Service Commission (MPSC) has issued an order requiring modification of the BSA in Maryland so that revenues lost as a result of major storm outages are not collected through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (as discussed below).
- A modified fixed variable rate design (MFVRD) has been approved in concept for DPL electric service in Delaware, but the implementation has been deferred by the DPSC pending the development of an implementation plan and a customer education plan. DPL anticipates that the MFVRD will be in place for electric service by early 2013.
- A MFVRD has been approved in concept for DPL natural gas service in Delaware, but implementation likewise has been deferred until development of an implementation plan and a customer education plan. DPL anticipates that the MFVRD will be in place for natural gas service by early 2013.
- In New Jersey, a BSA proposed by ACE as part of a Phase 2 to the base rate proceeding filed in August 2009 was not included in the final settlement approved by the NJBPU on May 16, 2011. Accordingly, there is no BSA proposal currently pending in New Jersey.

Under the BSA, customer distribution rates are subject to adjustment (through a credit or surcharge mechanism), depending on whether actual distribution revenue per customer exceeds or falls short of the revenue-per-customer amount approved by the applicable public service commission. The MFVRD approved in concept in Delaware provides for a fixed customer charge (i.e., not tied to the customer's volumetric consumption) to recover the utility's fixed costs, plus a reasonable rate of return. Although different from the BSA, PHI views the MFVRD as an appropriate distribution revenue decoupling mechanism.

In an effort to reduce the shortfall in revenues due to the delay in time or lag between when costs are incurred and when they are reflected in rates (regulatory lag), Pepco and DPL have proposed, in each of their respective jurisdictions, a reliability investment recovery mechanism (RIM) to recover reliability-related capital expenditures incurred between base rate cases. Through the RIM, Pepco or DPL, as applicable, in each year would collect through a surcharge the amount of its reliability-related capital expenditures based on its budget for that year. The budgeted amount would be reconciled with actual capital expenditures on an annual basis and any over-recovery or under-recovery would be reflected in the next year's surcharge. The work

undertaken pursuant to the RIM would be subject to a prudence review by the applicable state regulatory commission in the next base rate case or at more frequent intervals as determined by such commission. Pepco's or DPL's respective operation and maintenance costs and other capital expenditures would remain subject to recovery through the traditional ratemaking process.

Pepco and DPL also have each requested, in each of their respective jurisdictions, public service commission approval of the use of fully forecasted test years in future rate cases. Traditionally, past test years with actual historical costs are used for ratemaking purposes; however, fully forecasted test years would be comprised of forward-looking costs. If approved, such fully forecasted test years would be more reflective of current costs and would mitigate the effects of regulatory lag.

Delaware

Gas Cost Rates

DPL makes an annual Gas Cost Rate (GCR) filing with the DPSC for the purpose of allowing DPL to recover natural gas procurement costs through customer rates. In August 2011, DPL made its 2011 GCR filing. The filing includes the second year of the effect of a two-year amortization of under-recovered gas costs that had been proposed, and approved by the DPSC, in DPL's 2010 GCR filing (the settlement approved by the DPSC in the 2010 GCR case included the first year of such two-year amortization). The rates proposed in the 2011 GCR, which include the second year of the two-year amortization approved in the 2010 GCR case, would result in a GCR decrease for the typical retail natural gas customer of 5.6% in the level of GCR. On September 20, 2011, the DPSC issued an order allowing DPL to place the new rates into effect on November 1, 2011, subject to refund and pending final DPSC approval. The parties to the 2011 GCR proceeding have executed a settlement agreement that recommends approval of the 2011 GCR as filed. A DPSC decision on the settlement agreement is expected during the third quarter of 2012.

On February 21, 2012, DPL submitted its application for a waiver under its GCR tariff, which requires DPL to request an interim GCR rate increase when the under-recovery exceeds 6.0%. The DPSC granted the waiver on March 6, 2012.

Electric Distribution Base Rates

On December 2, 2011, DPL submitted an application with the DPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$31.8 million, based on a requested return on equity (ROE) of 10.75%, and requests approval of implementation of the MFVRD. DPL requested that the rates become effective on January 31, 2012. The filing includes a request for DPSC approval of a RIM and the use of fully forecasted test years in future DPL rate cases. On January 10, 2012, the DPSC entered an order suspending the full increase and allowing a temporary rate increase of \$2.5 million to go into effect on January 31, 2012, subject to refund and pending final DPSC approval. As permitted by Delaware law, DPL intends to place the remainder of approximately \$29.3 million of the requested increase into effect on July 2, 2012, subject to refund and pending final DPSC approval. A decision by the DPSC is expected by the end of 2012.

District of Columbia

On July 8, 2011, Pepco filed an application with the District of Columbia Public Service Commission (DCPSC) to increase its electric distribution base rates by approximately \$42 million annually, based on a requested ROE of 10.75%. The filing includes a request for DCPSC approval of a RIM and the use of fully forecasted test years in future Pepco rate cases. A decision by the DCPSC is expected in the third quarter of 2012.

*Maryland*DPL Electric Distribution Base Rates

On December 9, 2011, DPL submitted an application with the MPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$25.2 million, based on a requested ROE of 10.75%. The filing includes a request for MPSC approval of a RIM and the use of fully forecasted test years in future DPL rate cases. A decision by the MPSC is expected in July 2012.

Pepco Electric Distribution Base Rates

On December 16, 2011, Pepco submitted an application with the MPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$68.4 million, based on a requested ROE of 10.75%. The filing includes a request for MPSC approval of a RIM and the use of fully forecasted test years in future Pepco rate cases. A decision by the MPSC is expected in July 2012.

Major Storm Damage Recovery Proceedings

In February 2011, the MPSC initiated proceedings involving Pepco and DPL, as well as unaffiliated utilities in Maryland, for the purpose of reviewing how the BSA operates to recover revenues lost as a result of major storm outages. On January 25, 2012, the MPSC issued an order modifying the BSA to prevent the Maryland utilities, including Pepco and DPL, from collecting lost utility revenue through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (defined by the MPSC as a weather-related event during which more than the lesser of 10% or 100,000 of an electric utility's customers have a sustained outage for more than 24 hours). The period for which the lost utility revenue may not be collected through the BSA commences 24 hours after the start of the major storm and continues until all major storm-related outages are restored. The MPSC stated that waivers permitting collection of BSA revenues would be granted in rare and extraordinary circumstances where a utility can show that an outage was not due to inadequate emphasis on reliability and restoration efforts were reasonable under the circumstances. A similar provision excluding revenues lost as a result of major storm outages from the calculation of future BSA adjustments is already included in the BSA for Pepco in the District of Columbia as approved by the DCPSC. The financial impact of service interruptions due to a major storm as a result of this MPSC order would generally depend on the scope and duration of the outages.

*New Jersey*Electric Distribution Base Rates

On August 5, 2011, ACE filed a petition with the NJBPU to increase its electric distribution rates by the net amount of approximately \$58.9 million (increased to approximately \$80.2 million on February 24, 2012, to reflect the 2011 test year), based on a requested ROE of 10.75% (the ACE 2011 Base Rate Case). The modified net increase consists of a rate increase proposal of approximately \$90.3 million, less a deduction from base rates of approximately \$17 million attributable to excess depreciation expenses, plus approximately a \$6.3 million increase in sales-and-use taxes and an upward adjustment of approximately \$0.6 million in the Regulatory Asset Recovery Charge. A decision in the electric distribution rate case is expected by the end of 2012.

Infrastructure Investment Program

In July 2009, the NJBPU approved certain rate recovery mechanisms in connection with ACE's Infrastructure Investment Program (the IIP). In exchange for the increase in infrastructure investment, the NJBPU, through

the IIP, allowed recovery of ACE's infrastructure investment capital expenditures through a special rate outside the normal rate recovery mechanism of a base rate filing. The IIP was designed to stimulate the New Jersey economy and provide incremental employment in ACE's service territory by increasing the infrastructure expenditures to a level above otherwise normal budgeted levels. In an October 18, 2011 petition (subsequently amended December 16, 2011) with the NJBPU, ACE requested an extension and expansion to the IIP under which ACE proposes to spend approximately \$63 million, \$94 million and \$81 million in calendar years 2012, 2013 and 2014, respectively, on non-revenue reliability-related capital expenditures. As proposed, capital expenditures related to the proposed special rate would be subject to annual reconciliation and approval by the NJBPU. A decision by the NJBPU on ACE's IIP filing is expected by the end of the third quarter of 2012.

Storm Damage Restoration Costs Recovery

In August 2011, ACE filed a petition with the NJBPU seeking authorization for deferred accounting treatment of uninsured incremental storm damage restoration costs not otherwise recovered through base rates. In that petition, ACE sought deferred accounting treatment for recovery of storm costs of approximately \$8 million incurred during Hurricane Irene, which impacted ACE's service territory in the third quarter of 2011. In an order dated December 15, 2011, the NJBPU directed that this petition be transmitted to the Office of Administrative Law with a request that the matter be consolidated with the ACE 2011 Base Rate Case, discussed above.

Update and Reconciliation of Certain Under-Recovered Balances

In February 2012, ACE filed a petition with the NJBPU seeking to reconcile and update several pass-through charges related to (i) the recovery of above-market costs associated with ACE's long-term power purchase contracts with the NUGs, (ii) costs related to surcharges that fund several statewide social programs and ACE's uncollected accounts, and (iii) operating costs associated with ACE's residential appliance cycling program. The filing proposes to recover the projected deferred under-recovered balance related to the NUGs of \$113.8 million as of May 31, 2012 through a four-year amortization schedule. The net impact of adjusting the charges as proposed (including both the annual impact of the proposed four-year amortization of the historical under-recovered balances related to the NUGs and the going-forward cost recovery of all the other components for the period June 1, 2012 through May 31, 2013, and including associated changes in sales-and-use taxes), is an overall annual rate increase of approximately \$54.5 million. A decision by the NJBPU on this filing is expected by the end of the second quarter of 2012.

Maryland Public Service Commission New Generation Contract Requirement

On September 29, 2009, the MPSC initiated an investigation into whether the EDCs in Maryland should be required to enter into long-term contracts with entities that construct, acquire or lease, and operate, new electric generation facilities in Maryland.

The MPSC issued an order on April 12, 2012, in which it determined that there is a need for one new power plant in the range of 650 to 700 MW beginning in 2015. The order requires Pepco, DPL and Baltimore Gas and Electric Company to negotiate and enter into a contract with the winning bidder in amounts proportionate to their relative SOS loads. Under the contract, the winning bidder will construct a 661 MW natural gas-fired combined cycle generation plant in Waldorf, Maryland, with a commercial operation date of June 1, 2015. The order acknowledges the EDCs' concerns about the requirements of the contract and directs them to negotiate with the winning bidder and submit any proposed changes in the contract to the MPSC for approval. The order further specifies that the EDCs entering into the contract will recover the associated costs from their respective SOS customers through surcharges. PHI is evaluating the impact of the order on each of Pepco and DPL, and, at this time, cannot predict (i) the extent of the negative effect that the order and, once finalized, the contract for new generation, may have on PHI's, Pepco's and DPL's balance sheets, as well as their respective credit metrics, as

calculated by independent rating agencies that evaluate and rate PHI, Pepco and DPL and each of their debt issuances, (ii) the effect on Pepco's and DPL's ability to recover their associated costs of the contract for new generation if a significant number of SOS customers elect to buy their energy from alternative energy suppliers, and (iii) the effect of the order on the financial condition, results of operations and cash flows of each of PHI, Pepco and DPL. On April 27, 2012, a group of generators operating in the PJM region filed a complaint in the United States District Court for the Northern District of Maryland challenging the MPSC's order on the grounds that that such order violated the commerce clause and the supremacy clause of the U.S. Constitution. PHI continues to evaluate whether to seek judicial review of the MPSC's order.

ACE Standard Offer Capacity Agreements

In April 2011, ACE entered into three SOCAs by order of the NJBPU, each with a different generation company, as more fully described in Note (2), "Significant Accounting Policies – Consolidation of Variable Interest Entities – ACE Standard Offer Capacity Agreements." ACE and the other New Jersey EDCs entered the SOCAs under protest based on concerns about the potential cost to distribution customers. In May 2011, the NJBPU denied a joint motion for reconsideration of its order requiring each of the EDCs to enter into the SOCAs. In June 2011, ACE and the other EDCs filed appeals related to the NJBPU orders with the Appellate Division of the New Jersey Superior Court. On March 5, 2012, the court remanded the case to the NJBPU with instructions to refer the case to an Administrative Law Judge for further consideration.

In February 2011, ACE joined other plaintiffs in an action filed in the United States District Court for the District of New Jersey challenging the constitutionality of the New Jersey law under which the SOCAs were established. ACE and the other plaintiffs filed a motion for summary judgment with the United States District Court for the District of New Jersey in December 2011. Cross motions for summary judgment were filed in January 2012. The motions remain pending.

In October 2011 and January 2012, respectively, two of the three generation companies sent notices of dispute under the SOCA to ACE. The notices of dispute allege that certain actions taken by PJM will have an adverse effect on the generation company's ability to clear the PJM auction, which is required for payment under the SOCA. As of February 2012, the two generation companies had filed petitions with the NJBPU seeking to amend their respective SOCAs. One of the generation companies seeks to postpone the effective date (currently expected to be in 2015) of the SOCA until the litigation is complete. The other generation company proposes to adjust the payment terms of the SOCA to reflect the total expected revenues under the original bid, which the generation company alleges may be in jeopardy if it were unable to clear in the PJM auction commencing in 2015. ACE does not believe that a dispute exists under the SOCAs and is disputing the amendment of the SOCAs jointly with the other EDCs. ACE does not believe the impact of either of such SOCA amendments would be material, although the result of such amendments, if approved, may be to prolong the term of one or both SOCAs. In April 2012, the NJBPU issued an order consolidating the two matters. A decision is expected in the second quarter of 2012.

(8) LEASING ACTIVITIES

Investment in Finance Leases Held in Trust

PHI has a portfolio of cross-border energy lease investments (the lease portfolio) consisting of hydroelectric generation facilities, coal-fired electric generation facilities and natural gas distribution networks located outside of the United States. Each lease investment is comprised of a number of leases. As of March 31, 2012 and December 31, 2011, the lease portfolio consisted of seven investments with an aggregate book value of \$1.4 billion and \$1.3 billion, respectively.

The components of the cross-border energy lease investments as of March 31, 2012 and as of December 31, 2011 are summarized below:

	<u>March 31,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
	<i>(millions of dollars)</i>	
Scheduled lease payments to PHI, net of non-recourse debt	\$ 2,120	\$ 2,120
Less: Unearned and deferred income	(758)	(771)
Investment in finance leases held in trust	1,362	1,349
Less: Deferred income tax liabilities	(797)	(793)
Net investment in finance leases held in trust	<u>\$ 565</u>	<u>\$ 556</u>

Income recognized from cross-border energy lease investments was comprised of the following for the three months ended March 31, 2012 and 2011:

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2012</u>	<u>2011</u>
	<i>(millions of dollars)</i>	
Pre-tax income from PHI's cross-border energy lease investments (included in Other Revenue)	\$ 13	\$ 14
Income tax expense	1	4
Net income from PHI's cross-border energy lease investments	<u>\$ 12</u>	<u>\$ 10</u>

To ensure credit quality, PHI regularly monitors the financial performance and condition of the lessees under its cross-border energy lease investments. Changes in credit quality are also assessed to determine if they should be reflected in the carrying value of the leases. PHI reviews each lessee's performance versus annual compliance requirements set by the terms and conditions of the leases. This includes a comparison of published credit ratings to minimum credit rating requirements in the leases for lessees with public credit ratings. In addition, PHI routinely meets with senior executives of the lessees to discuss their company and asset performance. If the annual compliance requirements or minimum credit ratings are not met, remedies are available under the leases. At March 31, 2012, all lessees were in compliance with the terms and conditions of their lease agreements.

The table below shows PHI's net investment in these leases by the published credit ratings of the lessees as of March 31, 2012 and December 31, 2011:

<u>Lessee Rating (a)</u>	<u>March 31,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
	<i>(millions of dollars)</i>	
<u>Rated Entities</u>		
AA/Aa and above	\$ 746	\$ 737
A	616	612
Total	<u>\$ 1,362</u>	<u>\$ 1,349</u>

(a) Excludes the credit ratings associated with collateral posted by the lessees in these transactions.

(9) PENSION AND OTHER POSTRETIREMENT BENEFITS

The following Pepco Holdings information is for the three months ended March 31, 2012 and 2011:

	Pension Benefits		Other Postretirement Benefits	
	2012	2011	2012	2011
	<i>(millions of dollars)</i>			
Service cost	\$ 11	\$ 10	\$ 1	\$ 2
Interest cost	26	26	9	9
Expected return on plan assets	(34)	(31)	(5)	(5)
Amortization of prior service cost	—	—	(1)	(1)
Amortization of net actuarial loss	14	13	5	4
Net periodic benefit cost	<u>\$ 17</u>	<u>\$ 18</u>	<u>\$ 9</u>	<u>\$ 9</u>

Pension and Other Postretirement Benefits

Net periodic benefit cost related to continuing operations is included in other operation and maintenance expense, net of the portion of the net periodic benefit cost that is capitalized as part of the cost of labor for internal construction projects. After intercompany allocations, the three utility subsidiaries are responsible for substantially all of the total PHI net periodic pension and other postretirement benefit costs related to continuing operations.

Pension Contributions

PHI's funding policy with regard to PHI's non-contributory retirement plan (the PHI Retirement Plan) is to maintain a funding level that is at least equal to the target liability as defined under the Pension Protection Act of 2006. In the first quarter of 2012, Pepco, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of \$85 million, \$85 million and \$30 million, respectively, which is expected to bring the PHI Retirement Plan assets to at least the funding target level for 2012 under the Pension Protection Act. In the first quarter of 2011, Pepco, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of \$40 million, \$40 million and \$30 million, which brought plan assets to the funding target level for 2011 under the Pension Protection Act.

(10) DEBT**Credit Facility**

PHI, Pepco, DPL and ACE maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement with respect to the facility, which among other changes extended the expiration date of the facility to August 1, 2016.

The aggregate borrowing limit under the amended and restated credit facility is \$1.5 billion, all or any portion of which may be used to obtain loans and up to \$500 million of which may be used to obtain letters of credit. The facility also includes a swingline loan sub-facility, pursuant to which each company may make same day borrowings in an aggregate amount not to exceed 10% of the total amount of the facility. Any swingline loan must be repaid by the borrower within fourteen days of receipt. The initial credit sublimit for PHI is \$750 million and \$250 million for each of Pepco, DPL and ACE. The sublimits may be increased or

decreased by the individual borrower during the term of the facility, except that (i) the sum of all of the borrower sublimits following any such increase or decrease must equal the total amount of the facility and (ii) the aggregate amount of credit used at any given time by (a) PHI may not exceed \$1.25 billion and (b) each of Pepco, DPL or ACE may not exceed the lesser of \$500 million and the maximum amount of short-term debt the company is permitted to have outstanding by its regulatory authorities. The total number of the sublimit reallocations may not exceed eight per year during the term of the facility.

The interest rate payable by each company on utilized funds is, at the borrowing company's election, (i) the greater of the prevailing prime rate, the federal funds effective rate plus 0.5% and one month LIBOR plus 1.0%, or (ii) the prevailing Eurodollar rate, plus a margin that varies according to the credit rating of the borrower.

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of March 31, 2012.

The absence of a material adverse change in PHI's business, property, results of operations or financial condition is not a condition to the availability of credit under the credit agreement. The credit agreement does not include any rating triggers.

At March 31, 2012 and December 31, 2011, the amount of cash plus unused borrowing capacity under the credit facility available to meet the future liquidity needs of PHI and its utility subsidiaries on a consolidated basis totaled \$679 million and \$1 billion, respectively. PHI's utility subsidiaries had combined cash and unused borrowing capacity under the credit facility of \$452 million and \$711 million at March 31, 2012 and December 31, 2011, respectively.

Commercial Paper

PHI, Pepco, DPL and ACE maintain on-going commercial paper programs to address short-term liquidity needs. As of March 31, 2012, the maximum capacity available under these programs was \$875 million, \$500 million, \$500 million and \$250 million, respectively, subject to available borrowing capacity under the credit facility. In January 2012, the Board of Directors approved an increase in PHI's maximum to \$1.25 billion, which has not been put into effect as of March 31, 2012.

PHI, Pepco and DPL had \$521 million, \$204 million and \$133 million, respectively, of commercial paper outstanding at March 31, 2012. ACE did not issue commercial paper during the first quarter of 2012 and had no commercial paper outstanding at March 31, 2012. The weighted average interest rate for commercial paper issued by PHI, Pepco and DPL during the three months ended March 31, 2012 was 0.75%, 0.40% and 0.39%, respectively. The weighted average maturity of all commercial paper issued by PHI, Pepco and DPL during the three months ended March 31, 2012 was twelve, five and four days, respectively.

Other Financing Activities

In January 2012, ACE Funding made principal payments of \$7 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

Financing Activities Subsequent to March 31, 2012

Bond Payments

In April 2012, ACE Funding made principal payments of \$6 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

Bond Issuance

In April 2012, Pepco issued \$200 million of 3.05% first mortgage bonds due April 1, 2022. Proceeds from the issuance of the long-term debt were primarily used to repay Pepco's outstanding commercial paper that was issued to temporarily fund capital expenditures and working capital, to redeem, prior to maturity, all of the \$38.3 million outstanding of the 5.375% pollution control revenue refunding bonds due February 15, 2024 issued by the Industrial Development Authority of the City of Alexandria, Virginia, on Pepco's behalf and for general corporate purposes.

Bond Redemption

On April 30, 2012, all of the \$38.3 million of the outstanding 5.375% pollution control revenue refunding bonds were redeemed as noted in the preceding paragraph. In connection with such redemption, Pepco redeemed all of the \$38.3 million outstanding of its 5.375% first mortgage bonds due February 15, 2024 that secured the obligations under such pollution control bonds.

Term Loan Agreement

On April 24, 2012, PHI entered into a \$200 million term loan agreement, pursuant to which PHI has borrowed (and may not reborrow) \$200 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to LIBOR with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.875%. PHI's Eurodollar borrowings under the loan agreement may be converted into floating rate loans under certain circumstances, and, in that event, for so long as any loan remains a floating rate loan, interest would accrue on that loan at a rate per year equal to (i) the highest of (a) the prevailing prime rate, (b) the federal funds effective rate plus 0.5%, or (c) the one-month Eurodollar rate plus 1%, plus (ii) a margin of 0.875%. As of April 24, 2012, outstanding borrowings under the loan agreement bore an annual interest rate of 1.115%, which is subject to adjustment from time to time. All borrowings under the loan agreement are unsecured, and the aggregate principal amount of all loans, together with any accrued but unpaid interest due under the loan agreement, must be repaid in full on or before April 23, 2013.

PHI intends to use the net proceeds of the borrowings under the loan agreement to repay outstanding commercial paper obligations and for general corporate purposes. Under the terms of the loan agreement, PHI must be in compliance with specified covenants, including (i) the requirement that PHI maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the loan agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) a restriction on sales or other dispositions of assets, other than certain permitted sales and dispositions, and (iii) a restriction on the incurrence of liens (other than liens permitted by the loan agreement) on the assets of PHI or any of its significant subsidiaries. The loan agreement does not include any rating triggers.

Collateral Requirements of Pepco Energy Services

In the ordinary course of its energy supply business, which is in the process of being wound down, Pepco Energy Services enters into various contracts to buy and sell electricity, fuels and related products, including derivative instruments, designed to reduce its financial exposure to changes in the value of its assets and obligations due to energy price fluctuations. These contracts typically have collateral requirements. Depending on the contract terms, the collateral required to be posted by Pepco Energy Services can be of varying forms, including cash and letters of credit.

As of March 31, 2012, Pepco Energy Services had posted net cash collateral of \$92 million and letters of credit of \$1 million. At December 31, 2011, Pepco Energy Services had posted net cash collateral of \$112 million and letters of credit of \$1 million.

At March 31, 2012 and December 31, 2011, the amount of cash, plus borrowing capacity under PHI's credit facility available to meet the future liquidity needs of Pepco Energy Services totaled \$227 million and \$283 million, respectively.

(11) INCOME TAXES

A reconciliation of PHI's consolidated effective income tax rate from continuing operations is as follows:

	Three Months Ended March 31,			
	2012		2011	
	(millions of dollars)			
Income tax at Federal statutory rate	\$ 29	35.0%	\$ 33	35.0%
Increases (decreases) resulting from:				
State income taxes, net of Federal effect	4	4.9	5	5.0
Asset removal costs	(3)	(3.7)	(1)	(0.7)
Cross-border energy lease investments	(1)	(1.2)	(1)	(1.2)
Change in estimates and interest related to uncertain and effectively settled tax positions	(13)	(15.9)	1	1.2
Investment tax credits	(1)	(1.2)	(1)	(1.2)
Permanent differences related to deferred compensation	(1)	(1.2)	(2)	(2.2)
Other, net	—	0.4	—	(0.5)
Consolidated income tax expense related to continuing operations	\$ 14	17.1%	\$ 34	35.4%

PHI's consolidated effective tax rates for the three months ended March 31, 2012 and 2011 were 17.1% and 35.4%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the Internal Revenue Service (IRS) with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position in Pepco. The effective rate was further decreased as a result of the increase in asset removal costs in Pepco in 2012 primarily related to a higher level of asset retirements.

(12) EQUITY AND EARNINGS PER SHARE**Basic and Diluted Earnings Per Share**

PHI's basic and diluted earnings per share (EPS) calculations are shown below:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars, except per share data)	
<u>Income (Numerator):</u>		
Net income from continuing operations	\$ 68	\$ 62
Net income from discontinued operations	—	2
Net income	<u>\$ 68</u>	<u>\$ 64</u>
<u>Shares (Denominator) (in millions):</u>		
Weighted average shares outstanding for basic computation:		
Average shares outstanding	228	225
Adjustment to shares outstanding	—	—
Weighted Average Shares Outstanding for Computation of Basic Earnings Per Share of Common Stock	228	225
Net effect of potentially dilutive shares (a)	—	—
Weighted Average Shares Outstanding for Computation of Diluted Earnings Per Share of Common Stock	<u>228</u>	<u>225</u>
<u>Basic and Diluted Earnings per Share</u>		
Earnings per share of common stock from continuing operations	\$ 0.30	\$ 0.27
Earnings per share of common stock from discontinued operations	—	0.01
Basic and diluted earnings per share	<u>\$ 0.30</u>	<u>\$ 0.28</u>

(a) The number of options to purchase shares of common stock that were excluded from the calculation of diluted EPS because they were anti-dilutive was 3,000 and 133,066 for the three months ended March 31, 2012 and 2011, respectively.

Equity Forward Transaction

On March 5, 2012, PHI entered into an equity forward transaction in connection with a public offering of 17,922,077 shares of PHI common stock. The use of an equity forward transaction substantially eliminates future equity market price risk by fixing a common equity offering sales price under the then existing market conditions, while mitigating immediate share dilution resulting from the offering by postponing the actual issuance of common stock until funds are needed in accordance with PHI's capital investment and regulatory plans.

Pursuant to the terms of this transaction, a forward counterparty borrowed 17,922,077 shares of PHI's common stock from third parties and sold them to a group of underwriters for \$19.25 per share, less an underwriting discount equal to \$0.67375 per share. Under the terms of the equity forward transaction, to the extent that the transaction is physically settled, PHI would be required to issue and deliver shares of PHI common stock to the forward counterparty at the then applicable forward sale price. The forward sale price was initially determined to be \$18.57625 per share at the time the equity forward transaction was entered into, and the amount of cash to be received by PHI upon physical settlement of the equity forward is subject to certain adjustments in accordance with the terms of the equity forward transaction. The equity forward transaction must be settled fully within 12 months of the transaction date. Except in specified circumstances or events that would require physical settlement, PHI is able to elect to settle the equity forward transaction by means of physical, cash or net share settlement, and in whole or in part, at any time on or prior to March 5, 2013.

The equity forward transaction has no initial fair value since it was entered into at the then market price of the common stock. PHI will not receive any proceeds from the sale of common stock until the equity forward transaction is settled, and at that time PHI will record the proceeds, if any, in equity. PHI concluded that the equity forward transaction was an equity instrument based on the accounting guidance in ASC 480 and ASC 815 and that it qualified for an exception from derivative accounting under ASC 815 because the forward sale transaction was indexed to its own stock. Currently, PHI anticipates settling the equity forward transaction through physical settlement.

At March 31, 2012, the equity forward transaction could have been settled with physical delivery of the shares to the forward counterparty in exchange for cash of \$328 million. At March 31, 2012, the equity forward transaction could also have been cash settled, with delivery of cash of approximately \$14 million to the forward counterparty, or net share settled with delivery of approximately 740,000 shares of common stock to the forward counterparty.

Prior to its settlement, the equity forward transaction will be reflected in PHI's diluted earnings per share calculations using the treasury stock method. Under this method, the number of shares of PHI's common stock used in calculating diluted earnings per share for a reporting period is deemed to be increased by the excess, if any, of the number of shares that would be issued upon physical settlement of the equity forward transaction less the number of shares that could be purchased by PHI in the market (based on the average market price during that reporting period) using the proceeds receivable upon settlement (based on the adjusted forward sale price at the end of that reporting period). The excess number of shares is weighted for the portion of the reporting period in which the equity forward transaction is outstanding.

Accordingly, before physical or net share settlement of the equity forward transaction, and subject to the occurrence of certain events, PHI anticipates that the forward sale agreement will have a dilutive effect on PHI's earnings per share only during periods when the applicable average market price per share of PHI's common stock is above the per share adjusted forward sale price, as described above. However, if PHI decides to physically or net share settle the forward sale agreement, any delivery by PHI of shares upon settlement could result in dilution to PHI's earnings per share.

For the three months ended March 31, 2012, the equity forward transaction did not have a material dilutive effect on PHI's earnings per share.

(13) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Derivatives are used by Pepco Energy Services and Power Delivery to hedge commodity price risk, as well as by PHI, from time to time, to hedge interest rate risk.

The retail energy supply business of Pepco Energy Services, which is in the process of being wound down, enters into energy commodity contracts in the form of electricity and natural gas futures, swaps, options and forward contracts to hedge commodity price risk in connection with the purchase of physical natural gas and electricity for distribution to customers. The primary risk management objective is to manage the spread between retail sales commitments and the cost of supply used to service those commitments to ensure stable cash flows and lock in favorable prices and margins when they become available.

Pepco Energy Services' commodity contracts that are not designated for hedge accounting, do not qualify for hedge accounting, or do not meet the requirements for normal purchase and normal sale accounting, are marked to market through current earnings. Forward contracts that meet the requirements for normal purchase and normal sale accounting are recorded on an accrual basis.

In Power Delivery, DPL uses derivative instruments in the form of swaps and over-the-counter options primarily to reduce natural gas commodity price volatility and to limit its customers' exposure to increases in the market price of natural gas under a hedging program approved by the DPSC. DPL uses these derivatives to manage the commodity price risk associated with its physical natural gas purchase contracts. The natural

gas purchase contracts qualify as normal purchases, which are not required to be recorded in the financial statements until settled. DPL's capacity contracts are not classified as derivatives. All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all gains and losses related to hedging activities, are deferred under FASB guidance on regulated operations (ASC 980) until recovered from its customers through a fuel adjustment clause approved by the DPSC.

PHI also uses derivative instruments from time to time to mitigate the effects of fluctuating interest rates on debt issued in connection with the operation of their businesses. In June 2002, PHI entered into several treasury rate lock transactions in anticipation of the issuance of several series of fixed-rate debt commencing in August 2002. Upon issuance of the fixed rate-debt in August 2002, the treasury rate locks were terminated at a loss. The loss has been deferred in Accumulated Other Comprehensive Loss (AOCL) and is being recognized in income over the life of the debt issued as interest payments are made.

The tables below identify the balance sheet location and fair values of derivative instruments as of March 31, 2012 and December 31, 2011:

<u>Balance Sheet Caption</u>	<u>As of March 31, 2012</u>				
	<u>Derivatives Designated as Hedging Instruments (a)</u>	<u>Other Derivative Instruments (b)</u>	<u>Gross Derivative Instruments</u> <i>(millions of dollars)</i>	<u>Effects of Cash Collateral and Netting</u>	<u>Net Derivative Instruments</u>
Derivative assets (current assets)	\$ 9	\$ 8	\$ 17	\$ (11)	\$ 6
Derivative assets (non-current assets)	—	1	1	—	1
Total Derivative assets	9	9	18	(11)	7
Derivative liabilities (current liabilities)	(38)	(50)	(88)	63	(25)
Derivative liabilities (non-current liabilities)	(8)	(6)	(14)	12	(2)
Total Derivative liabilities	(46)	(56)	(102)	75	(27)
Net Derivative (liability) asset	<u>\$ (37)</u>	<u>\$ (47)</u>	<u>\$ (84)</u>	<u>\$ 64</u>	<u>\$ (20)</u>

- (a) Amounts included in Derivatives Designated as Hedging Instruments primarily consist of derivatives that were designated as cash flow hedges prior to Pepco Energy Services' election to discontinue cash flow hedge accounting for these derivatives.
- (b) Amounts included in Other Derivative Instruments include gains or losses on gas derivatives that are not accounted for as cash flow hedges subsequent to Pepco Energy Services' election to discontinue cash flow hedge accounting.

As of December 31, 2011					
<u>Balance Sheet Caption</u>	<u>Derivatives Designated as Hedging Instruments (a)</u>	<u>Other Derivative Instruments (b)</u>	<u>Gross Derivative Instruments</u>	<u>Effects of Cash Collateral and Netting</u>	<u>Net Derivative Instruments</u>
	<i>(millions of dollars)</i>				
Derivative assets (current assets)	\$ 17	\$ 6	\$ 23	\$ (18)	\$ 5
Derivative assets (non-current assets)	—	1	1	(1)	—
Total Derivative assets	17	7	24	(19)	5
Derivative liabilities (current liabilities)	(55)	(48)	(103)	77	(26)
Derivative liabilities (non-current liabilities)	(11)	(10)	(21)	15	(6)
Total Derivative liabilities	(66)	(58)	(124)	92	(32)
Net Derivative (liability) asset	\$ (49)	\$ (51)	\$ (100)	\$ 73	\$ (27)

- (a) Amounts included in Derivatives Designated as Hedging Instruments primarily consist of derivatives that were designated as cash flow hedges prior to Pepco Energy Services' election to discontinue cash flow hedge accounting for these derivatives.
- (b) Amounts included in Other Derivative Instruments include gains or losses on gas derivatives that are not accounted for as cash flow hedges subsequent to Pepco Energy Services' election to discontinue cash flow hedge accounting.

Under FASB guidance on the offsetting of balance sheet accounts (ASC 210-20), PHI offsets the fair value amounts recognized for derivative instruments and the fair value amounts recognized for related collateral positions executed with the same counterparty under master netting agreements. The amount of cash collateral that was offset against these derivative positions is as follows:

	<u>March 31, 2012</u>	<u>December 31, 2011</u>
	<i>(millions of dollars)</i>	
Cash collateral pledged to counterparties with the right to reclaim (a)	\$ 64	\$ 73

- (a) Includes cash deposits on commodity brokerage accounts

As of March 31, 2012 and December 31, 2011, all PHI cash collateral pledged related to derivative instruments accounted for at fair value was entitled to offset under master netting agreements.

Derivatives Designated as Hedging Instruments

Cash Flow Hedges

Pepco Energy Services

For energy commodity contracts that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of AOCL and is reclassified into income in the same period or periods during which the hedged transactions affect income. Gains and losses on the derivative that are related to hedge ineffectiveness or the forecasted hedged transaction being probable not to occur, are recognized in income. Pepco Energy Services has elected to no longer apply cash flow hedge accounting to certain of its electricity derivatives and all of its natural gas derivatives. Amounts included in AOCL for these cash flow hedges as of March 31, 2012 represent net losses on derivatives prior to the election to discontinue cash flow hedge accounting less amounts reclassified into income as the hedged transactions occur or because the hedged transactions were deemed probable not to occur. Gains or losses on these derivatives after the election to discontinue cash flow hedge accounting are recognized directly in income.

The cash flow hedge activity during the three months ended March 31, 2012 and 2011 is provided in the tables below:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars)	
Amount of net pre-tax loss arising during the period included in accumulated other comprehensive loss	\$ —	\$ (1)
Amount of net pre-tax loss reclassified into income:		
<u>Effective portion:</u>		
Fuel and purchased energy	13	27
<u>Ineffective portion: (a)</u>		
Revenue	—	—
Total net pre-tax loss reclassified into income	13	27
Net pre-tax gain on commodity derivatives included in accumulated other comprehensive loss	\$ 13	\$ 26

- (a) For the three months ended March 31, 2012 and 2011, no amounts were reclassified from AOCL to income because it was deemed probable that the forecasted hedged transactions would not occur.

As of March 31, 2012 and December 31, 2011, Pepco Energy Services had the following types and quantities of outstanding energy commodity contracts employed as cash flow hedges of forecasted purchases and forecasted sales.

Commodity	Quantities	
	March 31, 2012	December 31, 2011
<u>Forecasted Purchases Hedges</u>		
Natural gas (One Million British Thermal Units (MMBtu))	—	—
Electricity (Megawatt hours (MWh))	246,680	614,560
Electricity capacity (MW-Days)	—	—
<u>Forecasted Sales Hedges</u>		
Electricity (MWh)	246,680	614,560

Power Delivery

All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all of DPL's gains and losses related to hedging activities, are deferred under FASB guidance on regulated operations until recovered from customers based on the fuel adjustment clause approved by the DPSC. The following table indicates the amount of the net unrealized derivative losses arising during the period included in Regulatory assets and the realized losses recognized in the consolidated statements of income for the three months ended March 31, 2012 and 2011 associated with cash flow hedges:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars)	
Net unrealized (loss) gain arising during the period included in Regulatory assets	\$ —	\$ —
Net realized loss recognized in Fuel and purchased energy expense	—	(2)

Cash Flow Hedges Included in Accumulated Other Comprehensive Loss

The tables below provide details regarding effective cash flow hedges included in PHI's consolidated balance sheets as of March 31, 2012 and 2011. Cash flow hedges are marked to market on the consolidated balance sheets with corresponding adjustments to AOCL for effective cash flow hedges. As of March 31, 2012, \$33 million of the losses in AOCL were associated with derivatives that Pepco Energy Services previously designated as cash flow hedges. Although Pepco Energy Services no longer designates these derivatives as cash flow hedges, gains or losses previously deferred in AOCL prior to the decision to discontinue cash flow hedge accounting will remain in AOCL until the hedged forecasted transaction occurs unless it is deemed probable that the hedged forecasted transaction will not occur. The data in the following tables indicate the cumulative net loss after-tax related to effective cash flow hedges by contract type included in AOCL, the portion of AOCL expected to be reclassified to income during the next 12 months, and the maximum hedge or deferral term:

<u>Contracts</u>	<u>As of March 31, 2012</u>		<u>Maximum Term</u>
	<u>Accumulated Other Comprehensive Loss After-tax</u>	<u>Portion Expected to be Reclassified to Income during the Next 12 Months</u>	
	<i>(millions of dollars)</i>		
Energy commodity (a)	\$ 21	\$ 17	26 months
Interest rate	10	1	245 months
Total	\$ 31	\$ 18	

- (a) The unrealized derivative losses recorded in AOCL relate to forecasted physical natural gas and electricity purchases which are used to supply retail natural gas and electricity contracts that are in gain positions and subject to accrual accounting. Under accrual accounting, no asset is recorded on PHI's consolidated balance sheet and the purchase cost is not recognized until the period of distribution.

Contracts	As of March 31, 2011		Maximum Term
	Accumulated Other Comprehensive Loss After-tax	Portion Expected to be Reclassified to Income during the Next 12 Months	
	(millions of dollars)		
Energy commodity (a)	\$ 62	\$ 38	38 months
Interest rate	11	1	257 months
Total	\$ 73	\$ 39	

- (a) The unrealized derivative losses recorded in AOCL relate to forecasted physical natural gas and electricity purchases which are used to supply retail natural gas and electricity contracts that are in gain positions and subject to accrual accounting. Under accrual accounting, no asset is recorded on PHI's consolidated balance sheet and the purchase cost is not recognized until the period of distribution.

Other Derivative ActivityPepco Energy Services

Pepco Energy Services holds certain derivatives that are not in hedge accounting relationships and are not designated as normal purchases or normal sales. These derivatives are recorded at fair value on the balance sheet with changes in fair value recorded through income.

For the three months ended March 31, 2012 and 2011, the amount of the derivative gain (loss) for Pepco Energy Services recognized in income is provided in the table below:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars)	
Reclassification to realized on settlement of contracts	\$ 10	\$ (4)
Unrealized mark-to-market loss	(10)	—
Total net loss	\$ —	\$ (4)

As of March 31, 2012 and December 31, 2011, Pepco Energy Services had the following net outstanding commodity forward contract quantities and net position on derivatives that did not qualify for hedge accounting:

Commodity	March 31, 2012		December 31, 2011	
	Quantity	Net Position	Quantity	Net Position
Financial transmission rights (MWh)	79,607	Long	267,480	Long
Electric capacity (MW-Days)	5,185	Long	12,920	Long
Electric (MWh)	657,240	Long	788,280	Long
Natural gas (MMBtu)	15,037,300	Long	24,550,257	Long

Power Delivery

DPL holds certain derivatives that are not in hedge accounting relationships and are not designated as normal purchases or normal sales. These derivatives are recorded at fair value on the consolidated balance sheets with the gain or loss for the change in fair value recorded in income. In accordance with FASB guidance on regulated operations, offsetting regulatory liabilities or regulatory assets are recorded on the consolidated balance sheets and the recognition of the derivative gain or loss is deferred because of the DPSC-approved fuel adjustment clause. For the three months ended March 31, 2012 and 2011, the net unrealized derivative losses arising during the period included in Regulatory assets and the net realized losses recognized in the consolidated statements of income are provided in the table below:

	Three Months Ended March 31,	
	2012	2011
Net unrealized gain (loss) arising during the period included in Regulatory assets	\$ (4)	\$ (1)
Net realized loss recognized in Fuel and purchased energy expense	(7)	(7)

As of March 31, 2012 and December 31, 2011, DPL had the following net outstanding natural gas commodity forward contracts that did not qualify for hedge accounting:

Commodity	March 31, 2012		December 31, 2011	
	Quantity	Net Position	Quantity	Net Position
Natural gas (MMBtu)	4,109,100	Long	6,161,200	Long

Contingent Credit Risk Features

The primary contracts used by Pepco Energy Services and Power Delivery for derivative transactions are entered into under the International Swaps and Derivatives Association Master Agreement (ISDA) or similar agreements that closely mirror the principal credit provisions of the ISDA. The ISDAs include a Credit Support Annex (CSA) that governs the mutual posting and administration of collateral security. The failure of a party to comply with an obligation under the CSA, including an obligation to transfer collateral security when due or the failure to maintain any required credit support, constitutes an event of default under the ISDA for which the other party may declare an early termination and liquidation of all transactions entered into under the ISDA, including foreclosure against any collateral security. In addition, some of the ISDAs have cross default provisions under which a default by a party under another commodity or derivative contract, or the breach by a party of another borrowing obligation in excess of a specified threshold, is a breach under the ISDA.

Under the ISDA or similar agreements, the parties establish a dollar threshold of unsecured credit for each party in excess of which the party would be required to post collateral to secure its obligations to the other party. The amount of the unsecured credit threshold varies according to the senior, unsecured debt rating of the respective parties or that of a guarantor of the party's obligations. The fair values of all transactions between the parties are netted under the master netting provisions. Transactions may include derivatives accounted for on-balance sheet as well as those designated as normal purchases and normal sales that are accounted for off-balance sheet. If the aggregate fair value of the transactions in a net loss position exceeds the unsecured credit threshold, then collateral is required to be posted in an amount equal to the amount by which the unsecured credit threshold is exceeded. The obligations of Pepco Energy Services are usually guaranteed by PHI. The obligations of DPL are stand-alone obligations without the guaranty of PHI. If PHI's or DPL's debt rating were to fall below "investment grade," the unsecured credit threshold would typically be set at zero and collateral would be required for the entire net loss position. Exchange-traded contracts are required to be fully collateralized without regard to the debt rating of the holder.

The gross fair values of PHI's derivative liabilities with credit risk-related contingent features as of March 31, 2012 and December 31, 2011, were \$40 million and \$54 million, respectively, before giving effect to offsetting transactions or collateral under master netting agreements. As of March 31, 2012, PHI had posted no cash collateral against its gross derivative liability, resulting in a net liability of \$40 million. As of December 31, 2011, PHI had posted cash collateral of \$1 million against its gross derivative liability, resulting in a net liability of \$53 million. If PHI's and DPL's debt ratings had been downgraded below investment grade as of March 31, 2012 and December 31, 2011, PHI's net settlement amounts, including both the fair value of its derivative liabilities and its normal purchase and normal sale contracts in loss positions, would have been approximately \$111 million and \$124 million, respectively, and PHI would have been required to post additional collateral with the counterparties of approximately \$111 million and \$123 million, respectively. The net settlement and additional collateral amounts reflect the effect of offsetting transactions under master netting agreements.

PHI's primary sources for posting cash collateral or letters of credit are its credit facility. At March 31, 2012 and December 31, 2011, the aggregate amount of cash plus borrowing capacity under the credit facility available to meet the future liquidity needs of PHI and its subsidiaries totaled \$679 million and \$1 billion, respectively, of which \$227 million and \$283 million, respectively, was available to Pepco Energy Services.

(14) FAIR VALUE DISCLOSURES**Financial Instruments Measured at Fair Value on a Recurring Basis**

PHI applies FASB guidance on fair value measurement and disclosures (ASC 820) that established a framework for measuring fair value and expanded disclosures about fair value measurements. As defined in the guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). PHI utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. Accordingly, PHI utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3).

The following tables set forth, by level within the fair value hierarchy, PHI's financial assets and liabilities (excluding Conectiv Energy assets and liabilities held for sale) that were accounted for at fair value on a recurring basis as of March 31, 2012 and December 31, 2011. As required by the guidance, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. PHI's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Description	Total	Fair Value Measurements at March 31, 2012		
		Quoted Prices in Active Markets for Identical Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs
		(Level 1) (a)	(Level 2) (a)	(Level 3)
		(millions of dollars)		
ASSETS				
Derivative instruments (b)				
Electricity (c)	\$ 3	\$ —	\$ 3	\$ —
Cash equivalents				
Treasury fund	70	70	—	—
Executive deferred compensation plan assets				
Money market funds	16	16	—	—
Life insurance contracts	61	—	43	18
	<u>\$150</u>	<u>\$ 86</u>	<u>\$ 46</u>	<u>\$ 18</u>
LIABILITIES				
Derivative instruments (b)				
Electricity (c)	\$ 31	\$ —	\$ 31	\$ —
Natural gas (d)	56	42	—	14
Executive deferred compensation plan liabilities				
Life insurance contracts	28	—	28	—
	<u>\$115</u>	<u>\$ 42</u>	<u>\$ 59</u>	<u>\$ 14</u>

- (a) There were no transfers of instruments between level 1 and level 2 valuation categories.
- (b) The fair value of derivative assets and liabilities reflect netting by counterparty before the impact of collateral.
- (c) Represents wholesale electricity futures and swaps that are used mainly as part of Pepco Energy Services' retail energy supply business.
- (d) Level 1 instruments represent wholesale gas futures and swaps that are used mainly as part of Pepco Energy Services' retail energy supply business and level 3 instruments represent natural gas options purchased by DPL as part of a natural gas hedging program approved by the DPSC, as well as Pepco Energy Services physical basis contracts.

Description	Total	Fair Value Measurements at December 31, 2011		
		Quoted Prices in Active Markets for Identical Instruments (Level 1) (a)	Significant Other Observable Inputs (Level 2) (a)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
ASSETS				
Cash equivalents				
Treasury fund	\$114	\$ 114	\$ —	\$ —
Executive deferred compensation plan assets				
Money market funds	18	18	—	—
Life insurance contracts	60	—	43	17
	<u>\$192</u>	<u>\$ 132</u>	<u>\$ 43</u>	<u>\$ 17</u>
LIABILITIES				
Derivative instruments (b)				
Electricity (c)	\$ 32	\$ —	\$ 32	\$ —
Natural gas (d)	67	50	—	17
Capacity	1	—	1	—
Executive deferred compensation plan liabilities				
Life insurance contracts	28	—	28	—
	<u>\$128</u>	<u>\$ 50</u>	<u>\$ 61</u>	<u>\$ 17</u>

- (a) There were no transfers of instruments between level 1 and level 2 valuation categories.
- (b) The fair value of derivative liabilities reflect netting by counterparty before the impact of collateral.
- (c) Represents wholesale electricity futures and swaps that are used mainly as part of Pepco Energy Service's retail energy supply business.
- (d) Level 1 instruments represent wholesale gas futures and swaps that are used mainly as part of Pepco Energy Services' retail energy supply business and level 3 instruments represent natural gas options purchased by DPL as part of a natural gas hedging program approved by the DPSC.

PHI classifies its fair value balances in the fair value hierarchy based on the observability of the inputs used in the fair value calculation as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis, such as the New York Mercantile Exchange (NYMEX).

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using broker quotes in liquid markets and other observable data. Level 2 also includes those financial instruments that are valued using methodologies that have been corroborated by observable market data through correlation or by other means. Significant assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

PHI's level 2 derivative instruments primarily consist of electricity derivatives at March 31, 2012. Level 2 power swaps are provided by a pricing service that uses liquid trading hub prices or liquid hub prices plus a congestion adder to estimate the fair value at zonal locations within trading hubs.

Executive deferred compensation plan assets consist of life insurance policies that are categorized as level 2 assets because they are priced based on the assets underlying the policies, which consist of short-term cash equivalents and fixed income securities that are priced using observable market data and can be liquidated for the value of the underlying assets as of March 31, 2012. The level 2 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance sub-accounts. The sub-accounts are designed to mirror existing mutual funds and money market funds that are observable and actively traded.

Level 3 – Pricing inputs include significant inputs that are generally less observable than those from objective sources. Level 3 includes those financial instruments that are valued using models or other valuation methodologies.

Derivative instruments categorized as level 3 include natural gas options used by DPL as part of a natural gas hedging program approved by the DPSC and natural gas physical basis contracts held by Pepco Energy Services. DPL applies a Black-Scholes model to value its options, which contains inputs, such as the forward price curves, contract prices, contract volumes, the risk-free rate and the implied volatility factors, which are based on a range of historical NYMEX option prices. The implied volatility is a factor based on a range between 0.60 and 2.03. DPL maintains valuation policies and procedures and reviews the validity and relevance of the inputs used to estimate the fair value of its options. The natural gas physical basis contracts held by Pepco Energy Services are valued using liquid hub prices plus a congestion adder. The congestion adder is between the range of two cents to forty-three cents, which is an internally derived adder based on historical data and experience. Pepco Energy Services obtains the liquid hub prices from a third party and reviews the valuation methodologies, inputs, and reasonableness of the congestion adder on a quarterly basis.

The table below summarizes the primary unobservable inputs used to determine the fair value of PHI's level 3 instruments and the range of values that could be used for those inputs as of March 31, 2012:

<u>Type of Instrument</u>	<u>Fair Value at March 31, 2012</u> <i>(millions of dollars)</i>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range</u>
Natural Gas Options	\$ 12	Option model	Volatility Factor	0.60 – 2.03
Natural Gas Physical Basis Contracts	\$ 2	Market comparable	Congestion adder	\$0.02 – \$0.43

PHI used values within these ranges as part of its fair value estimates, and a significant change in any of the unobservable inputs within these ranges would have an insignificant impact on the reported fair value as of March 31, 2012.

Executive deferred compensation plan assets and liabilities include certain life insurance policies that are valued using the cash surrender value of the policies, net of loans against those policies. The cash surrender values do not represent a quoted price in an active market; therefore, are unobservable and are categorized as level 3. Cash surrender values are provided by third parties and reviewed by PHI for reasonableness.

Reconciliations of the beginning and ending balances of PHI's fair value measurements using significant unobservable inputs (level 3) for the three months ended March 31, 2012 and 2011 are shown below:

	Three Months Ended March 31, 2012	
	Natural Gas	Life Insurance Contracts
	<i>(millions of dollars)</i>	
Beginning balance as of January 1	\$ (17)	\$ 17
Total gains (losses) (realized and unrealized)		
Included in income	—	1
Included in accumulated other comprehensive loss	—	—
Included in regulatory assets	(3)	—
Purchases	—	—
Issuances	—	—
Settlements	6	—
Transfers in (out) of level 3	—	—
Ending balance as of March 31	<u>\$ (14)</u>	<u>\$ 18</u>

	Three Months Ended March 31, 2011	
	Natural Gas	Life Insurance Contracts
	<i>(millions of dollars)</i>	
Beginning balance as of January 1	\$ (23)	\$ 19
Total gains (losses) (realized and unrealized)		
Included in income	—	3
Included in accumulated other comprehensive loss	—	—
Included in regulatory assets	(1)	—
Purchases	—	—
Issuances	—	(1)
Settlements	5	(4)
Transfers in (out) of level 3	—	—
Ending balance as of March 31	<u>\$ (19)</u>	<u>\$ 17</u>

The breakdown of realized and unrealized gains on level 3 instruments included in income as a component of Other income or Other operation and maintenance expense for the periods below were as follows:

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Total net gains included in income for the period	<u>\$ 1</u>	<u>\$ 3</u>
Change in unrealized gains relating to assets still held at reporting date	<u>\$ 1</u>	<u>\$ 1</u>

Other Financial Instruments

The estimated fair values of PHI's debt instruments that are measured at amortized cost in PHI's consolidated financial statements and the associated level of the estimates within the fair value hierarchy as of March 31, 2012 are shown in the table below. As required by the fair value measurement guidance, debt instruments are classified in their entirety within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. PHI's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, which may affect the valuation of fair value debt instruments and their placement within the fair value hierarchy levels.

Description	Total	Fair Value Measurements at March 31, 2012		
		Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
LIABILITIES				
Debt instruments				
Long-term debt (a)	\$4,569	\$ 408	\$ 3,681	\$ 480
Transition Bonds issued by ACE Funding (b)	370	—	370	—
Long-term project funding	15	—	—	15
	<u>\$4,954</u>	<u>\$ 408</u>	<u>\$ 4,051</u>	<u>\$ 495</u>

- (a) The carrying amount for Long-term debt is \$3,868 million as of March 31, 2012.
 (b) The carrying amount for Transition Bonds issued by ACE Funding, including amounts due within one year, is \$323 million as of March 31, 2012.

The fair value of Long-term debt categorized as level 1 is based on actual quoted trade prices for the debt in active markets on the measurement date.

The fair value of Long-term debt and Transition Bonds issued by ACE Funding categorized as level 2 is based on a blend of quoted prices for the debt and quoted prices for similar debt in active markets, but not on the measurement date. The blend places more weight on current pricing information when determining the final fair value measurement. The fair value information is provided by brokers and PHI reviews the methodologies and results.

The fair value of Long-term debt categorized as level 3 is based on a discounted cash flow methodology using observable inputs, such as the U.S. Treasury yield, and unobservable inputs, such as credit spreads, because quoted prices for the debt or similar debt in active markets were insufficient. The Long-Term project funding represents debt instruments issued by Pepco Energy Services related to its energy savings contracts. Long-Term project funding is categorized as level 3 because PHI concluded that the amortized cost carrying amounts for these instruments approximates fair value, which does not represent a quoted price in an active market.

The estimated fair values of PHI's debt instruments at December 31, 2011 are shown below:

	December 31, 2011	
	Carrying Amount	Fair Value
	<i>(millions of dollars)</i>	
Long-term debt	\$ 3,867	\$4,577
Transition Bonds issued by ACE Funding	332	380
Long-term project funding	15	15

The carrying amounts of all other financial instruments in the accompanying consolidated financial statements approximate fair value.

(15) COMMITMENTS AND CONTINGENCIES

General Litigation

In 1993, Pepco was served with Amended Complaints filed in the state Circuit Courts of Prince George's County, Baltimore City and Baltimore County, Maryland in separate ongoing, consolidated proceedings known as "In re: Personal Injury Asbestos Case." Pepco and other corporate entities were brought into these cases on a theory of premises liability. Under this theory, the plaintiffs argued that Pepco was negligent in not providing a safe work environment for employees or its contractors, who allegedly were exposed to asbestos while working on Pepco's property. Initially, a total of approximately 448 individual plaintiffs added Pepco to their complaints. While the pleadings were not entirely clear, it appeared that each plaintiff sought \$2 million in compensatory damages and \$4 million in punitive damages from each defendant. In the intervening years, most of the cases were voluntarily dismissed by the plaintiffs prior to their respective trial dates. At the beginning of the first quarter of 2012, there were approximately 90 cases pending against Pepco in the Maryland State Courts (excluding those tendered to Mirant Corporation (Mirant) for defense and indemnification in connection with the sale by Pepco of its generation assets to Mirant in 2000), with an aggregate amount of monetary damages sought of approximately \$360 million. On March 1, 2012, the parties to these consolidated proceedings (each represented by the same law firm) filed a stipulation of dismissal, by which the plaintiffs voluntarily dismissed Pepco as a defendant, eliminating any reasonably possible liability Pepco may have had with respect to these proceedings.

In September 2011, an asbestos complaint was filed in the New Jersey Superior Court, Law Division, against ACE (among other defendants) asserting claims under New Jersey's Wrongful Death and Survival statutes. The complaint, filed by the estate of a decedent who was the wife of a former employee of ACE, alleges that the decedent's mesothelioma was caused by exposure to asbestos brought home by her husband on his work clothes. Unlike the other jurisdictions to which PHI subsidiaries are subject, New Jersey courts have recognized a cause of action against a premise owner in a so-called "take home" case if it can be shown that the harm was foreseeable. In this case, the complaint seeks recovery of an unspecified amount of damages for, among other things, the decedent's past medical expenses, loss of earnings, and pain and suffering between the time of injury and death, and asserts a punitive damage claim. At this time, ACE has concluded that a loss is reasonably possible with respect to this matter, but ACE was unable to estimate an amount or range of reasonably possible loss because (i) the damages sought are indeterminate, (ii) the proceedings are in the early stages, and (iii) the matter involves facts that ACE believes are distinguishable from the facts of the "take home" cause of action recognized by the New Jersey courts.

Environmental Matters

PHI, through its subsidiaries, is subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of its operations, including air and water quality control, solid and hazardous waste disposal and limitations on land use. Although penalties assessed for violations of environmental laws and regulations are not recoverable from customers of PHI's utility subsidiaries, environmental clean-up costs incurred by Pepco, DPL and ACE generally are included by each company in its respective cost of service for ratemaking purposes. The total accrued liabilities for the environmental contingencies of PHI and its subsidiaries described below at March 31, 2012 are summarized as follows:

	Transmission and Distribution	Legacy Generation		Other	Total
		Regulated	Non-Regulated		
		(millions of dollars)			
Beginning balance as of January 1	\$ 15	\$ 8	\$ 10	\$ 2	\$ 35
Accruals	—	—	—	—	—
Payments	—	1	—	—	1
Ending balance as of March 31	15	7	10	2	34
Less amounts in Other current liabilities	2	2	—	2	6
Amounts in Other deferred credits	<u>\$ 13</u>	<u>\$ 5</u>	<u>\$ 10</u>	<u>\$ —</u>	<u>\$ 28</u>

Conectiv Energy Wholesale Power Generation Sites

On July 1, 2010, PHI sold the Conectiv Energy wholesale power generation business to Calpine. Under New Jersey's Industrial Site Recovery Act (ISRA), the transfer of ownership triggered an obligation on the part of Conectiv Energy to remediate any environmental contamination at each of the nine Conectiv Energy generating facility sites located in New Jersey. Under the terms of the sale, Calpine has assumed responsibility for performing the ISRA-required remediation and for the payment of all related ISRA compliance costs up to \$10 million. PHI is obligated to indemnify Calpine for any ISRA compliance remediation costs in excess of \$10 million. According to preliminary estimates, the costs of ISRA-required remediation activities at the nine generating facility sites located in New Jersey are in the range of approximately \$7 million to \$18 million. The amount accrued by PHI for the ISRA-required remediation activities at the nine generating facility sites is included in the table above under the column entitled Legacy Generation – Non-Regulated.

On September 14, 2011, PHI received a request for data from the U.S. Environmental Protection Agency (EPA) regarding operations at the Deepwater generating facility in New Jersey (which was included in the sale to Calpine) between January 1, 2001 and July 1, 2010, to demonstrate compliance with the Clean Air Act's new source review permitting program. The data request covers the period from February 2004 to July 1, 2010. Under the terms of the Calpine sale, PHI is obligated to indemnify Calpine for any failure of PHI, on or prior to the closing date of the sale, to comply with environmental laws attributable to the construction of new, or modification of existing, sources of air emissions. At this time, PHI does not expect this inquiry to have a material effect on its financial position or results of operations.

The sale of the Conectiv Energy wholesale power generation business to Calpine did not include a coal ash landfill site located at the Edge Moor generating facility, which PHI intends to close. The preliminary estimate of the costs to PHI to close the coal ash landfill ranges from approximately \$2 million to \$3 million, plus annual post-closure operations, maintenance and monitoring costs, estimated to range between \$120,000 and \$193,000 per year for 30 years. The amounts accrued by PHI for this matter are included in the table above under the column entitled Legacy Generation – Non-Regulated.

Franklin Slag Pile Site

In November 2008, ACE received a general notice letter from EPA concerning the Franklin Slag Pile site in Philadelphia, Pennsylvania, asserting that ACE is a potentially responsible party (PRP) that may have liability for clean-up costs with respect to the site and for the costs of implementing an EPA-mandated remedy. EPA's claims are based on ACE's sale of boiler slag from the B.L. England generating facility, then owned by ACE, to MDC Industries, Inc. (MDC) during the period June 1978 to May 1983. EPA claims that the boiler slag ACE sold to MDC contained copper and lead, which are hazardous substances under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), and that the sales transactions may have constituted an arrangement for the disposal or treatment of hazardous substances at the site, which could be a basis for liability under CERCLA. The EPA letter also states that, as of the date of the letter, EPA's expenditures for response measures at the site have exceeded \$6 million. EPA estimates the additional cost for future response measures will be approximately \$6 million. ACE believes that EPA sent similar general notice letters to three other companies and various individuals.

ACE believes that the B.L. England boiler slag sold to MDC was a valuable material with various industrial applications and, therefore, the sale was not an arrangement for the disposal or treatment of any hazardous substances as would be necessary to constitute a basis for liability under CERCLA. ACE intends to contest any claims to the contrary made by EPA. In a May 2009 decision arising under CERCLA, which did not involve ACE, the U.S. Supreme Court rejected an EPA argument that the sale of a useful product constituted an arrangement for disposal or treatment of hazardous substances. While this decision supports ACE's position, at this time ACE cannot predict how EPA will proceed with respect to the Franklin Slag Pile site, or what portion, if any, of the Franklin Slag Pile site response costs EPA would seek to recover from ACE. Costs to resolve this matter are not expected to be material and are expensed as incurred.

Peck Iron and Metal Site

EPA informed Pepco in a May 2009 letter that Pepco may be a PRP under CERCLA with respect to the cleanup of the Peck Iron and Metal site in Portsmouth, Virginia, and for costs EPA has incurred in cleaning up the site. The EPA letter states that Peck Iron and Metal purchased, processed, stored and shipped metal scrap from military bases, governmental agencies and businesses and that Peck's metal scrap operations resulted in the improper storage and disposal of hazardous substances. EPA bases its allegation that Pepco arranged for disposal or treatment of hazardous substances sent to the site on information provided by former Peck Iron and Metal personnel, who informed EPA that Pepco was a customer at the site. Pepco has advised EPA by letter that its records show no evidence of any sale of scrap metal by Pepco to the site. Even if EPA has such records and such sales did occur, Pepco believes that any such scrap metal sales may be entitled to the recyclable material exemption from CERCLA liability. In a Federal Register notice published on November 4, 2009, EPA placed the Peck Iron and Metal site on the National Priorities List (NPL). The NPL, among other things, serves as a guide to EPA in determining which sites warrant further investigation to assess the nature and extent of the human health and environmental risks associated with a site. In September 2011, EPA initiated a remedial investigation/feasibility study (RI/FS) using federal funds. Pepco cannot at this time estimate an amount or range of reasonably possible loss associated with the RI/FS, any remediation activities to be performed at the site or any other costs that EPA might seek to impose on Pepco.

Ward Transformer Site

In April 2009, a group of PRPs with respect to the Ward Transformer site in Raleigh, North Carolina, filed a complaint in the U.S. District Court for the Eastern District of North Carolina, alleging cost recovery and/or contribution claims against a number of entities, including ACE, DPL and Pepco with respect to past and

future response costs incurred by the PRP group in performing a removal action at the site. In a March 2010 order, the court denied the defendants' motion to dismiss. The next step in the litigation will be the filing of summary judgment motions regarding liability for certain "test case" defendants, not including ACE, DPL and Pepco. The case has been stayed as to the remaining defendants pending rulings upon the test cases. Although PHI cannot at this time estimate an amount or range of reasonably possible losses to which it may be exposed, PHI does not believe that any of its three utility subsidiaries had extensive business transactions, if any, with the Ward Transformer site and therefore, costs incurred to resolve this matter are not expected to be material.

Benning Road Site

In September 2010, PHI received a letter from EPA stating that EPA and the District of Columbia Department of the Environment (DDOE) have identified the Benning Road location, consisting of a transmission and distribution facility operated by Pepco and a generation facility operated by Pepco Energy Services, as one of six land-based sites potentially contributing to contamination of the lower Anacostia River. The letter stated that the principal contaminants of concern are polychlorinated biphenyls and polycyclic aromatic hydrocarbons. In January 2011, Pepco and Pepco Energy Services entered into a proposed consent decree with DDOE that requires Pepco and Pepco Energy Services to conduct a RI/FS for the Benning Road site and an approximately 10-15 acre portion of the adjacent Anacostia River. The RI/FS will form the basis for DDOE's selection of a remedial action for the Benning Road site and for the Anacostia River sediment associated with the site. In February 2011, the District of Columbia filed a complaint against Pepco and Pepco Energy Services in the United States District Court for the District of Columbia for the purpose of obtaining judicial approval of the consent decree. On December 1, 2011, the District Court issued an order granting the motion to enter a revised consent decree. The District Court's order entering the consent decree requires DDOE to solicit and consider public comment on the key RI/FS documents prior to final approval, requires DDOE to make final versions of all approved RI/FS documents available to the public, and requires the parties to submit a written status report to the District Court on May 24, 2013 regarding the implementation of the requirements of the consent decree and any related plans for remediation. In addition, if the RI/FS has not been completed by May 24, 2013, the status report must provide an explanation and a showing of good cause for why the work has not been completed.

Pepco and Pepco Energy Services anticipate that a RI/FS work plan will be approved by the DDOE by the end of the third quarter of 2012, at which time the RI/FS field work activities will commence.

The remediation costs accrued for this matter are included in the table above under the columns entitled Transmission and Distribution, Legacy Generation – Regulated and Legacy Generation – Non-Regulated.

Indian River Oil Release

In 2001, DPL entered into a consent agreement with the Delaware Department of Natural Resources and Environmental Control for remediation, site restoration, natural resource damage compensatory projects and other costs associated with environmental contamination resulting from an oil release at the Indian River generating facility, which was sold in June 2001. The amount of remediation costs accrued for this matter is included in the table above under the column entitled Legacy Generation - Regulated.

Potomac River Mineral Oil Release

In January 2011, a coupling failure on a transformer cooler pipe resulted in a release of non-toxic mineral oil at Pepco's Potomac River substation in Alexandria, Virginia. An overflow of an underground secondary containment reservoir resulted in approximately 4,500 gallons of mineral oil flowing into the Potomac River.

The release falls within the regulatory jurisdiction of multiple federal and state agencies. Beginning in March 2011, DDOE issued a series of compliance directives that require Pepco to prepare an incident report, provide certain records, and prepare and implement plans for sampling surface water and river sediments and assessing ecological risks and natural resources damages. Pepco has submitted an incident report and is providing the requested records. In December 2011, Pepco completed field sampling and anticipates submitting a report to DDOE during the second quarter of 2012.

On March 16, 2011, the Virginia Department of Environmental Quality (VADEQ) requested documentation regarding the release and the preparation of an emergency response report, which Pepco submitted to the agency on April 20, 2011. On March 25, 2011, Pepco received a notice of violation from VADEQ and in December 2011, VADEQ executed a consent agreement that had been executed by Pepco in August, pursuant to which Pepco paid a civil penalty of approximately \$40,000. The U.S. Coast Guard assessed a \$5,000 penalty against Pepco for the release of oil into the waters of the United States, which Pepco has paid.

During March 2011, EPA conducted an inspection of the Potomac River substation to review compliance with federal regulations regarding Spill Prevention, Control, and Countermeasure (SPCC) plans for facilities using oil-containing equipment in proximity to surface waters. As a result, EPA identified several potential violations of the SPCC regulations relating to SPCC plan content, recordkeeping, and secondary containment, which EPA advised may lead to an EPA demand for noncompliance penalties. As a result of the oil release, Pepco submitted a revised SPCC plan to EPA in August 2011 and implemented certain interim operational changes to the secondary containment systems at the facility which involve pumping accumulated storm water to an aboveground holding tank for off-site disposal. In December 2011, Pepco completed the installation of a treatment system designed to allow automatic discharge of accumulated storm water from the secondary containment system. Pepco is currently seeking DDOE's and EPA's approval to commence operation of the new system and, after receiving such approval, will submit a further revised SPCC plan to EPA. In the meantime, Pepco will continue to use the above ground holding tank to manage storm water from the secondary containment system.

In addition to the cost to remediate impacts to the river and shoreline, Pepco also may be liable for non-compliance penalties and/or natural resource damages in addition to those it has already paid. It is not possible to accurately estimate an amount or range of reasonably possible loss to which it may be exposed associated with this liability at this time; however, based on current information, PHI and Pepco do not believe this matter will have a material adverse effect on their respective financial conditions, results of operations or cash flows.

The amounts accrued for these matters are included in the table above under the column entitled Transmission and Distribution.

Fauquier County Landfill Site

In October 2011, Pepco Energy Services received a notice of violation from the VADEQ, which advised Pepco Energy Services of information on which VADEQ may rely to institute an administrative or judicial enforcement action in connection with alleged violation of Virginia air pollution control law and regulations at the facility of Pepco Energy Services' subsidiary Fauquier County Landfill Gas, L.L.C. in Warrenton, Virginia. The notice of violation is based on an on-site VADEQ inspection during which VADEQ observed certain alleged deficiencies relating to the facility's permit to construct and operate. On February 21, 2012, Pepco Energy Services signed a proposed consent order sent by VADEQ, pursuant to which Pepco Energy Services agreed to perform certain remedial actions and agreed to pay a civil charge of approximately \$10,000.

PHI's Cross-Border Energy Lease Investments

PCI has entered seven cross-border energy lease investments involving public utility assets (primarily consisting of hydroelectric generation and coal-fired electric generation facilities and natural gas distribution networks) located outside of the United States. Each of these investments is comprised of multiple leases and each investment is structured as a sale and leaseback transaction commonly referred to by the IRS as a sale-in, lease-out, or SILO transaction. PHI current annual tax benefits from these lease investments are approximately \$48 million. As of March 31, 2012, the book value of PHI's investment in its cross-border energy lease investments was approximately \$1.4 billion. After taking into consideration the \$74 million paid with the 2001-2002 audit (as discussed below), the net federal and state tax benefits received for the remaining leases from January 1, 2001, the earliest year that remains open to audit, to March 31, 2012, has been approximately \$522 million.

Since 2005, PHI's cross-border energy lease investments have been under examination by the IRS as part of the PHI federal income tax audits. In connection with the audit of PHI's 2001-2002 and 2003-2005 income tax returns, respectively, the IRS disallowed the depreciation and interest deductions in excess of rental income claimed by PHI with respect to each of its cross-border energy lease investments. In addition, the IRS has sought to recharacterize each of the leases as a loan transaction as to which PHI would be subject to original issue discount income. PHI disagreed with the IRS' proposed adjustments and filed protests of these findings with the Office of Appeals of the IRS. In November 2010, PHI entered into a settlement agreement with the IRS for the 2001 and 2002 tax years and subsequently filed refund claims in July 2011 for the disallowed tax deductions relating to the leases for these years. In January 2011, as part of this settlement, PHI paid \$74 million of additional tax for 2001 and 2002, penalties of \$1 million, and \$28 million in interest associated with the disallowed deductions. Since the July 2011 claim for refund was not approved by the IRS within the statutory six-month period, in January 2012 PHI filed complaints in the U.S. Court of Federal Claims seeking recovery of the tax payment, interest and penalties. Absent a settlement, this litigation against the IRS may take several years to resolve. The 2003-2005 income tax return review continues to be in process with the IRS Office of Appeals and at present, will not be a part of the U.S. Court of Federal Claims litigation discussed above.

In the event that the IRS were to be successful in disallowing 100% of the tax benefits associated with these lease investments and recharacterizing these lease investments as loans, PHI estimates that, as of March 31, 2012, it would be obligated to pay approximately \$658 million in additional federal and state taxes and \$127 million of interest on the remaining leases. The \$785 million in additional federal and state taxes and interest is net of the \$74 million tax payment made in January 2011. In addition, the IRS could require PHI to pay a penalty of up to 20% on the amount of additional taxes due.

PHI anticipates that any additional taxes that it would be required to pay as a result of the disallowance of prior deductions or a re-characterization of the leases as loans would be recoverable in the form of lower taxes over the remaining terms of the affected leases. Moreover, the entire amount of any additional federal and state tax would not be due immediately, but rather, the federal and state taxes would be payable when the open audit years are closed and PHI amends subsequent tax returns not then under audit. To mitigate the taxes due in the event of a total disallowance of tax benefits, PHI could elect to liquidate all or a portion of its remaining cross-border energy lease investments, which PHI estimates could be accomplished over a period of six months to one year. Based on current market values, PHI estimates that liquidation of the remaining portfolio would generate sufficient cash proceeds to cover the estimated \$785 million in federal and state taxes and interest due as of March 31, 2012, in the event of a total disallowance of tax benefits and a recharacterization of the leases as loans. If payments of additional taxes and interest preceded the receipt of liquidation proceeds, the payments would be funded by currently available sources of liquidity.

To the extent that PHI does not prevail in this matter and suffers a disallowance of the tax benefits and incurs imputed original issue discount income, PHI would be required under FASB guidance on leases (ASC 840) to recalculate the timing of the tax benefits generated by the cross-border energy lease investments and adjust the equity value of the investments, which would result in a non-cash charge to earnings.

District of Columbia Tax Legislation

On January 20, 2012, the District of Columbia Office of Tax and Revenue issued proposed regulations to implement the mandatory unitary combined reporting method for tax years beginning in 2011. PHI will continue to analyze these regulations and will record the impact, if any, of such regulations on PHI's results of operations in the period in which the proposed regulations are adopted as final regulations.

Third Party Guarantees, Indemnifications, and Off-Balance Sheet Arrangements

PHI and certain of its subsidiaries have various financial and performance guarantees and indemnification obligations that they have entered into in the normal course of business to facilitate commercial transactions with third parties as discussed below.

As of March 31, 2012, PHI and its subsidiaries were parties to a variety of agreements pursuant to which they were guarantors for standby letters of credit, energy procurement obligations, and other commitments and obligations. The commitments and obligations, in millions of dollars, were as follows:

	Guarantor				Total
	PHI	Pepco	DPL	ACE	
Energy procurement obligations of Pepco Energy Services (a)	\$160	\$—	\$—	\$—	\$160
Guarantees associated with disposal of Conectiv Energy assets (b)	18	—	—	—	18
Guaranteed lease residual values (c)	2	4	5	3	14
Total	<u>\$180</u>	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 3</u>	<u>\$192</u>

- (a) PHI has contractual commitments for performance and related payments of Pepco Energy Services to counterparties under routine energy sales and procurement obligations.
- (b) Represents guarantees by PHI of Conectiv Energy's tolling agreements and derivatives portfolio transferred in connection with the disposition of Conectiv Energy's wholesale business. The tolling agreement guarantees cover the payment by the entity to which the tolling agreement was assigned. The guaranteed amounts on the transferred tolling agreements totaled \$5 million at March 31, 2012 and decline until the termination of the guarantees in June 2012. The derivative portfolio guarantee is currently \$13 million and covers Conectiv Energy's performance prior to the assignment. This guarantee will remain in effect until the end of 2015.
- (c) Subsidiaries of PHI have guaranteed any residual values in excess of fair value of certain leased equipment and fleet vehicles. As of March 31, 2012, obligations under the guarantees were approximately \$14 million. Assets leased under agreements subject to residual value guarantees are typically for periods ranging from 2 years to 10 years. Historically, payments under the guarantees have not been made by the guarantor as, under normal conditions, the contract runs to full term at which time the residual value is immaterial. As such, PHI believes the likelihood of payments being required under the guarantees is remote.

PHI and certain of its subsidiaries have entered into various indemnification agreements related to purchase and sale agreements and other types of contractual agreements with vendors and other third parties. These indemnification agreements typically cover environmental, tax, litigation and other matters, as well as breaches of representations, warranties and covenants set forth in these agreements. Typically, claims may be made by third parties under these indemnification agreements over various periods of time depending on the nature of the claim. The maximum potential exposure under these indemnification agreements can range from a specified dollar amount to an unlimited amount depending on the nature of the claim and the particular transaction. The total maximum potential amount of future payments under these indemnification agreements is not estimable due to several factors, including uncertainty as to whether or when claims may be made under these indemnities.

Energy Services Performance and Construction Contracts

Pepco Energy Services has a diverse portfolio of energy services performance contracts that are associated with the installation of energy savings equipment or combined heat and power for federal, state and local government customers. As part of the energy savings contracts, Pepco Energy Services typically guarantees that the equipment or systems installed by Pepco Energy Services will generate a specified amount of energy savings on an annual basis over a multi-year period. As of March 31, 2012, Pepco Energy Services' energy savings guarantees on both completed projects and projects under construction totaled \$441 million over the

life of the performance contracts with the longest remaining term being 15 years. On an annual basis, Pepco Energy Services undertakes a measurement and verification process to determine the amount of energy savings for the year and whether there is any shortfall in the annual energy savings compared to the guaranteed amount. As of March 31, 2012, Pepco Energy Services had performance guarantee contracts associated with the production at its combined heat and power facilities on both completed projects and projects under construction totaling \$15 million over the life of the contracts, with the longest remaining term being 20 years. Pepco Energy Services recognizes a liability for the value of the estimated energy savings or production shortfalls when it is probable that the guaranteed amounts will not be achieved and the amount is reasonably estimable. As of March 31, 2012, Pepco Energy Services did not have an accrued liability for energy savings or combined heat and power performance contracts. There was no significant change in the type of contracts issued for the three months ended March 31, 2012. Based on its historical experience, Pepco Energy Services believes the probability of incurring a material loss under its energy savings or combined heat and power performance contracts is remote.

From time to time, PHI is also required to guarantee the obligations of Pepco Energy Services under certain of its construction contracts. At March 31, 2012, PHI's guarantees of Pepco Energy Services' construction projects totaled \$143 million.

Dividends

On April 26, 2012, Pepco Holdings' Board of Directors declared a dividend on common stock of 27 cents per share payable June 29, 2012, to stockholders of record on June 11, 2012.

(16) ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of Pepco Holdings' AOCL relating to continuing operations are as follows. For additional information, see the consolidated statements of comprehensive income.

	<u>Commodity Derivatives</u>	<u>Treasury Lock</u>	<u>Prior Service Costs</u>	<u>Total</u>
	<i>(millions of dollars)</i>			
Balance, December 31, 2011	\$ (29)	\$ (10)	\$ (24)	\$(63)
Current year change	8	—	—	8
Balance, March 31, 2012	<u>\$ (21)</u>	<u>\$ (10)</u>	<u>\$ (24)</u>	<u>\$(55)</u>

The income tax expense for each component of Pepco Holdings' other comprehensive income is as follows:

	<u>Commodity Derivatives (a)</u>	<u>Treasury Lock (b)</u>	<u>Prior Service Costs (b)</u>	<u>Total</u>
	<i>(millions of dollars)</i>			
For the three months ended March 31, 2012	\$ 5	\$ —	\$ 1	\$ 6
For the three months ended March 31, 2011	\$ 11	\$ —	\$ —	\$ 11

- (a) Includes tax expense for losses reclassified to income during the three months ended March 31, 2012 and 2011, of \$5 million and \$11 million, respectively.
- (b) No material income tax effect of losses reclassified to income in the current period.

(17) DISCONTINUED OPERATIONS

In April 2010, the Board of Directors approved a plan for the disposition of PHI's competitive wholesale power generation, marketing and supply business, which had been conducted through Conectiv Energy. On July 1, 2010, PHI completed the sale of Conectiv Energy's wholesale power generation business to Calpine. The disposition of all of Conectiv Energy's remaining assets and businesses, consisting of its load service supply contracts, energy hedging portfolio, certain tolling agreements and other assets not included in the Calpine sale, is complete.

Income from discontinued operations, net of income taxes for the three months ended March 31, 2012 and 2011, was zero and \$2 million, respectively.

POTOMAC ELECTRIC POWER COMPANY
STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Operating Revenue	<u>\$ 465</u>	<u>\$ 534</u>
Operating Expenses		
Purchased energy	185	255
Other operation and maintenance	103	102
Depreciation and amortization	47	42
Other taxes	90	92
Total Operating Expenses	<u>425</u>	<u>491</u>
Operating Income	<u>40</u>	<u>43</u>
Other Income (Expenses)		
Interest expense	(25)	(24)
Other income	4	6
Total Other Expenses	<u>(21)</u>	<u>(18)</u>
Income Before Income Tax Expense	19	25
Income Tax (Benefit) Expense	(5)	7
Net Income	<u>\$ 24</u>	<u>\$ 18</u>

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

POTOMAC ELECTRIC POWER COMPANY
BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars)</i>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 7	\$ 12
Accounts receivable, less allowance for uncollectible accounts of \$16 million and \$18 million, respectively	305	339
Inventories	54	50
Prepayments of income taxes	18	7
Income taxes receivable	31	31
Prepaid expenses and other	29	32
Total Current Assets	<u>444</u>	<u>471</u>
INVESTMENTS AND OTHER ASSETS		
Regulatory assets	332	299
Prepaid pension expense	368	289
Investment in trust	30	31
Income taxes receivable	103	24
Other	63	55
Total Investments and Other Assets	<u>896</u>	<u>698</u>
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	6,691	6,578
Accumulated depreciation	<u>(2,722)</u>	<u>(2,704)</u>
Net Property, Plant and Equipment	3,969	3,874
TOTAL ASSETS	<u>\$ 5,309</u>	<u>\$ 5,043</u>

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

POTOMAC ELECTRIC POWER COMPANY
BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars, except shares)</i>	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Short-term debt	\$ 204	\$ 74
Accounts payable and accrued liabilities	200	209
Accounts payable due to associated companies	64	57
Capital lease obligations due within one year	8	8
Taxes accrued	51	63
Interest accrued	36	17
Other	111	110
Total Current Liabilities	<u>674</u>	<u>538</u>
DEFERRED CREDITS		
Regulatory liabilities	173	169
Deferred income taxes, net	1,173	1,039
Investment tax credits	5	5
Other postretirement benefit obligations	67	66
Liabilities and accrued interest related to uncertain tax positions	5	38
Other	68	68
Total Deferred Credits	<u>1,491</u>	<u>1,385</u>
LONG-TERM LIABILITIES		
Long-term debt	1,540	1,540
Capital lease obligations	78	78
Total Long-Term Liabilities	<u>1,618</u>	<u>1,618</u>
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
EQUITY		
Common stock, \$.01 par value, 200,000,000 shares authorized, 100 shares outstanding	—	—
Premium on stock and other capital contributions	705	705
Retained earnings	821	797
Total Equity	<u>1,526</u>	<u>1,502</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 5,309</u>	<u>\$ 5,043</u>

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

POTOMAC ELECTRIC POWER COMPANY
STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
OPERATING ACTIVITIES		
Net income	\$ 24	\$ 18
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	47	42
Deferred income taxes	127	26
Changes in:		
Accounts receivable	35	28
Inventories	(4)	(4)
Regulatory assets and liabilities, net	(14)	(4)
Accounts payable and accrued liabilities	(7)	(33)
Pension contributions	(85)	(40)
Taxes accrued	(139)	50
Interest accrued	19	19
Other assets and liabilities	4	16
Net Cash From Operating Activities	<u>7</u>	<u>118</u>
INVESTING ACTIVITIES		
Investment in property, plant and equipment	(158)	(97)
Department of Energy capital reimbursement awards received	6	8
Net other investing activities	<u>2</u>	<u>(1)</u>
Net Cash Used By Investing Activities	<u>(150)</u>	<u>(90)</u>
FINANCING ACTIVITIES		
Issuances of short-term debt, net	130	—
Net other financing activities	<u>8</u>	<u>—</u>
Net Cash From Financing Activities	<u>138</u>	<u>—</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(5)	28
Cash and Cash Equivalents at Beginning of Period	12	88
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u><u>\$ 7</u></u>	<u><u>\$ 116</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid (received) for income taxes (includes payments to (from) PHI for federal income taxes)	\$ 1	\$ (70)

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

POTOMAC ELECTRIC POWER COMPANY
STATEMENT OF EQUITY
(Unaudited)

<i>(millions of dollars, except shares)</i>	Common Stock		Premium on Stock	Retained Earnings	Total
	Shares	Par Value			
BALANCE, DECEMBER 31, 2011	100	\$ —	\$ 705	\$ 797	\$1,502
Net Income	—	—	—	24	24
BALANCE, MARCH 31, 2012	<u>100</u>	<u>\$ —</u>	<u>\$ 705</u>	<u>\$ 821</u>	<u>\$1,526</u>

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

NOTES TO FINANCIAL STATEMENTS**POTOMAC ELECTRIC POWER COMPANY****(1) ORGANIZATION**

Potomac Electric Power Company (Pepco) is engaged in the transmission and distribution of electricity in the District of Columbia and major portions of Prince George's County and Montgomery County in suburban Maryland. Pepco also provides Default Electricity Supply, which is the supply of electricity at regulated rates to retail customers in its service territories who do not elect to purchase electricity from a competitive supplier. Default Electricity Supply is known as Standard Offer Service in both the District of Columbia and Maryland. Pepco is a wholly owned subsidiary of Pepco Holdings, Inc. (Pepco Holdings or PHI).

(2) SIGNIFICANT ACCOUNTING POLICIES**Financial Statement Presentation**

Pepco's unaudited financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the Securities and Exchange Commission, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in Pepco's annual report on Form 10-K for the year ended December 31, 2011, as amended to include the executive compensation and other information required by Part III of Form 10-K (which information originally had been omitted as permitted by that form). In the opinion of Pepco's management, the financial statements contain all adjustments (which all are of a normal recurring nature) necessary to state fairly Pepco's financial condition as of March 31, 2012, in accordance with GAAP. The year-end December 31, 2011 balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. Interim results for the three months ended March 31, 2012 may not be indicative of results that will be realized for the full year ending December 31, 2012.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the financial statements and accompanying notes. Although Pepco believes that its estimates and assumptions are reasonable, they are based upon information available to management at the time the estimates are made. Actual results may differ significantly from these estimates.

Significant matters that involve the use of estimates include the assessment of contingencies, the calculation of future cash flows and fair value amounts for use in asset impairment evaluations, pension and other postretirement benefits assumptions, the assessment of the probability of recovery of regulatory assets, accrual of storm restoration costs, accrual of unbilled revenue, recognition of changes in network service transmission rates for prior service year costs, accrual of self-insurance reserves for general and auto liability claims, and income tax provisions and reserves. Additionally, Pepco is subject to legal, regulatory and other proceedings and claims that arise in the ordinary course of its business. Pepco records an estimated liability for these proceedings and claims when it is probable that a loss has been incurred and the loss is reasonably estimable.

Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions

Taxes included in Pepco's gross revenues were \$84 million and \$85 million for the three months ended March 31, 2012 and 2011, respectively.

Reclassifications and Adjustments

Certain prior period amounts have been reclassified in order to conform to the current period presentation. The following adjustment has been recorded and is not considered material:

Income Tax Adjustments

During the first quarter of 2011, Pepco recorded an adjustment to correct certain income tax errors related to prior periods associated with interest on uncertain tax positions. The adjustment resulted in an increase in income tax expense of \$1 million for the three months ended March 31, 2011.

(3) NEWLY ADOPTED ACCOUNTING STANDARDS

Fair Value Measurements and Disclosures (Accounting Standards Codification (ASC) 820)

The Financial Accounting Standards Board (FASB) issued new guidance on fair value measurement and disclosures that was effective beginning with Pepco's March 31, 2012 financial statements. The new measurement guidance did not have a material impact on Pepco's financial statements and the new disclosure requirements are in Note (10), "Fair Value Disclosures," of Pepco's financial statements.

(4) RECENTLY ISSUED ACCOUNTING STANDARDS, NOT YET ADOPTED

None.

(5) SEGMENT INFORMATION

Pepco operates its business as one regulated utility segment, which includes all of its services as described above.

(6) REGULATORY MATTERS

Rate Proceedings

Over the last several years, Pepco has proposed in each of its jurisdictions the adoption of a mechanism to decouple retail distribution revenue from the amount of power delivered to retail customers. To date, a bill stabilization adjustment (BSA) has been approved and implemented for Pepco electric service in Maryland and the District of Columbia. The Maryland Public Service Commission (MPSC) has issued an order requiring modification of the BSA in Maryland so that revenues lost as a result of major storm outages are not collected through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (as discussed below). Under the BSA, customer distribution rates are subject to adjustment (through a credit or surcharge mechanism), depending on whether actual distribution revenue per customer exceeds or falls short of the revenue-per-customer amount approved by the applicable public service commission.

In an effort to reduce the shortfall in revenues due to the delay in time or lag between when costs are incurred and when they are reflected in rates (regulatory lag), Pepco has proposed, in each of its jurisdictions, a reliability investment recovery mechanism (RIM) to recover reliability-related capital expenditures incurred between base rate cases. Through the RIM, Pepco in each year would collect through a surcharge the amount of its reliability-related capital expenditures based on its budget for that year. The budgeted amount would be reconciled with actual capital expenditures on an annual basis and any over-recovery or under-recovery would be reflected in the next year's surcharge. The work undertaken pursuant to the RIM would be subject to a prudency review by the applicable state regulatory commission in the next base rate case or at more frequent intervals as determined by such commission. Pepco's operation and maintenance costs and other capital expenditures would remain subject to recovery through the traditional ratemaking process.

Pepco also has requested in each of its jurisdictions approval of the use of fully forecasted test years in future rate cases. Traditionally, past test years with actual historical costs are used for ratemaking purposes; however, fully forecasted test years would be comprised of forward-looking costs. If approved, such fully forecasted test years would be more reflective of current costs and would mitigate the effects of regulatory lag.

District of Columbia

On July 8, 2011, Pepco filed an application with the District of Columbia Public Service Commission (DCPSC) to increase its electric distribution base rates by approximately \$42 million annually, based on a requested return on equity (ROE) of 10.75%. The filing includes a request for DCPSC approval of a RIM and the use of fully forecasted test years in future Pepco rate cases. A decision by the DCPSC is expected in the third quarter of 2012.

Maryland

Electric Distribution Base Rates

On December 16, 2011, Pepco submitted an application with the MPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$68.4 million, based on a requested ROE of 10.75%. The filing includes a request for MPSC approval of a RIM and the use of fully forecasted test years in future Pepco rate cases. A decision by the MPSC is expected in July 2012.

Major Storm Damage Recovery Proceedings

In February 2011, the MPSC initiated proceedings involving Pepco, as well as its affiliate Delmarva Power & Light Company (DPL) and unaffiliated utilities in Maryland, for the purpose of reviewing how the BSA operates to recover revenues lost as a result of major storm outages. On January 25, 2012, the MPSC issued an order modifying the BSA to prevent the Maryland utilities, including Pepco and DPL, from collecting lost utility revenue through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (defined by the MPSC as a weather-related event during which more than the lesser of 10% or 100,000 of an electric utility's customers have a sustained outage for more than 24 hours). The period for which the lost utility revenue may not be collected through the BSA commences 24 hours after the start of the major storm and continues until all major storm-related outages are restored. The MPSC stated that waivers permitting collection of BSA revenues would be granted in rare and extraordinary circumstances where a utility can show that an outage was not due to inadequate emphasis on reliability and restoration efforts were reasonable under the circumstances. A similar provision excluding revenues lost as a result of major storm outages from the calculation of future BSA adjustments is already included in the BSA for Pepco in the District of Columbia as approved by the DCPSC. The financial impact of service interruptions due to a major storm as a result of this MPSC order would generally depend on the scope and duration of the outages.

Maryland Public Service Commission New Generation Contract Requirement

On September 29, 2009, the MPSC initiated an investigation into whether the regulated electric distribution companies (EDCs) in Maryland should be required to enter into long-term contracts with entities that construct, acquire or lease, and operate, new electric generation facilities in Maryland.

The MPSC issued an order on April 12, 2012, in which it determined that there is a need for one new power plant in the range of 650 to 700 MW beginning in 2015. The order requires Pepco, DPL and Baltimore Gas and Electric Company to negotiate and enter into a contract with the winning bidder in amounts proportionate to their relative SOS loads. Under the contract, the winning bidder will construct a 661 MW natural gas-fired combined cycle generation plant in Waldorf, Maryland, with a commercial operation date of

June 1, 2015. The order acknowledges the EDCs' concerns about the requirements of the contract and directs them to negotiate with the winning bidder and submit any proposed changes in the contract to the MPSC for approval. The order further specifies that the EDCs entering into the contract will recover the associated costs from their respective SOS customers through surcharges. Pepco is evaluating the impact of the order, and, at this time, cannot predict (i) the extent of the negative effect that the order and, once finalized, the contract for new generation, may have on its balance sheets, as well as its credit metrics, as calculated by independent rating agencies that evaluate and rate Pepco and its debt issuances, (ii) the effect on its ability to recover its associated costs of the contract for new generation if a significant number of SOS customers elect to buy their energy from alternative energy suppliers, and (iii) the effect of the order on its financial condition, results of operations and cash flows. On April 27, 2012, a group of generators operating in the PJM region filed a complaint in the United States District Court for the Northern District of Maryland challenging the MPSC's order on the grounds that such order violated the commerce clause and the supremacy clause of the U.S. Constitution. Pepco continues to evaluate whether to seek judicial review of the MPSC's order.

(7) PENSION AND OTHER POSTRETIREMENT BENEFITS

Pepco accounts for its participation in its parent's single-employer plans, the Pepco Holdings, Inc. Retirement Plan (the PHI Retirement Plan) and the Pepco Holdings, Inc. Welfare Plan for Retirees, as participation in multiemployer plans. PHI's pension and other postretirement net periodic benefit cost for the three months ended March 31, 2012 and 2011, before intercompany allocations from the PHI Service Company, were \$26 million and \$27 million, respectively. Pepco's allocated share was \$11 million and \$10 million, respectively, for the three months ended March 31, 2012 and 2011.

In the first quarter of 2012, Pepco made a discretionary tax-deductible contribution to the PHI Retirement Plan of \$85 million. In the first quarter of 2011, Pepco made a discretionary tax-deductible contribution to the PHI Retirement Plan in the amount of \$40 million.

(8) DEBT

Credit Facility

PHI, Pepco, DPL and Atlantic City Electric Company (ACE) maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement with respect to the facility, which among other changes extended the expiration date of the facility to August 1, 2016.

The aggregate borrowing limit under the amended and restated credit facility is \$1.5 billion, all or any portion of which may be used to obtain loans and up to \$500 million of which may be used to obtain letters of credit. The facility also includes a swingline loan sub-facility, pursuant to which each company may make same day borrowings in an aggregate amount not to exceed 10% of the total amount of the facility. Any swingline loan must be repaid by the borrower within fourteen days of receipt. The initial credit sublimit for PHI is \$750 million and \$250 million for each of Pepco, DPL and ACE. The sublimits may be increased or decreased by the individual borrower during the term of the facility, except that (i) the sum of all of the borrower sublimits following any such increase or decrease must equal the total amount of the facility and (ii) the aggregate amount of credit used at any given time by (a) PHI may not exceed \$1.25 billion and (b) each of Pepco, DPL or ACE may not exceed the lesser of \$500 million and the maximum amount of short-term debt the company is permitted to have outstanding by its regulatory authorities. The total number of the sublimit reallocations may not exceed eight per year during the term of the facility.

The interest rate payable by each company on utilized funds is, at the borrowing company's election, (i) the greater of the prevailing prime rate, the federal funds effective rate plus 0.5% and one month LIBOR plus 1.0%, or (ii) the prevailing Eurodollar rate, plus a margin that varies according to the credit rating of the borrower.

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of March 31, 2012.

The absence of a material adverse change in PHI's business, property, results of operations or financial condition is not a condition to the availability of credit under the credit agreement. The credit agreement does not include any rating triggers.

At March 31, 2012 and December 31, 2011, the amount of cash plus borrowing capacity under the credit facility available to meet the liquidity needs of PHI's utility subsidiaries in the aggregate was \$452 million and \$711 million, respectively. Pepco's borrowing capacity under the credit facility at any given time depends on the amount of the subsidiary borrowing capacity being utilized by DPL and ACE and the portion of the total capacity being used by PHI.

Commercial Paper

Pepco maintains an on-going commercial paper program to address its short-term liquidity needs. As of March 31, 2012, the maximum capacity available under the program was \$500 million, subject to available borrowing capacity under the credit facility.

Pepco had \$204 million of commercial paper outstanding at March 31, 2012. The weighted average interest rate for commercial paper issued by Pepco during the three months ended March 31, 2012 was 0.40% and the weighted average maturity of all commercial paper issued by Pepco during the three months ended March 31, 2012 was five days.

Financing Activities Subsequent to March 31, 2012

In April 2012, Pepco issued \$200 million of 3.05% first mortgage bonds due April 1, 2022. Proceeds from the issuance of the long-term debt were primarily used to repay outstanding commercial paper that was issued to temporarily fund capital expenditures and working capital, to redeem, prior to maturity, all of the \$38.3 million outstanding of the 5.375% pollution control revenue refunding bonds due February 15, 2024 issued by the Industrial Development Authority of the City of Alexandria, Virginia, on Pepco's behalf and for general corporate purposes.

On April 30, 2012, all of the \$38.3 million outstanding of the 5.375% pollution control revenue refunding bonds were redeemed as noted in the preceding paragraph. In connection with such redemption, Pepco redeemed all of the \$38.3 million outstanding of its 5.375% first mortgage bonds due February 15, 2024 that secured the obligations under such pollution control bonds.

(9) INCOME TAXES

A reconciliation of Pepco's effective income tax rate is as follows:

	Three Months Ended March 31,			
	2012		2011	
	(millions of dollars)			
Income tax at Federal statutory rate	\$ 7	35.0%	\$ 9	35.0%
Increases (decreases) resulting from:				
State income taxes, net of Federal effect	1	6.3	1	4.4
Change in estimates and interest related to uncertain and effectively settled tax positions	(10)	(50.5)	—	—
Permanent differences related to deferred compensation	—	(1.0)	(1)	(4.4)
Asset removal costs	(3)	(15.8)	(1)	(4.0)
Amortization of software costs	—	2.1	—	(0.4)
Deferred tax basis adjustments	—	(2.1)	—	—
Other, net	—	(0.3)	(1)	(2.6)
Income tax expense	\$ (5)	(26.3)%	\$ 7	28.0%

Pepco's effective tax rates for the three months ended March 31, 2012 and 2011 were (26.3)% and 28.0%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the Internal Revenue Service with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position. The effective rate was further decreased as a result of the increase in asset removal costs in 2012 primarily related to a higher level of asset retirements.

(10) FAIR VALUE DISCLOSURES**Financial Instruments Measured at Fair Value on a Recurring Basis**

Pepco applies FASB guidance on fair value measurement and disclosures (ASC 820) that established a framework for measuring fair value and expanded disclosures about fair value measurements. As defined in the guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). Pepco utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. Accordingly, Pepco utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3).

The following tables set forth, by level within the fair value hierarchy, Pepco's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2012 and December 31, 2011. As required by the guidance, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Pepco's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Description	Fair Value Measurements at March 31, 2012			
	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1) (a)	Significant Other Observable Inputs (Level 2) (a)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
ASSETS				
Executive deferred compensation plan assets				
Money market funds	\$ 13	\$ 13	\$ —	\$ —
Life insurance contracts	57	—	39	18
	<u>\$ 70</u>	<u>\$ 13</u>	<u>\$ 39</u>	<u>\$ 18</u>
LIABILITIES				
Executive deferred compensation plan liabilities				
Life insurance contracts	<u>\$ 10</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ —</u>
	<u>\$ 10</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ —</u>

(a) There were no transfers of instruments between level 1 and level 2 valuation categories.

Description	Fair Value Measurements at December 31, 2011			
	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1) (a)	Significant Other Observable Inputs (Level 2) (a)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
ASSETS				
Executive deferred compensation plan assets				
Money market funds	\$ 12	\$ 12	\$ —	\$ —
Life insurance contracts	57	—	40	17
	<u>\$ 69</u>	<u>\$ 12</u>	<u>\$ 40</u>	<u>\$ 17</u>
LIABILITIES				
Executive deferred compensation plan liabilities				
Life insurance contracts	\$ 10	\$ —	\$ 10	\$ —
	<u>\$ 10</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ —</u>

(a) There were no transfers of instruments between level 1 and level 2 valuation categories.

Pepco classifies its fair value balances in the fair value hierarchy based on the observability of the inputs used in the fair value calculation as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using broker quotes in liquid markets and other observable data. Level 2 also includes those financial instruments that are valued using methodologies that have been corroborated by observable market data through correlation or by other means. Significant assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Executive deferred compensation plan assets consist of life insurance policies that are categorized as level 2 assets because they are priced based on the assets underlying the policies, which consist of short-term cash equivalents and fixed income securities that are priced using observable market data and can be liquidated for the value of the underlying assets as of March 31, 2012. The level 2 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance sub-accounts. The sub-accounts are designed to mirror existing mutual funds and money market funds that are observable and actively traded.

Level 3 – Pricing inputs include significant inputs that are generally less observable than those from objective sources. Level 3 includes those financial instruments that are valued using models or other valuation methodologies.

Executive deferred compensation plan assets and liabilities include certain life insurance policies that are valued using the cash surrender value of the policies, net of loans against those policies. The cash surrender values do not represent a quoted price in an active market; therefore, are unobservable and are categorized as level 3. Cash surrender values are provided by third parties and reviewed by Pepco for reasonableness.

Reconciliations of the beginning and ending balances of Pepco's fair value measurements using significant unobservable inputs (level 3) for the three months ended March 31, 2012 and 2011 are shown below:

	Life Insurance Contracts	
	Three Months Ended	
	March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Beginning balance as of January 1	\$ 17	\$ 18
Total gains (losses) (realized and unrealized)		
Included in income	1	3
Included in accumulated other comprehensive loss	—	—
Purchases	—	—
Issuances	—	(1)
Settlements	—	(4)
Transfers in (out) of level 3	—	—
Ending balance as of March 31	<u>\$ 18</u>	<u>\$ 16</u>

The breakdown of realized and unrealized gains on level 3 instruments included in income as a component of Other operation and maintenance expense for the periods below were as follows:

	Three Months Ended	
	March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Total gains included in income for the period	<u>\$ 1</u>	<u>\$ 3</u>
Change in unrealized gains relating to assets still held at reporting date	<u>\$ 1</u>	<u>\$ 1</u>

Other Financial Instruments

The estimated fair values of Pepco's debt instruments that are measured at amortized cost in Pepco's financial statements and the associated level of the estimates within the fair value hierarchy as of March 31, 2012 are shown in the table below. As required by the fair value measurement guidance, debt instruments are classified in their entirety within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. Pepco's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, which may affect the valuation of fair value debt instruments and their placement within the fair value hierarchy levels.

Description	Fair Value Measurements at March 31, 2012				
	Total	Quoted Prices in	Significant	Significant	
		Active Markets	Other		Unobservable
		for Identical	Observable		Inputs
		Instruments	Inputs	Inputs	
		(Level 1)	(Level 2)	(Level 3)	
		(millions of dollars)			
LIABILITIES					
Debt instruments					
Long-term debt (a)	\$1,927	\$ 408	\$ 1,519	\$ —	
	\$1,927	\$ 408	\$ 1,519	\$ —	

(a) The carrying amount for Long-term debt is \$1,540 million as of March 31, 2012.

The fair value of Long-term debt categorized as level 1 is based on actual quoted trade prices for the debt in active markets on the measurement date.

The fair value of Long-term debt categorized as level 2 is based on a blend of quoted prices for the debt and quoted prices for similar

debt in active markets, but not on the measurement date. The blend places more weight on current pricing information when determining the final fair value measurement. The fair value information is provided by brokers and Pepco reviews the methodologies and results.

The fair value of Long-term debt categorized as level 3 is based on a discounted cash flow methodology using observable inputs, such as the U.S. Treasury yield, and unobservable inputs, such as credit spreads, because quoted prices for the debt or similar debt in active markets were insufficient.

The estimated fair values of Pepco's debt instruments at December 31, 2011 are shown below:

	December 31, 2011	
	Carrying Amount	Fair Value
	<i>(millions of dollars)</i>	
Long-term debt	\$ 1,540	\$1,943

The carrying amount of all other financial instruments in the accompanying financial statements approximate fair value.

(11) COMMITMENTS AND CONTINGENCIES

General Litigation

In 1993, Pepco was served with Amended Complaints filed in the state Circuit Courts of Prince George's County, Baltimore City and Baltimore County, Maryland in separate ongoing, consolidated proceedings known as "In re: Personal Injury Asbestos Case." Pepco and other corporate entities were brought into these cases on a theory of premises liability. Under this theory, the plaintiffs argued that Pepco was negligent in not providing a safe work environment for employees or its contractors, who allegedly were exposed to asbestos while working on Pepco's property. Initially, a total of approximately 448 individual plaintiffs added Pepco to their complaints. While the pleadings were not entirely clear, it appeared that each plaintiff sought \$2 million in compensatory damages and \$4 million in punitive damages from each defendant. In the intervening years, most of the cases were voluntarily dismissed by the plaintiffs prior to their respective trial dates. At the beginning of the first quarter of 2012, there were approximately 90 cases pending against Pepco in the Maryland State Courts (excluding those tendered to Mirant Corporation (Mirant) for defense and indemnification in connection with the sale by Pepco of its generation assets to Mirant in 2000), with an aggregate amount of monetary damages sought of approximately \$360 million. On March 1, 2012, the parties to these consolidated proceedings (each represented by the same law firm) filed a stipulation of dismissal, by which the plaintiffs voluntarily dismissed Pepco as a defendant, eliminating any reasonably possible liability Pepco may have had with respect to these proceedings.

Environmental Matters

Pepco is subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of its operations, including air and water quality control, solid and hazardous waste disposal and limitations on land use. Although penalties assessed for violations of environmental laws and regulations are not recoverable from Pepco's customers, environmental clean-up costs incurred by Pepco generally are included in its cost of service for ratemaking purposes. The total accrued liabilities for the environmental contingencies of Pepco described below at March 31, 2012 are summarized as follows:

	<u>Transmission and Distribution</u>	<u>Legacy Generation</u>		<u>Other</u>	<u>Total</u>
		<u>Regulated</u>	<u>Non - Regulated</u>		
		<i>(millions of dollars)</i>			
Beginning balance as of January 1	\$ 14	\$ 4	\$ —	\$—	\$ 18
Accruals	—	—	—	—	—
Payments	—	—	—	—	—
Ending balance as of March 31	14	4	—	—	18
Less amounts in Other current liabilities	2	—	—	—	2
Amounts in Other deferred credits	<u>\$ 12</u>	<u>\$ 4</u>	<u>\$ —</u>	<u>\$—</u>	<u>\$ 16</u>

Peck Iron and Metal Site

The U.S. Environmental Protection Agency (EPA) informed Pepco in a May 2009 letter that Pepco may be a potentially responsible party (PRP) under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) with respect to the cleanup of the Peck Iron and Metal site in Portsmouth, Virginia, and for costs EPA has incurred in cleaning up the site. The EPA letter states that Peck Iron and Metal purchased, processed, stored and shipped metal scrap from military bases, governmental agencies and businesses and that Peck's metal scrap operations resulted in the improper storage and disposal of hazardous substances. EPA bases its allegation that Pepco arranged for disposal or treatment of hazardous substances sent to the site on information provided by former Peck Iron and Metal personnel, who informed EPA that Pepco was a customer at the site. Pepco has advised EPA by letter that its records show no evidence of any sale of scrap metal by Pepco to the site. Even if EPA has such records and such sales did occur, Pepco believes that any such scrap metal sales may be entitled to the recyclable material exemption from CERCLA liability. In a Federal Register notice published on November 4, 2009, EPA placed the Peck Iron and Metal site on the National Priorities List (NPL). The NPL, among other things, serves as a guide to EPA in determining which sites warrant further investigation to assess the nature and extent of the human health and environmental risks associated with a site. In September 2011, EPA initiated a remedial investigation/feasibility study (RI/FS) using federal funds. Pepco cannot at this time estimate an amount or range of reasonably possible loss associated with the RI/FS, any remediation activities to be performed at the site or any other costs that EPA might seek to impose on Pepco.

Ward Transformer Site

In April 2009, a group of PRPs with respect to the Ward Transformer site in Raleigh, North Carolina, filed a complaint in the U.S. District Court for the Eastern District of North Carolina, alleging cost recovery and/or contribution claims against a number of entities, including Pepco with respect to past and future response costs incurred by the PRP group in performing a removal action at the site. In a March 2010 order, the court denied the defendants' motion to dismiss. The next step in the litigation will be the filing of summary judgment motions regarding liability for certain "test case" defendants, not including Pepco. The case has been stayed as to the remaining defendants pending rulings upon the test cases. Although Pepco cannot at this time estimate an amount or range of reasonably possible losses to which it may be exposed, Pepco does not believe that it had extensive business transactions, if any, with the Ward Transformer site and therefore, costs incurred to resolve this matter are not expected to be material.

Benning Road Site

In September 2010, PHI received a letter from EPA stating that EPA and the District of Columbia Department of the Environment (DDOE) have identified the Benning Road location, consisting of a transmission and distribution facility operated by Pepco and a generation facility operated by a subsidiary of Pepco's affiliate, Pepco Energy Services, Inc. (collectively with its subsidiaries, Pepco Energy Services) as one of six land-based sites potentially contributing to contamination of the lower Anacostia River. The letter stated that the principal contaminants of concern are polychlorinated biphenyls and polycyclic aromatic hydrocarbons. In January 2011, Pepco and Pepco Energy Services entered into a proposed consent decree with DDOE that requires Pepco and Pepco Energy Services to conduct a RI/FS for the Benning Road site and an approximately 10-15 acre portion of the adjacent Anacostia River. The RI/FS will form the basis for DDOE's selection of a remedial action for the Benning Road site and for the Anacostia River sediment associated with the site. In February 2011, the District of Columbia filed a complaint against Pepco and Pepco Energy Services in the United States District Court for the District of Columbia for the purpose of obtaining judicial approval of the consent decree. On December 1, 2011, the District Court issued an order granting the motion to enter a revised consent decree. The District Court's order entering the consent decree requires DDOE to solicit and consider public comment on the key RI/FS documents prior to final approval, requires DDOE to make final versions of all approved RI/FS documents available to the public, and requires the parties to submit a written status report to the District Court on May 24, 2013 regarding the implementation of the

requirements of the consent decree and any related plans for remediation. In addition, if the RI/FS has not been completed by May 24, 2013, the status report must provide an explanation and a showing of good cause for why the work has not been completed.

Pepco and Pepco Energy Services anticipate that a RI/FS work plan will be approved by the DDOE by the end of the third quarter of 2012, at which time the RI/FS field work activities will commence. The remediation costs accrued by Pepco for this matter are included in the table above under the columns entitled Transmission and Distribution and Legacy Generation – Regulated.

Potomac River Mineral Oil Release

In January 2011, a coupling failure on a transformer cooler pipe resulted in a release of non-toxic mineral oil at Pepco's Potomac River substation in Alexandria, Virginia. An overflow of an underground secondary containment reservoir resulted in approximately 4,500 gallons of mineral oil flowing into the Potomac River.

The release falls within the regulatory jurisdiction of multiple federal and state agencies. Beginning in March 2011, DDOE issued a series of compliance directives that require Pepco to prepare an incident report, provide certain records, and prepare and implement plans for sampling surface water and river sediments and assessing ecological risks and natural resources damages. Pepco has submitted an incident report and is providing the requested records. In December 2011, Pepco completed field sampling and anticipates submitting a report to DDOE during the second quarter of 2012.

On March 16, 2011, the Virginia Department of Environmental Quality (VADEQ) requested documentation regarding the release and the preparation of an emergency response report, which Pepco submitted to the agency on April 20, 2011. On March 25, 2011, Pepco received a notice of violation from VADEQ and in December 2011, VADEQ executed a consent agreement that had been executed by Pepco in August, pursuant to which Pepco paid a civil penalty of approximately \$40,000. The U.S. Coast Guard assessed a \$5,000 penalty against Pepco for the release of oil into the waters of the United States, which Pepco has paid.

During March 2011, EPA conducted an inspection of the Potomac River substation to review compliance with federal regulations regarding Spill Prevention, Control, and Countermeasure (SPCC) plans for facilities using oil-containing equipment in proximity to surface waters. As a result, EPA identified several potential violations of the SPCC regulations relating to SPCC plan content, recordkeeping, and secondary containment, which EPA advised may lead to an EPA demand for noncompliance penalties. As a result of the oil release, Pepco submitted a revised SPCC plan to EPA in August 2011 and implemented certain interim operational changes to the secondary containment systems at the facility which involve pumping accumulated storm water to an aboveground holding tank for off-site disposal. In December 2011, Pepco completed the installation of a treatment system designed to allow automatic discharge of accumulated storm water from the secondary containment system. Pepco is currently seeking DDOE's and EPA's approval to commence operation of the new system and, after receiving such approval, will submit a further revised SPCC plan to EPA. In the meantime, Pepco will continue to use the above ground holding tank to manage storm water from the secondary containment system.

In addition to the cost to remediate impacts to the river and shoreline, Pepco also may be liable for non-compliance penalties and/or natural resource damages in addition to those it has already paid. It is not possible to accurately estimate an amount or range of reasonably possible loss to which it may be exposed associated with this liability at this time; however, based on current information, PHI and Pepco do not believe this matter will have a material adverse effect on their respective financial conditions, results of operations or cash flows.

The amounts accrued for these matters are included in the table above under the column entitled Transmission and Distribution.

District of Columbia Tax Legislation

On January 20, 2012, the District of Columbia Office of Tax and Revenue issued proposed regulations to implement the mandatory unitary combined reporting method for tax years beginning in 2011. Pepco will continue to analyze these regulations and will record the impact, if any, of such regulations on Pepco's results of operations in the period in which the proposed regulations are adopted as final regulations.

(12) RELATED PARTY TRANSACTIONS

PHI Service Company provides various administrative and professional services to PHI and its regulated and unregulated subsidiaries, including Pepco. The cost of these services is allocated in accordance with cost allocation methodologies set forth in the service agreement using a variety of factors, including the subsidiaries' share of employees, operating expenses, assets and other cost methods. These intercompany transactions are eliminated by PHI in consolidation and no profit results from these transactions at PHI. PHI Service Company costs directly charged or allocated to Pepco for the three months ended March 31, 2012 and 2011 were approximately \$51 million and \$43 million, respectively.

Pepco Energy Services performs utility maintenance services, including services that are treated as capital costs, for Pepco. Amounts charged to Pepco by Pepco Energy Services for the three months ended March 31, 2012 and 2011 were approximately \$5 million and \$4 million, respectively.

As of March 31, 2012 and December 31, 2011, Pepco had the following balances on its balance sheets due to related parties:

	<u>March 31,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
<u>(Liability) Asset</u>	<u>(millions of dollars)</u>	
(Payable to) Receivable from Related Party (current) (a)		
PHI Parent Company	\$ —	\$ 15
PHI Service Company	(24)	(32)
Pepco Energy Services (b)	(40)	(40)
Total	<u>\$ (64)</u>	<u>\$ (57)</u>

- (a) Included in Accounts payable due to associated companies.
- (b) Pepco bills customers on behalf of Pepco Energy Services where customers have selected Pepco Energy Services as their alternative energy supplier or where Pepco Energy Services has performed work for certain government agencies under a General Services Administration area-wide agreement.

DELMARVA POWER & LIGHT COMPANY
STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Operating Revenue		
Electric	\$ 259	\$ 298
Natural gas	74	102
Total Operating Revenue	<u>333</u>	<u>400</u>
Operating Expenses		
Purchased energy	143	182
Gas purchased	49	71
Other operation and maintenance	65	65
Depreciation and amortization	24	22
Other taxes	9	11
Total Operating Expenses	<u>290</u>	<u>351</u>
Operating Income	<u>43</u>	<u>49</u>
Other Income (Expenses)		
Interest expense	(11)	(11)
Other income	3	2
Total Other Expenses	<u>(8)</u>	<u>(9)</u>
Income Before Income Tax Expense	35	40
Income Tax Expense	<u>14</u>	<u>17</u>
Net Income	<u><u>\$ 21</u></u>	<u><u>\$ 23</u></u>

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

DELMARVA POWER & LIGHT COMPANY
BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars)</i>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4	\$ 5
Accounts receivable, less allowance for uncollectible accounts of \$11 million and \$12 million, respectively	170	186
Inventories	40	44
Prepayments of income taxes	32	14
Income taxes receivable	10	11
Prepaid expenses and other	14	17
Total Current Assets	<u>270</u>	<u>277</u>
INVESTMENTS AND OTHER ASSETS		
Goodwill	8	8
Regulatory assets	222	227
Prepaid pension expense	243	162
Other	26	23
Total Investments and Other Assets	<u>499</u>	<u>420</u>
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	3,249	3,188
Accumulated depreciation	(936)	(926)
Net Property, Plant and Equipment	<u>2,313</u>	<u>2,262</u>
TOTAL ASSETS	<u><u>\$ 3,082</u></u>	<u><u>\$ 2,959</u></u>

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

DELMARVA POWER & LIGHT COMPANY
BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars, except shares)</i>	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Short-term debt	\$ 238	\$ 152
Current portion of long-term debt	66	66
Accounts payable and accrued liabilities	84	92
Accounts payable due to associated companies	18	21
Taxes accrued	7	11
Interest accrued	12	6
Derivative liabilities	12	12
Other	59	59
Total Current Liabilities	<u>496</u>	<u>419</u>
DEFERRED CREDITS		
Regulatory liabilities	292	297
Deferred income taxes, net	655	615
Investment tax credits	6	6
Other postretirement benefit obligations	23	22
Liabilities and accrued interest related to uncertain tax positions	—	9
Derivative liabilities	—	3
Other	38	37
Total Deferred Credits	<u>1,014</u>	<u>989</u>
LONG-TERM LIABILITIES		
Long-term debt	<u>699</u>	<u>699</u>
COMMITMENTS AND CONTINGENCIES (NOTE 13)		
EQUITY		
Common stock, \$2.25 par value, 1,000 shares authorized, 1,000 shares outstanding	—	—
Premium on stock and other capital contributions	347	347
Retained earnings	<u>526</u>	<u>505</u>
Total Equity	873	852
TOTAL LIABILITIES AND EQUITY	<u><u>\$ 3,082</u></u>	<u><u>\$ 2,959</u></u>

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

DELMARVA POWER & LIGHT COMPANY
STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
OPERATING ACTIVITIES		
Net income	\$ 21	\$ 23
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	24	22
Deferred income taxes	41	18
Changes in:		
Accounts receivable	16	6
Inventories	4	9
Regulatory assets and liabilities, net	(7)	18
Accounts payable and accrued liabilities	(8)	(34)
Pension contributions	(85)	(40)
Taxes accrued	(31)	(4)
Interest accrued	6	6
Other assets and liabilities	4	10
Net Cash (Used By) From Operating Activities	<u>(15)</u>	<u>34</u>
INVESTING ACTIVITIES		
Investment in property, plant and equipment	(69)	(41)
Net other investing activities	<u>(1)</u>	<u>1</u>
Net Cash Used By Investing Activities	<u>(70)</u>	<u>(40)</u>
FINANCING ACTIVITIES		
Issuances of short-term debt, net	87	—
Net other financing activities	<u>(3)</u>	<u>—</u>
Net Cash From Financing Activities	<u>84</u>	<u>—</u>
Net Decrease in Cash and Cash Equivalents	(1)	(6)
Cash and Cash Equivalents at Beginning of Period	<u>5</u>	<u>69</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u><u>\$ 4</u></u>	<u><u>\$ 63</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for income taxes (includes payments to PHI for federal income taxes)	\$ —	\$ 4

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

DELMARVA POWER & LIGHT COMPANY
STATEMENT OF EQUITY
(Unaudited)

<i>(millions of dollars, except shares)</i>	<u>Common Stock</u>		<u>Premium on Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Par Value</u>			
BALANCE, DECEMBER 31, 2011	1,000	\$ —	\$ 347	\$ 505	\$852
Net Income	—	—	—	21	21
BALANCE, MARCH 31, 2012	<u>1,000</u>	<u>\$ —</u>	<u>\$ 347</u>	<u>\$ 526</u>	<u>\$873</u>

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

NOTES TO FINANCIAL STATEMENTS**DELMARVA POWER & LIGHT COMPANY****(1) ORGANIZATION**

Delmarva Power & Light Company (DPL) is engaged in the transmission and distribution of electricity in Delaware and portions of Maryland and provides natural gas distribution service in northern Delaware. Additionally, DPL provides Default Electricity Supply, which is the supply of electricity at regulated rates to retail customers in its service territories who do not elect to purchase electricity from a competitive supplier. Default Electricity Supply is known as Standard Offer Service in both Delaware and Maryland. DPL is a wholly owned subsidiary of Conectiv, LLC, which is wholly owned by Pepco Holdings, Inc. (Pepco Holdings or PHI).

(2) SIGNIFICANT ACCOUNTING POLICIES**Financial Statement Presentation**

DPL's unaudited financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the Securities and Exchange Commission, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted. Therefore, these financial statements should be read along with the annual financial statements included in DPL's annual report on Form 10-K for the year ended December 31, 2011, as amended to include the executive compensation and other information required by Part III of Form 10-K (which information originally had been omitted as permitted by that form). In the opinion of DPL's management, the financial statements contain all adjustments (which all are of a normal recurring nature) necessary to state fairly DPL's financial condition as of March 31, 2012, in accordance with GAAP. The year-end December 31, 2011 balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. Interim results for the three months ended March 31, 2012 may not be indicative of DPL's results that will be realized for the full year ending December 31, 2012.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the financial statements and accompanying notes. Although DPL believes that its estimates and assumptions are reasonable, they are based upon information available to management at the time the estimates are made. Actual results may differ significantly from these estimates.

Significant matters that involve the use of estimates include the assessment of contingencies, the calculation of future cash flows and fair value amounts for use in asset and goodwill impairment evaluations, fair value calculations for derivative instruments, pension and other postretirement benefits assumptions, the assessment of the probability of recovery of regulatory assets, accrual of storm restoration costs, accrual of unbilled revenue, recognition of changes in network service transmission rates for prior service year costs, accrual of self-insurance reserves for general and auto liability claims, and income tax provisions and reserves. Additionally, DPL is subject to legal, regulatory and other proceedings and claims that arise in the ordinary course of its business. DPL records an estimated liability for these proceedings and claims when it is probable that a loss has been incurred and the loss is reasonably estimable.

Consolidation of Variable Interest Entities - DPL Renewable Energy Transactions

DPL assesses its contractual arrangements with variable interest entities to determine whether it is the primary beneficiary and thereby has to consolidate the entities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810. The guidance addresses conditions under which an entity should be consolidated based upon variable interests rather than voting interests.

DPL is subject to Renewable Energy Portfolio Standards (RPS) in the state of Delaware that require it to obtain renewable energy credits (RECs) for energy delivered to its customers. DPL's costs associated with obtaining RECs to fulfill its RPS obligations are recoverable from its customers by law. DPL has entered into three land-based wind power purchase agreements (PPAs) in the aggregate amount of 128 megawatts and one solar PPA with a 10 megawatt facility as of March 31, 2012. All of the facilities associated with these PPAs are operational, and DPL is obligated to purchase energy and RECs in amounts generated and delivered by the wind facilities and solar renewable energy credits (SRECs) from the solar facility at rates that are primarily fixed under these agreements. DPL has concluded that consolidation is not required for any of these agreements under the FASB guidance on the consolidation of variable interest entities.

DPL is obligated to purchase energy and RECs from one of the wind facilities through 2024 in amounts not to exceed 50 megawatts, the second of the wind facilities through 2031 in amounts not to exceed 40 megawatts, and the third facility through 2031 in amounts not to exceed 38 megawatts. DPL's purchases under the three wind PPAs totaled \$9 million and \$5 million for the three months ended March 31, 2012 and 2011, respectively. The term of the agreement with the solar facility is 20 years and DPL is obligated to purchase SRECs in an amount up to 70 percent of the energy output at a fixed price. DPL's purchases under the solar agreement were zero for the three months ended March 31, 2012.

On October 18, 2011, the Delaware Public Service Commission (DPSC) approved a tariff submitted by DPL in accordance with the requirements of the RPS specific to fuel cell facilities totaling 30 megawatts to be constructed by a qualified fuel cell provider. The tariff and the RPS establish that DPL would be an agent to collect payments in advance from its distribution customers and remit them to the qualified fuel cell provider for each megawatt hour of energy produced by the fuel cell facilities over 21 years. DPL would have no liability to the qualified fuel cell provider other than to remit payments collected from its distribution customers pursuant to the tariff. The RPS provide for a reduction in DPL's REC requirements based upon the actual energy output of the facilities. In June 2012, a 3 megawatt generation facility is expected to be placed into service under the tariff. A 27 megawatt generation facility is expected to be placed into service in 5 megawatt increments beginning in January 2013. PHI has concluded that DPL would account for this arrangement as an agency transaction.

Goodwill

Goodwill represents the excess of the purchase price of an acquisition over the fair value of the net assets acquired at the acquisition date. All of DPL's goodwill was generated by DPL's acquisition of Conowingo Power Company in 1995. DPL tests its goodwill for impairment annually and whenever an event occurs or circumstances change in the interim that would more likely than not reduce the fair value of DPL below the carrying amount of its net assets. DPL performs its annual impairment test as of November 1. Factors that may result in an interim impairment test include, but are not limited to: a change in the identified reporting units; an adverse change in business conditions; an adverse regulatory action; or an impairment of DPL's long-lived assets. DPL concluded that an interim impairment test was not required during the three months ended March 31, 2012.

Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions

Taxes included in DPL's gross revenues were \$4 million and \$5 million for the three months ended March 31, 2012 and 2011, respectively.

(3) NEWLY ADOPTED ACCOUNTING STANDARDS**Fair Value Measurements and Disclosures (ASC 820)**

The FASB issued new guidance on fair value measurement and disclosures that was effective beginning with DPL's March 31, 2012 financial statements. The new measurement guidance did not have a material impact on DPL's financial statements and the new disclosure requirements are in Note (12), "Fair Value Disclosures," of DPL's financial statements.

Goodwill (ASC 350)

The FASB issued new guidance that changes the annual and interim assessments of goodwill for impairment. The new guidance modifies the required annual impairment test by giving entities the option to perform a qualitative assessment of whether it is more likely than not that goodwill is impaired before performing a quantitative assessment. The new guidance also amends the events and circumstances that entities should assess to determine whether an interim quantitative impairment test is necessary. As of January 1, 2012, DPL has adopted the new guidance and concluded it did not have a material impact on its financial statements.

(4) RECENTLY ISSUED ACCOUNTING STANDARDS, NOT YET ADOPTED**Balance Sheet (ASC 210)**

In December 2011, the FASB issued new disclosure requirements for financial assets and liabilities, such as derivatives, that are subject to contractual netting arrangements. The new disclosures will include information about the gross exposures of the instruments and the net exposure of the instruments under contractual netting arrangements, how the exposures are presented in the financial statements, and the terms and conditions of the contractual netting arrangements. The new disclosures are effective beginning with DPL's March 31, 2013 financial statements. DPL is evaluating the impact of this new guidance on its financial statements.

(5) SEGMENT INFORMATION

DPL operates its business as one regulated utility segment, which includes all of its services as described above.

(6) GOODWILL

DPL's goodwill balance of \$8 million was unchanged during the three months ended March 31, 2012. All of DPL's goodwill was generated by its acquisition of Conowingo Power Company in 1995.

DPL's annual impairment test as of November 1, 2011 indicated that goodwill was not impaired. For the three months ended March 31, 2012, DPL concluded that there were no events requiring it to perform an interim goodwill impairment test. DPL will perform its next annual impairment test as of November 1, 2012.

(7) REGULATORY MATTERS

Rate Proceedings

Over the last several years, DPL has proposed in each of its jurisdictions the adoption of a mechanism to decouple retail distribution revenue from the amount of power delivered to retail customers. To date:

- A bill stabilization adjustment (BSA) has been approved and implemented for electric service in Maryland. The Maryland Public Service Commission (MPSC) has issued an order requiring modification of the BSA in Maryland so that revenues lost as a result of major storm outages are not collected through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (as discussed below).
- A modified fixed variable rate design (MFVRD) has been approved in concept for electric service in Delaware, but the implementation has been deferred by the Delaware Public Service Commission (DPSC) pending the development of an implementation plan and a customer education plan. DPL anticipates that the MFVRD will be in place for electric service by early 2013.
- A MFVRD has been approved in concept for natural gas service in Delaware, but implementation likewise has been deferred until development of an implementation plan and a customer education plan. DPL anticipates that the MFVRD will be in place for natural gas service by early 2013.

Under the BSA, customer distribution rates are subject to adjustment (through a credit or surcharge mechanism), depending on whether actual distribution revenue per customer exceeds or falls short of the revenue-per-customer amount approved by the applicable public service commission. The MFVRD approved in concept in Delaware provides for a fixed customer charge (i.e., not tied to the customer's volumetric consumption) to recover the utility's fixed costs, plus a reasonable rate of return. Although different from the BSA, DPL views the MFVRD as an appropriate distribution revenue decoupling mechanism.

In an effort to reduce the shortfall in revenues due to the delay in time or lag between when costs are incurred and when they are reflected in rates (regulatory lag), DPL has proposed, in each of its jurisdictions, a reliability investment recovery mechanism (RIM) to recover reliability-related capital expenditures incurred between base rate cases. Through the RIM, DPL in each year would collect through a surcharge the amount of its reliability-related capital expenditures based on its budget for that year. The budgeted amount would be reconciled with actual capital expenditures on an annual basis and any over-recovery or under-recovery would be reflected in the next year's surcharge. The work undertaken pursuant to the RIM would be subject to a prudence review by the applicable state regulatory commission in the next base rate case or at more frequent intervals as determined by such commission. DPL's operation and maintenance costs and other capital expenditures would remain subject to recovery through the traditional ratemaking process.

DPL also has requested approval in each of its jurisdictions of the use of fully forecasted test years in future rate cases. Traditionally, past test years with actual historical costs are used for ratemaking purposes; however, fully forecasted test years would be comprised of forward-looking costs. If approved, such fully forecasted test years would be more reflective of current costs and would mitigate the effects of regulatory lag.

Delaware

Gas Cost Rates

DPL makes an annual Gas Cost Rate (GCR) filing with the DPSC for the purpose of allowing DPL to recover natural gas procurement costs through customer rates. In August 2011, DPL made its 2011 GCR filing. The filing includes the second year of the effect of a two-year amortization of under-recovered gas costs that had

been proposed, and approved by the DPSC, in DPL's 2010 GCR filing (the settlement approved by the DPSC in the 2010 GCR case included the first year of such two-year amortization). The rates proposed in the 2011 GCR, which include the second year of the two-year amortization approved in the 2010 GCR case, would result in a GCR decrease for the typical retail natural gas customer of 5.6% in the level of GCR. On September 20, 2011, the DPSC issued an order allowing DPL to place the new rates into effect on November 1, 2011, subject to refund and pending final DPSC approval. The parties to the 2011 GCR proceeding have executed a settlement agreement that recommends approval of the 2011 GCR as filed. A DPSC decision on the settlement agreement is expected during the third quarter of 2012.

On February 21, 2012, DPL submitted its application for a waiver under its GCR tariff, which requires DPL to request an interim GCR rate increase when the under-recovery exceeds 6.0%. The DPSC granted the waiver on March 6, 2012.

Electric Distribution Base Rates

On December 2, 2011, DPL submitted an application with the DPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$31.8 million, based on a requested return on equity (ROE) of 10.75%, and requests approval of implementation of the MFVRD. DPL requested that the rates become effective on January 31, 2012. The filing includes a request for DPSC approval of a RIM and the use of fully forecasted test years in future DPL rate cases. On January 10, 2012, the DPSC entered an order suspending the full increase and allowing a temporary rate increase of \$2.5 million to go into effect on January 31, 2012, subject to refund and pending final DPSC approval. As permitted by Delaware law, DPL intends to place the remainder of approximately \$29.3 million of the requested increase into effect on July 2, 2012, subject to refund and pending final DPSC approval. A decision by the DPSC is expected by the end of 2012.

Maryland

Electric Distribution Base Rates

On December 9, 2011, DPL submitted an application with the MPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately \$25.2 million, based on a requested ROE of 10.75%. The filing includes a request for MPSC approval of a RIM and the use of fully forecasted test years in future DPL rate cases. A decision by the MPSC is expected in July 2012.

Major Storm Damage Recovery Proceedings

In February 2011, the MPSC initiated proceedings involving DPL, as well as its affiliate Potomac Electric Power Company (Pepco) and unaffiliated utilities in Maryland, for the purpose of reviewing how the BSA operates to recover revenues lost as a result of major storm outages. On January 25, 2012, the MPSC issued an order modifying the BSA to prevent the Maryland utilities, including DPL and Pepco, from collecting lost utility revenue through the BSA if electric service is not restored to the pre-major storm levels within 24 hours of the start of a major storm (defined by the MPSC as a weather-related event during which more than the lesser of 10% or 100,000 of an electric utility's customers have a sustained outage for more than 24 hours). The period for which the lost utility revenue may not be collected through the BSA commences 24 hours after the start of the major storm and continues until all major storm-related outages are restored. The MPSC stated that waivers permitting collection of BSA revenues would be granted in rare and extraordinary circumstances where a utility can show that an outage was not due to inadequate emphasis on reliability and restoration efforts were reasonable under the circumstances. The financial impact of service interruptions due to a major storm as a result of this MPSC order would generally depend on the scope and duration of the outages.

Maryland Public Service Commission New Generation Contract Requirement

On September 29, 2009, the MPSC initiated an investigation into whether the regulated electric distribution companies (EDCs) in Maryland should be required to enter into long-term contracts with entities that construct, acquire or lease, and operate, new electric generation facilities in Maryland.

The MPSC issued an order on April 12, 2012, in which it determined that there is a need for one new power plant in the range of 650 to 700 MW beginning in 2015. The order requires DPL, Pepco and Baltimore Gas and Electric Company to negotiate and enter into a contract with the winning bidder in amounts proportionate to their relative SOS loads. Under the contract, the winning bidder will construct a 661 MW natural gas-fired combined cycle generation plant in Waldorf, Maryland, with a commercial operation date of June 1, 2015. The order acknowledges the EDCs' concerns about the requirements of the contract and directs them to negotiate with the winning bidder and submit any proposed changes in the contract to the MPSC for approval. The order further specifies that the EDCs entering into the contract will recover the associated costs from their respective SOS customers through surcharges. DPL is evaluating the impact of the order, and, at this time, cannot predict (i) the extent of the negative effect that the order and, once finalized, the contract for new generation, may have on its balance sheets, as well as its credit metrics, as calculated by independent rating agencies that evaluate and rate DPL and its debt issuances, (ii) the effect on DPL's ability to recover its associated costs of the contract for new generation if a significant number of SOS customers elect to buy their energy from alternative energy suppliers, and (iii) the effect of the order on its financial condition, results of operations and cash flows. On April 27, 2012, a group of generators operating in the PJM region filed a complaint in the United States District Court for the Northern District of Maryland challenging the MPSC's order on the grounds that that such order violated the commerce clause and the supremacy clause of the U.S. Constitution. DPL continues to evaluate whether to seek judicial review of the MPSC's order.

(8) PENSION AND OTHER POSTRETIREMENT BENEFITS

DPL accounts for its participation in its parent's single-employer plans, the Pepco Holdings, Inc. Retirement Plan (the PHI Retirement Plan) and the Pepco Holdings, Inc. Welfare Plan for Retirees, as participation in multiemployer plans. PHI's pension and other postretirement net periodic benefit cost for the three months ended March 31, 2012 and 2011, before intercompany allocations from the PHI Service Company, were \$26 million and \$27 million, respectively. DPL's allocated share was \$6 million and \$7 million, respectively, for the three months ended March 31, 2012 and 2011.

In the first quarter of 2012, DPL made a discretionary tax-deductible contribution to the PHI Retirement Plan of \$85 million. In the first quarter of 2011, DPL made a discretionary tax-deductible contribution to the PHI Retirement Plan in the amount of \$40 million.

(9) DEBT

Credit Facility

PHI, Pepco, DPL and Atlantic City Electric Company (ACE) maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement with respect to the facility, which among other changes extended the expiration date of the facility to August 1, 2016.

The aggregate borrowing limit under the amended and restated credit facility is \$1.5 billion, all or any portion of which may be used to obtain loans and up to \$500 million of which may be used to obtain letters of credit. The facility also includes a swingline loan sub-facility, pursuant to which each company may make same day borrowings in an aggregate amount not to exceed 10% of the total amount of the facility. Any swingline loan must be repaid by the borrower within fourteen days of receipt. The initial credit sublimit for PHI is \$750 million and \$250 million for each of Pepco, DPL and ACE. The sublimits may be increased or decreased by the individual borrower during the term of the facility, except that (i) the sum of all of the borrower sublimits following any such increase or decrease must equal the total amount of the facility and (ii)

the aggregate amount of credit used at any given time by (a) PHI may not exceed \$1.25 billion and (b) each of Pepco, DPL or ACE may not exceed the lesser of \$500 million and the maximum amount of short-term debt the company is permitted to have outstanding by its regulatory authorities. The total number of the sublimit reallocations may not exceed eight per year during the term of the facility.

The interest rate payable by each company on utilized funds is, at the borrowing company's election, (i) the greater of the prevailing prime rate, the federal funds effective rate plus 0.5% and one month LIBOR plus 1.0%, or (ii) the prevailing Eurodollar rate, plus a margin that varies according to the credit rating of the borrower.

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of March 31, 2012.

The absence of a material adverse change in PHI's business, property, results of operations or financial condition is not a condition to the availability of credit under the credit agreement. The credit agreement does not include any rating triggers.

At March 31, 2012 and December 31, 2011, the amount of cash plus borrowing capacity under the credit facility available to meet the liquidity needs of PHI's utility subsidiaries in the aggregate was \$452 million and \$711 million, respectively. DPL's borrowing capacity under the credit facility at any given time depends on the amount of the subsidiary borrowing capacity being utilized by Pepco and ACE and the portion of the total capacity being used by PHI.

Commercial Paper

DPL maintains an on-going commercial paper program to address its short-term liquidity needs. As of March 31, 2012, the maximum capacity available under the program was \$500 million, subject to available borrowing capacity under the credit facility.

DPL had \$133 million of commercial paper outstanding at March 31, 2012. The weighted average interest rate for commercial paper issued by DPL during the three months ended March 31, 2012 was 0.39% and the weighted average maturity of all commercial paper issued by DPL during the three months ended March 31, 2012 was four days.

(10) INCOME TAXES

A reconciliation of DPL's effective income tax rate is as follows:

	<u>Three Months Ended March 31,</u>			
	<u>2012</u>		<u>2011</u>	
	<i>(millions of dollars)</i>			
Income tax at Federal statutory rate	\$ 12	35.0%	\$14	35.0%
Increases (decreases) resulting from:				
State income taxes, net of Federal effect	2	5.7%	2	6.0
Other, net	<u>—</u>	<u>(0.7)</u>	<u>1</u>	<u>1.5</u>
Income tax expense	\$ 14	40.0%	\$17	42.5%

DPL's effective tax rates for the three months ended March 31, 2012 and 2011 were 40.0% and 42.5%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2011.

(11) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

DPL uses derivative instruments in the form of swaps and over-the-counter options primarily to reduce natural gas commodity price volatility and limit its customers' exposure to increases in the market price of natural gas under a hedging program approved by the DPSC. DPL uses these derivatives to manage the commodity price risk associated with its physical natural gas purchase contracts. The natural gas purchase contracts qualify as normal purchases, which are not required to be recorded in the financial statements until settled. DPL's capacity contracts are not classified as derivatives. All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all gains and losses related to hedging activities, are deferred under FASB guidance on regulated operations (ASC 980) until recovered from its customers through a fuel adjustment clause approved by the DPSC.

The tables below identify the balance sheet location and fair values of derivative instruments as of March 31, 2012 and December 31, 2011:

Balance Sheet Caption	As of March 31, 2012				
	Derivatives Designated as Hedging Instruments	Other Derivative Instruments	Gross Derivative Instruments	Effects of Cash Collateral and Netting	Net Derivative Instruments
	(millions of dollars)				
Derivative liabilities (current liabilities)	\$ —	\$ (14)	\$ (14)	\$ 2	\$ (12)
Derivative liabilities (non-current liabilities)	—	—	—	—	—
Total Derivative liabilities	—	(14)	(14)	2	(12)
Net Derivative (liability) asset	<u>\$ —</u>	<u>\$ (14)</u>	<u>\$ (14)</u>	<u>\$ 2</u>	<u>\$ (12)</u>

Balance Sheet Caption	As of December 31, 2011				
	Derivatives Designated as Hedging Instruments	Other Derivative Instruments	Gross Derivative Instruments (millions of dollars)	Effects of Cash Collateral and Netting	Net Derivative Instruments
Derivative liabilities (current liabilities)	\$ —	\$ (14)	\$ (14)	\$ 2	\$ (12)
Derivative liabilities (non-current liabilities)	—	(3)	(3)	—	(3)
Total Derivative liabilities	—	(17)	(17)	2	(15)
Net Derivative (liability) asset	\$ —	\$ (17)	\$ (17)	\$ 2	\$ (15)

Under FASB guidance on the offsetting of balance sheet accounts (ASC 210), DPL offsets the fair value amounts recognized for derivative instruments and fair value amounts recognized for related collateral positions executed with the same counterparty under master netting agreements. The amount of cash collateral that was offset against these derivative positions is as follows:

	March 31, 2012	December 31, 2011
	(millions of dollars)	
Cash collateral pledged to counterparties with the right to reclaim	\$ 2	\$ 2

As of March 31, 2012 and December 31, 2011, all DPL cash collateral pledged related to derivative instruments accounted for at fair value was entitled to be offset under master netting agreements.

Derivatives Designated as Hedging Instruments

Cash Flow Hedges

All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all of DPL's gains and losses related to hedging activities, are deferred under FASB guidance on regulated operations until recovered from customers based on the fuel adjustment clause approved by the DPSC. The following table indicates the net unrealized derivative losses arising during the period included in Regulatory assets and the realized losses recognized in the statements of income for the three months ended March 31, 2012 and 2011 associated with cash flow hedges:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars)	
Net unrealized (loss) gain arising during the period included in Regulatory assets	\$ —	\$ —
Net realized losses recognized in Purchased energy or Gas Purchased	—	(2)

Other Derivative Activity

DPL holds certain derivatives that are not in hedge accounting relationships and are not designated as normal purchases or normal sales. These derivatives are recorded at fair value on the balance sheets with changes in the fair value recorded in income. In accordance with FASB guidance on regulated operations, offsetting regulatory liabilities or regulatory assets are recorded on the balance sheets and the recognition of the derivative gain or loss is deferred because of the DPSC-approved fuel adjustment clause. For the three months ended March 31, 2012 and 2011, the net unrealized derivative losses arising during the period included in Regulatory Assets and the net realized losses recognized in the statements of income are provided in the table below:

	Three Months Ended March 31,	
	2012	2011
	(millions of dollars)	
Net unrealized (loss) gain arising during the period included in Regulatory assets	\$ (4)	\$ (1)
Net realized loss recognized in Purchased energy or Gas purchased	(7)	(7)

As of March 31, 2012 and December 31, 2011, DPL had the following net outstanding natural gas commodity forward contracts that did not qualify for hedge accounting:

<u>Commodity</u>	<u>March 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Quantity</u>	<u>Net Position</u>	<u>Quantity</u>	<u>Net Position</u>
Natural gas (MMBtu)	4,109,100	Long	6,161,200	Long

Contingent Credit Risk Features

The primary contracts used by DPL for derivative transactions are entered into under the International Swaps and Derivatives Association Master Agreement (ISDA) or similar agreements that closely mirror the principal credit provisions of the ISDA. The ISDAs include a Credit Support Annex (CSA) that governs the mutual posting and administration of collateral security. The failure of a party to comply with an obligation under the CSA, including an obligation to transfer collateral security when due or the failure to maintain any required credit support, constitutes an event of default under the ISDA for which the other party may declare an early termination and liquidation of all transactions entered into under the ISDA, including foreclosure against any collateral security. In addition, some of the ISDAs have cross default provisions under which a default by a party under another commodity or derivative contract, or the breach by a party of another borrowing obligation in excess of a specified threshold, is a breach under the ISDA.

Under the collateral requirements of the ISDA or similar agreements, the parties establish a dollar threshold of unsecured credit for each party in excess of which the party would be required to post collateral to secure its obligations to the other party. The amount of the unsecured credit threshold varies according to the senior, unsecured debt rating of the respective parties or that of a guarantor of the party's obligations. The fair values of all transactions between the parties are netted under the master netting provisions. Transactions may include derivatives accounted for on-balance sheet as well as normal purchases and normal sales that are accounted for off-balance sheet. If the aggregate fair value of the transactions in a net loss position exceeds the unsecured credit threshold, then collateral is required to be posted in an amount equal to the amount by which the unsecured credit threshold is exceeded. The obligations of DPL are stand-alone obligations without the guaranty of PHI. If DPL's debt rating were to fall below "investment grade," the unsecured credit threshold would typically be set at zero and collateral would be required for the entire net loss position. Exchange-traded contracts are required to be fully collateralized without regard to the debt rating of the holder.

The gross fair values of DPL's derivative liabilities with credit-risk-related contingent features as of March 31, 2012 and December 31, 2011, were \$12 million and \$15 million, respectively. As of those dates, DPL had posted no cash collateral in the normal course of business against its gross derivative liabilities, resulting in net liabilities of \$12 million and \$15 million, respectively. If DPL's debt ratings had been downgraded below investment grade as of March 31, 2012 and December 31, 2011, DPL's net settlement amounts would have been approximately \$12 million and \$15 million, respectively, and DPL would have been required to post additional collateral with the counterparties of approximately \$12 million and \$15 million, respectively. The net settlement and additional collateral amounts reflect the effect of offsetting transactions under master netting agreements.

DPL's primary source for posting cash collateral or letters of credit is PHI's credit facility. At March 31, 2012 and December 31, 2011, the aggregate amount of cash plus borrowing capacity under the credit facility available to meet the liquidity needs of PHI's utility subsidiaries was \$452 million and \$711 million, respectively.

(12) FAIR VALUE DISCLOSURES

Financial Instruments Measured at Fair Value on a Recurring Basis

DPL applies FASB guidance on fair value measurement and disclosures (ASC 820) that established a framework for measuring fair value and expanded disclosures about fair value measurements. As defined in the guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). DPL utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. Accordingly, DPL utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3).

The following tables set forth, by level within the fair value hierarchy, DPL's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2012 and December 31, 2011. As required by the guidance, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. DPL's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Description	Total	Fair Value Measurements at March 31, 2012		
		Quoted Prices in Active Markets for Identical Instruments (Level 1) (a)	Significant Other Observable Inputs (Level 2) (a)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
ASSETS				
Executive deferred compensation plan assets				
Money market funds	\$ 2	\$ 2	\$ —	\$ —
Life insurance contracts	1	—	—	1
	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 1</u>
LIABILITIES				
Derivative instruments (b)				
Natural gas (c)	\$ 14	\$ 2	\$ —	\$ 12
	<u>\$ 14</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 12</u>

- (a) There were no transfers of instruments between level 1 and level 2 valuation categories.
 (b) The fair value of derivative liabilities reflect netting by counterparty before the impact of collateral.
 (c) Represents natural gas options purchased by DPL as part of a natural gas hedging program approved by the DPSC.

Description	Fair Value Measurements at December 31, 2011				
	Total	Quoted Prices in	Significant	Significant	
		Active Markets	Other		Unobservable
		for Identical	Observable		Inputs
		Instruments	Inputs	Inputs	
		(Level 1) (a)	(Level 2) (a)	(Level 3)	
		(millions of dollars)			
ASSETS					
Executive deferred compensation plan assets					
Money market funds	\$ 2	\$ 2	\$ —	\$ —	
Life insurance contracts	1	—	—	1	
	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 1</u>	
LIABILITIES					
Derivative instruments (b)					
Natural gas (c)	<u>\$ 17</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 15</u>	
	\$ 17	\$ 2	\$ —	\$ 15	

- (a) There were no transfers of instruments between level 1 and level 2 valuation categories.
(b) The fair value of derivative liabilities reflect netting by counterparty before the impact of collateral.
(c) Represents natural gas options purchased by DPL as part of a natural gas hedging program approved by the DPSC.

DPL classifies its fair value balances in the fair value hierarchy based on the observability of the inputs used in the fair value calculation as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis, such as the New York Mercantile Exchange (NYMEX).

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using broker quotes in liquid markets and other observable data. Level 2 also includes those financial instruments that are valued using methodologies that have been corroborated by observable market data through correlation or by other means. Significant assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 – Pricing inputs include significant inputs that are generally less observable than those from objective sources. Level 3 includes those financial instruments that are valued using models or other valuation methodologies.

Derivative instruments categorized as level 3 include natural gas options used by DPL as part of a natural gas hedging program approved by the DPSC. DPL applies a Black-Scholes model to value its options, which contains inputs, such as the forward price curves, contract prices, contract volumes, the risk-free rate and the implied volatility factors, which are based on a range of historical NYMEX option prices. The implied volatility is a factor based on a range between 0.60 and 2.03. DPL maintains valuation policies and procedures and reviews the validity and relevance of the inputs used to estimate the fair value of its options.

The table below summarizes the primary unobservable input used to determine the fair value of DPL's level 3 instruments and the range of values that could be used for the input as of March 31, 2012:

<u>Type of Instrument</u>	<u>Fair Value at March 31, 2012 (millions of dollars)</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range</u>
Natural Gas Options	\$ 12	Option model	Volatility Factor	0.60 – 2.03

DPL used values within this range as part of its fair value estimates, and a significant change in the unobservable input within this range would have an insignificant impact on the reported fair value as of March 31, 2012.

Executive deferred compensation plan assets and liabilities include certain life insurance policies that are valued using the cash surrender value of the policies, net of loans against those policies. The cash surrender values do not represent a quoted price in an active market; therefore, are unobservable and are categorized as level 3. Cash surrender values are provided by third parties and reviewed by DPL for reasonableness.

Reconciliations of the beginning and ending balances of DPL's fair value measurements using significant unobservable inputs (level 3) for the three months ended March 31, 2012 and 2011 are shown below:

	<u>Three Months Ended March 31, 2012</u>	
	<u>Natural Gas</u>	<u>Life Insurance Contracts</u>
	<i>(millions of dollars)</i>	
Beginning balance as of January 1	\$ (15)	\$ 1
Total gains (losses) (realized and unrealized):		
Included in income	—	—
Included in accumulated other comprehensive loss	—	—
Included in regulatory assets	(3)	—
Purchases	—	—
Issuances	—	—
Settlements	6	—
Transfers in (out) of level 3	—	—
Ending balance as of March 31	<u>\$ (12)</u>	<u>\$ 1</u>

	Three Months Ended March 31, 2011	
	Natural Gas	Life Insurance Contracts
	<i>(millions of dollars)</i>	
Beginning balance as of January 1	\$ (23)	\$ 1
Total gains (losses) (realized and unrealized):		
Included in income	—	—
Included in accumulated other comprehensive loss	—	—
Included in regulatory assets	(1)	—
Purchases	—	—
Issuances	—	—
Settlements	5	—
Transfers in (out) of level 3	—	—
Ending balance as of March 31	<u>\$ (19)</u>	<u>\$ 1</u>

Other Financial Instruments

The estimated fair values of DPL's debt instruments that are measured at amortized cost in DPL's financial statements and the associated level of the estimates within the fair value hierarchy as of March 31, 2012 are shown in the table below. As required by the fair value measurement guidance, debt instruments are classified in their entirety within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. DPL's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, which may affect the valuation of fair value debt instruments and their placement within the fair value hierarchy levels.

Description	Total	Fair Value Measurements at March 31, 2012		
		Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
LIABILITIES				
Debt instruments				
Long-term debt (a)	\$833	\$ —	\$ 720	\$ 113
	\$833	\$ —	\$ 720	\$ 113

(a) The carrying amount for Long-term debt is \$765 million as of March 31, 2012.

The fair value of Long-term debt categorized as level 1 is based on actual quoted trade prices for the debt in active markets on the measurement date.

The fair value of Long-term debt categorized as level 2 is based on a blend of quoted prices for the debt and quoted prices for similar debt in active markets, but not on the measurement date. The blend places more weight on current pricing information when determining the final fair value measurement. The fair value information is provided by brokers and DPL reviews the methodologies and results.

The fair value of Long-term debt categorized as level 3 is based on a discounted cash flow methodology using observable inputs, such as the U.S. Treasury yield, and unobservable inputs, such as credit spreads, because quoted prices for the debt or similar debt in active markets were insufficient.

The estimated fair values of DPL's debt instruments at December 31, 2011 are shown below:

	December 31, 2011	
	Carrying Amount	Fair Value
	(millions of dollars)	
Long-term debt	\$ 765	\$ 834

The carrying amounts of all other financial instruments in the accompanying financial statements approximate fair value.

(13) COMMITMENTS AND CONTINGENCIES

Environmental Matters

DPL is subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of its operations, including air and water quality control, solid and hazardous waste disposal and limitations on land use. Although penalties assessed for violations of environmental laws and regulations are not recoverable from DPL's customers, environmental clean-up costs incurred by DPL generally are included in its cost of service for ratemaking purposes. The total accrued liabilities for the environmental contingencies of DPL described below at March 31, 2012 are summarized as follows:

	Transmission and Distribution	Legacy Generation		Other	Total
		Regulated	Non-Regulated		
		(millions of dollars)			
Beginning balance as of January 1	\$ 1	\$ 4	\$ —	\$ 2	\$ 7
Accruals	—	—	—	—	—
Payments	—	1	—	—	1
Ending balance as of March 31	1	3	—	2	6
Less amounts in Other current liabilities	1	1	—	2	4
Amounts in Other deferred credits	\$ —	\$ 2	\$ —	\$ —	\$ 2

Ward Transformer Site

In April 2009, a group of potentially responsible parties (PRPs) with respect to the Ward Transformer site in Raleigh, North Carolina, filed a complaint in the U.S. District Court for the Eastern District of North Carolina, alleging cost recovery and/or contribution claims against a number of entities, including DPL with respect to past and future response costs incurred by the PRP group in performing a removal action at the site. In a March 2010 order, the court denied the defendants' motion to dismiss. The next step in the litigation will be the filing of summary judgment motions regarding liability for certain "test case" defendants, not including DPL. The case has been stayed as to the remaining defendants pending rulings upon the test cases. Although DPL cannot at this time estimate an amount or range of reasonably possible losses to which it may be exposed, DPL does not believe that it had extensive business transactions, if any, with the Ward Transformer site and therefore, costs incurred to resolve this matter are not expected to be material.

Indian River Oil Release

In 2001, DPL entered into a consent agreement with the Delaware Department of Natural Resources and Environmental Control for remediation, site restoration, natural resource damage compensatory projects and other costs associated with environmental contamination resulting from an oil release at the Indian River generating facility, which was sold in June 2001. The amount of remediation costs accrued for this matter is included in the table above under the column entitled Legacy Generation - Regulated.

(14) RELATED PARTY TRANSACTIONS

PHI Service Company provides various administrative and professional services to PHI and its regulated and unregulated subsidiaries, including DPL. The cost of these services is allocated in accordance with cost allocation methodologies set forth in the service agreement using a variety of factors, including the subsidiaries' share of employees, operating expenses, assets and other cost methods. These intercompany transactions are eliminated by PHI in consolidation and no profit results from these transactions at PHI. PHI Service Company costs directly charged or allocated to DPL for the three months ended March 31, 2012 and 2011 were approximately \$37 million and \$31 million, respectively.

In addition to the PHI Service Company charges described above, DPL's financial statements include the following related party transactions in its statements of income:

<u>Income (Expenses)</u>	<u>Three Months Ended</u>	
	<u>March 31,</u>	
	<u>2012</u>	<u>2011</u>
	<i>(millions of dollars)</i>	
Purchased power under Default Electricity Supply contracts with Conectiv Energy Supply, Inc.		
(a)	\$ —	\$ 1
Intercompany lease transactions (b)	1	1

(a) Included in Purchased energy expense.

(b) Included in electric revenue.

As of March 31, 2012 and December 31, 2011, DPL had the following balances on its balance sheets due (to) from related parties:

<u>Liability</u>	<u>March 31,</u>	<u>December 31,</u>
	<u>2012</u>	<u>2011</u>
	<i>(millions of dollars)</i>	
Payable to Related Party (current) (a)		
PHI Service Company	\$ (17)	\$ (20)
Conectiv Energy Supply, Inc.	—	(1)
Pepco Energy Services Inc. and its subsidiaries (Pepco Energy Services) (b)	(1)	—
Total	<u>\$ (18)</u>	<u>\$ (21)</u>

(a) Included in Accounts payable due to associated companies.

(b) DPL bills customers on behalf of Pepco Energy Services where customers have selected Pepco Energy Services as their alternative energy supplier.

ATLANTIC CITY ELECTRIC COMPANY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
Operating Revenue	\$ 256	\$ 315
Operating Expenses		
Purchased energy	166	198
Other operation and maintenance	56	55
Depreciation and amortization	28	33
Other taxes	4	6
Deferred electric service costs	(15)	(3)
Total Operating Expenses	<u>239</u>	<u>289</u>
Operating Income	<u>17</u>	<u>26</u>
Other Income (Expenses)		
Interest expense	(17)	(15)
Other income	<u>1</u>	<u>—</u>
Total Other Expenses	<u>(16)</u>	<u>(15)</u>
Income Before Income Tax Expense	1	11
Income Tax (Benefit) Expense	<u>(1)</u>	<u>5</u>
Net Income	<u>\$ 2</u>	<u>\$ 6</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars)</i>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 49	\$ 91
Restricted cash equivalents	10	11
Accounts receivable, less allowance for uncollectible accounts of \$11 million and \$12 million, respectively	168	185
Inventories	25	25
Prepayments of income taxes	45	26
Income taxes receivable	5	5
Prepaid expenses and other	9	16
Total Current Assets	<u>311</u>	<u>359</u>
INVESTMENTS AND OTHER ASSETS		
Regulatory assets	670	662
Prepaid pension expense	99	71
Income taxes receivable	133	61
Restricted cash equivalents	15	15
Assets and accrued interest related to uncertain tax positions	22	42
Other	12	14
Total Investments and Other Assets	<u>951</u>	<u>865</u>
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	2,592	2,548
Accumulated depreciation	<u>(772)</u>	<u>(766)</u>
Net Property, Plant and Equipment	<u>1,820</u>	<u>1,782</u>
TOTAL ASSETS	<u><u>\$ 3,082</u></u>	<u><u>\$ 3,006</u></u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2012	December 31, 2011
	<i>(millions of dollars, except shares)</i>	
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Short-term debt	\$ 23	\$ 23
Current portion of long-term debt	38	37
Accounts payable and accrued liabilities	122	117
Accounts payable due to associated companies	14	14
Taxes accrued	17	10
Interest accrued	21	15
Other	41	45
Total Current Liabilities	<u>276</u>	<u>261</u>
DEFERRED CREDITS		
Regulatory liabilities	62	60
Deferred income taxes, net	768	698
Investment tax credits	7	7
Other postretirement benefit obligations	31	31
Other	16	20
Total Deferred Credits	<u>884</u>	<u>816</u>
LONG-TERM LIABILITIES		
Long-term debt	833	832
Transition Bonds issued by ACE Funding	285	295
Total Long-Term Liabilities	<u>1,118</u>	<u>1,127</u>
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
EQUITY		
Common stock, \$3.00 par value, 25,000,000 shares authorized, 8,546,017 shares outstanding	26	26
Premium on stock and other capital contributions	576	576
Retained earnings	202	200
Total Equity	<u>804</u>	<u>802</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 3,082</u>	<u>\$ 3,006</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
	<i>(millions of dollars)</i>	
OPERATING ACTIVITIES		
Net income	\$ 2	\$ 6
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	28	33
Deferred income taxes	72	9
Changes in:		
Accounts receivable	17	16
Inventories	(1)	—
Regulatory assets and liabilities, net	(16)	(3)
Accounts payable and accrued liabilities	(8)	(23)
Pension contributions	(30)	(30)
Taxes accrued	(63)	12
Interest accrued	—	3
Other assets and liabilities	10	10
Net Cash From Operating Activities	<u>11</u>	<u>33</u>
INVESTING ACTIVITIES		
Investment in property, plant and equipment	(53)	(22)
Department of Energy capital reimbursement awards received	1	1
Net other investing activities	<u>—</u>	<u>(3)</u>
Net Cash Used By Investing Activities	<u>(52)</u>	<u>(24)</u>
FINANCING ACTIVITIES		
Redemption of preferred stock	—	(6)
Reacquisitions of long-term debt	(9)	(9)
Issuances of short-term debt, net	—	7
Net other financing activities	<u>8</u>	<u>(1)</u>
Net Cash Used By Financing Activities	<u>(1)</u>	<u>(9)</u>
Net Decrease in Cash and Cash Equivalents	(42)	—
Cash and Cash Equivalents at Beginning of Period	91	4
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u><u>\$ 49</u></u>	<u><u>\$ 4</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash received for income taxes (includes payments from PHI for federal income taxes)	\$ —	\$ (6)

The accompanying Notes are an integral part of these Consolidated Financial Statements.

ATLANTIC CITY ELECTRIC COMPANY
CONSOLIDATED STATEMENT OF EQUITY
(Unaudited)

<i>(millions of dollars, except shares)</i>	<u>Common Stock</u>		<u>Premium on Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Par Value</u>			
BALANCE, DECEMBER 31, 2011	8,546,017	\$ 26	\$ 576	\$ 200	\$802
Net Income	—	—	—	2	2
BALANCE, MARCH 31, 2012	<u>8,546,017</u>	<u>\$ 26</u>	<u>\$ 576</u>	<u>\$ 202</u>	<u>\$804</u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**ATLANTIC CITY ELECTRIC COMPANY****(1) ORGANIZATION**

Atlantic City Electric Company (ACE) is engaged in the transmission and distribution of electricity in southern New Jersey. ACE also provides Default Electricity Supply, which is the supply of electricity at regulated rates to retail customers in its service territory who do not elect to purchase electricity from a competitive energy supplier. Default Electricity Supply is known as Basic Generation Service in New Jersey. ACE is a wholly owned subsidiary of Conectiv, LLC, which is wholly owned by Pepco Holdings, Inc. (Pepco Holdings or PHI).

(2) SIGNIFICANT ACCOUNTING POLICIES**Financial Statement Presentation**

ACE's unaudited consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Pursuant to the rules and regulations of the Securities and Exchange Commission, certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with GAAP have been omitted. Therefore, these consolidated financial statements should be read along with the annual consolidated financial statements included in ACE's annual report on Form 10-K for the year ended December 31, 2011, as amended to include the executive compensation and other information required by Part III of Form 10-K (which information originally had been omitted as permitted by that form). In the opinion of ACE's management, the consolidated financial statements contain all adjustments (which all are of a normal recurring nature) necessary to state fairly ACE's financial condition as of March 31, 2012, in accordance with GAAP. The year-end December 31, 2011 consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP. Interim results for the three months ended March 31, 2012 may not be indicative of ACE's results that will be realized for the full year ending December 31, 2012.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Although ACE believes that its estimates and assumptions are reasonable, they are based upon information available to management at the time the estimates are made. Actual results may differ significantly from these estimates.

Significant matters that involve the use of estimates include the assessment of contingencies, the calculation of future cash flows and fair value amounts for use in asset impairment evaluations, pension and other postretirement benefits assumptions, the assessment of the probability of recovery of regulatory assets, accrual of storm restoration costs, accrual of unbilled revenue, recognition of changes in network service transmission rates for prior service year costs, accrual of self-insurance reserves for general and auto liability claims, and income tax provisions and reserves. Additionally, ACE is subject to legal, regulatory and other proceedings and claims that arise in the ordinary course of its business. ACE records an estimated liability for these proceedings and claims when it is probable that a loss has been incurred and the loss is reasonably estimable.

Consolidation of Variable Interest Entities

ACE assesses its contractual arrangements with variable interest entities to determine whether it is the primary beneficiary and thereby has to consolidate the entities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810. The guidance addresses conditions under which an entity should be consolidated based upon variable interests rather than voting interests.

ACE Power Purchase Agreements

ACE is a party to three power purchase agreements (PPAs) with unaffiliated, non-utility generators (NUGs) totaling 459 megawatts. One of the agreements ends in 2016 and the other two end in 2024. ACE was unable to obtain sufficient information to determine whether these three entities were variable interest entities or if ACE was the primary beneficiary. As a result, ACE applied the scope exemption from the consolidation guidance for enterprises that have not been able to obtain such information.

Net purchase activities with the NUGs for the three months ended March 31, 2012 and 2011 were approximately \$51 million and \$57 million, respectively, of which approximately \$50 million and \$53 million, respectively, consisted of power purchases under the PPAs. The power purchase costs are recoverable from ACE's customers through regulated rates.

Atlantic City Electric Transition Funding LLC

Atlantic City Electric Transition Funding LLC (ACE Funding) was established in 2001 by ACE solely for the purpose of securitizing authorized portions of ACE's recoverable stranded costs through the issuance and sale of bonds (Transition Bonds). The proceeds of the sale of each series of Transition Bonds have been transferred to ACE in exchange for the transfer by ACE to ACE Funding of the right to collect non-bypassable transition bond charges (the Transition Bond Charges) from ACE customers pursuant to bondable stranded costs rate orders issued by the New Jersey Board of Public Utilities (NJBPU) in an amount sufficient to fund the principal and interest payments on the Transition Bonds and related taxes, expenses and fees (Bondable Transition Property). ACE collects the Transition Bond Charges from its customers on behalf of ACE Funding and the holders of the Transition Bonds. The assets of ACE Funding, including the Bondable Transition Property, and the Transition Bond Charges collected from ACE's customers, are not available to creditors of ACE. The holders of the Transition Bonds have recourse only to the assets of ACE Funding. ACE owns 100 percent of the equity of ACE Funding and consolidates ACE Funding in its financial statements as ACE is the primary beneficiary of ACE Funding under the variable interest entity consolidation guidance.

ACE Standard Offer Capacity Agreements

In April 2011, ACE entered into three Standard Offer Capacity Agreements (SOCAs) by order of the NJBPU, each with a different generation company. The SOCAs were established under a New Jersey law enacted to promote the construction of qualified electric generation facilities in New Jersey. The SOCAs are 15-year, financially settled transactions approved by the NJBPU that allow generators to receive payments from, or make payments to, ACE based on the difference between the fixed price in the SOCAs and the price for capacity that clears PJM Interconnection, LLC (PJM). Each of the other electricity distribution companies (EDCs) in New Jersey has entered into SOCAs having the same terms with the same generation companies. The annual share of payments or receipts for ACE and the other EDCs is based upon each company's annual proportion of the total New Jersey load attributable to all EDCs. The NJBPU has approved full recovery from distribution customers of payments made by ACE and the other EDCs, and distribution customers would be entitled to any payments received by ACE and the other EDCs.

Currently, ACE believes that FASB guidance on derivative accounting and the accounting for regulated operations would apply to a SOCA once capacity has cleared a PJM auction. Once cleared, the gain (loss) associated with the fair value of a derivative would be offset by the recognition of a regulatory liability (asset). The next PJM capacity auction is scheduled for May 2012. ACE has concluded that consolidation is not required for the SOCAs under the FASB guidance on the consolidation of variable interest entities.

Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions

Taxes included in ACE's gross revenues were \$4 million and \$6 million for the three months ended March 31, 2012 and 2011, respectively.

(3) NEWLY ADOPTED ACCOUNTING STANDARDS

Fair Value Measurements and Disclosures (ASC 820)

The FASB issued new guidance on fair value measurement and disclosures that was effective beginning with ACE's March 31, 2012 consolidated financial statements. The new measurement guidance did not have a material impact on ACE's consolidated financial statements and the new disclosure requirements are in Note (10), "Fair Value Disclosures," of ACE's consolidated financial statements.

(4) RECENTLY ISSUED ACCOUNTING STANDARDS, NOT YET ADOPTED

None.

(5) SEGMENT INFORMATION

ACE operates its business as one regulated utility segment, which includes all of its services as described above.

(6) REGULATORY MATTERS

Rate Proceedings

Over the last several years, ACE has proposed the adoption of a mechanism to decouple retail distribution revenue from the amount of power delivered to retail customers. A bill stabilization adjustment mechanism (BSA) proposed by ACE as part of a Phase 2 to the base rate proceeding filed in August 2009 was not included in the final settlement approved by the NJBPU on May 16, 2011. Accordingly, there is no BSA proposal currently pending in New Jersey. Under the BSA, customer distribution rates are subject to adjustment (through a credit or surcharge mechanism), depending on whether actual distribution revenue per customer exceeds or falls short of the revenue-per-customer amount approved by the applicable public service commission.

Electric Distribution Base Rates

On August 5, 2011, ACE filed a petition with the NJBPU to increase its electric distribution rates by the net amount of approximately \$58.9 million (increased to approximately \$80.2 million on February 24, 2012, to reflect the 2011 test year), based on a requested return on equity of 10.75% (the ACE 2011 Base Rate Case). The modified net increase consists of a rate increase proposal of approximately \$90.3 million, less a deduction from base rates of approximately \$17 million attributable to excess depreciation expenses, plus approximately a \$6.3 million increase in sales-and-use taxes and an upward adjustment of approximately \$0.6 million in the Regulatory Asset Recovery Charge. A decision in the electric distribution rate case is expected by the end of 2012.

Infrastructure Investment Program

In July 2009, the NJBPU approved certain rate recovery mechanisms in connection with ACE's Infrastructure Investment Program (the IIP). In exchange for the increase in infrastructure investment, the NJBPU, through the IIP, allowed recovery of ACE's infrastructure investment capital expenditures through a special rate outside the normal rate recovery mechanism of a base rate filing. The IIP was designed to stimulate the New Jersey economy and provide incremental employment in ACE's service territory by increasing the infrastructure expenditures to a level above otherwise normal budgeted levels. In an October 18, 2011 petition (subsequently amended December 16, 2011) with the NJBPU, ACE requested an extension and expansion to the IIP under which ACE proposes to spend approximately \$63 million, \$94 million and \$81 million in calendar years 2012, 2013 and 2014, respectively, on non-revenue reliability-related capital expenditures. As proposed, capital expenditures related to the proposed special rate would be subject to annual reconciliation and approval by the NJBPU. A decision by the NJBPU on ACE's IIP filing is expected by the end of the third quarter of 2012.

Storm Damage Restoration Costs Recovery

In August 2011, ACE filed a petition with the NJBPU seeking authorization for deferred accounting treatment of uninsured incremental storm damage restoration costs not otherwise recovered through base rates. In that petition, ACE sought deferred accounting treatment for recovery of storm costs of approximately \$8 million incurred during Hurricane Irene, which impacted ACE's service territory in the third quarter of 2011. In an order dated December 15, 2011, the NJBPU directed that this petition be transmitted to the Office of Administrative Law with a request that the matter be consolidated with the ACE 2011 Base Rate Case, discussed above.

Update and Reconciliation of Certain Under-Recovered Balances

In February 2012, ACE filed a petition with the NJBPU seeking to reconcile and update several pass-through charges related to (i) the recovery of above-market costs associated with ACE's long-term power purchase contracts with the NUGs, (ii) costs related to surcharges that fund several statewide social programs and ACE's uncollected accounts, and (iii) operating costs associated with ACE's residential appliance cycling program. The filing proposes to recover the projected deferred under-recovered balance related to the NUGs of \$113.8 million as of May 31, 2012 through a four-year amortization schedule. The net impact of adjusting the charges as proposed (including both the annual impact of the proposed four-year amortization of the historical under-recovered balances related to the NUGs and the going-forward cost recovery of all the other components for the period June 1, 2012 through May 31, 2013, and including associated changes in sales-and-use taxes), is an overall annual rate increase of approximately \$54.5 million. A decision by the NJBPU on this filing is expected by the end of the second quarter of 2012.

Standard Offer Capacity Agreements

In April 2011, ACE entered into three SOCAs by order of the NJBPU, each with a different generation company, as more fully described in Note (2), "Significant Accounting Policies – Consolidation of Variable Interest Entities – ACE Standard Offer Capacity Agreements." ACE and the other New Jersey EDCs entered the SOCAs under protest based on concerns about the potential cost to distribution customers. In May 2011, the NJBPU denied a joint motion for reconsideration of its order requiring each of the EDCs to enter into the SOCAs. In June 2011, ACE and the other EDCs filed appeals related to the NJBPU orders with the Appellate Division of the New Jersey Superior Court. On March 5, 2012, the court remanded the case to the NJBPU with instructions to refer the case to an Administrative Law Judge for further consideration.

In February 2011, ACE joined other plaintiffs in an action filed in the United States District Court for the District of New Jersey challenging the constitutionality of the New Jersey law under which the SOCAs were established. ACE and the other plaintiffs filed a motion for summary judgment with the United States District Court for the District of New Jersey in December 2011. Cross motions for summary judgment were filed in January 2012. The motions remain pending.

In October 2011 and January 2012, respectively, two of the three generation companies sent notices of dispute under the SOCA to ACE. The notices of dispute allege that certain actions taken by PJM will have an adverse effect on the generation company's ability to clear the PJM auction, which is required for payment under the SOCA. As of February 2012, the two generation companies had filed petitions with the NJBPU seeking to amend their respective SOCAs. One of the generation companies seeks to postpone the effective date (currently expected to be in 2015) of the SOCA until the litigation is complete. The other generation company proposes to adjust the payment terms of the SOCA to reflect the total expected revenues under the original bid, which the generation company alleges may be in jeopardy if it were unable to clear in the PJM auction commencing in 2015. ACE does not believe that a dispute exists under the SOCAs and is disputing the amendment of the SOCAs jointly with the other EDCs. ACE does not believe the impact of either of such SOCA amendments would be material, although the result of such amendments, if approved, may be to prolong the term of one or both SOCAs. In April 2012, the NJBPU issued an order consolidating the two matters. A decision is expected in the second quarter of 2012.

(7) PENSION AND OTHER POSTRETIREMENT BENEFITS

ACE accounts for its participation in its parent's single-employer plans, the Pepco Holdings, Inc. Retirement Plan (the PHI Retirement Plan) and the Pepco Holdings, Inc. Welfare Plan for Retirees, as participation in multiemployer plans. PHI's pension and other postretirement net periodic benefit cost for the three months ended March 31, 2012 and 2011, before intercompany allocations from the PHI Service Company, were \$26 million and \$27 million, respectively. ACE's allocated share was \$6 million and \$6 million, respectively, for the three months ended March 31, 2012 and 2011.

In the first quarter of 2012, ACE made a discretionary tax-deductible contribution to the PHI Retirement Plan of \$30 million. In the first quarter of 2011, ACE made a discretionary tax-deductible contribution to the PHI Retirement Plan in the amount of \$30 million.

(8) DEBT

Credit Facility

PHI, Potomac Electric Power Company (Pepco), Delmarva Power & Light Company (DPL) and ACE maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement with respect to the facility, which among other changes extended the expiration date of the facility to August 1, 2016.

The aggregate borrowing limit under the amended and restated credit facility is \$1.5 billion, all or any portion of which may be used to obtain loans and up to \$500 million of which may be used to obtain letters of credit. The facility also includes a swingline loan sub-facility, pursuant to which each company may make same day borrowings in an aggregate amount not to exceed 10% of the total amount of the facility. Any swingline loan must be repaid by the borrower within fourteen days of receipt. The initial credit sublimit for PHI is \$750 million and \$250 million for each of Pepco, DPL and ACE. The sublimits may be increased or decreased by the individual borrower during the term of the facility, except that (i) the sum of all of the borrower sublimits following any such increase or decrease must equal the total amount of the facility and (ii) the aggregate amount of credit used at any given time by (a) PHI may not exceed \$1.25 billion and (b) each of Pepco, DPL or ACE may not exceed the lesser of \$500 million and the maximum amount of short-term debt the company is permitted to have outstanding by its regulatory authorities. The total number of the sublimit reallocations may not exceed eight per year during the term of the facility.

The interest rate payable by each company on utilized funds is, at the borrowing company's election, (i) the greater of the prevailing prime rate, the federal funds effective rate plus 0.5% and one month LIBOR plus 1.0%, or (ii) the prevailing Eurodollar rate, plus a margin that varies according to the credit rating of the borrower.

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of March 31, 2012.

The absence of a material adverse change in PHI's business, property, results of operations or financial condition is not a condition to the availability of credit under the credit agreement. The credit agreement does not include any rating triggers.

At March 31, 2012 and December 31, 2011, the amount of cash plus borrowing capacity under the credit facility available to meet the liquidity needs of PHI's utility subsidiaries in the aggregate was \$452 million and \$711 million, respectively. ACE's borrowing capacity under the credit facility at any given time depends on the amount of the subsidiary borrowing capacity being utilized by Pepco and DPL and the portion of the total capacity being used by PHI.

Commercial Paper

ACE maintains an on-going commercial paper program to address its short-term liquidity needs. As of March 31, 2012, the maximum capacity available under the program was \$250 million, subject to available borrowing capacity under the credit facility.

ACE did not issue commercial paper during the first quarter of 2012 and had no commercial paper outstanding at March 31, 2012.

Financing Activities

In January 2012, ACE Funding made principal payments of \$7 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

Financing Activities Subsequent to March 31, 2012

In April 2012, ACE Funding made principal payments of \$6 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

(9) INCOME TAXES

ACE's consolidated effective tax rates for the three months ended March 31, 2012 and 2011 were (100)% and 45.5%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the Internal Revenue Service with respect to the methodology used historically to calculate deductible mixed service costs.

(10) FAIR VALUE DISCLOSURES**Financial Instruments Measured at Fair Value on a Recurring Basis**

ACE applies FASB guidance on fair value measurement and disclosures (ASC 820) that established a framework for measuring fair value and expanded disclosures about fair value measurements. As defined in the guidance, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). ACE utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. Accordingly, ACE utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3).

The following tables set forth, by level within the fair value hierarchy, ACE's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2012 and December 31, 2011. As required by the guidance, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. ACE's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Description	Fair Value Measurements at March 31, 2012			
	Total	Quoted Prices in	Significant	Significant
		Active Markets	Other	Unobservable
		for Identical	Observable	Inputs
		Instruments	Inputs	Inputs
		(Level 1) (a)	(Level 2) (a)	(Level 3)
		(millions of dollars)		
ASSETS				
Cash equivalents				
Treasury fund	\$ 70	\$ 70	\$ —	\$ —
	<u>\$ 70</u>	<u>\$ 70</u>	<u>\$ —</u>	<u>\$ —</u>
LIABILITIES				
Executive deferred compensation plan liabilities				
Life insurance contracts	\$ 1	\$ —	\$ 1	\$ —
	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ —</u>

(a) There were no transfers of instruments between level 1 and level 2 valuation categories.

Description	Fair Value Measurements at December 31, 2011			
	Total	Quoted Prices in	Significant	Significant
		Active Markets	Other	Unobservable
		for Identical	Observable	Inputs
		Instruments	Inputs	Inputs
		(Level 1) (a)	(Level 2) (a)	(Level 3)
		(millions of dollars)		
ASSETS				
Cash equivalents				
Treasury fund	\$114	\$ 114	\$ —	\$ —
	<u>\$114</u>	<u>\$ 114</u>	<u>\$ —</u>	<u>\$ —</u>
LIABILITIES				
Executive deferred compensation plan liabilities				
Life insurance contracts	\$ 1	\$ —	\$ 1	\$ —
	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ —</u>

(a) There were no transfers of instruments between level 1 and level 2 valuation categories.

ACE classifies its fair value balances in the fair value hierarchy based on the observability of the inputs used in the fair value calculation as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using broker quotes in liquid markets and other observable data. Level 2 also includes those financial instruments that are valued using methodologies that have been corroborated by observable market data through correlation or by other means. Significant assumptions are observable in the marketplace throughout the full term of the instrument and can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

The level 2 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance sub-accounts. The sub-accounts are designed to mirror existing mutual funds and money market funds that are observable and actively traded.

Level 3 – Pricing inputs include significant inputs that are generally less observable than those from objective sources. Level 3 includes those financial instruments that are valued using models or other valuation methodologies.

Other Financial Instruments

The estimated fair values of ACE's debt instruments that are measured at amortized cost in ACE's consolidated financial statements and the associated level of the estimates within the fair value hierarchy as of March 31, 2012 are shown in the table below. As required by the fair value measurement guidance, debt instruments are classified in their entirety within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. ACE's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, which may affect the valuation of fair value debt instruments and their placement within the fair value hierarchy levels.

Description	Total	Fair Value Measurements at March 31, 2012		
		Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
LIABILITIES				
Debt instruments				
Long-term debt (a)	\$ 989	\$ —	\$ 865	\$ 124
Transition Bonds issued by ACE Funding (b)	370	—	370	—
	\$1,359	\$ —	\$ 1,235	\$ 124

- (a) The carrying amount for Long-term debt is \$833 million as of March 31, 2012.
- (b) The carrying amount for Transition Bonds issued by ACE Funding, including amounts due within one year, is \$323 million as of March 31, 2012.

The fair value of Long-term debt categorized as level 1 is based on actual quoted trade prices for the debt in active markets on the measurement date.

The fair value of Long-term debt and Transition Bonds issued by ACE Funding categorized as level 2 is based on a blend of quoted prices for the debt and quoted prices for similar debt in active markets, but not on the measurement date. The blend places more weight on current pricing information when determining the final fair value measurement. The fair value information is provided by brokers and ACE reviews the methodologies and results.

The fair value of Long-term debt categorized as level 3 was based on a discounted cash flow methodology using observable inputs, such as the U.S. Treasury yield, and unobservable inputs, such as credit spreads, because quoted prices for the debt or similar debt in active markets were insufficient.

The estimated fair values of ACE's debt instruments at December 31, 2011 are shown below:

	December 31, 2011	
	Carrying Amount	Fair Value
	<i>(millions of dollars)</i>	
Long-term debt	\$ 832	\$1,003
Transition Bonds issued by ACE Funding	332	380

The carrying amounts of all other financial instruments in the accompanying consolidated financial statements approximate fair value.

(11) COMMITMENTS AND CONTINGENCIES

General Litigation

In September 2011, an asbestos complaint was filed in the New Jersey Superior Court, Law Division, against ACE (among other defendants) asserting claims under New Jersey's Wrongful Death and Survival statutes. The complaint, filed by the estate of a decedent who was the wife of a former employee of ACE, alleges that the decedent's mesothelioma was caused by exposure to asbestos brought home by her husband on his work clothes. Unlike the other jurisdictions to which ACE's affiliated utility subsidiaries are subject, New Jersey courts have recognized a cause of action against a premise owner in a so-called "take home" case if it can be shown that the harm was foreseeable. In this case, the complaint seeks

recovery of an unspecified amount of damages for, among other things, the decedent's past medical expenses, loss of earnings, and pain and suffering between the time of injury and death, and asserts a punitive damage claim. At this time, ACE has concluded that a loss is reasonably possible with respect to this matter, but ACE was unable to estimate an amount or range of reasonably possible loss because (i) the damages sought are indeterminate, (ii) the proceedings are in the early stages, and (iii) the matter involves facts that ACE believes are distinguishable from the facts of the "take home" cause of action recognized by the New Jersey courts.

Environmental Matters

ACE is subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of its operations, including air and water quality control, solid and hazardous waste disposal and limitations on land use. Although penalties assessed for violations of environmental laws and regulations are not recoverable from ACE's customers, environmental clean-up costs incurred by ACE generally are included in its cost of service for ratemaking purposes. The total accrued liabilities for the environmental contingencies of ACE described below at March 31, 2012 are summarized as follows:

	Transmission and Distribution	Legacy Generation		Other	Total
		Regulated	Non-Regulated		
		(millions of dollars)			
Beginning balance as of January 1	\$ —	\$ 1	\$ —	\$—	\$ 1
Accruals	—	—	—	—	—
Payments	—	—	—	—	—
Ending balance as of March 31	—	1	—	—	1
Less amounts in Other current liabilities	—	—	—	—	—
Amounts in Other deferred credits	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$—</u>	<u>\$ 1</u>

Franklin Slag Pile Site

In November 2008, ACE received a general notice letter from the U.S. Environmental Protection Agency (EPA) concerning the Franklin Slag Pile site in Philadelphia, Pennsylvania, asserting that ACE is a potentially responsible party (PRP) that may have liability for clean-up costs with respect to the site and for the costs of implementing an EPA-mandated remedy. EPA's claims are based on ACE's sale of boiler slag from the B.L. England generating facility, then owned by ACE, to MDC Industries, Inc. (MDC) during the period June 1978 to May 1983. EPA claims that the boiler slag ACE sold to MDC contained copper and lead, which are hazardous substances under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), and that the sales transactions may have constituted an arrangement for the disposal or treatment of hazardous substances at the site, which could be a basis for liability under CERCLA. The EPA letter also states that, as of the date of the letter, EPA's expenditures for response measures at the site have exceeded \$6 million. EPA estimates the additional cost for future response measures will be approximately \$6 million. ACE believes that EPA sent similar general notice letters to three other companies and various individuals.

ACE believes that the B.L. England boiler slag sold to MDC was a valuable material with various industrial applications and, therefore, the sale was not an arrangement for the disposal or treatment of any hazardous substances as would be necessary to constitute a basis for liability under CERCLA. ACE intends to contest any claims to the contrary made by EPA. In a May 2009 decision arising under CERCLA, which did not involve ACE, the U.S. Supreme Court rejected an EPA argument that the sale of a useful product constituted an arrangement for disposal or treatment of hazardous substances. While this

decision supports ACE's position, at this time ACE cannot predict how EPA will proceed with respect to the Franklin Slag Pile site, or what portion, if any, of the Franklin Slag Pile site response costs EPA would seek to recover from ACE. Costs to resolve this matter are not expected to be material and are expensed as incurred.

Ward Transformer Site

In April 2009, a group of PRPs with respect to the Ward Transformer site in Raleigh, North Carolina, filed a complaint in the U.S. District Court for the Eastern District of North Carolina, alleging cost recovery and/or contribution claims against a number of entities, including ACE with respect to past and future response costs incurred by the PRP group in performing a removal action at the site. In a March 2010 order, the court denied the defendants' motion to dismiss. The next step in the litigation will be the filing of summary judgment motions regarding liability for certain "test case" defendants, not including ACE. The case has been stayed as to the remaining defendants pending rulings upon the test cases. Although ACE cannot at this time estimate an amount or range of reasonably possible losses to which it may be exposed, ACE does not believe that it had extensive business transactions, if any, with the Ward Transformer site and therefore, costs incurred to resolve this matter are not expected to be material.

(12) RELATED PARTY TRANSACTIONS

PHI Service Company provides various administrative and professional services to PHI and its regulated and unregulated subsidiaries, including ACE. The cost of these services is allocated in accordance with cost allocation methodologies set forth in the service agreement using a variety of factors, including the subsidiaries' share of employees, operating expenses, assets and other cost methods. These intercompany transactions are eliminated by PHI in consolidation and no profit results from these transactions at PHI. PHI Service Company costs directly charged or allocated to ACE for the three months ended March 31, 2012 and 2011 were approximately \$28 million and \$24 million, respectively.

In addition to the PHI Service Company charges described above, ACE's consolidated financial statements include the following related party transactions in the consolidated statements of income:

<u>Income (Expenses)</u>	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2012</u>	<u>2011</u>
	<i>(millions of dollars)</i>	
Meter reading services provided by Millennium Account Services LLC (an ACE affiliate) (a)	\$ (1)	\$ (1)

(a) Included in Other operation and maintenance expense.

As of March 31, 2012 and December 31, 2011, ACE had the following balances on its consolidated balance sheets due to related parties:

<u>Liability</u>	<u>March 31,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
	<i>(millions of dollars)</i>	
Payable to Related Party (current) (a)		
PHI Service Company	\$ (12)	\$ (12)
Other	(2)	(2)
Total	<u>\$ (14)</u>	<u>\$ (14)</u>

(a) Included in Accounts payable due to associated companies.

Item 2. **MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information required by this item is contained herein, as follows:

<u>Registrants</u>	<u>Page No.</u>
<u>Pepco Holdings</u>	105
<u>Pepco</u>	130
<u>DPL</u>	137
<u>ACE</u>	144

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**Pepco Holdings, Inc.****General Overview**

Pepco Holdings, a Delaware corporation incorporated in 2001, is a holding company that, through its regulated public utility subsidiaries, is engaged primarily in the transmission, distribution and default supply of electricity and the distribution and supply of natural gas (Power Delivery). Through Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services), PHI provides energy efficiency services primarily to government and institutional customers and is in the process of winding down its competitive electricity and natural gas retail supply business. Each of Power Delivery and Pepco Energy Services constitutes a separate segment for financial reporting purposes. A third segment, Other Non-Regulated, owns a portfolio of cross-border energy lease investments.

The following table sets forth the percentage contributions to consolidated operating revenue and consolidated operating income from continuing operations attributable to the Power Delivery, Pepco Energy Services and Other Non-Regulated segments.

	Three Months Ended March 31,	
	2012	2011
Percentage of Consolidated Operating Revenue		
Power Delivery	82%	76%
Pepco Energy Services	18%	23%
Other Non-Regulated	—	1%
Percentage of Consolidated Operating Income		
Power Delivery	73%	79%
Pepco Energy Services	12%	11%
Other Non-Regulated	15%	10%
Percentage of Power Delivery Operating Revenue		
Power Delivery Electric	93%	92%
Power Delivery Gas	7%	8%

Power Delivery

Power Delivery Electric consists primarily of the transmission, distribution and default supply of electricity, and Power Delivery Gas consists of the delivery and supply of natural gas. Power Delivery represents a single operating segment for financial reporting purposes.

Each utility comprising Power Delivery is a regulated public utility in the jurisdictions that encompass its service territory. Each utility is responsible for the distribution of electricity and, in the case of DPL, natural gas in its service territory, for which it is paid tariff rates established by the applicable local public service commission in each jurisdiction. Each utility also supplies electricity at regulated rates to retail customers in its service territory who do not elect to purchase electricity from a competitive energy supplier. The regulatory term for this supply service is Standard Offer Service (SOS) in Delaware, the District of Columbia and Maryland, and Basic Generation Service (BGS) in New Jersey. In this quarterly report, these supply service obligations are referred to generally as Default Electricity Supply.

Pepco, DPL and ACE each is responsible for the transmission of wholesale electricity into and across its service territory. The rates each utility is permitted to charge for the wholesale transmission of electricity are regulated by the Federal Energy Regulatory Commission (FERC). Transmission rates are updated annually based on a FERC-approved formula methodology.

The profitability of Power Delivery depends on its ability to recover costs and earn a reasonable return on its capital investments through the rates it is permitted to charge. Operating results also can be affected by economic conditions, energy prices, the impact of energy efficiency measures on customer usage of electricity, and in some jurisdictions, weather.

Power Delivery's results historically have been seasonal, generally producing higher revenue and income in the warmest and coldest periods of the year. For retail customers of Pepco and DPL in Maryland and of Pepco in the District of Columbia, revenue is not affected by unseasonably warmer or colder weather because a bill stabilization adjustment (BSA) for retail customers was implemented that provides for a fixed distribution charge per customer rather than a charge based upon energy usage. The BSA has the effect of decoupling the distribution revenue recognized in a reporting period from the amount of power delivered during the period. As a result, the only factors that will cause distribution revenue from retail customers in Maryland and the District of Columbia to fluctuate from period to period are changes in the number of customers and changes in the approved distribution charge per customer. A comparable revenue decoupling mechanism for DPL electricity and natural gas customers in Delaware has been approved in concept by the Delaware Public Service Commission (DPSC) and is pending development of an implementation plan and a customer education plan.

In accounting for the BSA in Maryland and the District of Columbia, a Revenue Decoupling Adjustment is recorded representing either (i) a positive adjustment equal to the amount by which revenue from retail distribution sales falls short of the revenue that Pepco and DPL are entitled to earn based on the approved distribution charge per customer or (ii) a negative adjustment equal to the amount by which revenue from such distribution sales exceeds the revenue that Pepco and DPL are entitled to earn based on the approved distribution charge per customer.

The following are developments in some of the key initiatives of Power Delivery as of March 31, 2012:

Reliability Enhancement and Emergency Restoration Improvement Plans

In 2010, PHI announced that Pepco had adopted and begun to implement comprehensive reliability enhancement plans in Maryland and the District of Columbia. These reliability enhancement plans include various initiatives to improve electrical system reliability, such as:

- enhanced vegetation management;
- the identification and upgrading of under-performing feeder lines;
- the addition of new facilities to support load;
- the installation of distribution automation systems on both the overhead and underground network system;
- the rejuvenation and replacement of underground residential cables;
- improvements to substation supply lines; and
- selective undergrounding of portions of existing above ground primary feeder lines, where appropriate to improve reliability.

In 2011, prior to the start of the summer storm season, PHI initiated a program to improve Pepco's emergency restoration efforts that included, among other initiatives, an expansion and enhancement of customer service capabilities. PHI has extended its reliability enhancement efforts to DPL and ACE.

Blueprint for the Future

Each of PHI's three utilities is participating in a PHI initiative referred to as "Blueprint for the Future." The installation of smart meters (also known as advanced metering infrastructure (AMI)), a key initiative of Blueprint for the Future, is almost complete for DPL electric customers in Delaware, with meter activation expected to be completed in 2012. Meter installation is still underway for Pepco customers in

both the District of Columbia and Maryland, with installation of residential meters expected to be complete in the second and fourth quarters of 2012, respectively. The respective public service commissions have approved the creation of regulatory assets to defer AMI costs between rate cases, as well as the accrual of a return on the deferred costs. Thus, these costs will be recovered through base rates in the future. In addition to the replacement of existing meters, the AMI system involves the construction of a wireless network across the service territories of PHI's utility subsidiaries and the implementation and integration of new and existing information technology systems to collect and manage data made available by the advanced meters. The implementation of the AMI system involves a combination of technologies provided by multiple vendors.

Approval of AMI is still pending for electric customers in DPL's Maryland jurisdiction, and such approval has been deferred for ACE in New Jersey.

In 2011, the DPSC approved DPL's request to implement dynamic pricing for its Delaware customers. Dynamic pricing will reward SOS customers with lower rates for decreasing their energy use during those times when energy demand and, consequently, the cost of supplying electricity, are higher. Implementation for customers will be phased in between 2012 and 2014. For DPL's Maryland customers, dynamic pricing has been approved in concept pending AMI deployment authorization. In Pepco's Maryland service territory, dynamic pricing has been approved in concept, with phase-in for residential customers beginning in 2012. In Pepco's District of Columbia jurisdiction, proposals are pending with proposed phase-in for residential customers anticipated to begin in 2012. Dynamic pricing has been deferred for ACE's customers in New Jersey.

Regulatory Lag

An important factor in the ability of each of Pepco, DPL and ACE to earn its authorized rate of return is the willingness of applicable public service commissions to adequately recognize forward-looking costs in the utility's rate structure in order to address the shortfall in revenues due to the delay in time or "lag" between when costs are incurred and when they are reflected in rates. This delay is commonly known as "regulatory lag." Each of Pepco, DPL and ACE is currently experiencing significant regulatory lag because their investment in the rate base and their operating expenses are outpacing revenue growth. Each of PHI's utility subsidiaries is continuing to seek cost recovery and tracking mechanisms from applicable public service commissions to reduce the effects of regulatory lag. There can be no assurance that these proposals or any other attempts by PHI's utility subsidiaries to mitigate regulatory lag will be approved, or that even if approved, the rate recovery mechanisms or any base rate cases will fully ameliorate the effects of regulatory lag. Until such time as these proposed mechanisms are approved, PHI's utility subsidiaries plan to file rate cases at least annually in an effort to align more closely PHI's utility subsidiaries revenue and related cash flow levels with other operation and maintenance spending and capital investments. In future rate cases, PHI's utility subsidiaries would also continue to seek cost recovery and tracking mechanisms from applicable regulatory commissions to reduce the effects of regulatory lag.

Pepco Energy Services

Pepco Energy Services is engaged in the following businesses:

- providing energy efficiency services principally to federal, state and local government customers, and designing, constructing and operating combined heat and power and central energy plants,
- providing high voltage electric construction and maintenance services to customers throughout the United States and low voltage electric construction and maintenance services and streetlight construction and asset management services to utilities, municipalities and other customers in the Washington, D.C. area, and
- providing retail customers electricity and natural gas under its remaining contractual obligations.

Most of Pepco Energy Services' contracts with federal, state and local governments, as well as independent agencies such as housing and water authorities, contain provisions authorizing the governmental authority or independent agency to terminate the contract at any time. Those provisions include explicit mechanisms that, if exercised, would require the other party to pay Pepco Energy Services for work performed through the date of termination and for additional costs incurred as a result of the termination.

From time to time, PHI is required to guarantee the obligations of Pepco Energy Services under certain of its construction contracts. In addition, Pepco Energy Services provides energy services guarantees in connection with its energy services performance contracts. At March 31, 2012 PHI's guarantees of Pepco Energy Services' projects totaled \$143 million. See Note (15), "Commitments and Contingencies," to the consolidated financial statements of PHI.

Pepco Energy Services also has historically been engaged in the business of providing retail energy supply services, consisting of the sale of electricity, including electricity from renewable resources, primarily to commercial, industrial and government customers located primarily in the mid-Atlantic and northeastern regions of the United States, as well as Texas and Illinois, and the sale of natural gas to customers located primarily in the mid-Atlantic region. In December 2009, PHI announced that it will wind down the retail energy supply component of the Pepco Energy Services business.

Pepco Energy Services' retail natural gas sales volumes and revenues are seasonally dependent. Colder weather from November through March of each year generally translates into increased sales volumes, which, when coupled with higher natural gas prices during these months, allows Pepco Energy Services to recognize generally higher revenues as compared to other months of the year. Retail electricity sales volumes are also seasonally dependent, with sales in the summer and winter months being generally higher than other months of the year, which, when coupled with higher electricity prices during these periods, allows Pepco Energy Services to recognize generally higher revenues as compared to other periods during the year. However, as Pepco Energy Services is in the process of winding down its retail energy supply business, this effect of seasonality will likely decrease as such wind-down is completed. The energy services business is not seasonal.

To effectuate the wind-down, Pepco Energy Services is continuing to fulfill all of its commercial and regulatory obligations and perform its customer service functions to ensure that it meets the needs of its existing customers, but is not entering into any new retail energy supply contracts. Operating revenues related to the retail energy supply business for the three months ended March 31, 2012 and 2011 were \$160 million and \$305 million, respectively, and operating income for the same periods was \$15 million and \$12 million, respectively.

PHI expects the operating results of the retail energy supply business, excluding the effects of unrealized mark-to-market gains or losses on derivatives contracts, to be profitable in 2012, based on its existing retail contracts and its corresponding portfolio of wholesale hedges, with immaterial losses beyond that date. Substantially all of Pepco Energy Services' retail customer obligations will be fully performed by June 1, 2014.

In connection with the operation of the retail energy supply business, as of March 31, 2012 and December 31, 2011, Pepco Energy Services had collateral pledged to counterparties primarily for the instruments it uses to hedge commodity price risk of approximately \$93 million and \$113 million, respectively. The collateral pledged as of March 31, 2012 included \$1 million in the form of letters of credit and \$92 million posted in cash. Pepco Energy Services estimates that at current market prices, with the wind-down of the retail energy supply business, an aggregate of 80% of the collateral will no longer need to be pledged by December 31, 2012, and all collateral will no longer need to be pledged by June 1, 2014.

Pepco Energy Services' remaining businesses will not be affected by the wind-down of the retail energy supply business.

Other Non-Regulated

Through its subsidiary Potomac Capital Investment Corporation and its subsidiaries, PHI maintains a portfolio of cross-border energy lease investments with a book value at March 31, 2012 of approximately \$1.4 billion. This activity constitutes a third operating segment, which is designated as "Other Non-Regulated," for financial reporting purposes. For a discussion of PHI's cross-border energy lease investments, see Note (8), "Leasing Activities – Investment in Finance Leases Held in Trust," and Note (15), "Commitments and Contingencies – PHI's Cross-Border Energy Lease Investments," to the consolidated financial statements of PHI.

Discontinued Operations

On April 20, 2010, the Board of Directors of PHI approved a plan for the disposition of PHI's competitive wholesale power generation, marketing and supply business, which had been conducted through subsidiaries of Conectiv Energy Holding Company (collectively, Conectiv Energy). On July 1, 2010, PHI completed the sale of Conectiv Energy's wholesale power generation business to Calpine Corporation (Calpine) for \$1.64 billion. The disposition of all of Conectiv Energy's remaining assets and businesses not included in the Calpine sale, including its load service supply contracts, energy hedging portfolio and certain tolling agreements, has been completed. The former operations of Conectiv Energy, which previously comprised a separate segment for financial reporting purposes, have been classified as a discontinued operation in PHI's consolidated financial statements, and the business is no longer treated as a separate segment for financial reporting purposes. Accordingly, in this Management's Discussion and Analysis of Financial Condition and Results of Operations, all references to continuing operations exclude the operations of the former Conectiv Energy segment.

Earnings OverviewThree Months Ended March 31, 2012 Compared to Three Months Ended March 31, 2011

Net income from continuing operations for the three months ended March 31, 2012 was \$68 million, or \$0.30 per share, compared to \$62 million, or \$0.27 per share, for the three months ended March 31, 2011.

Net income from discontinued operations for the three months ended March 31, 2011 was \$2 million, or \$0.01 per share.

Net income for the three months ended March 31, 2012 and 2011, by operating segment, is set forth in the table below (in millions of dollars):

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Power Delivery	\$ 47	\$47	\$ —
Pepco Energy Services	10	10	—
Other Non-Regulated	10	6	4
Corporate and Other	<u>1</u>	<u>(1)</u>	<u>2</u>
Net Income from Continuing Operations	68	62	6
Discontinued Operations	<u>—</u>	<u>2</u>	<u>(2)</u>
Total PHI Net Income	<u>\$ 68</u>	<u>\$64</u>	<u>\$ 4</u>

Discussion of Operating Segment Net Income Variances:

Power Delivery's earnings were unchanged primarily due to the following:

- An increase of \$10 million from federal and state income tax adjustments primarily resulting from changes in estimates and interest related to uncertain and effectively settled income tax positions.
- An increase of \$3 million from electric (DPL Maryland) and gas (DPL Delaware) distribution rate increases in 2011.
- An increase of \$3 million from higher transmission revenue primarily attributable to higher rates effective June 1, 2011, related to an increase in transmission plant investment.

- A decrease of \$8 million due to lower distribution sales, primarily from the effect of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$2 million associated with lower Default Electricity Supply margins for Pepco, primarily due to the approval by the District of Columbia Public Service Commission of a favorable adjustment in 2011 that provides for recovery of higher cash working capital costs.
- A decrease of \$2 million associated with ACE BGS, primarily attributable to a decrease in unbilled revenue.
- A decrease of \$2 million due to higher operation and maintenance expenses primarily from increased system maintenance and reliability costs in 2012, partially offset by higher storm restoration costs in 2011.

Pepco Energy Services' earnings were unchanged primarily due to the on-going wind-down of the retail energy supply business and lower Energy Services project activity which were offset by higher mark-to-market losses on derivative contracts in 2011.

Other Non-Regulated's \$4 million increase in earnings was primarily due to favorable income tax adjustments in 2012 related to uncertain and effectively settled income tax positions.

Corporate and Other's \$2 million increase in earnings was primarily due lower postemployment benefits expenses.

Net income from discontinued operations of \$2 million for the three months ended March 31, 2011 was primarily related to adjustments to certain accrued expenses for obligations associated with the sale of the wholesale power generation business to Calpine. These adjustments were made to reflect the actual amounts paid to Calpine during the first quarter of 2011.

Consolidated Results of Operations

The following results of operations discussion compares the three months ended March 31, 2012, to the three months ended March 31, 2011. All amounts in the tables (except sales and customers) are in millions of dollars.

Continuing Operations**Operating Revenue**

A detail of the components of PHI's consolidated operating revenue is as follows:

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Power Delivery	\$1,055	\$1,249	\$ (194)
Pepco Energy Services	228	373	(145)
Other Non-Regulated	13	14	(1)
Corporate and Other	(4)	(2)	(2)
Total Operating Revenue	<u>\$1,292</u>	<u>\$1,634</u>	<u>\$ (342)</u>

Power Delivery Business

The following table categorizes Power Delivery's operating revenue by type of revenue.

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Regulated T&D Electric Revenue	\$ 452	\$ 452	\$ —
Default Electricity Supply Revenue	512	679	(167)
Other Electric Revenue	17	16	1
Total Electric Operating Revenue	<u>981</u>	<u>1,147</u>	<u>(166)</u>
Regulated Gas Revenue	65	91	(26)
Other Gas Revenue	9	11	(2)
Total Gas Operating Revenue	<u>74</u>	<u>102</u>	<u>(28)</u>
Total Power Delivery Operating Revenue	<u>\$1,055</u>	<u>\$1,249</u>	<u>\$ (194)</u>

Regulated Transmission and Distribution (T&D) Electric Revenue includes revenue from the distribution of electricity, including the distribution of Default Electricity Supply, by PHI's utility subsidiaries to customers within their service territories at regulated rates. Regulated T&D Electric Revenue also includes transmission service revenue that PHI's utility subsidiaries receive as transmission owners from PJM at rates regulated by FERC.

Default Electricity Supply Revenue is the revenue received from the supply of electricity by PHI's utility subsidiaries at regulated rates to retail customers who do not elect to purchase electricity from a competitive energy supplier. The costs related to Default Electricity Supply are included in Fuel and Purchased Energy. Default Electricity Supply Revenue also includes revenue from non-bypassable transition bond charges (Transition Bond Charges) that ACE receives, and pays to ACE Funding, to fund the principal and interest payments on Transition Bonds issued by ACE Funding, and revenue in the form of transmission enhancement credits that PHI utility subsidiaries receive as transmission owners from PJM for approved regional transmission expansion plan costs.

Other Electric Revenue includes work and services performed on behalf of customers, including other utilities, which is generally not subject to price regulation. Work and services include mutual assistance to other utilities, highway relocation, rentals of pole attachments, late payment fees and collection fees.

Regulated Gas Revenue includes the revenue DPL receives from on-system natural gas delivered sales and the transportation of natural gas for customers within its service territory at regulated rates.

Other Gas Revenue consists of DPL's off-system natural gas sales and the short-term release of interstate pipeline transportation and storage capacity not needed to serve customers. Off-system sales are made possible when low demand for natural gas by regulated customers creates excess pipeline capacity.

Regulated T&D Electric

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Revenue</i>			
Residential	\$162	\$168	\$ (6)
Commercial and industrial	201	202	(1)
Transmission and other	89	82	7
Total Regulated T&D Electric Revenue	<u>\$452</u>	<u>\$452</u>	<u>\$ —</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Sales (Gigawatt hours (GWh))</i>			
Residential	4,195	4,775	(580)
Commercial and industrial	7,081	7,305	(224)
Transmission and other	68	68	—
Total Regulated T&D Electric Sales	<u>11,344</u>	<u>12,148</u>	<u>(804)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Customers (in thousands)</i>			
Residential	1,640	1,638	2
Commercial and industrial	198	198	—
Transmission and other	2	2	—
Total Regulated T&D Electric Customers	<u>1,840</u>	<u>1,838</u>	<u>2</u>

The Pepco, DPL and ACE service territories are located within a corridor extending from the District of Columbia to southern New Jersey. These service territories are economically diverse and include key industries that contribute to the regional economic base, as follows:

- Commercial activities in the region include banking and other professional services, government, insurance, real estate, shopping malls, casinos, stand alone construction and tourism.
- Industrial activities in the region include chemical, glass, pharmaceutical, steel manufacturing, food processing and oil refining.

Regulated T&D Electric Revenue was unchanged primarily due to:

- An increase of \$7 million in transmission revenue primarily attributable to higher rates effective June 1, 2011 related to an increase in transmission plant investment.
- An increase of \$3 million due to a DPL distribution rate increase in Maryland, effective July 2011.
- An increase of \$3 million due to an EmPower Maryland (a demand side management program) rate increase effective February 2012 (which is substantially offset by a corresponding increase in Depreciation and Amortization).
- An increase of \$2 million primarily due to Pepco customer growth in 2012.

The aggregate amount of these increases were partially offset by:

- A decrease of \$6 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$4 million due to lower pass-through revenue (which is substantially offset by a corresponding decrease in Other Taxes) primarily the result of lower sales that resulted in a decrease in Montgomery County, Maryland utility taxes that are collected by Pepco on behalf of the county.
- A decrease of \$4 million due to lower non-weather related average customer usage.

Default Electricity Supply

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Revenue</i>			
Residential	\$358	\$469	\$ (111)
Commercial and industrial	130	168	(38)
Other	24	42	(18)
Total Default Electricity Supply Revenue	<u>\$512</u>	<u>\$679</u>	<u>\$ (167)</u>

Other Default Electricity Supply Revenue consists primarily of (i) revenue from the resale by ACE in the PJM regional transmission organization (PJM RTO) market of energy and capacity purchased under contracts with unaffiliated non-utility generators (NUGs), and (ii) revenue from transmission enhancement credits.

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Sales (GWh)</i>			
Residential	3,578	4,298	(720)
Commercial and industrial	1,393	1,558	(165)
Other	15	19	(4)
Total Default Electricity Supply Sales	<u>4,986</u>	<u>5,875</u>	<u>(889)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Customers (in thousands)</i>			
Residential	1,426	1,495	(69)
Commercial and industrial	135	144	(9)
Other	—	1	(1)
Total Default Electricity Supply Customers	<u>1,561</u>	<u>1,640</u>	<u>(79)</u>

Default Electricity Supply Revenue decreased by \$167 million primarily due to:

- A decrease of \$51 million as a result of lower Pepco and DPL Default Electricity Supply rates.
- A decrease of \$45 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$40 million due to lower sales, primarily as a result of customer migration to competitive suppliers.

- A decrease of \$18 million in wholesale energy and capacity resale revenues primarily due to the sale at lower market prices of electricity and capacity purchased from NUGs.
- A decrease of \$10 million due to lower non-weather related average customer usage of electricity.

Total Default Electricity Supply Revenue for the three months ended March 31, 2012 includes a decrease of \$2 million in unbilled revenue attributable to ACE's BGS (\$1 million decrease in net income), primarily due to lower Default Electricity Supply rates during the unbilled revenue period at March 31, 2012 as compared to the corresponding period in 2011. Under the BGS terms approved by the New Jersey Board of Public Utilities (NJBPU), ACE's BGS unbilled revenue is not included in the deferral calculation until it is billed to customers, and therefore has an impact on the results of operations in the period during which it is accrued.

Regulated Gas

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Revenue</i>			
Residential	\$43	\$57	\$ (14)
Commercial and industrial	19	31	(12)
Transportation and other	3	3	—
Total Regulated Gas Revenue	<u>\$65</u>	<u>\$91</u>	<u>\$ (26)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Sales (billion cubic feet)</i>			
Residential	3	4	(1)
Commercial and industrial	2	2	—
Transportation and other	2	3	(1)
Total Regulated Gas Sales	<u>7</u>	<u>9</u>	<u>(2)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Customers (in thousands)</i>			
Residential	114	114	—
Commercial and industrial	10	10	—
Transportation and other	—	—	—
Total Regulated Gas Customers	<u>124</u>	<u>124</u>	<u>—</u>

DPL's natural gas service territory is located in New Castle County, Delaware. Several key industries contribute to the economic base as well as to growth, as follows:

- Commercial activities in the region include banking and other professional services, government, insurance, real estate, shopping malls, stand alone construction and tourism.
- Industrial activities in the region include chemical and pharmaceutical.

Regulated Gas Revenue decreased by \$26 million primarily due to:

- A decrease of \$19 million due to lower sales primarily as a result of milder weather during the winter months of 2012, as compared to the winter of 2011.
- A decrease of \$7 million due to lower non-weather related average customer usage.

- A decrease of \$2 million due to a Gas Cost Rate decrease effective November 2011.

The aggregate amount of these decreases was partially offset by an increase of \$2 million due to a distribution rate increase effective July 2011.

Other Gas Revenue

Other Gas Revenue decreased by \$2 million primarily due to lower average prices, partially offset by higher volumes of off-system sales to electric generators and gas marketers.

Pepco Energy Services

Pepco Energy Services' operating revenue decreased by \$145 million primarily due to:

- A decrease of \$143 million due to lower retail supply sales volume primarily attributable to the ongoing wind down of the retail energy supply business.
- A decrease of \$3 million due to lower generation and capacity revenues at its generating facilities.

Operating Expenses

Fuel and Purchased Energy and Other Services Cost of Sales

A detail of PHI's consolidated Fuel and Purchased Energy and Other Services Cost of Sales is as follows:

	2012	2011	Change
Power Delivery	\$543	\$ 706	\$(163)
Pepco Energy Services	187	331	(144)
Corporate and Other	(1)	1	(2)
Total	<u>\$729</u>	<u>\$1,038</u>	<u>\$(309)</u>

Power Delivery Business

Power Delivery's Fuel and Purchased Energy consists of the cost of electricity and natural gas purchased by its utility subsidiaries to fulfill their respective Default Electricity Supply and Regulated Gas obligations and, as such, is recoverable from customers in accordance with the terms of public service commission orders. It also includes the cost of natural gas purchased for off-system sales. Fuel and Purchased Energy expense decreased by \$163 million primarily due to:

- A decrease of \$46 million primarily due to customer migration to competitive suppliers.
- A decrease of \$46 million due to lower average electricity costs under Default Electricity Supply contracts.
- A decrease of \$39 million due to lower electricity sales primarily as a result of milder weather during the winter months of 2012, as compared to 2011.
- A decrease of \$14 million in the cost of gas purchases for on-system sales as a result of lower volumes purchased, lower average gas prices and lower withdrawals from storage.
- A decrease of \$13 million in deferred electricity expense primarily due to lower Default Electricity Supply rates, which resulted in a lower rate of recovery of Default Electricity Supply costs.
- A decrease of \$5 million in deferred natural gas expense as a result of a lower rate of recovery of natural gas supply costs.

Pepco Energy Services

Pepco Energy Services' Fuel and Purchased Energy and Other Services Cost of Sales decreased \$144 million primarily due to lower volumes of electricity and gas purchased to serve decreased retail supply sales volume as a result of the ongoing wind down of the retail energy supply business.

Other Operation and Maintenance

A detail of PHI's Other Operation and Maintenance expense is as follows:

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Power Delivery	\$224	\$222	\$ 2
Pepco Energy Services	18	21	(3)
Corporate and Other	(17)	(9)	(8)
Total	<u>\$225</u>	<u>\$234</u>	<u>\$ (9)</u>

Other Operation and Maintenance expense for Power Delivery increased by \$2 million primarily due to:

- An increase of \$8 million associated with higher tree trimming and maintenance costs.
- An increase of \$7 million in customer support service and system support costs.
- An increase of \$3 million in expenses related to regulatory filings.
- An increase of \$2 million in communication costs.

The aggregate amount of these increases was partially offset by a decrease of \$18 million in emergency restoration costs, which were higher in 2011 largely due to the severe winter storm in January 2011.

Depreciation and Amortization

Depreciation and Amortization expenses increased by \$5 million to \$110 million in 2012 from \$105 million in 2011 primarily due to:

- An increase of \$4 million due to utility plant additions.
- An increase of \$3 million in amortization of regulatory assets primarily due to an EmPower Maryland surcharge rate increase effective February 2012 (which is substantially offset by a corresponding increase in Regulated T&D Electric Revenue).
- An increase of \$2 million due to decommissioning activity associated with Pepco Energy Services generating facilities scheduled for deactivation in May 2012.
- An increase of \$1 million in amortization of AMI projects.

The aggregate amount of these increases was partially offset by a decrease of \$6 million in amortization of stranded costs as the result of lower revenue due to rate decreases effective October 2011 for the ACE Transition Bond Charge and Market Transition Charge Tax (partially offset in Default Electricity Supply Revenue).

Other Taxes

Other Taxes decreased by \$7 million to \$104 million in 2012 from \$111 million in 2011. The decrease was primarily due to lower utility taxes, primarily the result of lower sales, that are collected and passed through by Power Delivery (substantially offset by a corresponding increase in Regulated T&D Electric Revenue).

Deferred Electric Service Costs

Deferred Electric Service Costs, which relate only to ACE, represent (i) the over- or under-recovery of electricity costs incurred by ACE to fulfill its Default Electricity Supply obligation and (ii) the over- or under-recovery of New Jersey Societal Benefit Program costs incurred by ACE. The cost of electricity purchased is reported under Fuel and Purchased Energy and the corresponding revenue is reported under Default Electricity Supply Revenue. The cost of New Jersey Societal Benefit Programs is reported under Other Operation and Maintenance and the corresponding revenue is reported under Regulated T&D Electric Revenue.

Deferred Electric Service Costs decreased by \$12 million, to an expense reduction of \$15 million in 2012 as compared to an expense reduction of \$3 million in 2011, primarily due to higher electricity supply costs, partially offset by higher Default Electricity Supply rates.

Other Income (Expenses)

Other Expenses (which are net of Other Income) increased by \$4 million to a net expense of \$57 million in 2012 from a net expense of \$53 million in 2011. The increase was primarily due to:

- A decrease of \$3 million in other income due to March 2011 net proceeds from a company owned life insurance policy.
- An increase of \$2 million in long-term debt interest expense due to \$200 million of First Mortgage Bonds issued by ACE in April 2011.

Income Tax Expense

PHI's income tax expense decreased by \$20 million in the three months ended March 31, 2012. PHI's consolidated effective tax rates for the three months ended March 31, 2012 and 2011 were 17.1% and 35.4%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the Internal Revenue Service (IRS) with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position in Pepco. The effective rate was further decreased as a result of the increase in asset removal costs in Pepco in 2012 primarily related to a higher level of asset retirements.

Discontinued Operations

For the three months ended March 31, 2012, the income from discontinued operations, net of income taxes, was zero.

For the three months ended March 31, 2011, the \$2 million income from discontinued operations, net of income taxes, includes after-tax income of \$4 million arising from adjustments to certain accrued expenses for obligations associated with the sale of the wholesale power generation business to Calpine.

Capital Resources and Liquidity

This section discusses PHI's working capital, cash flow activity, capital requirements and other uses and sources of capital.

Working Capital

At March 31, 2012, PHI's current assets on a consolidated basis totaled \$1.3 billion and its consolidated current liabilities totaled \$2.1 billion, resulting in a working capital deficit of \$747 million. PHI expects the working capital deficit at March 31, 2012 to be funded during 2012 through the issuance of long-term debt by the utilities and physical settlement of the equity forward transaction, as well as from cash flows from operations. Additional working capital will be provided by anticipated reductions in collateral requirements due to the ongoing wind-down of the Pepco Energy Services retail energy supply business. At December 31, 2011, PHI's current assets on a consolidated basis totaled \$1.4 billion and its current liabilities totaled \$1.9 billion. The increase in working capital deficit from December 31, 2011 to March 31, 2012 was primarily due to an increase in short-term debt for Pepco and DPL, and the use of cash and cash equivalents in ACE to temporarily support higher spending by the utilities on infrastructure investments and reliability initiatives until long-term financing for these initiatives is obtained.

At March 31, 2012, PHI's consolidated cash and cash equivalents totaled \$64 million, of which \$44 million was invested in money market funds, and the balance was held as cash and uncollected funds. Current restricted cash equivalents (cash that is available to be used only for designated purposes) totaled \$10 million. At December 31, 2011, PHI's consolidated cash and cash equivalents totaled \$109 million, of which \$87 million was invested in money market funds, and the balance was held as cash and uncollected funds. Its current restricted cash equivalents totaled \$11 million.

A detail of PHI's short-term debt balance and current maturities of long-term debt and project funding balance is as follows:

Type	As of March 31, 2012 (millions of dollars)						
	PHI Parent	Pepco	DPL	ACE	ACE Funding	Pepco Energy Services	PHI Consolidated
Variable Rate Demand Bonds	\$ —	\$ —	\$105	\$ 23	\$ —	\$ —	\$ 128
Commercial Paper	521	204	133	—	—	—	858
Total Short-Term Debt	<u>\$ 521</u>	<u>\$204</u>	<u>\$238</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 986</u>
Current Maturities of Long-Term Debt and Project Funding	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 66</u>	<u>\$ —</u>	<u>\$ 38</u>	<u>\$ 10</u>	<u>\$ 114</u>

Type	As of December 31, 2011 (millions of dollars)						
	PHI Parent	Pepco	DPL	ACE	ACE Funding	Pepco Energy Services	PHI Consolidated
Variable Rate Demand Bonds	\$ —	\$ —	\$105	\$ 23	\$ —	\$ 18	\$ 146
Commercial Paper	465	74	47	—	—	—	586
Total Short-Term Debt	<u>\$ 465</u>	<u>\$ 74</u>	<u>\$152</u>	<u>\$ 23</u>	<u>\$ —</u>	<u>\$ 18</u>	<u>\$ 732</u>
Current Maturities of Long-Term Debt and Project Funding	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 66</u>	<u>\$ —</u>	<u>\$ 37</u>	<u>\$ 9</u>	<u>\$ 112</u>

Commercial Paper

PHI, Pepco, DPL and ACE maintain commercial paper programs to address short-term liquidity needs. As of March 31, 2012, the maximum capacity available under these programs was \$875 million, \$500 million, \$500 million and \$250 million, respectively, subject to available borrowing capacity under the credit facility. In January 2012, the Board of Directors approved an increase in PHI's maximum to \$1.25 billion, which has not been put into effect as of March 31, 2012.

PHI, Pepco and DPL had \$521 million, \$204 million and \$133 million, respectively, of commercial paper outstanding at March 31, 2012. ACE did not issue commercial paper during the first quarter of 2012 and had no commercial paper outstanding at March 31, 2012. The weighted average interest rate for commercial paper issued by PHI, Pepco and DPL during the three months ended March 31, 2012 was 0.75%, 0.40% and 0.39%, respectively. The weighted average maturity of all commercial paper issued by PHI, Pepco and DPL during the three months ended March 31, 2012 was twelve, five and four days, respectively.

Financing Activity During the Three Months Ended March 31, 2012

In January 2012, ACE Funding made principal payments of \$7 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

Equity Forward Transaction

On March 5, 2012, PHI entered into an equity forward transaction in connection with a public offering of 17,922,077 shares of PHI common stock. The use of an equity forward transaction substantially eliminates future equity market price risk by fixing a common equity offering sales price under the then existing market conditions, while mitigating immediate share dilution resulting from the offering by postponing the actual issuance of common stock until funds are needed in accordance with PHI's capital investment and regulatory plans.

Pursuant to the terms of this transaction, a forward counterparty borrowed 17,922,077 shares of PHI's common stock from third parties and sold them to a group of underwriters for \$19.25 per share, less an underwriting discount equal to \$0.67375 per share. Under the terms of the equity forward transaction, to the extent that the transaction is physically settled, PHI would be required to issue and deliver shares of PHI common stock to the forward counterparty at the then applicable forward sale price. The forward sale price was initially determined to be \$18.57625 per share at the time the equity forward transaction was entered into, and the amount of cash to be received by PHI upon physical settlement of the equity forward is subject to certain adjustments in accordance with the terms of the equity forward transaction. The equity forward transaction must be settled fully within 12 months of the transaction date. Except in specified circumstances or events that would require physical settlement, PHI is able to elect to settle the equity forward transaction by means of physical, cash or net share settlement, in whole or in part, at any time on or prior to March 5, 2013.

The equity forward transaction has no initial fair value since it was entered into at the then market price of the common stock. PHI will not receive any proceeds from the sale of common stock until the equity forward transaction is settled, and at that time PHI will record the proceeds, if any, in equity. PHI concluded that the equity forward transaction was an equity instrument based on the accounting guidance in ASC 480 and ASC 815 and that it qualified for an exception from derivative accounting under ASC 815 because the forward sale transaction was indexed to its own stock. Currently, PHI anticipates settling the equity forward transaction through physical settlement.

At March 31, 2012, the equity forward transaction could have been settled with physical delivery of the shares to the forward counterparty in exchange for cash of \$328 million. At March 31, 2012, the equity forward transaction could also have been cash settled, with delivery of cash of approximately \$14 million to the forward counterparty, or net share settled with delivery of approximately 740,000 shares of common stock to the forward counterparty.

Prior to its settlement, the equity forward transaction will be reflected in PHI's diluted earnings per share calculations using the treasury stock method. Under this method, the number of shares of PHI's common stock used in calculating diluted earnings per share for a reporting period is deemed to be increased by the excess, if any, of the number of shares that would be issued upon physical settlement of the equity forward transaction less the number of shares that could be purchased by PHI in the market (based on the average market price during that reporting period) using the proceeds receivable upon settlement (based on the adjusted forward sale price at the end of that reporting period). The excess number of shares is weighted for the portion of the reporting period in which the equity forward transaction is outstanding.

Accordingly, before physical or net share settlement of the equity forward transaction, and subject to the occurrence of certain events, PHI anticipates that the forward sale agreement will have a dilutive effect on PHI's earnings per share only during periods when the applicable average market price per share of PHI's common stock is above the per share adjusted forward sale price, as described above. However, if PHI decides to physically or net share settle the forward sale agreement, any delivery by PHI of shares upon settlement could result in dilution to PHI's earnings per share.

For the three months ended March 31, 2012, the equity forward transaction did not have a material dilutive effect on PHI's earnings per share.

Credit Facility

PHI, Pepco, DPL and ACE maintain an on-going unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement with respect to the facility, which among other changes, extended the expiration date of the facility to August 1, 2016.

The aggregate borrowing limit under the amended and restated credit facility is \$1.5 billion, all or any portion of which may be used to obtain loans and up to \$500 million of which may be used to obtain letters of credit. The facility also includes a swingline loan sub-facility, pursuant to which each company may make same day borrowings in an aggregate amount not to exceed 10% of the total amount of the facility. Any swingline loan must be repaid by the borrower within fourteen days of receipt. The initial credit sublimit for PHI is \$750 million and \$250 million for each of Pepco, DPL and ACE. The sublimits may be increased or decreased by the individual borrower during the term of the facility, except that (i) the sum of all of the borrower sublimits following any such increase or decrease must equal the total amount of the facility and (ii) the aggregate amount of credit used at any given time by (a) PHI may not exceed \$1.25 billion and (b) each of Pepco, DPL or ACE may not exceed the lesser of \$500 million and the maximum amount of short-term debt the company is permitted to have outstanding by its regulatory authorities. The total number of the sublimit reallocations may not exceed eight per year during the term of the facility.

The interest rate payable by each company on utilized funds is, at the borrowing company's election, (i) the greater of the prevailing prime rate, the federal funds effective rate plus 0.5% and one month LIBOR plus 1.0%, or (ii) the prevailing Eurodollar rate, plus a margin that varies according to the credit rating of the borrower.

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of

its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of March 31, 2012.

The absence of a material adverse change in PHI's business, property, results of operations or financial condition is not a condition to the availability of credit under the credit agreement. The credit agreement does not include any rating triggers.

Cash and Credit Facility Available as of March 31, 2012

	Consolidated PHI	PHI Parent (millions of dollars)	Utility Subsidiaries
Credit Facility (Total Capacity)	\$ 1,500	\$ 750	\$ 750
Less: Letters of Credit issued	7	2	5
Commercial Paper outstanding	858	521	337
Remaining Credit Facility Available	635	227	408
Cash Invested in Money Market Funds (a)	44	—	44
Total Cash and Credit Facility Available	<u>\$ 679</u>	<u>\$ 227</u>	<u>\$ 452</u>

- (a) Cash and cash equivalents reported on the PHI consolidated balance sheet total \$64 million, of which \$44 million was invested in money market funds, and the balance was held in cash and uncollected funds.

Collateral Requirements of Pepco Energy Services

In the ordinary course of its energy supply business which is in the process of winding down, Pepco Energy Services entered into various contracts to buy and sell electricity, fuels and related products, including derivative instruments, designed to reduce its financial exposure to changes in the value of its assets and obligations due to energy price fluctuations. These contracts typically have collateral requirements. Depending on the contract terms, the collateral required to be posted by Pepco Energy Services can be of varying forms, including cash and letters of credit. As of March 31, 2012, Pepco Energy Services posted net cash collateral of \$92 million and letters of credit of \$1 million. At December 31, 2011, Pepco Energy Services posted net cash collateral of \$112 million and letters of credit of \$1 million.

At March 31, 2012 and December 31, 2011, the amount of cash, plus borrowing capacity under the primary credit facility available to meet the future liquidity needs of Pepco Energy Services, totaled \$227 million and \$283 million, respectively.

Financing Activities Subsequent to March 31, 2012

Bond Payments

In April 2012, ACE Funding made principal payments of \$6 million on its Series 2002-1 Bonds, Class A-3, and \$2 million on its Series 2003-1 Bonds, Class A-2.

Bond Issuance

In April 2012, Pepco issued \$200 million of 3.05% first mortgage bonds due April 1, 2022. Proceeds from the issuance of the long-term debt were primarily used to repay Pepco's outstanding commercial paper that was issued to temporarily fund capital expenditures and working capital, to redeem, prior to maturity, all of the \$38.3 million outstanding of the 5.375% pollution control revenue refunding bonds due February 15, 2024 issued by the Industrial Development Authority of the City of Alexandria, Virginia, on Pepco's behalf and for general corporate purposes.

Bond Redemption

On April 30, 2012, all of the \$38.3 million of the outstanding 5.375% pollution control revenue refunding bonds were redeemed as noted in the preceding paragraph. In connection with such redemption, Pepco redeemed all of the \$38.3 million outstanding of its 5.375% first mortgage bonds due February 15, 2024 that secured the obligations under such pollution control bonds.

Term Loan Agreement

On April 24, 2012, PHI entered into a \$200 million term loan agreement, pursuant to which PHI has borrowed (and may not reborrow) \$200 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to LIBOR with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.875%. PHI's Eurodollar borrowings under the loan agreement may be converted into floating rate loans under certain circumstances, and, in that event, for so long as any loan remains a floating rate loan, interest would accrue on that loan at a rate per year equal to (i) the highest of (a) the prevailing prime rate, (b) the federal funds effective rate plus 0.5%, or (c) the one-month Eurodollar rate plus 1%, plus (ii) a margin of 0.875%. As of April 24, 2012, outstanding borrowings under the loan agreement bore an annual interest rate of 1.115%, which is subject to adjustment from time to time. All borrowings under the loan agreement are unsecured, and the aggregate principal amount of all loans, together with any accrued but unpaid interest due under the loan agreement, must be repaid in full on or before April 23, 2013.

PHI intends to use the net proceeds of the borrowings under the loan agreement to repay outstanding commercial paper obligations and for general corporate purposes. Under the terms of the loan agreement, PHI must be in compliance with specified covenants, including (i) the requirement that PHI maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the loan agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) a restriction on sales or other dispositions of assets, other than certain permitted sales and dispositions, and (iii) a restriction on the incurrence of liens (other than liens permitted by the loan agreement) on the assets of PHI or any of its significant subsidiaries. The loan agreement does not include any rating triggers.

Pension and Postretirement Benefit Plans

Pension benefits are provided under PHI's non-contributory retirement plan (the PHI Retirement Plan), a defined benefit pension plan that covers substantially all employees of Pepco, DPL and ACE and certain employees of other PHI subsidiaries. PHI's funding policy with regard to the PHI Retirement Plan is to maintain a funding level that is at least equal to the target liability as defined under the Pension Protection Act of 2006.

PHI satisfied the minimum required contribution rules under the Pension Protection Act in 2011, 2010 and 2009. On January 31, 2012, Pepco, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of \$85 million, \$85 million and \$30 million, respectively, which is expected to bring the PHI Retirement Plan assets to at least the funding target level for 2012 under the Pension Protection Act.

Based on the results of the 2011 actuarial valuation, PHI's net periodic pension and other postretirement benefit costs were approximately \$94 million in 2011 versus \$116 million in 2010. The current estimate of benefit cost for 2012 is \$103 million. The utility subsidiaries are responsible for substantially all of the

total PHI net periodic pension and other postretirement benefit costs. Approximately 30% of net periodic pension and other postretirement benefit costs are capitalized. PHI estimates that its net periodic pension and other postretirement benefit expense will be approximately \$72 million in 2012, as compared to \$66 million in 2011 and \$81 million in 2010.

Cash Flow Activity

PHI's cash flows for the three months ended March 31, 2012 and 2011 are summarized below:

	Cash Source (Use)		
	2012	2011	Change
	(millions of dollars)		
Operating Activities	\$ 23	\$ 197	\$ (174)
Investing Activities	(281)	(164)	(117)
Financing Activities	213	(36)	249
Net decrease in cash and cash equivalents	<u>\$ (45)</u>	<u>\$ (3)</u>	<u>\$ (42)</u>

Operating Activities

Cash flows from operating activities during the three months ended March 31, 2012 and 2011 are summarized below:

	Cash Source (Use)		
	2012	2011	Change
	(millions of dollars)		
Net income from continuing operations	\$ 68	\$ 62	\$ 6
Non-cash adjustments to net income	93	87	6
Pension contributions	(200)	(110)	(90)
Changes in cash collateral related to derivative activities	20	31	(11)
Changes in other assets and liabilities	42	96	(54)
Changes in Conectiv Energy net assets held for sale	—	31	(31)
Net cash from operating activities	<u>\$ 23</u>	<u>\$ 197</u>	<u>\$ (174)</u>

Net cash from operating activities decreased \$174 million for the three months ended March 31, 2012, compared to the same period in 2011. The decrease was due primarily to the disposition of all of Conectiv Energy's remaining assets, a \$90 million increase in pension contributions compared to 2011 and a decrease in regulatory liabilities in 2012 that was the result of a lower rate of recovery by ACE of costs associated with energy and capacity purchases under the NUG contracts.

Investing Activities

Cash flows from investing activities during the three months ended March 31, 2012 and 2011 are summarized below:

	Cash (Use) Source		
	2012	2011	Change
	(millions of dollars)		
Investment in property, plant and equipment	\$(291)	\$(171)	\$(120)
Department of Energy (DOE) capital reimbursement awards received	7	9	(2)
Changes in restricted cash equivalents	1	(2)	3
Net other investing activities	<u>2</u>	<u>—</u>	<u>2</u>
Net cash used by investing activities	<u>\$(281)</u>	<u>\$(164)</u>	<u>\$(117)</u>

Net cash used by investing activities increased \$117 million for the three months ended March 31, 2012, compared to the same period in 2011. The increase was due primarily to a \$120 million increase in capital expenditures associated with new customer services, distribution reliability and transmission.

Financing Activities

Cash flows from financing activities during the three months ended March 31, 2012 and 2011 are summarized below:

	Cash (Use) Source		
	2012	2011	Change
	<i>(millions of dollars)</i>		
Dividends paid on common stock	\$ (61)	\$ (61)	\$ —
Common stock issued for the Dividend Reinvestment Plan and employee-related compensation	17	14	3
Redemption of preferred stock of subsidiaries	—	(6)	6
Reacquisitions of long-term debt	(9)	(9)	—
Issuances of short-term debt, net	253	33	220
Cost of issuances	(3)	—	(3)
Net other financing activities	16	(7)	23
Net cash from (used by) financing activities	<u>\$213</u>	<u>\$ (36)</u>	<u>\$ 249</u>

Net cash from financing activities increased \$249 million for the three months ended March 31, 2012 compared to the same period in 2011. The increase was primarily due to a \$220 million increase in short-term debt issuances to temporarily support higher spending by the utilities on infrastructure investments and reliability initiatives until long-term financing is obtained.

Redemption of Preferred Stock

On February 25, 2011, ACE redeemed all of its outstanding cumulative preferred stock for approximately \$6 million.

Changes in Outstanding Long-Term Debt

Cash flows from the reacquisition of long-term debt for the three months ended March 31, 2012 and 2011 is summarized in the chart below:

	Reacquisitions	
	2012	2011
	<i>(millions of dollars)</i>	
ACE securitization bonds due 2011-2012	\$ 9	\$ 9
	<u>\$ 9</u>	<u>\$ 9</u>

Changes in Short-Term Debt

As of March 31, 2012, PHI had a total of \$858 million of commercial paper outstanding as compared to \$586 million of commercial paper outstanding as of December 31, 2011.

Capital RequirementsCapital Expenditures

Pepco Holdings' capital expenditures for the three months ended March 31, 2012 were \$291 million, of which \$158 million was incurred by Pepco, \$69 million was incurred by DPL, \$53 million was incurred by ACE, \$5 million by Pepco Energy Services and \$6 million for Corporate and Other. The Power Delivery expenditures were primarily related to capital costs associated with new customer services, distribution reliability and transmission. Corporate and Other capital expenditures primarily consisted of hardware and software expenditures that will be allocated to Power Delivery when the assets are placed in service.

In its 2011 Form 10-K, PHI presented its projected capital expenditures for the five-year period 2012 through 2016. There have been no changes in PHI's projected capital expenditures from those presented in the 2011 Form 10-K. Projected capital expenditures include expenditures for distribution, transmission and gas delivery which primarily relate to facility replacements and upgrades to accommodate customer growth and service reliability, including capital expenditures for continuing reliability enhancement efforts. These projected capital expenditures also include expenditures for the programs undertaken by each of PHI's utility subsidiaries to install smart meters, further automate their electric distribution systems and enhance their communications infrastructure, which is referred to as the Blueprint for the Future.

MAPP Project

PJM has approved the construction of the Mid-Atlantic Power Pathway (MAPP), a new 152-mile, interstate transmission line as part of PJM's regional transmission expansion plan. In August 2011, PJM notified PHI that the scheduled in-service date for MAPP has been delayed from June 1, 2015 to the 2019 to 2021 time period. In light of the delayed in-service date for MAPP, substantially all of the anticipated capital expenditures associated with MAPP have been delayed until at least 2016 based on current projections. The exact revised in-service date of MAPP will be evaluated as part of PJM's 2012 Regional Transmission Expansion Plan review process.

MAPP/DOE Loan Program

To assist in the funding of the MAPP project, PHI has applied for a \$684 million loan guarantee from the DOE for a substantial portion of the MAPP project, primarily the Calvert Cliffs to Indian River segment. The application has been made under a federal loan guarantee program for projects that employ innovative energy efficiency, renewable energy and advanced transmission and distribution technologies. If granted, PHI believes the guarantee could allow PHI to acquire financing at a lower cost than it would otherwise be able to obtain in the capital markets. Whether PHI's application will be granted and, if so, the amount of debt guaranteed is subject to the discretion of the DOE and the negotiation of terms that will satisfy the conditions of the guarantee program. On February 28, 2011, the DOE issued a Notice of Intent to prepare an Environmental Impact Statement to assist the DOE in assessing the environmental impact of constructing the portion of the MAPP project to be supported by the loan guarantee. Since February 2011, the DOE has conducted field inspections of the entire route and has held public meetings to obtain input from the communities along the route.

The DOE's review of the loan guarantee program has delayed the DOE's review of PHI's loan guarantee application. There is not an approval deadline under the loan guarantee program, but this program could change or be terminated in the future. PHI continues to coordinate environmental activities with the DOE.

DOE Capital Reimbursement Awards

In 2009, the DOE announced awards under the American Recovery and Reinvestment Act of 2009 of:

- \$105 million and \$44 million in Pepco's Maryland and District of Columbia service territories, respectively, for the implementation of an AMI system, direct load control, distribution automation, and communications infrastructure.
- \$19 million to ACE for the implementation of an AMI system, direct load control, distribution automation, and communications infrastructure in its New Jersey service territory.

In April 2010, Pepco, ACE and the DOE signed agreements formalizing the \$168 million in awards. Of the \$168 million, \$130 million is expected to offset incurred and projected Blueprint for the Future and other capital expenditures of Pepco and ACE. The remaining \$38 million will be used to offset incremental expenses associated with direct load control and other Pepco and ACE programs. During the first quarter of 2012, Pepco and ACE received award payments of \$9 million and \$1 million, respectively. Cumulative award payments received by Pepco and ACE since April 2010, were \$76 million and \$10 million, respectively.

The IRS has announced that, to the extent these grants are expended on capital items, they will not be considered taxable income.

Third Party Guarantees, Indemnifications, Obligations and Off-Balance Sheet Arrangements

For a discussion of PHI's third party guarantees, indemnifications, obligations and off-balance sheet arrangements, see Note (15), "Commitments and Contingencies," to the consolidated financial statements of PHI.

Dividends

On April 26, 2012, Pepco Holdings' Board of Directors declared a dividend on common stock of 27 cents per share payable June 29, 2012 to stockholders of record on June 11, 2012. PHI had approximately \$1,079 million and \$1,072 million of retained earnings free of restrictions at March 31, 2012 and December 31, 2011, respectively.

Energy Contract Net Asset Activity

The following table provides detail on changes in the net asset or liability positions of the Pepco Energy Services segment with respect to energy commodity contracts for the three months ended March 31, 2012. The balances in the table are pre-tax and the derivative assets and liabilities reflect netting by counterparty before the impact of collateral.

PEPCO HOLDINGS

	Energy Commodity Activities (a) <i>(millions of dollars)</i>
Total Fair Value of Energy Contract Net Liabilities at December 31, 2011	\$ (83)
Current period unrealized mark-to-market losses	(10)
Effective portion of changes in fair value – recorded in Accumulated Other Comprehensive Loss	—
Cash flow hedge ineffectiveness – recorded in income	—
Reclassification to realized on settlement of contracts	23
Total Fair Value of Energy Contract Net Liabilities at March 31, 2012	\$ (70)
Detail of Fair Value of Energy Contract Net Liabilities at March 31, 2012 (see above)	
Derivative assets (current assets)	\$ 3
Derivative assets (non-current assets)	—
Total Fair Value of Energy Contract Assets	3
Derivative liabilities (current liabilities)	(71)
Derivative liabilities (non-current liabilities)	(2)
Total Fair Value of Energy Contract Liabilities	(73)
Total Fair Value of Energy Contract Net Liabilities	\$ (70)

- (a) Includes all effective hedging activities from continuing operations recorded at fair value through Accumulated Other Comprehensive Loss (AOCL) or trading activities from continuing operations recorded at fair value in the consolidated statements of income.

The \$70 million net liability on energy contracts at March 31, 2012 was primarily attributable to losses on power swaps and natural gas futures held by Pepco Energy Services. Pepco Energy Services' net liability decreased to \$70 million at March 31, 2012 from \$83 million at December 31, 2011 primarily due to settlements of the derivatives. PHI expects that future revenues from existing customer sales obligations that are accounted for on an accrual basis will largely offset expected realized net losses on Pepco Energy Services' energy contracts.

PHI uses its best estimates to determine the fair value of the commodity derivative contracts that are entered into by Pepco Energy Services. The fair values in each category presented below reflect forward prices and volatility factors as of March 31, 2012, and the fair values are subject to change as a result of changes in these prices and factors. As of March 31, 2012, all of these contracts were entered into by Pepco Energy Services.

	Fair Value of Contracts at March 31, 2012				
	Maturities				
Source of Fair Value	2012	2013	2014	2015 and Beyond	Total Fair Value
	(millions of dollars)				
Energy Commodity Activities, net (a)					
Actively Quoted (i.e., exchange-traded) prices	\$(29)	\$ (10)	\$ (2)	\$ —	\$(41)
Prices provided by other external sources (b)	(19)	(8)	—	—	(27)
Modeled (c)	(2)	—	—	—	(2)
Total	\$(50)	\$ (18)	\$ (2)	\$ —	\$(70)

- (a) Includes all effective hedging activities recorded at fair value through AOCL, and hedge ineffectiveness and trading activities on the consolidated statements of income, as required.
- (b) Prices provided by other external sources reflect information obtained from over-the-counter brokers, industry services, or multiple-party on-line platforms that are readily observable in the market.

- (c) Modeled values include significant inputs, usually representing more than 10% of the valuation, not readily observable in the market. The modeled valuation above represents the fair valuation of certain long-dated power transactions based on limited observable broker prices extrapolated for periods beyond two years into the future.

Contractual Arrangements with Credit Rating Triggers or Margining Rights

Under certain contractual arrangements entered into by PHI's subsidiaries, the subsidiary may be required to provide cash collateral or letters of credit as security for its contractual obligations if the credit ratings of PHI or the subsidiary are downgraded. In the event of a downgrade, the amount required to be posted would depend on the amount of the underlying contractual obligation existing at the time of the downgrade. Based on contractual provisions in effect at March 31, 2012, a downgrade in the unsecured debt credit ratings of PHI and each of its rated subsidiaries to below "investment grade" would increase the collateral obligation of PHI and its subsidiaries by up to \$221 million, none of which is related to discontinued operations of Conectiv Energy, and \$111 million of which is the net settlement amount attributable to derivatives, normal purchase and normal sale contracts, collateral, and other contracts under master netting agreements as described in Note (13), "Derivative Instruments and Hedging Activities" to the consolidated financial statements of PHI set forth in Part I, Item 1 of this Form 10-Q. The remaining \$110 million of the collateral obligation that would be incurred in the event PHI were downgraded to below "investment grade" is attributable primarily to energy services contracts and accounts payable to independent system operators and distribution companies on full requirements contracts entered into by Pepco Energy Services. PHI believes that it and its subsidiaries currently have sufficient liquidity to fund their operations and meet their financial obligations.

Many of the contractual arrangements entered into by PHI's subsidiaries in connection with competitive energy and Default Electricity Supply activities include margining rights pursuant to which the PHI subsidiary or a counterparty may request collateral if the market value of the contractual obligations reaches levels in excess of the credit thresholds established in the applicable arrangements. Pursuant to these margining rights, the affected PHI subsidiary may receive, or be required to post, collateral due to energy price movements. As of March 31, 2012, Pepco Energy Services provided net cash collateral in the amount of \$92 million in connection with these activities.

Regulatory and Other Matters

Maryland Public Service Commission New Generation Contract Requirement

On September 29, 2009, the Maryland Public Service Commission (MPSC) initiated an investigation into whether the regulated electric distribution companies (EDCs) in Maryland should be required to enter into long-term contracts with entities that construct, acquire or lease, and operate, new electric generation facilities in Maryland.

The MPSC issued an order on April 12, 2012, in which it determined that there is a need for one new power plant in the range of 650 to 700 MW beginning in 2015. The order requires Pepco, DPL and Baltimore Gas and Electric Company to negotiate and enter into a contract with the winning bidder in amounts proportionate to their relative SOS loads. Under the contract, the winning bidder will construct a 661 MW natural gas-fired combined cycle generation plant in Waldorf, Maryland, with a commercial operation date of June 1, 2015. The order acknowledges the EDCs' concerns about the requirements of the contract and directs them to negotiate with the winning bidder and submit any proposed changes in the contract to the MPSC for approval. The order further specifies that the EDCs entering into the contract will recover the associated costs from their respective SOS customers through surcharges. PHI is evaluating the impact of the order on each of Pepco and DPL, and, at this time, cannot predict (i) the extent of the negative effect that the order and, once finalized, the contract for new generation, may have on PHI's, Pepco's and DPL's balance sheets, as well as their respective credit metrics, as calculated by independent rating agencies that evaluate and rate PHI, Pepco and DPL and each of their debt issuances, (ii) the effect on Pepco's and DPL's ability to recover their associated costs of the contract for new generation if a significant number of SOS customers elect to buy their energy from alternative energy suppliers, and (iii) the effect of the order on the financial condition, results of operations and cash flows of each of PHI, Pepco and DPL. On April 27, 2012, a group of generators operating in the PJM region filed a complaint in the United States District Court for the Northern District of Maryland challenging the MPSC's order on the grounds that that such order violated the commerce clause and the supremacy clause of the U.S. Constitution. PHI continues to evaluate whether to seek judicial review of the MPSC's order.

For a discussion of other regulatory matters, see Note (7), “Regulatory Matters,” to the consolidated financial statements of PHI.

Legal Proceedings

For a discussion of legal proceedings, see Note (15), “Commitments and Contingencies,” to the consolidated financial statements of PHI.

Critical Accounting Policies

For a discussion of Pepco Holdings’ critical accounting policies, please refer to Part II, Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations in Pepco Holdings’ 2011 Form 10-K. There have been no material changes to PHI’s critical accounting policies as disclosed in the 2011 Form 10-K.

New Accounting Standards and Pronouncements

For information concerning new accounting standards and pronouncements that have recently been adopted by PHI and its subsidiaries or that one or more of the companies will be required to adopt on or before a specified date in the future, see Note (3), “Newly Adopted Accounting Standards,” and Note (4), “Recently Issued Accounting Standards, Not Yet Adopted,” to the consolidated financial statements of PHI.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Potomac Electric Power Company

Pepco meets the conditions set forth in General Instruction H(1)(a) and (b) to the Form 10-Q, and accordingly information otherwise required under this Item has been omitted in accordance with General Instruction H(2) to Form 10-Q.

General Overview

Pepco is engaged in the transmission and distribution of electricity in the District of Columbia and major portions of Prince George's County and Montgomery County in suburban Maryland. Pepco also provides Default Electricity Supply. Pepco's service territory covers approximately 640 square miles and has a population of approximately 2.2 million. As of March 31, 2012, approximately 58% of delivered electricity sales were to Maryland customers and approximately 42% were to District of Columbia customers.

Pepco's results historically have been seasonal, generally producing higher revenue and income in the warmest and coldest periods of the year. For retail customers of Pepco in Maryland and in the District of Columbia, revenue is not affected by unseasonably warmer or colder weather because a BSA for retail customers was implemented that recognizes distribution revenue based on an approved distribution charge per customer. Consequently, distribution revenue recognized is decoupled in a reporting period from the amount of power delivered during the period and the only factors that will cause distribution revenue recognized in Maryland and the District of Columbia to fluctuate from period to period are changes in the number of customers and changes in the approved distribution charge per customer. Changes in customer usage (such as due to weather conditions, energy prices, energy efficiency programs or other reasons) from period to period have no impact on reported distribution revenue for customers to whom the BSA applies.

In accounting for the BSA in Maryland and the District of Columbia, a Revenue Decoupling Adjustment is recorded representing either (i) a positive adjustment equal to the amount by which revenue from Maryland and District of Columbia retail distribution sales falls short of the revenue that Pepco is entitled to earn based on the approved distribution charge per customer or (ii) a negative adjustment equal to the amount by which revenue from such distribution sales exceeds the revenue that Pepco is entitled to earn based on the approved distribution charge per customer.

Pepco is a wholly owned subsidiary of PHI. Because PHI is a public utility holding company subject to the Public Utility Holding Company Act of 2005 (PUHCA 2005), the relationship between each of PHI, PHI Service Company (a subsidiary service company of PHI, which provides a variety of support services, including legal, accounting, treasury, tax, purchasing and information technology services to PHI and its operating subsidiaries) and Pepco, as well as certain activities of Pepco, are subject to FERC's regulatory oversight under PUHCA 2005.

Reliability Enhancement and Emergency Restoration Improvement Plans

In 2010, Pepco announced that it had adopted and begun to implement comprehensive reliability enhancement plans in Maryland and the District of Columbia. These reliability enhancement plans include various initiatives to improve electrical system reliability, such as:

- enhanced vegetation management;
- the identification and upgrading of under-performing feeder lines;
- the addition of new facilities to support load;

- the installation of distribution automation systems on both the overhead and underground network system;
- the rejuvenation and replacement of underground residential cables;
- improvements to substation supply lines; and
- selective undergrounding of portions of existing above ground primary feeder lines, where appropriate to improve reliability.

In 2011, prior to the start of the summer storm season, Pepco initiated a program to improve its emergency restoration efforts that included, among other initiatives, an expansion and enhancement of customer service capabilities.

Blueprint for the Future

Pepco is participating in a PHI initiative referred to as “Blueprint for the Future,” which is designed to meet the challenges of rising energy costs, concerns about the environment, improved reliability and government energy reduction goals. For a discussion of the Blueprint for the Future initiative, see PHI’s “Management’s Discussion and Analysis of Financial Condition and Results of Operations – General Overview – Blueprint for the Future.”

Regulatory Lag

An important factor in Pepco’s ability to earn its authorized rate of return is the willingness of applicable public service commissions to adequately recognize forward-looking costs in Pepco’s rate structure in order to address the shortfall in revenues due to the delay in time or “lag” between when costs are incurred and when they are reflected in rates. This delay is commonly known as “regulatory lag.” Pepco is currently experiencing significant regulatory lag because its investment in the rate base and its operating expenses are outpacing revenue growth. In its most recent rate cases, Pepco (in the District of Columbia and Maryland) has proposed mechanisms that would track reliability and other expenses and permit Pepco between rate cases to make adjustments in its rates for prudent investments as made, thereby seeking to reduce the effects of regulatory lag. There can be no assurance that these proposals or any other attempts by Pepco to mitigate regulatory lag will be approved, or that even if approved, the rate recovery mechanisms or any base rate cases will fully ameliorate the effects of regulatory lag. Until such time as these proposed mechanisms are approved, Pepco plans to file rate cases at least annually in an effort to align more closely its revenue and related cash flow levels with other operation and maintenance spending and capital investments. In future rate cases, Pepco would also continue to seek cost recovery and tracking mechanisms from applicable regulatory commissions to reduce the effects of regulatory lag.

Results of Operations

The following results of operations discussion compares the three months ended March 31, 2012 to the three months ended March 31, 2011. All amounts in the tables (except sales and customers) are in millions of dollars.

Operating Revenue

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Regulated T&D Electric Revenue	\$264	\$258	\$ 6
Default Electricity Supply Revenue	193	268	(75)
Other Electric Revenue	8	8	—
Total Operating Revenue	<u>\$465</u>	<u>\$534</u>	<u>\$ (69)</u>

The table above shows the amount of Operating Revenue earned that is subject to price regulation (Regulated T&D Electric Revenue and Default Electricity Supply Revenue) and that which is not subject to price regulation (Other Electric Revenue).

Regulated T&D Electric Revenue includes revenue from the distribution of electricity, including the distribution of Default Electricity Supply, to Pepco's customers within its service territory at regulated rates. Regulated T&D Electric Revenue also includes transmission service revenue that Pepco receives as a transmission owner from PJM at rates regulated by FERC. Transmission rates are updated annually based on a FERC-approved formula methodology.

The costs related to Default Electricity Supply are included in Purchased Energy. Default Electricity Supply Revenue also includes transmission enhancement credits that Pepco receives as a transmission owner from PJM for approved regional transmission expansion plan costs.

Other Electric Revenue includes work and services performed on behalf of customers, including other utilities, which is generally not subject to price regulation. Work and services include mutual assistance to other utilities, highway relocation, rentals of pole attachments, late payment fees and collection fees.

Regulated T&D Electric

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Revenue</i>			
Residential	\$ 77	\$ 78	\$ (1)
Commercial and industrial	148	147	1
Transmission and other	39	33	6
Total Regulated T&D Electric Revenue	<u>\$264</u>	<u>\$258</u>	<u>\$ 6</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Sales (GWh)</i>			
Residential	1,958	2,177	(219)
Commercial and industrial	4,209	4,384	(175)
Transmission and other	44	44	—
Total Regulated T&D Electric Sales	<u>6,211</u>	<u>6,605</u>	<u>(394)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Customers (in thousands)</i>			
Residential	717	715	2
Commercial and industrial	74	74	—
Transmission and other	—	—	—
Total Regulated T&D Electric Customers	<u>791</u>	<u>789</u>	<u>2</u>

Regulated T&D Electric Revenue increased by \$6 million primarily due to:

- An increase of \$6 million in transmission revenue primarily attributable to higher rates effective June 1, 2011 related to an increase in transmission plant investment.
- An increase of \$2 million primarily due to customer growth in 2012.
- An increase of \$2 million due to an EmPower Maryland rate increase effective February 2012 (which is substantially offset by a corresponding increase in Depreciation and Amortization).

The aggregate amount of these increases was partially offset by a decrease of \$4 million due to lower pass-through revenue (which is substantially offset by a corresponding decrease in Other Taxes) primarily the result of lower sales that resulted in a decrease in Montgomery County, Maryland utility taxes that are collected by Pepco on behalf of the county.

Default Electricity Supply

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Revenue</i>			
Residential	\$138	\$199	\$ (61)
Commercial and industrial	53	67	(14)
Other	<u>2</u>	<u>2</u>	<u>—</u>
Total Default Electricity Supply Revenue	<u>\$193</u>	<u>\$268</u>	<u>\$ (75)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Sales (GWh)</i>			
Residential	1,581	1,892	(311)
Commercial and industrial	650	694	(44)
Other	<u>2</u>	<u>2</u>	<u>—</u>
Total Default Electricity Supply Sales	<u>2,233</u>	<u>2,588</u>	<u>(355)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Customers (in thousands)</i>			
Residential	595	633	(38)
Commercial and industrial	45	47	(2)
Other	<u>—</u>	<u>—</u>	<u>—</u>
Total Default Electricity Supply Customers	<u>640</u>	<u>680</u>	<u>(40)</u>

Default Electricity Supply Revenue decreased by \$75 million primarily due to:

- A decrease of \$36 million as a result of lower Default Electricity Supply rates.
- A decrease of \$22 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$15 million due to lower sales, primarily as a result of residential and commercial customer migration to competitive suppliers.

The following table shows the percentages of Pepco's total distribution sales by jurisdiction that are derived from customers receiving Default Electricity Supply from Pepco. Amounts are for the three months ended March 31:

	<u>2012</u>	<u>2011</u>
Sales to District of Columbia customers	26%	29%
Sales to Maryland customers	43%	47%

Operating Expenses

Purchased Energy

Purchased Energy consists of the cost of electricity purchased by Pepco to fulfill its Default Electricity Supply obligation and, as such, is recoverable from customers in accordance with the terms of public service commission orders. Purchased Energy decreased by \$70 million to \$185 million in 2012 from \$255 million in 2011 primarily due to:

- A decrease of \$36 million due to lower average electricity costs under Default Electricity Supply contracts.
- A decrease of \$20 million due to lower electricity sales primarily as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$12 million primarily due to customer migration to competitive suppliers.
- A decrease of \$2 million in deferred electricity expense primarily due to lower Default Electricity Supply rates, which resulted in a lower rate of recovery of Default Electricity Supply costs.

Other Operation and Maintenance

Other Operation and Maintenance increased by \$1 million to \$103 million in 2012 from \$102 million in 2011 primarily due to:

- An increase of \$6 million associated with higher tree trimming costs.
- An increase of \$3 million in customer support service and system support costs.
- An increase of \$2 million in corporate cost allocations.
- An increase of \$2 million in expenses related to regulatory filings.
- An increase of \$1 million in communication costs.
- An increase of \$1 million in employee-related-costs, primarily benefit expenses.

The aggregate amount of these increases was partially offset by a decrease of \$15 million in emergency restoration costs, which were higher in 2011 largely due to the severe winter storm in January 2011.

Depreciation and Amortization

Depreciation and Amortization expense increased by \$5 million to \$47 million in 2012 from \$42 million in 2011 primarily due to:

- An increase of \$2 million in amortization of regulatory assets primarily due to an EmPower Maryland surcharge rate increase effective February 2012 (which is substantially offset by a corresponding increase in Regulated T&D Electric Revenue).
- An increase of \$2 million due to utility plant additions.
- An increase of \$1 million in amortization of AMI projects.

Other Taxes

Other Taxes decreased by \$2 million to \$90 million in 2012 from \$92 million in 2011. The decrease was primarily the result of lower sales that resulted in a decrease in the Montgomery County, Maryland utility taxes that are collected and passed through by Pepco (substantially offset by a corresponding increase in Regulated T&D Electric Revenue).

Other Income (Expenses)

Other Expenses (which are net of Other Income) increased by \$3 million to a net expense of \$21 million in 2012 from a net expense of \$18 million in 2011. The increase was primarily due to a decrease in other income due to March 2011 net proceeds from a company owned life insurance policy.

Income Tax Expense

Pepco's income tax expense decreased by \$12 million in the three months ended March 31, 2012. Pepco's effective tax rates for the three months ended March 31, 2012 and 2011 were (26.3)% and 28.0%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the IRS with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position. The effective rate was further decreased as a result of the increase in asset removal costs in 2012 primarily related to a higher level of asset retirements.

Capital Requirements

Capital Expenditures

Pepco's capital expenditures for the three months ended March 31, 2012 were \$158 million. These expenditures were primarily related to capital costs associated with new customer services, distribution reliability and transmission. The expenditures also include an allocation by PHI of hardware and software expenditures that primarily benefit Power Delivery and are allocated to Pepco when the assets are placed in service.

In its 2011 Form 10-K, Pepco presented its projected capital expenditures for the five-year period 2012 through 2016. There have been no changes in Pepco's projected capital expenditures from those presented in the 2011 Form 10-K. Projected capital expenditures include expenditures for distribution and transmission, which primarily relate to facility replacements and upgrades to accommodate customer growth and service reliability, including capital expenditures for continuing reliability enhancement efforts. These projected capital expenditures also include expenditures for the programs undertaken by Pepco to install smart meters, further automate electric distribution systems and enhance Pepco's communications infrastructure, which is referred to as the Blueprint for the Future.

MAPP Project

PJM has approved PHI's proposal to construct MAPP, a new 152-mile, interstate transmission line as part of PJM's regional transmission expansion plan. In August 2011, PJM notified PHI that the scheduled in-service date for MAPP has been delayed from June 1, 2015 to the 2019 to 2021 time period. In light of the delayed in-service date for MAPP, substantially all of the anticipated capital expenditures associated with MAPP have been delayed until at least 2016 based on current projections. The exact revised in-service date of MAPP will be evaluated as part of PJM's 2012 Regional Transmission Expansion Plan review process.

MAPP/DOE Loan Program

To assist in the funding of the MAPP project, PHI has applied for a \$684 million loan guarantee from the DOE for a substantial portion of the MAPP project, primarily the Calvert Cliffs to Indian River segment. The application has been made under a federal loan guarantee program for projects that employ innovative energy efficiency, renewable energy and advanced transmission and distribution technologies. If granted, PHI believes the guarantee could allow PHI to acquire financing at a lower cost than it would otherwise be able to obtain in the capital markets. Whether PHI's application will be granted and, if so, the amount of debt guaranteed is subject to the discretion of the DOE and the negotiation of terms that will satisfy the conditions of the guarantee program. On February 28, 2011, the DOE issued a Notice of Intent to prepare an Environmental Impact Statement to assist the DOE in assessing the environmental impact of constructing the portion of the MAPP project to be supported by the loan guarantee. Since February 2011, the DOE has conducted field inspections of the entire route and has held public meetings to obtain input from the communities along the route.

The DOE's review of the loan guarantee program has delayed the DOE's review of PHI's loan guarantee application. There is not an approval deadline under the loan guarantee program, but this program could change or be terminated in the future. PHI continues to coordinate environmental activities with the DOE.

DOE Capital Reimbursement Awards

In 2009, the DOE announced a \$168 million award to PHI under the American Recovery and Reinvestment Act of 2009 for the implementation of an AMI system, direct load control, distribution automation and communications infrastructure. Pepco was awarded \$149 million with \$105 million to be used in the Maryland service territory and \$44 million to be used in the District of Columbia service territory.

In April 2010, Pepco and the DOE signed agreements formalizing Pepco's \$149 million share of the \$168 million award. Of the \$149 million, \$118 million is expected to offset incurred and projected Blueprint for the Future and other capital expenditures of Pepco. The remaining \$31 million will be used to offset incremental expenses associated with direct load control and other programs. During the first quarter of 2012, Pepco received award payments of \$9 million. Cumulative award payments received by Pepco since April 2010, were \$76 million.

The IRS has announced that, to the extent these grants are expended on capital items, they will not be considered taxable income.

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Delmarva Power & Light Company

DPL meets the conditions set forth in General Instruction H(1)(a) and (b) to the Form 10-Q, and accordingly information otherwise required under this Item has been omitted in accordance with General Instruction H(2) to Form 10-Q.

General Overview

DPL is engaged in the transmission and distribution of electricity in Delaware and portions of Maryland. DPL also provides Default Electricity Supply. DPL’s electricity distribution service territory covers approximately 5,000 square miles and has a population of approximately 1.4 million. As of March 31, 2012, approximately 66% of delivered electricity sales were to Delaware customers and approximately 34% were to Maryland customers. In northern Delaware, DPL also supplies and distributes natural gas to retail customers and provides transportation-only services to retail customers who purchase natural gas from other suppliers. DPL’s natural gas distribution service territory covers approximately 275 square miles and has a population of approximately 500,000.

DPL’s results historically have been seasonal, generally producing higher revenue and income in the warmest and coldest periods of the year. For retail customers of DPL in Maryland, revenues are not affected by unseasonably warmer or colder weather because a BSA for retail customers was implemented that recognizes distribution revenue based on an approved distribution charge per customer. Consequently, distribution revenue recognized is decoupled in a reporting period from the amount of power delivered during the period and the only factors that will cause distribution revenue recognized in Maryland to fluctuate from period to period are changes in the number of customers and changes in the approved distribution charge per customer. A comparable revenue decoupling mechanism for DPL electricity and natural gas customers in Delaware is under consideration by the DPSC. Changes in customer usage (such as due to weather conditions, energy prices, energy efficiency programs or other reasons) from period to period have no impact on reported distribution revenue for customers to whom the BSA applies.

In accounting for the BSA in Maryland, a Revenue Decoupling Adjustment is recorded representing either (i) a positive adjustment equal to the amount by which revenue from Maryland retail distribution sales falls short of the revenue that DPL is entitled to earn based on the approved distribution charge per customer or (ii) a negative adjustment equal to the amount by which revenue from such distribution sales exceeds the revenue that DPL is entitled to earn based on the approved distribution charge per customer.

DPL is a wholly owned subsidiary of Conectiv, LLC (Conectiv) which is wholly owned by PHI. Because each of PHI and Conectiv is a public utility holding company subject to PUHCA 2005, the relationship between each of PHI, Conectiv, PHI Service Company and DPL, as well as certain activities of DPL, are subject to FERC’s regulatory oversight under PUHCA 2005.

Blueprint for the Future

DPL is participating in a PHI initiative referred to as “Blueprint for the Future,” which is designed to meet the challenges of rising energy costs, concerns about the environment, improved reliability and government energy reduction goals. For a discussion of the Blueprint for the Future initiative, see PHI’s “Management’s Discussion and Analysis of Financial Condition and Results of Operations – General Overview – Blueprint for the Future.”

Regulatory Lag

An important factor in DPL's ability to earn its authorized rate of return is the willingness of applicable public service commissions to adequately recognize forward-looking costs in DPL's rate structure in order to address the shortfall in revenues due to the delay in time or "lag" between when costs are incurred and when they are reflected in rates. This delay is commonly known as "regulatory lag." DPL is currently experiencing significant regulatory lag because its investment in the rate base and its operating expenses are outpacing revenue growth. In its most recent rate cases, DPL (in Delaware and Maryland) has proposed mechanisms that would track reliability and other expenses and permit DPL between rate cases to make adjustments in its rates for prudent investments as made, thereby seeking to reduce the effects of regulatory lag. There can be no assurance that these proposals or any other attempts by DPL to mitigate regulatory lag will be approved, or that even if approved, the rate recovery mechanisms or any base rate cases will fully ameliorate the effects of regulatory lag. Until such time as these proposed mechanisms are approved, DPL plans to file rate cases at least annually in an effort to align more closely its revenue and related cash flow levels with other operation and maintenance spending and capital investments. In future rate cases, DPL would also continue to seek cost recovery and tracking mechanisms from applicable regulatory commissions to reduce the effects of regulatory lag.

Results of Operations

The following results of operations discussion compares the three months ended March 31, 2012 to the three months ended March 31, 2011. All amounts in the tables (except sales and customers) are in millions of dollars.

Electric Operating Revenue

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Regulated T&D Electric Revenue	\$106	\$104	\$ 2
Default Electricity Supply Revenue	149	190	(41)
Other Electric Revenue	4	4	—
Total Electric Operating Revenue	<u>\$259</u>	<u>\$298</u>	<u>\$ (39)</u>

The table above shows the amount of Electric Operating Revenue earned that is subject to price regulation (Regulated T&D Electric Revenue and Default Electricity Supply Revenue) and that which is not subject to price regulation (Other Electric Revenue).

Regulated T&D Electric Revenue includes revenue from the distribution of electricity, including the distribution of Default Electricity Supply, to DPL's customers within its service territory at regulated rates. Regulated T&D Electric Revenue also includes transmission service revenue that DPL receives as a transmission owner from PJM at rates regulated by FERC. Transmission rates are updated annually based on a FERC-approved formula methodology.

The costs related to Default Electricity Supply are included in Purchased Energy. Default Electricity Supply Revenue also includes transmission enhancement credits that DPL receives as a transmission owner from PJM for approved regional transmission expansion plan costs.

Other Electric Revenue includes work and services performed on behalf of customers, including other utilities, which is generally not subject to price regulation. Work and services include mutual assistance to other utilities, highway relocation, rentals of pole attachments, late payment fees and collection fees.

Regulated T&D Electric

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Revenue</i>			
Residential	\$ 52	\$ 52	\$ —
Commercial and industrial	27	27	—
Transmission and other	27	25	2
Total Regulated T&D Electric Revenue	<u>\$ 106</u>	<u>\$ 104</u>	<u>\$ 2</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Sales (GWh)</i>			
Residential	1,293	1,520	(227)
Commercial and industrial	1,740	1,744	(4)
Transmission and other	12	12	—
Total Regulated T&D Electric Sales	<u>3,045</u>	<u>3,276</u>	<u>(231)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Customers (in thousands)</i>			
Residential	442	441	1
Commercial and industrial	59	59	—
Transmission and other	1	1	—
Total Regulated T&D Electric Customers	<u>502</u>	<u>501</u>	<u>1</u>

Regulated T&D Electric Revenue increased by \$2 million primarily due to:

- An increase of \$3 million due to a distribution rate increase in Maryland effective July 2011.
- An increase of \$2 million in transmission revenue primarily attributable to higher rates effective June 1, 2011 related to an increase in transmission plant investment.

The aggregate amount of these increases was partially offset by a decrease of \$3 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.

Default Electricity Supply

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Revenue</i>			
Residential	\$ 115	\$ 147	\$ (32)
Commercial and industrial	31	40	(9)
Other	3	3	—
Total Default Electricity Supply Revenue	<u>\$ 149</u>	<u>\$ 190</u>	<u>\$ (41)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Sales (GWh)</i>			
Residential	1,197	1,429	(232)
Commercial and industrial	451	480	(29)
Other	7	7	—
Total Default Electricity Supply Sales	<u>1,655</u>	<u>1,916</u>	<u>(261)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Default Electricity Supply Customers (in thousands)</i>			
Residential	415	419	(4)
Commercial and industrial	42	44	(2)
Other	—	1	(1)
Total Default Electricity Supply Customers	<u>457</u>	<u>464</u>	<u>(7)</u>

Default Electricity Supply Revenue decreased by \$41 million primarily due to:

- A decrease of \$18 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$15 million as a result of lower Default Electricity Supply rates.
- A decrease of \$8 million due to lower sales, primarily as a result of customer migration to competitive suppliers.

The following table shows the percentages of DPL's total distribution sales by jurisdiction that are derived from customers receiving Default Electricity Supply from DPL. Amounts are for the three months ended March 31:

	<u>2012</u>	<u>2011</u>
Sales to Delaware customers	52%	55%
Sales to Maryland customers	59%	64%

Natural Gas Operating Revenue

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Regulated Gas Revenue	\$65	\$ 91	\$ (26)
Other Gas Revenue	9	11	(2)
Total Natural Gas Operating Revenue	<u>\$74</u>	<u>\$102</u>	<u>\$ (28)</u>

The table above shows the amounts of Natural Gas Operating Revenue from sources that are subject to price regulation (Regulated Gas Revenue) and those that generally are not subject to price regulation (Other Gas Revenue). Regulated Gas Revenue includes the revenue DPL receives from on-system natural gas delivered sales and the transportation of natural gas for customers within its service territory at regulated rates. Other Gas Revenue includes off-system natural gas sales and the short-term release of interstate pipeline transportation and storage capacity not needed to serve customers. Off-system sales are made possible when low demand for natural gas by regulated customers creates excess pipeline capacity.

Regulated Gas

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Revenue</i>			
Residential	\$43	\$57	\$ (14)
Commercial and industrial	19	31	(12)
Transportation and other	3	3	—
Total Regulated Gas Revenue	<u>\$65</u>	<u>\$91</u>	<u>\$ (26)</u>

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Sales (billion cubic feet)</i>			
Residential	3	4	(1)
Commercial and industrial	2	2	—
Transportation and other	2	3	(1)
Total Regulated Gas Sales	<u>7</u>	<u>9</u>	<u>(2)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated Gas Customers (in thousands)</i>			
Residential	114	114	—
Commercial and industrial	10	10	—
Transportation and other	—	—	—
Total Regulated Gas Customers	<u>124</u>	<u>124</u>	<u>—</u>

Regulated Gas Revenue decreased by \$26 million primarily due to:

- A decrease of \$19 million due to lower sales primarily as a result of milder weather during the winter months of 2012, as compared to the winter of 2011.
- A decrease of \$7 million due to lower non-weather related average customer usage.
- A decrease of \$2 million due to a Gas Cost Rate decrease effective November 2011.

The aggregate amount of these decreases was partially offset by an increase of \$2 million due to a distribution rate increase effective July 2011.

Other Gas Revenue

Other Gas Revenue decreased by \$2 million primarily due to lower average prices, partially offset by higher volumes of off-system sales to electric generators and gas marketers.

Operating Expenses

Purchased Energy

Purchased Energy consists of the cost of electricity purchased by DPL to fulfill its Default Electricity Supply obligation and, as such, is recoverable from customers in accordance with the terms of public service commission orders. Purchased Energy decreased by \$39 million to \$143 million in 2012 from \$182 million in 2011 primarily due to:

- A decrease of \$15 million due to lower electricity sales primarily as a result of milder weather during the 2012 winter months, as compared to 2011.
- A decrease of \$11 million in deferred electricity expense primarily due to lower Default Electricity Supply rates, which resulted in a lower rate of recovery of Default Electricity Supply costs.
- A decrease of \$10 million due to lower average electricity costs under Default Electricity Supply contracts.
- A decrease of \$7 million primarily due to customer migration to competitive suppliers.

Gas Purchased

Gas Purchased consists of the cost of gas purchased by DPL to fulfill its obligation to regulated gas customers and, as such, is recoverable from customers in accordance with the terms of public service commission orders. It also includes the cost of gas purchased for off-system sales. Total Gas Purchased decreased by \$22 million to \$49 million in 2012 from \$71 million in 2011 primarily due to:

- A decrease of \$14 million in the cost of gas purchases for on-system sales as a result of lower volumes purchased, lower average gas prices and lower withdrawals from storage.
- A decrease of \$5 million in deferred gas expense as a result of a lower rate of recovery of natural gas supply costs.
- A decrease of \$2 million from the settlement of financial hedges entered into as part of DPL's hedge program for the purchase of regulated natural gas.
- A decrease of \$2 million in the cost of gas purchases for off-system sales as a result of lower average gas prices, partially offset by higher volumes purchased.

Depreciation and Amortization

Depreciation and Amortization expense increased by \$2 million to \$24 million in 2012 from \$22 million in 2011 primarily due to:

- An increase of \$1 million due to utility plant additions.
- An increase of \$1 million in amortization of regulatory assets primarily due to an EmPower Maryland surcharge rate increase effective February 2012 (which is substantially offset by a corresponding increase in Regulated T&D Electric Revenue).

Other Taxes

Other Taxes decreased by \$2 million to \$9 million in 2012 from \$11 million in 2011. The decrease was primarily due to rate decreases in Delaware public utility taxes (substantially offset by a corresponding decrease in Regulated T&D Electric Revenue).

Income Tax Expense

DPL's income tax expense decreased by \$3 million in the three months ended March 31, 2012. DPL's effective tax rates for the three months ended March 31, 2012 and 2011 were 40.0% and 42.5%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2011.

Capital Requirements*Capital Expenditures*

DPL's capital expenditures for the three months ended March 31, 2012 were \$69 million. These expenditures were primarily related to capital costs associated with new customer services, distribution reliability and transmission. The expenditures also include an allocation by PHI of hardware and software expenditures that primarily benefit Power Delivery and are allocated to DPL when the assets are placed in service.

In its 2011 Form 10-K, DPL presented the projected capital expenditures for the five-year period 2012 through 2016. There have been no changes in DPL's projected capital expenditures from those presented in the 2011 Form 10-K. Projected capital expenditures include expenditures for distribution, transmission, and gas delivery which primarily relate to facility replacements and upgrades to accommodate customer growth and service reliability, including capital expenditures for continuing reliability enhancement efforts. These projected capital expenditures also include expenditures for the programs undertaken by DPL to install smart meters, further automate electric distribution systems and enhance DPL's communications infrastructure, which is referred to as the Blueprint for the Future.

MAPP Project

PJM has approved PHI's proposal to construct MAPP, a new 152-mile, interstate transmission line as part of PJM's regional transmission expansion plan. In August 2011, PJM notified PHI that the scheduled in-service date for MAPP has been delayed from June 1, 2015 to the 2019 to 2021 time period. In light of the delayed in-service date for MAPP, substantially all of the anticipated capital expenditures associated with MAPP have been delayed until at least 2016 based on current projections. The exact revised in-service date of MAPP will be evaluated as part of PJM's 2012 Regional Transmission Expansion Plan review process.

MAPP/DOE Loan Program

To assist in the funding of the MAPP project, PHI has applied for a \$684 million loan guarantee from the DOE for a substantial portion of the MAPP project, primarily the Calvert Cliffs to Indian River segment. The application has been made under a federal loan guarantee program for projects that employ innovative energy efficiency, renewable energy and advanced transmission and distribution technologies. If granted, PHI believes the guarantee could allow PHI to acquire financing at a lower cost than it would otherwise be able to obtain in the capital markets. Whether PHI's application will be granted and, if so, the amount of debt guaranteed is subject to the discretion of the DOE and the negotiation of terms that will satisfy the conditions of the guarantee program. On February 28, 2011, the DOE issued a Notice of Intent to prepare an Environmental Impact Statement to assist the DOE in assessing the environmental impact of constructing the portion of the MAPP project to be supported by the loan guarantee. Since February 2011, the DOE has conducted field inspections of the entire route and has held public meetings to obtain input from the communities along the route.

The DOE's review of the loan guarantee program has delayed the DOE's review of PHI's loan guarantee application. There is not an approval deadline under the loan guarantee program, but this program could change or be terminated in the future. PHI continues to coordinate environmental activities with the DOE.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**Atlantic City Electric Company**

ACE meets the conditions set forth in General Instruction H(1)(a) and (b) to the Form 10-Q, and accordingly information otherwise required under this Item has been omitted in accordance with General Instruction H(2) to Form 10-Q.

General Overview

ACE is engaged in the transmission and distribution of electricity in southern New Jersey. ACE also provides Default Electricity Supply. ACE's service territory covers approximately 2,700 square miles and has a population of approximately 1.1 million.

ACE is a wholly owned subsidiary of Conectiv, which is wholly owned by PHI. Because each of PHI and Conectiv is a public utility holding company subject to PUHCA 2005, the relationship between each of PHI, Conectiv, PHI Service Company and ACE, as well as certain activities of ACE, are subject to FERC's regulatory oversight under PUHCA 2005.

Blueprint for the Future

ACE is participating in a PHI initiative referred to as "Blueprint for the Future," which is designed to meet the challenges of rising energy costs, concerns about the environment, improved reliability and government energy reduction goals. For a discussion of the Blueprint for the Future initiative, see PHI's "Management's Discussion and Analysis of Financial Condition and Results of Operations – General Overview – Blueprint for the Future."

Regulatory Lag

An important factor in ACE's ability to earn its authorized rate of return is the willingness of the NJBPU to adequately recognize forward-looking costs in ACE's rate structure in order to address the shortfall in revenues due to the delay in time or "lag" between when costs are incurred and when they are reflected in rates. This delay is commonly known as "regulatory lag." ACE is currently experiencing significant regulatory lag because its investment in the rate base and its operating expenses are outpacing revenue growth. The NJBPU has approved certain rate recovery mechanisms in connection with ACE's Infrastructure Investment Program (IIP), which ACE has proposed to extend and expand. There can be no assurance that this proposal or any other attempts by ACE to mitigate regulatory lag will be approved, or that even if approved, the rate recovery mechanisms or any base rate cases will fully ameliorate the effects of regulatory lag. Until such time as this proposed mechanism is approved, ACE plans to file rate cases at least annually in an effort to align more closely its revenue and related cash flow levels with other operation and maintenance spending and capital investments. In future rate cases, ACE would also continue to seek cost recovery and tracking mechanisms from applicable regulatory commissions to reduce the effects of regulatory lag.

Results of Operations

The following results of operations discussion compares the three months ended March 31, 2012 to the three months ended March 31, 2011. All amounts in the tables (except sales and customers) are in millions of dollars.

Operating Revenue

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Regulated T&D Electric Revenue	\$ 82	\$ 90	\$ (8)
Default Electricity Supply Revenue	170	221	(51)
Other Electric Revenue	4	4	—
Total Operating Revenue	<u>\$256</u>	<u>\$315</u>	<u>\$ (59)</u>

The table above shows the amount of Operating Revenue earned that is subject to price regulation (Regulated T&D Electric Revenue and Default Electricity Supply Revenue) and that which is not subject to price regulation (Other Electric Revenue).

Regulated T&D Electric Revenue includes revenue from the distribution of electricity, including the distribution of Default Electricity Supply, to ACE's customers within its service territory at regulated rates. Regulated T&D Electric Revenue also includes transmission service revenue that ACE receives as a transmission owner from PJM at rates regulated by FERC. Transmission rates are updated annually based on a FERC-approved formula methodology.

The costs related to Default Electricity Supply are included in Purchased Energy. Default Electricity Supply Revenue also includes revenue from Transition Bond Charges that ACE receives, and pays to ACE Funding, to fund the principal and interest payments on Transition Bonds issued by ACE Funding, and revenue in the form of transmission enhancement credits.

Other Electric Revenue includes work and services performed on behalf of customers, including other utilities, which is generally not subject to price regulation. Work and services include mutual assistance to other utilities, highway relocation, rentals of pole attachments, late payment fees and collection fees.

Regulated T&D Electric

	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Revenue</i>			
Residential	\$ 33	\$ 38	\$ (5)
Commercial and industrial	26	28	(2)
Transmission and other	23	24	(1)
Total Regulated T&D Electric Revenue	<u>\$ 82</u>	<u>\$ 90</u>	<u>\$ (8)</u>
	<u>2012</u>	<u>2011</u>	<u>Change</u>
<i>Regulated T&D Electric Sales (GWh)</i>			
Residential	944	1,078	(134)
Commercial and industrial	1,132	1,177	(45)
Transmission and other	12	12	—
Total Regulated T&D Electric Sales	<u>2,088</u>	<u>2,267</u>	<u>(179)</u>

	2012	2011	Change
<i>Regulated T&D Electric Customers (in thousands)</i>			
Residential	481	482	(1)
Commercial and industrial	65	65	—
Transmission and other	1	1	—
Total Regulated T&D Electric Customers	<u>547</u>	<u>548</u>	<u>(1)</u>

Regulated T&D Electric Revenue decreased by \$8 million primarily due to:

- A decrease of \$4 million due to lower non-weather related average customer usage.
- A decrease of \$3 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.

Default Electricity Supply

	2012	2011	Change
<i>Default Electricity Supply Revenue</i>			
Residential	\$105	\$123	\$ (18)
Commercial and industrial	46	61	(15)
Other	19	37	(18)
Total Default Electricity Supply Revenue	<u>\$170</u>	<u>\$221</u>	<u>\$ (51)</u>

Other Default Electricity Supply Revenue consists primarily of (i) revenue from the resale in the PJM RTO market of energy and capacity purchased under contracts with unaffiliated NUGs, and (ii) revenue from transmission enhancement credits.

	2012	2011	Change
<i>Default Electricity Supply Sales (GWh)</i>			
Residential	800	977	(177)
Commercial and industrial	292	384	(92)
Other	6	10	(4)
Total Default Electricity Supply Sales	<u>1,098</u>	<u>1,371</u>	<u>(273)</u>

	2012	2011	Change
<i>Default Electricity Supply Customers (in thousands)</i>			
Residential	416	443	(27)
Commercial and industrial	48	53	(5)
Other	—	—	—
Total Default Electricity Supply Customers	<u>464</u>	<u>496</u>	<u>(32)</u>

Default Electricity Supply Revenue decreased by \$51 million primarily due to:

- A decrease of \$18 million in wholesale energy and capacity resale revenues primarily due to the sale at lower market prices of electricity and capacity purchased from NUGs.
- A decrease of \$17 million due to lower sales, primarily as a result of customer migration to competitive suppliers.
- A decrease of \$11 million due to lower non-weather related average customer usage.

- A decrease of \$5 million due to lower sales as a result of milder weather during the 2012 winter months, as compared to 2011.

Total Default Electricity Supply Revenue for the three months ended March 31, 2012 includes a decrease of \$2 million in unbilled revenue attributable to ACE's BGS (\$1 million decrease in net income), primarily due to lower Default Electricity Supply rates during the unbilled revenue period at March 31, 2012 as compared to the corresponding period in 2011. Under the BGS terms approved by the NJBPU, ACE's BGS unbilled revenue is not included in the deferral calculation until it is billed to customers, and therefore has an impact on the results of operations in the period during which it is accrued.

For the three months ended March 31, 2012 and 2011, the percentages of ACE's total distribution sales that are derived from customers receiving Default Electricity Supply are 53% and 60%, respectively.

Operating Expenses

Purchased Energy

Purchased Energy consists of the cost of electricity purchased by ACE to fulfill its Default Electricity Supply obligation and, as such, is recoverable from customers in accordance with the terms of public service commission orders. Purchased Energy decreased by \$32 million to \$166 million in 2012 from \$198 million in 2011 primarily due to:

- A decrease of \$27 million primarily due to customer migration to competitive suppliers.
- A decrease of \$4 million due to lower electricity sales primarily as a result of milder weather during the 2012 winter months, as compared to 2011.

Other Operation and Maintenance

Other Operation and Maintenance expense increased by \$1 million to \$56 million in 2012 from \$55 million in 2011 primarily due to an increase of \$2 million in customer support service costs. The increase was partially offset by a decrease of \$1 million in employee-related costs, primarily benefit expenses.

Depreciation and Amortization

Depreciation and Amortization expense decreased by \$5 million to \$28 million in 2012 from \$33 million in 2011 primarily due to a decrease of \$6 million in amortization of stranded costs as the result of lower revenue due to rate decreases effective October 2011 for the ACE Transition Bond Charge and Market Transition Charge Tax (partially offset in Default Electricity Supply Revenue). The decrease was partially offset by an increase of \$1 million due to utility plant additions.

Other Taxes

Other Taxes decreased by \$2 million to \$4 million in 2012 from \$6 million in 2011. The decrease was primarily due to decreased Transitional Energy Facility Assessment tax accruals due to a rate decrease effective January 2012 (partially offset by a corresponding decrease in Regulated T&D Electric Revenue).

Deferred Electric Service Costs

Deferred Electric Service Costs represent (i) the over- or under-recovery of electricity costs incurred by ACE to fulfill its Default Electricity Supply obligation and (ii) the over- or under-recovery of New Jersey Societal Benefit Program costs incurred by ACE. The cost of electricity purchased is reported under Purchased Energy and the corresponding revenue is reported under Default Electricity Supply Revenue. The cost of New Jersey Societal Benefit Programs is reported under Other Operation and Maintenance and the corresponding revenue is reported under Regulated T&D Electric Revenue.

Deferred Electric Service Costs decreased by \$12 million, to an expense reduction of \$15 million in 2012 as compared to an expense reduction of \$3 million in 2011, primarily due to higher electricity supply costs, partially offset by higher Default Electricity Supply rates.

Other Income (Expenses)

Other Expenses (which are net of Other Income) increased by \$1 million to a net expense of \$16 million in 2012 from a net expense of \$15 million in 2011. The increase was primarily due to an increase of \$2 million in long-term debt interest expense due to \$200 million of First Mortgage Bonds issued April 2011.

Income Tax Expense

ACE's income tax expense decreased by \$6 million in the three months ended March 31, 2012. ACE's consolidated effective tax rates for the three months ended March 31, 2012 and 2011 were (100)% and 45.5%, respectively. The decrease in the effective tax rate primarily resulted from changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2012, primarily due to the effective settlement with the IRS with respect to the methodology used historically to calculate deductible mixed service costs.

Capital Requirements

Capital Expenditures

ACE's capital expenditures for the three months ended March 31, 2012 were \$53 million. These expenditures were primarily related to capital costs associated with new customer services, distribution reliability and transmission. The expenditures also include an allocation by PHI of hardware and software expenditures that primarily benefit Power Delivery and are allocated to ACE when the assets are placed in service.

In its 2011 Form 10-K, ACE presented the projected capital expenditures for the five-year period 2012 through 2016. There have been no changes in ACE's projected capital expenditures from those presented in the 2011 Form 10-K. Projected capital expenditures include expenditures for distribution and transmission, which primarily relate to facility replacements and upgrades to accommodate customer growth and service reliability, including capital expenditures for continuing reliability enhancement efforts. These projected capital expenditures also include expenditures for the programs undertaken by ACE to install smart meters (for which approval by the NJBPU has been deferred), further automate electric distribution systems and enhance ACE's communications infrastructure, which is referred to as the Blueprint for the Future.

DOE Capital Reimbursement Awards

In 2009, the DOE announced a \$168 million award to PHI under the American Recovery and Reinvestment Act of 2009 for the implementation of an AMI system, direct load control, distribution automation, and communications infrastructure, of which \$19 million was for ACE's service territory.

In April 2010, ACE and the DOE signed agreements formalizing ACE's \$19 million share of the \$168 million award. Of the \$19 million, \$12 million is expected to offset incurred and projected Blueprint for the Future and other capital expenditures of ACE. The remaining \$7 million will be used to offset incremental expenses associated with direct load control and other programs. During the first quarter of 2012, ACE received award payments of \$1 million. Cumulative award payments received by ACE since April 2010, were \$10 million.

The IRS has announced that, to the extent these grants are expended on capital items, they will not be considered taxable income.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Risk management policies for PHI and its subsidiaries are determined by PHI's Corporate Risk Management Committee (CRMC), the members of which are PHI's Chief Risk Officer, Chief Operating Officer, Chief Financial Officer, General Counsel, Chief Information Officer and other senior executives. The CRMC monitors interest rate fluctuation, commodity price fluctuation, credit risk exposure, and sets risk management policies that establish limits on unhedged risk and determine risk reporting requirements. For information about PHI's derivative activities, other than the information otherwise disclosed herein, refer to Note (2), "Significant Accounting Policies – Accounting For Derivatives," Note (15), "Derivative Instruments and Hedging Activities," and Note (20), "Discontinued Operations," of the consolidated financial statements of PHI included in its 2011 Form 10-K, "Part I, Item 7A. Quantitative and Qualitative Disclosures About Market Risk" in PHI's 2011 Form 10-K, and Note (13), "Derivative Instruments and Hedging Activities," of the consolidated financial statements of PHI included herein.

Pepco Holdings, Inc.

Commodity Price Risk

The Pepco Energy Services segment engages in commodity risk management activities to reduce its financial exposure to changes in the value of its assets and obligations due to commodity price fluctuations. Certain of these risk management activities are conducted using instruments classified as derivatives based on Financial Accounting Standards Board (FASB) guidance on derivatives and hedging (ASC 815). Pepco Energy Services also manages commodity risk with contracts that are not classified as derivatives.

PHI's risk management policies place oversight at the senior management level through the CRMC, which has the responsibility for establishing corporate compliance requirements for energy market participation. PHI collectively refers to these energy market activities, including its commodity risk management activities, as "energy commodity" activities. PHI uses a value-at-risk (VaR) model to assess the market risk of the energy commodity activities of Pepco Energy Services. PHI also uses other measures to limit and monitor risk in its energy commodity activities, including limits on the nominal size of positions and periodic loss limits. VaR represents the potential fair value loss on energy contracts or portfolios due to changes in market prices for a specified time period and confidence level. PHI uses a delta-gamma VaR estimation model. The other parameters include a 95 percent, one-tailed confidence level and a one-day holding period. Since VaR is an estimate, it is not necessarily indicative of actual results that may occur.

The table below provides the VaR associated with energy contracts of the Pepco Energy Services segment for the three months ended March 31, 2012 in millions of dollars:

	VaR (a)
95% confidence level, one-day holding period, one-tailed	
Period end	\$ 1
Average for the period	\$ 1
High	\$ 1
Low	\$ 1

- (a) This column represents all energy derivative contracts, normal purchase and normal sales contracts, modeled generation output and fuel requirements, and modeled customer load obligations for Pepco Energy Services' energy commodity activities.

Pepco Energy Services purchases electric and natural gas futures, swaps, options and forward contracts to hedge price risk in connection with the purchase of physical natural gas and electricity for distribution to customers. Pepco Energy Services accounts for its derivatives as either cash flow hedges of forecasted transactions or they are marked to market through current earnings. Forward contracts that meet the requirements for normal purchase and normal sale accounting under FASB guidance on derivatives and hedging are recorded on an accrual basis.

Credit and Nonperformance Risk

The following table provides information on the credit exposure on competitive wholesale energy contracts, net of collateral, to wholesale counterparties as of March 31, 2012, in millions of dollars:

Rating	Exposure Before Credit Collateral (b)	Credit Collateral (c)	Net Exposure	Number of Counterparties Greater Than 10% (d)	Net Exposure of Counterparties Greater Than 10%
Investment Grade (a)	\$ —	\$ —	\$ —	2	\$ —
Non-Investment Grade	—	—	—	—	—
No External Ratings	—	—	—	1	—
Credit reserves	—	—	—	—	—

- (a) Investment Grade - primarily determined using publicly available credit ratings of the counterparty. If the counterparty has provided a guarantee by a higher-rated entity (e.g., its parent), it is determined based upon the rating of its guarantor. Included in "Investment Grade" are counterparties with a minimum Standard & Poor's or Moody's Investor Service rating of BBB- or Baa3, respectively.
- (b) Exposure before credit collateral - includes the marked to market (MTM) energy contract net assets for open/unrealized transactions, the net receivable/payable for realized transactions and net open positions for contracts not marked to market. Amounts due from counterparties are offset by liabilities payable to those counterparties to the extent that legally enforceable netting arrangements are in place. Thus, this column presents the net credit exposure to counterparties after reflecting all allowable netting, but before considering collateral held.
- (c) Credit collateral - the face amount of cash deposits, letters of credit and performance bonds received from counterparties, not adjusted for probability of default, and, if applicable, property interests (including oil and gas reserves).
- (d) Using a percentage of the total exposure.

For information regarding "Interest Rate Risk," please refer to Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in Pepco Holdings' 2011 Form 10-K.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR PEPSCO, DPL AND ACE AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 4. CONTROLS AND PROCEDURES

Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

Each Reporting Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in such Reporting Company's reports under the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to management of such Reporting Company, including the Reporting Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. This control system, no matter how well designed and operated, can provide only reasonable assurance that the objectives of the control system are met. Such Reporting Company's disclosure controls and procedures were designed to provide reasonable assurance of achieving their stated objectives. Under the supervision, and with the participation of management, including the CEO and the CFO, each Reporting Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2012, and, based upon this evaluation, the CEO and the CFO of such Reporting Company have concluded that these disclosure controls and procedures are effective to provide reasonable assurance that material information relating to such Reporting Company and its subsidiaries that is required to be disclosed in reports filed with, or submitted to, the SEC under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) is accumulated and communicated to management, including its CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Reports of Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of management, including the CEO and CFO of each Reporting Company, each such Reporting Company has evaluated changes in internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended March 31, 2012, and has concluded there was no change in such Reporting Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, such Reporting Company's internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Pepco Holdings

Other than ordinary routine litigation incidental to its and its subsidiaries' business, PHI is not a party to, and its subsidiaries' property is not subject to, any material pending legal proceedings except as described in Note (15), "Commitments and Contingencies," to the consolidated financial statements of PHI included herein, which description is incorporated by reference herein.

Pepco

Other than ordinary routine litigation incidental to its business, Pepco is not a party to, and its property is not subject to, any material pending legal proceedings except as described in Note (11), "Commitments and Contingencies," to the financial statements of Pepco included herein, which description is incorporated by reference herein.

DPL

Other than ordinary routine litigation incidental to its business, DPL is not a party to, and its property is not subject to, any material pending legal proceedings except as described in Note (13), "Commitments and Contingencies," to the financial statements of DPL included herein, which description is incorporated by reference herein.

ACE

Other than ordinary routine litigation incidental to its business, ACE is not a party to, and its property is not subject to, any material pending legal proceedings except as described in Note (11), "Commitments and Contingencies," to the consolidated financial statements of ACE included herein, which description is incorporated by reference herein.

Item 1A. RISK FACTORS

For a discussion of the risk factors applicable to each Reporting Company, please refer to "Part I, Item 1A. Risk Factors" in each Reporting Company's 2011 Form 10-K. There have been no material changes to any Reporting Company's risk factors as disclosed in the 2011 Form 10-K, except as set forth below.

The provisions contained in certain forward sale agreements entered into by PHI in connection with its March 2012 equity offering subject PHI to risks if certain events occur. (PHI only)

In March 2012, PHI entered into forward sale agreements with a forward counterparty, relating to the issuance and sale by PHI, and the purchase by the forward counterparty, of an aggregate of up to 17.9 million shares of PHI common stock. Upon physical settlement of the forward sale agreements, PHI will receive from the forward counterparty a stated per share amount of cash, subject to certain adjustments pursuant to the terms of the forward sale agreements.

The forward counterparty may accelerate settlement of the forward sale agreements and require PHI to physically settle the forward sale agreements on a date of its choosing under certain circumstances set forth in the forward sale agreements. Such a decision could be made regardless of PHI's interests, including its need for capital. In the case of such an acceleration, PHI could be required to issue and deliver shares of common stock under the physical settlement provisions of the forward sale agreements regardless of its capital needs or earlier than when PHI would otherwise have elected to settle the forward sale agreements. Moreover, PHI would no longer be permitted to elect that cash or net share settlement apply, which could result in dilution to PHI's earnings per share and return on equity.

Except in certain circumstances, PHI has the right to elect physical, cash or net share settlement under the forward sale agreements. Delivery of any shares upon physical settlement or net share settlement could result in dilution to PHI's earnings per share and return on equity. If PHI elects cash or net share settlement, the forward counterparty or one of its affiliates would likely purchase shares of common stock in open market transactions over a period of time in connection with such settlement and its related hedge position. If the price at which the forward counterparty or its affiliate makes these purchases exceeds the applicable forward sale price, then PHI would be required to deliver to the forward counterparty an amount equal to the difference in cash (in the case of cash settlement) or in a number of shares with a value equal to such difference (in the case of net share settlement). Accordingly, PHI may need to deliver a substantial amount of cash or a substantial number of shares of common stock, which could result in dilution to PHI's earnings per share and return on equity. Furthermore, these purchases of common stock by the forward counterparty or its affiliate could increase the trading price of PHI's common stock above the trading prices that would otherwise prevail. This, in turn, could increase the amount of cash, in the case of cash settlement, or the number of shares, in the case of net share settlement, PHI would owe, if any, to the forward counterparty upon settlement of the forward sale agreements.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Pepco Holdings

None.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR PEPCO, DPL AND ACE AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Pepco Holdings

None.

INFORMATION FOR THIS ITEM IS NOT REQUIRED FOR PEPCO, DPL AND ACE AS THEY MEET THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND THEREFORE ARE FILING THIS FORM WITH A REDUCED FILING FORMAT.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Pepco Holdings

None.

Pepco

None.

DPL

None.

ACE

None.

Item 6. EXHIBITS

The documents listed below are being filed, furnished or submitted on behalf of PHI, Pepco, DPL and/or ACE, as indicated. The warranties, representations and covenants contained in any of the agreements included or incorporated by reference herein or which appear as exhibits hereto should not be relied upon by buyers, sellers or holders of PHI's or its subsidiaries' securities and are not intended as warranties, representations or covenants to any individual or entity except as specifically set forth in such agreement.

<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>	<u>Reference</u>
3.1	PHI	Restated Certificate of Incorporation of Pepco Holdings, Inc. (as filed in Delaware)	Exhibit 3.1 to PHI's Form 10-K, March 13, 2006.
3.2	Pepco	Restated Articles of Incorporation (as filed in the District of Columbia)	Exhibit 3.1 to Pepco's Form 10-Q, May 5, 2006.
3.3	Pepco	Restated Articles of Incorporation and Articles of Restatement (as filed in Virginia)	Exhibit 3.3 to PHI's Form 10-Q, November 4, 2011.
3.4	DPL	Restated Certificate and Articles of Incorporation (as filed in Delaware and Virginia)	Exhibit 3.3 to DPL's Form 10-K, March 1, 2007.
3.5	ACE	Restated Certificate of Incorporation (as filed in New Jersey)	Exhibit B.8.1 to PHI's Amendment No. 1 to Form U5B, February 13, 2003.
3.6	PHI	Bylaws	Exhibit 3 to PHI's Form 8-K, December 21, 2011.
3.7	Pepco	By-Laws	Exhibit 3.2 to Pepco's Form 10-Q, May 5, 2006.
3.8	DPL	Amended and Restated Bylaws	Exhibit 3.2.1 to DPL's Form 10-Q, May 9, 2005.
3.9	ACE	Amended and Restated Bylaws	Exhibit 3.2.2 to ACE's Form 10-Q, May 9, 2005.
4.1	Pepco	Supplemental Indenture, dated as of March 28, 2012, with respect to the Mortgage and Deed of Trust, dated July 1, 1936	Exhibit 4.2 to Pepco's Form 8-K, March 29, 2012.
4.2	Pepco	Form of First Mortgage Bond, 3.05% Series due April 1, 2022 (included in Exhibit 4.1 hereto)	—
10.1	PHI	Purchase Agreement, dated March 5, 2012, among Pepco Holdings, Inc., Morgan Stanley & Co. LLC, J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Citigroup Global Markets Inc., individually and acting as representatives of each of the other underwriters named in Schedule A thereto, and Morgan Stanley & Co. LLC, as forward counterparty.	Exhibit 1.1 to PHI's Form 8-K, March 8, 2012.
10.2	PHI	Confirmation of Forward Sale Transaction dated March 5, 2012 between Pepco Holdings, Inc. and Morgan Stanley & Co. LLC.	Exhibit 10.1 to PHI's Form 8-K, March 8, 2012.
10.3	PHI	Confirmation of Additional Forward Sale Transaction dated March 6, 2012 between Pepco Holdings, Inc. and Morgan Stanley & Co. LLC.	Exhibit 10.2 to PHI's Form 8-K, March 8, 2012.
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10.5	PHI Pepco DPL ACE	Letter agreement between PHI and Frederick Boyle	Exhibit 10 to PHI's Form 8-K, March 26, 2012.

10.6	PHI	Form of 2012 Restricted Stock Unit Agreement (Time Based) under the PHI Long-Term Incentive Plan	Exhibit 10.36 to PHI's Form 10-K, February 24, 2012.
10.7	PHI	Form of 2012 Restricted Stock Unit Agreement (Performance Based) under the PHI Long-Term Incentive Plan	Exhibit 10.37 to PHI's Form 10-K, February 24, 2012.

<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>	<u>Reference</u>
10.8	PHI	Form of 2012 Restricted Stock Unit Agreement (Performance Based/162(m)) under the PHI Long-Term Incentive Plan	Exhibit 10.38 to PHI's Form 10-K, February 24, 2012.
10.9	PHI	Pepco Holdings, Inc. Long-Term Incentive Plan (as amended and restated)	Exhibit 10.5 to PHI's Form 10-K, March 2, 2009.
10.9.1	PHI	Amendment to the Pepco Holdings, Inc. Long-Term Incentive Plan	Exhibit 10.2.1 to PHI's Form 10-K, February 24, 2012.
10.10	PHI	Form of Election with Respect to Stock Tax Withholding	Exhibit 10.39 to PHI's Form 10-K, February 24, 2012.
10.11	PHI	PHI Named Executive Officer 2012 Compensation Determinations	Exhibit 10.40 to PHI's Form 10-K, February 24, 2012.
12.1	PHI	Statements Re: Computation of Ratios	Filed herewith.
12.2	Pepco	Statements Re: Computation of Ratios	Filed herewith.
12.3	DPL	Statements Re: Computation of Ratios	Filed herewith.
12.4	ACE	Statements Re: Computation of Ratios	Filed herewith.
31.1	PHI	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer	Filed herewith.
31.2	PHI	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.
31.3	Pepco	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer	Filed herewith.
31.4	Pepco	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.
31.5	DPL	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer	Filed herewith.
31.6	DPL	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.
31.7	ACE	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer	Filed herewith.
31.8	ACE	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.
32.1	PHI	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350	Furnished herewith.
32.2	Pepco	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350	Furnished herewith.
32.3	DPL	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350	Furnished herewith.
32.4	ACE	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350	Furnished herewith.
101.INS	PHI Pepco DPL ACE	XBRL Instance Document	Submitted herewith.
101.SCH	PHI Pepco DPL ACE	XBRL Taxonomy Extension Schema Document	Submitted herewith.
101.CAL	PHI Pepco DPL ACE	XBRL Taxonomy Extension Calculation Linkbase Document	Submitted herewith.

<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>	<u>Reference</u>
101.DEF	PHI Pepco DPL ACE	XBRL Taxonomy Extension Definition Linkbase Document	Submitted herewith.
101.LAB	PHI Pepco DPL ACE	XBRL Taxonomy Extension Label Linkbase Document	Submitted herewith.
101.PRE	PHI Pepco DPL ACE	XBRL Taxonomy Extension Presentation Linkbase Document	Submitted herewith.

Regulation S-K Item 10(d) requires registrants to identify the physical location, by SEC file number reference, of all documents incorporated by reference that are not included in a registration statement and have been on file with the SEC for more than five years. The SEC file number references for PHI, those of its subsidiaries that are currently registrants, Conectiv and ACE Funding are provided below:

Pepco Holdings, Inc. (File Nos. 001-31403 and 030-00359)
Potomac Electric Power Company (File No. 001-01072)
Delmarva Power & Light Company (File No. 001-01405)
Atlantic City Electric Company (File No. 001-03559)
Conectiv (File No. 001-13895)
Atlantic City Electric Transition Funding LLC (File No. 333-59558)

Certain instruments defining the rights of the holders of long-term debt of Pepco have not been filed as exhibits in accordance with Regulation S-K Item 601(b)(4)(iii) because such instruments do not authorize securities in an amount which exceeds 10% of the total assets of the applicable registrant and its subsidiaries on a consolidated basis. Pepco agrees to furnish to the SEC upon request a copy of any such instruments omitted by it.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, each of the registrants has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PEPCO HOLDINGS, INC. (PHI)
POTOMAC ELECTRIC POWER COMPANY (Pepco)
DELMARVA POWER & LIGHT COMPANY (DPL)
ATLANTIC CITY ELECTRIC COMPANY (ACE)
(Registrants)

May 3, 2012

By /s/ FREDERICK J. BOYLE

Frederick J. Boyle
Senior Vice President and Chief Financial Officer, PHI,
Pepco and DPL
Chief Financial Officer, ACE

INDEX TO EXHIBITS FILED HEREWITH OR INCORPORATED BY REFERENCE HEREIN

<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>	<u>Reference</u>
3.1	PHI	Restated Certificate of Incorporation of Pepco Holdings, Inc. (as filed in Delaware)	Exhibit 3.1 to PHI's Form 10-K, March 13, 2006.
3.2	Pepco	Restated Articles of Incorporation (as filed in the District of Columbia)	Exhibit 3.1 to Pepco's Form 10-Q, May 5, 2006.
3.3	Pepco	Restated Articles of Incorporation and Articles of Restatement (as filed in Virginia)	Exhibit 3.3 to PHI's Form 10-Q, November 4, 2011.
3.4	DPL	Restated Certificate and Articles of Incorporation (as filed in Delaware and Virginia)	Exhibit 3.3 to DPL's Form 10-K, March 1, 2007.
3.5	ACE	Restated Certificate of Incorporation (as filed in New Jersey)	Filed herewith. Exhibit B.8.1 to PHI's Amendment No. 1 to Form U5B, February 13, 2003.
3.6	PHI	Bylaws	Exhibit 3 to PHI's Form 8-K, December 21, 2011
3.7	Pepco	By-Laws	Exhibit 3.2 to Pepco's Form 10-Q, May 5, 2006.
3.8	DPL	Amended and Restated Bylaws	Exhibit 3.2.1 to DPL's Form 10-Q, May 9, 2005.
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4.1	Pepco	Supplemental Indenture, dated as of March 28, 2012, with respect to the Mortgage and Deed of Trust, dated July 1, 1936	Exhibit 4.2 to Pepco's Form 8-K, March 29, 2012.
4.2	Pepco	Form of First Mortgage Bond, 3.05% Series due April 1, 2022 (included in Exhibit 4.1 hereto)	—
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10.7	PHI	Form of 2012 Restricted Stock Unit Agreement (Performance Based) under the PHI Long-Term Incentive Plan	2012. Exhibit 10.37 to PHI's Form 10-K, February 24, 2012.
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<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>	<u>Reference</u>
10.9	PHI	Pepco Holdings, Inc. Long-Term Incentive Plan (as amended and restated)	Exhibit 10.5 to PHI's Form 10-K, March 2, 2009.
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31.6	DPL	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.
31.7	ACE	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer	Filed herewith.
31.8	ACE	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer	Filed herewith.

INDEX TO EXHIBITS FURNISHED HEREWITH

<u>Exhibit No.</u>	<u>Registrant(s)</u>	<u>Description of Exhibit</u>
32.1	PHI	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
32.2	Pepco	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
32.3	DPL	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
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101.SCH	PHI Pepco DPL ACE	XBRL Taxonomy Extension Schema Document
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Exhibit 12.1
Pepco Holdings, Inc.

	Three Months Ended March 31, 2012	For the Year Ended December 31,				
		2011	2010	2009	2008	2007
		<i>(millions of dollars)</i>				
Income from continuing operations (a)	\$ 68	\$ 263	\$ 140	\$ 221	\$ 187	\$ 254
Income tax expense	14	149	11	104	90	141
Fixed charges:						
Interest on long-term debt, amortization of discount, premium and expense	67	265	315	348	311	315
Other interest	6	22	22	23	24	25
Preferred dividend requirements of subsidiaries	—	—	—	—	—	—
Total fixed charges	73	287	337	371	335	340
Non-utility capitalized interest	—	—	—	—	(1)	—
Income from continuing operations before income tax expense, fixed charges and capitalized interest	\$ 155	\$ 699	\$ 488	\$ 696	\$ 611	\$ 735
Total fixed charges, shown above	73	287	337	371	335	340
Increase preferred stock dividend requirements of subsidiaries to a pre-tax amount	—	—	—	—	—	—
Fixed charges for ratio computation	\$ 73	\$ 287	\$ 337	\$ 371	\$ 335	\$ 340
Ratio of earnings to fixed charges and preferred dividends	2.12	2.44	1.45	1.88	1.82	2.16

(a) Excludes income/losses from equity investments.

Exhibit 12.2
Potomac Electric Power Company

	Three Months Ended March 31, 2012	For the Year Ended December 31,				
		2011	2010	2009	2008	2007
		<i>(millions of dollars)</i>				
Net income	\$ 24	\$ 99	\$ 108	\$ 106	\$ 116	\$ 125
Income tax (benefit) expense	(5)	36	37	76	64	62
Fixed charges:						
Interest on long-term debt, amortization of discount, premium and expense	26	101	101	103	95	86
Other interest	2	10	10	11	11	12
Total fixed charges	28	111	111	114	106	98
Income before income tax expense and fixed charges	\$ 47	\$ 246	\$ 256	\$ 296	\$ 286	\$ 285
Ratio of earnings to fixed charges	1.68	2.22	2.31	2.60	2.70	2.91
Total fixed charges, shown above	28	111	111	114	106	98
Preferred dividend requirements, adjusted to a pre-tax amount	—	—	—	—	—	—
Total fixed charges and preferred dividends	\$ 28	\$ 111	\$ 111	\$ 114	\$ 106	\$ 98
Ratio of earnings to fixed charges and preferred dividends	1.68	2.22	2.31	2.60	2.70	2.91

Delmarva Power & Light Company

	Three Months Ended March 31, 2012	For the Year Ended December 31,				
		2011	2010	2009	2008	2007
		<i>(millions of dollars)</i>				
Net income	\$ 21	\$ 71	\$ 45	\$ 52	\$ 68	\$ 45
Income tax expense	14	42	31	16	45	37
Fixed charges:						
Interest on long-term debt, amortization of discount, premium and expense	11	46	46	45	41	44
Other interest	1	3	2	2	2	2
Total fixed charges	12	49	48	47	43	46
Income before income tax expense and fixed charges	\$ 47	\$ 162	\$ 124	\$ 115	\$ 156	\$ 128
Ratio of earnings to fixed charges	3.92	3.31	2.58	2.45	3.63	2.78
Total fixed charges, shown above	12	49	48	47	43	46
Preferred dividend requirements, adjusted to a pre-tax amount	—	—	—	—	—	—
Total fixed charges and preferred dividends	\$ 12	\$ 49	\$ 48	\$ 47	\$ 43	\$ 46
Ratio of earnings to fixed charges and preferred dividends	3.92	3.31	2.58	2.45	3.63	2.78

Atlantic City Electric Company

	Three Months Ended March 31, 2012	For the Year Ended December 31,				
		2011	2010	2009	2008	2007
		<i>(millions of dollars)</i>				
Net income	\$ 2	\$ 39	\$ 53	\$ 41	\$ 64	\$ 60
Income tax (benefit) expense	(1)	33	43	17	30	41
Fixed charges:						
Interest on long-term debt, amortization of discount, premium and expense	18	71	66	69	64	66
Other interest	1	3	3	3	3	3
Total fixed charges	19	74	69	72	67	69
Income before income tax expense and fixed charges	\$ 20	\$ 146	\$ 165	\$ 130	\$ 161	\$ 170
Ratio of earnings to fixed charges	1.05	1.97	2.39	1.81	2.40	2.46
Total fixed charges, shown above	19	74	69	72	67	69
Preferred dividend requirements adjusted to a pre-tax amount	—	—	—	—	—	1
Total fixed charges and preferred dividends	\$ 19	\$ 74	\$ 69	\$ 72	\$ 67	\$ 70
Ratio of earnings to fixed charges and preferred dividends	1.05	1.97	2.39	1.81	2.40	2.44

CERTIFICATION

I, Joseph M. Rigby, certify that:

1. I have reviewed this report on Form 10-Q of Pepco Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ JOSEPH M. RIGBY

Joseph M. Rigby

Chairman of the Board, President and Chief Executive Officer

CERTIFICATION

I, Frederick J. Boyle, certify that:

1. I have reviewed this report on Form 10-Q of Pepco Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle

Senior Vice President and Chief Financial Officer

CERTIFICATION

I, David M. Velazquez, certify that:

1. I have reviewed this report on Form 10-Q of Potomac Electric Power Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ DAVID M. VELAZQUEZ

David M. Velazquez

President and Chief Executive Officer

CERTIFICATION

I, Frederick J. Boyle, certify that:

1. I have reviewed this report on Form 10-Q of Potomac Electric Power Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
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5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle

Senior Vice President and Chief Financial Officer

CERTIFICATION

I, David M. Velazquez, certify that:

1. I have reviewed this report on Form 10-Q of Delmarva Power & Light Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ DAVID M. VELAZQUEZ

David M. Velazquez

President and Chief Executive Officer

CERTIFICATION

I, Frederick J. Boyle, certify that:

1. I have reviewed this report on Form 10-Q of Delmarva Power & Light Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle

Senior Vice President and Chief Financial Officer

CERTIFICATION

I, David M. Velazquez, certify that:

1. I have reviewed this report on Form 10-Q of Atlantic City Electric Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ DAVID M. VELAZQUEZ

David M. Velazquez

President and Chief Executive Officer

CERTIFICATION

I, Frederick J. Boyle, certify that:

1. I have reviewed this report on Form 10-Q of Atlantic City Electric Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle
Chief Financial Officer

Certificate of Chief Executive Officer and Chief Financial Officer
of
Pepco Holdings, Inc.
(pursuant to 18 U.S.C. Section 1350)

I, Joseph M. Rigby, and I, Frederick J. Boyle, each certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q of Pepco Holdings, Inc. for the quarter ended March 31, 2012, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Pepco Holdings, Inc.

May 3, 2012

/s/ JOSEPH M. RIGBY

Joseph M. Rigby
Chairman of the Board, President and Chief Executive Officer

May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle
Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Pepco Holdings, Inc. and will be retained by Pepco Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Certificate of Chief Executive Officer and Chief Financial Officer
of
Potomac Electric Power Company
(pursuant to 18 U.S.C. Section 1350)

I, David M. Velazquez, and I, Frederick J. Boyle, each certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q of Potomac Electric Power Company for the quarter ended March 31, 2012 filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Potomac Electric Power Company.

May 3, 2012

/s/ DAVID M. VELAZQUEZ

David M. Velazquez

President and Chief Executive Officer

May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle

Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Potomac Electric Power Company and will be retained by Potomac Electric Power Company and furnished to the Securities and Exchange Commission or its staff upon request.

Certificate of Chief Executive Officer and Chief Financial Officer
of
Delmarva Power & Light Company
(pursuant to 18 U.S.C. Section 1350)

I, David M. Velazquez, and I, Frederick J. Boyle, each certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q of Delmarva Power & Light Company for the quarter ended March 31, 2012, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Delmarva Power & Light Company.

May 3, 2012

/s/ DAVID M. VELAZQUEZ

David M. Velazquez

President and Chief Executive Officer

May 3, 2012

/s/ FREDERICK J. BOYLE

Frederick J. Boyle

Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Delmarva Power & Light Company and will be retained by Delmarva Power & Light Company and furnished to the Securities and Exchange Commission or its staff upon request.

Certificate of Chief Executive Officer and Chief Financial Officer
of
Atlantic City Electric Company
(pursuant to 18 U.S.C. Section 1350)

I, David M. Velazquez, and I, Frederick J. Boyle, each certify that, to the best of my knowledge, (i) the Quarterly Report on Form 10-Q of Atlantic City Electric Company for the quarter ended March 31, 2012, filed with the Securities and Exchange Commission on the date hereof fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Atlantic City Electric Company.

May 3, 2012

/s/ DAVID M. VELAZQUEZ
David M. Velazquez
President and Chief Executive Officer

May 3, 2012

/s/ FREDERICK J. BOYLE
Frederick J. Boyle
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Atlantic City Electric Company and will be retained by Atlantic City Electric Company and furnished to the Securities and Exchange Commission or its staff upon request.