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PJM 2010 Financial Report

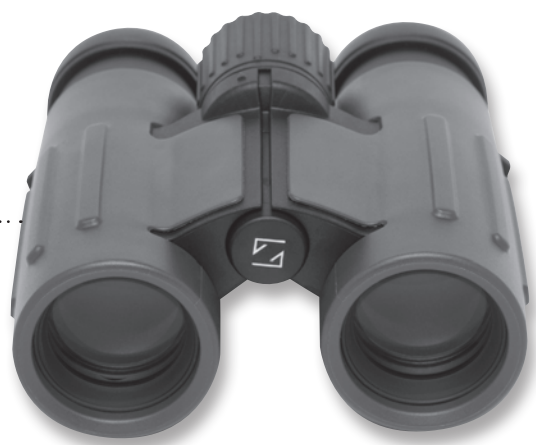
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## Forward-Looking Statements

In addition to the historical information presented throughout this report, there are forward-looking statements that reflect management's expectations for the future. Sometimes the words "estimate," "plan," "expect," "believe," or similar expressions will be used to identify such forward-looking statements. These forward-looking statements are based on current expectations. These statements are not guarantees of future performance and are subject to certain risks and uncertainties.

Many factors could cause actual results to differ materially from these statements. These factors include, but are not limited to, the results of regulatory proceedings, the conditions of the capital markets, interest rates, actuarial assumptions, availability of credit, liquidity and general economic conditions; changes in accounting principles and practices; acts of terrorists; the actions of adjacent control areas and other Regional Transmission Organizations (RTOs) and other operational conditions that could arise on the power system. For a description of these and other factors that may cause actual results to differ, reference is made hereby to PJM's Consolidated Financial Statements, Notes thereto and other documents filed by the Company from time to time with the Federal Energy Regulatory Commission (FERC).

These forward-looking statements represent PJM's estimates and assumptions only as of the date of this report and PJM assumes no responsibility to update these forward-looking statements.

## Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 164,000 megawatts and operates a wholesale electricity market with more than 660 companies that are eligible to transact in the markets PJM administers. PJM enables the delivery of electric power to more than 54 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

PJM manages a sophisticated regional planning process for generation and transmission expansion to ensure continued reliability of the electric system. Using information technology, PJM provides real-time information to market participants to support their daily transactions and business decision-making. In addition to ensuring the reliable supply of electricity, PJM administers Internet-based bid markets in which participants buy and sell day-ahead and spot market energy, capacity credits, financial transmission rights, synchronized reserves and regulation services.

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and RTOs.

PJM Environmental Information Services, Inc. (PJM EIS) is a wholly owned subsidiary of PJM Tech formed to provide environmental and emissions attributes reporting and tracking services to its subscribers in support of renewable portfolio standards and other disclosure requirements that may be implemented by governmental agencies. PJM EIS is not a FERC-regulated entity.

PJM EnviroTrade, Inc. (PJM EnviroTrade) is a wholly owned subsidiary of PJM Tech formed to provide an auction platform for trading solar renewable energy certificates across several states in the mid-Atlantic region. PJM EnviroTrade ran its first auction on July 6, 2010. PJM EnviroTrade is not a FERC-regulated entity.

During 2010, PJM filed with the FERC to create a new subsidiary to handle all of the credit, billing and settlement functions for PJM's members' transactions in the PJM markets and for transmission service. PJM received approval from the FERC on December 30, 2010, to begin operation of PJM Settlement, Inc. on January 1, 2011. PJM Settlement, Inc. is a Pennsylvania nonprofit corporation and is a FERC-regulated entity. As of January 1, 2011, PJM Settlement, Inc. acts as counterparty to members' pool transactions in the PJM markets for transmission service. For the pool transactions in the PJM market, flash title passes to PJM Settlement, Inc. at market clearing. This provides PJM the authority to continue to net a member's offsetting financial positions in PJM markets and also complies with the FERC guidance on credit policy requirements for grid operators.

## Tariff Cost Recovery

PJM recovers its administrative costs under its stated rate tariff, which was effective on June 1, 2006. The stated rate tariff has three elements.

The first component is a composite rate. The tariff establishes a four-step rate structure. Beginning June 1, 2007, the composite rate was 32 cents per megawatt-hour (MWh); beginning January 1, 2008, 31 cents per MWh; and beginning January 1, 2011, 30 cents per MWh.

The second element is a rider for the Advanced Second Control Center (AC<sup>2</sup>). The tariff establishes a specific mechanism for PJM to collect from its customers the actual costs to construct and operate AC<sup>2</sup>. The recovery of those costs is from a formula rate set forth in a separate schedule in the PJM Open Access Transmission Tariff (Tariff). The recovery is capped at the capitalized investment costs and operating costs of AC<sup>2</sup>. The rider will remain in effect until seven years from the in-service date of the AC<sup>2</sup> energy management system, which is projected to be during 2011. From June 2008 through December 2010, PJM placed into service certain assets at the AC<sup>2</sup> facility. PJM began to recover costs under this rider in July 2008. During 2010 and 2009, \$9.3 million and \$5.3 million were billed under this rider, respectively.

The third component provides for accumulation of a financial reserve up to six percent of annual revenues and subsequent refunds to PJM's members, if applicable.

PJM has the right to file with the FERC for prospective changes to these rates at any time, if necessary.

## Market Integrations

On August 17, 2009, FirstEnergy Service Company, on behalf of American Transmission Systems, Inc. (ATSI), its transmission affiliate, filed with the FERC to withdraw its transmission assets from the Midwest Independent System Operator (Midwest ISO) and to place them into PJM as of June 1, 2011. In addition to its ATSI transmission assets, the filing includes the ATSI Utilities, namely The Cleveland Electric Illuminating Company, Ohio Edison Company, The Toledo Edison Company and Pennsylvania Power Company, as well as the generation affiliate FirstEnergy Solutions. The FERC approved this filing on December 17, 2009.

On June 25, 2010, Duke Energy Ohio, Inc. and Duke Energy Kentucky, Inc., subsidiaries of Duke Energy Corporation, filed with the FERC to withdraw their transmission assets from the Midwest ISO and to place them into PJM as of January 1, 2012. In addition to the Duke Ohio and Duke Kentucky transmission assets, the filing includes the integration of certain Duke-owned and jointly owned generation assets. The FERC approved this filing on October 21, 2010.

PJM is working with all of the companies listed above and interested stakeholders to ensure that these integrations are accomplished safely and reliably in accordance with all reliability standards and market rules.

## Critical Accounting Policies

Preparation of the financial statements and related disclosures in compliance with generally accepted accounting principles requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. PJM's application of those principles involves judgments regarding many factors, which, in and of themselves, could materially affect the financial statements and disclosures. A future change in the assumptions or judgments applied in determining the following matters, among others, could have a material impact on future financial results: accounting for deferred recovery of pension and postretirement costs, accounting for deferred regulatory liability, benefit plan accounting and assumptions, fixed asset capitalization, income tax accounting, study interconnection activity and revenue recognition.

### Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the underfunded projected benefit obligation (PBO) of a defined benefit pension plan as a liability in the balance sheet. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. In addition to recording the underfunded PBO as a liability, PJM has recorded a regulatory asset pursuant to Financial Accounting Standards Board (FASB) guidance on accounting for the effects of certain types of regulation Accounting Standards Codification (ASC 980) to reflect the anticipated future recovery of the amounts to be funded in the future through the Company's rate structure. This regulatory asset, which will be amortized each quarter as the net periodic benefit cost of the underfunded liability as recognized, was \$18.2 million and \$11.0 million at December 31, 2010 and 2009, respectively.

### Deferred Regulatory Liability

PJM recovers as service fees its administrative costs under its stated rate tariff, which has been in effect since June 1, 2006.

The stated rate tariff provides for the accumulation of a financial reserve. PJM is permitted to maintain a reserve as a deferred regulatory liability in an amount up to six percent of its annual service fee revenues, less the expenses incurred under the AC<sup>2</sup> rider. The amount accumulated under those provisions is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. As the stated rate tariff was originally filed for the years 2006 through 2010, to the extent that such deferred regulatory liability exceeded six percent of PJM's revenues during any calendar year, PJM was to and did until 2008 refund such excess ratably over a nine-month period commencing April 1 of the following year. Refunds in any year were to be limited to amounts that would not reduce the regulatory liability balance below an amount equal to six percent of revenues collected in the previous year.

On January 31, 2008, PJM filed with the FERC a proposal to accelerate the stated rate refund mechanism for deferred regulatory liabilities accumulating in 2008 and forward. The FERC approved this proposal on March 12, 2008, with an effective date of April 1, 2008. PJM now refunds on a quarterly basis the deferred regulatory liability balance in excess of six percent of the annual revenue threshold. The quarterly refund rate is established after the financial close of each quarter, and refunds are distributed to the members on a prospective basis in the following quarter. For the year ended December 31, 2010, PJM made refunds of \$50.3 million.

In 2011 and every third year thereafter, refunds will reduce the non-current liability balance to \$6 million.

In accordance with the authoritative guidance for Regulatory Accounting (ASC 980), PJM recognizes deferred regulatory income or expense in the revenue section of the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income for the amount by which revenues pursuant to the stated rate tariff exceed expenses in the reporting period. The amount by which cumulative revenues under the stated rate tariff exceed cumulative expenses and stated rate refunds is reported as a deferred regulatory liability in the Consolidated Statement of Financial Position. Should there be periods in which revenues are less than expenses, PJM will reduce the deferred regulatory liability with an offset to deferred regulatory income.

At December 31, 2010, the deferred regulatory liability was \$20.2 million. At December 31, 2009, the deferred regulatory liability was \$20.8 million. At December 31, 2010 and December 31, 2009, the current portion of the deferred regulatory liability was \$14.2 million and \$7.1 million, respectively. The current balance at December 31, 2010, represents the amount to be refunded to members in the first quarter of 2011. The non-current portion of the deferred regulatory liability of \$6.0 million and \$13.7 million represents the amount of PJM's reserve at December 31, 2010 and December 31, 2009, respectively.

## Benefit Plan Accounting

PJM accrues the costs of providing future employee benefits in accordance with the guidance of Employers' Accounting for Pensions and Postretirement Benefits Other than Pensions (ASC 715). Under this guidance, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a relatively even recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

In addition to requiring employers to recognize the overfunded or underfunded PBO of a defined benefit pension plan as an asset or liability in the balance sheet, the FASB guidance also requires employers to recognize annual changes in gains or losses, prior service costs or other credits that have not been recognized as a part of the liability in the Consolidated Statement of Financial Position. The Company adopted the FASB guidance, which established a new framework for accounting for Deferred Benefit Pension and Postretirement Plans. FASB guidance on Regulated Operations (ASC 980) requires that a corresponding regulatory asset, Deferred Pension and Postretirement Costs, be included in the Consolidated Statement of Financial Position.

PJM's selection of the discount rate, healthcare cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

In selecting the discount rate assumption for the PJM retirement plan at December 31, 2010, the Company used a method that matches projected payouts from the plan with a yield curve that was produced from a universe containing over 500 U.S.-issued Aa-rated corporate bonds, all of which were noncallable (or callable with make-whole provisions), and excluding the 10 percent of the bonds with the highest yields and the 10 percent with the lowest yields. The discount rate was then developed as a level equivalent rate that would produce the same present value as would result using spot rates to discount the projected pension benefit payments. Based on this analysis, the discount rate for its pension plan and postretirement healthcare plan decreased to 5.50 percent at December 31, 2010.

In selecting an expected return on plan assets, PJM considers past performance and economic forecasts for the types of investments held by the plans. The expected rate of return on assets remained at 7.50 percent at December 31, 2010. The assumption for the expected rate for which compensation will increase remained at 4.50 percent at December 31, 2010. In selecting healthcare cost trend rates, PJM considers past performance and forecasts of healthcare costs. The rate used for 2010 was 8.50 percent, declining to 5.00 percent over seven years.

Changes in the assumptions listed above could have a significant impact on the accrued pension and other postretirement benefit liabilities and reported annual net periodic pension and other postretirement benefit costs. For example, the effect of a 1 percent increase in the assumed healthcare cost trend rate from 8.50 percent to 9.50 percent would increase the postretirement benefit obligation as of December 31, 2010 by \$10.5 million and the current year postretirement benefit cost by approximately \$1.3 million. A 1 percent decrease in the assumed healthcare cost trend rate from 8.50 percent to 7.50 percent would decrease the accumulated postretirement benefit obligation by approximately \$8.2 million and would decrease the postretirement benefit cost by approximately \$1.0 million annually.

During 2010, PJM expensed net periodic pension and other postretirement benefit costs of \$11.6 million. This amount represents a \$1.0 million decrease in expense compared with the amount recognized during 2009. This decrease was primarily due to lower postretirement benefit costs due to the changes in the plan during 2009.

### Fixed Asset Capitalization

PJM's fixed assets are comprised principally of software and capitalized software development costs, leasehold improvements, computer hardware and buildings. The costs incurred to acquire and develop computer software for internal use, including financing costs, are capitalized. However, costs incurred prior to the determination of feasibility of developed software and costs incurred following the in-service date of developed software are expensed. Fixed assets are depreciated or amortized using the straight-line method over the useful lives of the assets as follows:

Software and capitalized software development costs	3 to 10 years
Computer hardware	3 to 5 years
Leasehold improvements	10 years
Furniture and fixtures	10 years
Buildings	25 years
Vehicles	5 years

### Income Tax Accounting

PJM has elected to be taxed as a corporation. PJM and its subsidiaries file a consolidated federal income tax return. The Consolidated Financial Statements include prepaid income taxes, accrued income taxes and deferred income taxes. Prepaid income taxes relate to overpayments by PJM for the current federal tax period. These overpayments will be applied to future federal income tax liabilities. Accrued income taxes represent the amounts expected to be reported on PJM's and its subsidiaries' state income tax returns offset by estimated state payments. Deferred income tax assets represent the tax effects of temporary differences between the financial statement basis and tax basis of existing assets and liabilities and are measured using presently enacted tax rates. A valuation allowance has been provided where PJM believes that it is more likely than not that PJM will not realize such deferred tax assets in the future.

### Study and Interconnection Activity

Under the Tariff, PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and determine, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by third-party vendors at the request of transmission customers. In its system planning capacity as transmission service provider, PJM provides billing and collection services in the interconnection service agreement process. Billings and collections by PJM for work performed as an agent for the counterparties to the specific interconnection agreements are reported on a net basis in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

### Revenue Recognition

Effective January 1, 2011, with the operation of PJM Settlement, Inc., PJM is now in the chain of title for pool transactions. This change could impact how the financial information of PJM is presented, however, we do not expect the change to have a material impact on PJM's financial position, results of operations or cash flows.

## Results of Operations for 2010, 2009, 2008

### Revenues

PJM's service fees increased \$17.0 million, or 7 percent, to \$245.4 million from 2009 to 2010. The increase is attributable to higher member transaction volumes and higher collections during 2010 under the AC<sup>2</sup> rider, which provides for the collection of actual costs to construct and operate AC<sup>2</sup>. Collections under the AC<sup>2</sup> rider increased \$4.0 million, or 75 percent, to \$9.3 million from 2009 to 2010. The increase in AC<sup>2</sup> rider charges is primarily attributable to recovery of depreciation and amortization charges. Transmission volumes for 2010 were 745 terawatt hours (TWhs) as compared with 710 TWhs for 2009. The increase in transmission volumes is primarily attributable to higher customer demand due to warmer weather in the summer of 2010 and improvements in the economy.

Interest income was \$3.3 million, or 81 percent lower in 2010 than in 2009 due to declining interest rates. Interest income primarily represents interest on customer deposits, which is credited back to members that have customer deposits and charged to interest expense.

PJM's service fees decreased \$12.0 million, or 5 percent, to \$228.4 million from 2008 to 2009. The decline is primarily attributable to a decline in volumes. Transmission volumes for 2009 were 710 TWhs as compared with 759 TWhs for 2008.

Interest income was \$16.2 million, or 80 percent lower in 2009 than in 2008 due to declining interest rates and lower deposit and operating cash balances. The decrease in cash balances is a result of accelerating billing settlements from monthly to weekly.

Deferred regulatory income represents PJM's stated rate tariff service fees in excess of expenses and is reported as an offset to total revenues. The variance for the 12 months ended December 31, 2010, as compared with December 31, 2009, is primarily due to the Company recording a non-recurring income tax benefit in the second quarter of 2009. As a result of the changes to the Company's postretirement healthcare plan, the Company determined that it was appropriate to release the valuation allowance on certain deferred tax assets, resulting in the 2009 income tax benefit. This was a one-time adjustment.

Net income is derived from PJM's non-FERC regulated subsidiaries. Net income was \$0.5 million in 2010 as compared with \$0.7 million in 2009. The decrease is primarily attributable to start-up costs associated with PJM EnviroTrade.

## Expenses

The following table summarizes the percentage of total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, for the years ended December 31, 2010, 2009 and 2008:

Year Ended December 31,	2010	2009	2008
Compensation expense	46	46	46
Outside services	21	21	23
Depreciation and amortization expense, net	11	10	8
Software licenses and fees	6	5	5
Computer maintenance and office supplies	4	4	4
Other expenses	4	6	6
Pension and postretirement benefit expenses	6	6	6
Lease expenses	2	2	2
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased \$3.5 million, or 2 percent, to \$196.0 million in 2010 as compared with an increase of \$11.4 million, or 6 percent in 2009. The increase in 2010 resulted primarily from the following factors: (1) a \$2.7 million or 3 percent increase in compensation expense due to planned staffing levels and annual cost of living adjustments; and, (2) a \$1.8 million increase in net depreciation and amortization expense due to certain AC<sup>2</sup> assets and member billing systems being placed into service. For the years ended December 31, 2010 and 2009, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling \$0.9 million and \$1.2 million, respectively, which were predominantly for audits of the PJM Consolidated Financial Statements and examination of certain internal control systems in accordance with Statement on Auditing Standards No. 70.

Key information systems, system enhancements and capital investments completed by PJM in 2010 included:

- **Intelligent Event Processor**, providing the technology to alert dispatchers of unusual events, probable causes and action alternatives related to the transmission system in the PJM Region.
- **Security Constrained Economic Dispatch**, providing the technology to effectively dispatch generation units taking into consideration system constraints within the PJM Region and along its tie lines with neighboring transmission systems.
- **User Experience & Visualization**, providing visualization tools to dispatchers for greater understanding of the transmission system status in the PJM region.

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased \$11.4 million, or 6 percent, to \$192.6 million in 2009 as compared with a decrease of \$15.1 million, or 8 percent, in 2008. The increase in 2009 resulted primarily from the following factors: (1) a \$3.8 million increase in net depreciation and amortization expense due to certain AC<sup>2</sup> assets and member billing systems being placed into service; and, (2) a \$2.0 million increase in retirement plan expenses principally resulting from lower asset performance in 2008. For the years ended December 31, 2009 and 2008, outside services included amounts paid to PJM's independent auditor, PricewaterhouseCoopers LLP, totaling \$1.2 million and \$1.1 million, respectively, which were predominantly for audits of the PJM Consolidated Financial Statements and examination of certain internal control systems in accordance with Statement on Auditing Standards No. 70.

## Billings for Services

Membership increased to 660 members at December 31, 2010, as compared with 564 members at December 31, 2009. One of the metrics PJM utilizes to evaluate operating performance is the measure of Billings for Services. This information is intended to enhance a reader's overall understanding of operating results and is not a presentation defined under GAAP and may not be comparable to other companies' presentations or deemed more useful than the GAAP information provided elsewhere in this report. The only billings included in PJM's financial statements are PJM Scheduling, System Control and Dispatch, AC<sup>2</sup> Costs and the FERC annual Recovery Charge. For 2010, 2009 and 2008, settlements processed by PJM under the Tariff, Operating Agreement and Reliability Assurance Agreement were as follows:

(in millions)	2010 Amount Billed	2009 Amount Billed	2008 Amount Billed
Energy Markets	\$ 17,319	\$ 11,163	\$18,658
Capacity	9,626	8,752	6,721
Transmission Losses (Point-to-Point)	1,635	1,268	1,309
Transmission Congestion	1,502	785	2,222
Network Transmission Service	1,410	1,289	1,313
FTR Auction Revenues	1,312	1,902	2,258
Operating Reserves	622	324	464
Transmission Enhancement	284	164	51
Regulation Market	250	228	488
Reactive Supply	241	240	220
PJM Scheduling, System Control and Dispatch (Operating Expense Reimbursement, net of stated rate refunds)	186	150	158
Point-to-Point Transmission Service	75	63	95
RTO Scheduling, System Control and Dispatch (Transmission Owners' Control Center Expenses)	63	57	62
Spinning Reserve Market	47	32	55
FERC Annual Charge Recovery	47	40	31
Customer Default Allocation Assessments	17	5	63
Load Response Program	17	2	31
Generation Deactivation	16	6	31
Distribution Facilities	21	20	20
Inadvertent Interchange	13	2	2
Black Start Service	12	14	16
ReliabilityFirst Corporation (RFC)	10	6	6
AC <sup>2</sup> Costs	9	5	2
Market Monitoring Unit Funding	9	9	4
Expansion Cost Recovery and RTO Startup Cost Recovery	9	9	9
Day-Ahead Scheduling Reserve Market	7	8	3
North American Electric Reliability Corporation (NERC)	5	5	4
Seams Elimination Cost Assignment (SECA)	3	-	4
Ramapo PAR (Phase AngleRegulator) Facilities	1	1	1
Organization of PJM States, Inc. (OPSI) Fees	1	1	1
Miscellaneous	1	1	1
Unscheduled Transmission Service	-	-	1
<b>Total</b>	<b>\$ 34,770</b>	<b>\$ 26,551</b>	<b>\$34,304</b>

### Liquidity and Capital Resources

Under the stated rate tariff, PJM collected 31 cents per MWh in 2010. Beginning January 1, 2011, PJM will collect 30 cents per MWh. In 2010, the accumulated financial reserve was \$20.2 million, \$14.2 million of which will be refunded to members during the first quarter of 2011. PJM is projected to refund \$45 to \$50 million to members during 2011, which would result in a projected accumulated financial reserve balance of approximately \$23 million at December 31, 2011.

In the event PJM's actual expenses are projected to exceed its revenues and financial reserve, PJM is empowered to and would need to file a rate case with the FERC.

PJM has a \$50 million revolving line of credit agreement that expires in March 2011. Additionally, PJM has a \$110 million project development facility that expires in March 2011 and for which borrowings are collateralized by all of PJM's tangible and intangible property other than the assets acquired pursuant to the Facilities Agreement with a subset of PJM's members. At December 31, 2010, PJM had no outstanding borrowings on the working capital line of credit facility or the project development facility. The FERC approval for borrowings under these facilities must be requested biennially. However, the Company does not intend to renew these credit facilities.

During December 2010, PJM filed with the FERC to enter into a revolving line of credit agreement for \$65 million with PNC Bank (PNC). The interest rate under this facility is the London Interbank Offered Rate (LIBOR) plus 90 basis points. On January 31, 2011, the FERC approved PJM's application to enter into this new revolving line of credit arrangement.

On March 31, 2009, the FERC approved PJM's application to enter into a \$35 million loan agreement with PNC. The loan has a seven-year term and is secured by the AC<sup>2</sup> property in Milford, PA. The closing on this loan facility occurred on April 30, 2009. At December 31, 2010, outstanding borrowings were \$31.3 million. PJM is expected to make \$2.3 million of principal payments during 2011.

On March 28, 2008, the FERC approved PJM's application to borrow up to \$115 million under a private placement master note agreement. On September 15, 2009, PJM issued senior unsecured notes with a seven-year term totaling \$75 million under this facility. At December 31, 2010, outstanding borrowings were \$69.2 million. The purpose of this borrowing is to fund the technology investment in AC<sup>2</sup>. PJM is expected to make \$11.5 million of principal payments during 2011.

On April 2, 2010, the FERC approved PJM's application to utilize the remaining \$40 million under the private placement master agreement, if needed.

Under the loan covenants, PJM is required to provide unaudited financial statements 45 days after each quarter and audited financial statements 120 days after year-end.

As of December 31, 2010 and 2009, PJM was assigned an Aa3 issuer rating by Moody's Investors Service.

For study and interconnection work performed, PJM obtains liquid collateral from the transmission customer for the estimated costs of the transmission system modifications. PJM's study and interconnection receivables are comprised of billings to transmission customers for services performed under these interconnection service agreements. PJM's study and interconnection payables represent amounts due to the transmission owners for services performed under these interconnection service agreements. PJM held deposits related to study and interconnection activity totaling \$60.2 million and \$53.7 million at December 31, 2010 and 2009, respectively.

PJM requires deposits from various parties in connection with services to be performed or as collateral for market activity. PJM held credit deposits of \$684.0 million and \$493.6 million at December 31, 2010 and 2009, respectively. These deposits are maintained in separate cash accounts that are not legally restricted.

Net cash provided by operating activities was \$27.2 million in 2010 as compared with net cash used in operating activities of \$10.5 million in 2009. The swing of \$37.7 million is attributable principally to two items: (1) a difference of \$22.5 million between the two years in the amount of refunds associated with the deferred regulatory liability; and, (2) a tax refund of \$8.5 million in 2010. In 2009, PJM amended its postretirement healthcare plan, which resulted in a one-time income tax benefit of \$27 million. Inclusion of the effect of that tax benefit in deferred regulatory income was the principal reason for the high level of refunds associated with the deferred regulatory liability in 2009, which totaled \$72.8 million. In 2010, the refunds associated with the deferred regulatory liability totaled \$50.3 million, resulting in less cash disbursed and a corresponding increase in cash provided from operations. Also, cash provided by operations was increased in 2010 when the \$8.5 million tax refund, associated principally with the changes in the postretirement benefit, was received.

Net cash provided by financing activities was \$267.5 million in 2010 as compared with net cash used in financing activities of \$268.9 million in 2009. The difference is primarily due to higher customer deposits because of increased transmission volumes in 2010 as well as higher member prepayments at December 31, 2010 as compared with 2009. Further, PJM returned significant customer deposits during 2009 due to the acceleration of its billing and collection cycles.

For 2011, PJM's Board of Managers has approved a capital budget, excluding AC<sup>2</sup>, of \$30 million. These capital expenditures will be used for application replacements, system reliability applications, new products and services for PJM's membership, risk management and interregional coordination. PJM is anticipating capital expenditures to be incurred through 2011 of approximately \$156 million for the development of AC<sup>2</sup>, approximately \$145 million of which had been spent through December 31, 2010. Actual expenditures may differ from these amounts as PJM continues to assess its capital needs.

## **Risks and Uncertainties**

PJM does not provide forecasts of future financial performance. While PJM management is optimistic about the Company's long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating its outlook.

### **Recent Regulatory Actions**

#### *Consolidated Edison Wheel Proceeding*

In 2001, Consolidated Edison Company of New York, Inc. (ConEd) filed a complaint with the FERC concerning the implementation by PJM, the New York Independent System Operator (NYISO) and Public Service Electric and Gas Company (PSEG) of certain contracts entered into in the 1970s between ConEd and PSEG. After the FERC issued a series of decisions, PJM, the NYISO, and PSEG filed with the FERC a set of operating protocols intended to resolve the proceeding and guide future operations under the contracts. In approving these protocols, the FERC required a series of post-implementation reports to be submitted. Subsequently, in reports submitted by ConEd on September 30, 2005, December 30, 2005, and January 19, 2007, ConEd has claimed that PJM and the NYISO had not properly implemented the approved protocols and had jointly caused alleged damage to ConEd and its customers of \$111 million, of which \$9.5 million are described as direct losses. ConEd asked the FERC to initiate further proceedings and to make a determination of the amount of refunds necessary to make ConEd whole for these alleged economic consequences. PJM and the NYISO responded to ConEd's allegations and denied ConEd's right to the refunds it sought. On April 20, 2007, the FERC dismissed all of ConEd's requests for relief as procedurally insufficient, accepted all the informational reports filed and rejected ConEd's request that the FERC institute hearing and settlement procedures. On May 21, 2007, ConEd filed a Petition for Rehearing of the FERC's April 20, 2007 Order. PSEG and ConEd filed appeals with the D.C. Circuit Court of Appeals on June 18, 2007, and June 19, 2007, respectively.

On February 23, 2009, the parties to the complaint filed with the FERC a settlement offer to resolve all issues in this matter pending at the FERC and in the D.C. Circuit Court of Appeals. The settlement, if approved by the FERC, would provide "rolled over" service between ConEd and PSEG in accordance with transmission service agreements between PJM and ConEd and joint operating protocols between PJM and the NYISO. The filed settlement was contested. On February 19, 2010, the FERC found they are unable to approve the settlement because the current state of the record did not permit them to resolve the merits of some of the contested issues. Because these issues must be addressed before determining whether the settlement can be approved, the FERC ordered the parties to brief these issues. The parties filed the additional information required by the February 19, 2010 Order.

On September 16, 2010, the Commission issued an Order Approving Contested Settlement and Denying Rehearing and found that the settlement and the related non-conforming transmission service agreements and Joint Operating Agreement Protocol are just and reasonable. On October 18, 2010, the NRG Companies filed a Request for Rehearing, appealing the September 16, 2010 Order. The outcome of this matter is not anticipated to have any material adverse impact on PJM's financial position, results of operations or cash flow.

#### *Reliability Pricing Model Buyers*

On May 30, 2008, 18 PJM Members, calling themselves the Reliability Pricing Model (RPM) Buyers, filed with the FERC a complaint against PJM asking the FERC to find that PJM's RPM, as implemented through the "transitional" base residual auctions, has produced unjust and unreasonable capacity prices and to order refunds from the PJM members that received RPM revenues. PJM filed its answer on July 11, 2008, requesting that the FERC dismiss the complaint because the requested relief violates the filed rate doctrine, represents a collateral attack on the FERC's prior RPM orders, and is contrary to the FERC's policy not to order the re-running of markets.

The FERC dismissed the RPM Buyers' complaint on September 19, 2008. On October 20, 2008, the RPM Buyers filed a request for rehearing at the FERC on this matter. On November 18, 2008, the FERC issued an order granting rehearing for further consideration for the limited purpose of giving itself additional time to consider the matters raised in the RPM Buyers' request for rehearing. Thereafter, the FERC issued an order on June 18, 2009, denying the RPM Buyers' request for rehearing, denying their request for oral argument, and reaffirming its September 19, 2008 order dismissing their complaint filed against PJM.

On August 14, 2009, two of the 18 RPM Buyers, the Maryland Public Service Commission and New Jersey Board of Public Utilities, filed a Petition for Review and Notice in the Fourth Circuit Court of Appeals to appeal the FERC's September 19, 2008 and June 18, 2009 orders. On November 12, 2009, an order was granted transferring the matter to the U.S. Court of Appeals for the District of Columbia Circuit. RPM Buyers, the FERC, PJM and interveners filed briefs with the District Court and oral arguments were held on November 15, 2010. On February 8, 2011, the District Court upheld the FERC's approval of PJM's RPM. The District Court ruled that the FERC had substantial basis on which to conclude that the RPM was an appropriate tool for increasing reliability in electricity markets, that the RPM did precisely what it was intended to do, including during the transitional period; and, the resulting capacity prices were attributable to legitimate causes, not any supplier's exercise of market power. The District Court also asserted that the FERC had adequately explained why the new rates were just and reasonable.

#### *Market Flow Modeling Discrepancy*

On June 26, 2009, PJM reported to the FERC that it discovered a Market Flow modeling discrepancy that affected the calculation of market-to-market coordination payments under the Joint Operating Agreement (JOA) between PJM and the Midwest ISO. As a result of this discrepancy, the market-to-market coordination payments from PJM to the Midwest ISO had been underpaid. The market flow modeling discrepancy was rectified prospectively effective June 2010.

PJM and the Midwest ISO initiated alternative dispute resolution under the JOA in September 2009. On September 15, 2009, this dispute was submitted to the FERC for dispute resolution by a settlement judge. The first settlement conferences were held on October 19 and October 20, 2009. Additional settlement conferences were held on December 10 and December 11, 2009 and during February 2010. The Midwest ISO subsequently terminated the settlement proceedings and on March 8, 2010, filed two complaints against PJM with the FERC. The first complaint sought damages in the amount of \$130 million plus interest for the market flow modeling discrepancy for the period 2005 – June 2009. The second complaint alleged that PJM was in violation of the JOA because PJM allegedly demanded resettlement of amounts related to the Midwest ISO's use of substitute flowgates in the market-to-market processes under the JOA. The Midwest ISO asked the FERC to order PJM to acknowledge the use of substitute flowgates under the JOA. The Midwest ISO is seeking reimbursement of \$5 million under the second complaint. PJM filed answers disagreeing with both complaints on April 12, 2010. Additionally, on April 12, 2010, PJM filed with the FERC a complaint against the Midwest ISO regarding the Midwest ISO's use of surrogate flowgates in market-to-market coordination in violation of the JOA, seeking damages in excess of \$25 million for the period April 2005 to June 2009.

On June 29, 2010, after various answers, responses, motions and comments were filed by the parties to the complaints, the FERC issued an Order consolidating the three complaint proceedings discussed above. The FERC also established hearing and settlement judge procedures and denied all requests for summary disposition as to any complaints.

A settlement conference was held on August 4, 2010. During this conference, PJM and the Midwest ISO reported that an additional error in data provided by a third-party vendor concerning the firm flow entitlements had been identified that would impact the settlement negotiations. As a result, additional settlement conferences were held during fall 2010.

On November 3, 2010, the parties, including PJM and the Midwest ISO, came to a settlement agreement in principle that was filed on January 4, 2011. This Settlement includes revisions to the JOA but no payments by any party for damages or billing adjustments and resolves all issues in this proceeding without the need for an evidentiary hearing or further proceedings. The majority of the parties support the settlement, but comments were filed by a limited number of parties on specific issues in the settlement with which they disagree. Reply comments were required to be filed by February 3, 2011.

PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

## Other Items

### *Seams Elimination Cost Adjustments*

At March 31, 2009, PJM had a receivable due from the Midwest ISO of \$33.4 million for Seams Elimination Cost Adjustments (SECA) billed for the 11 months ended March 31, 2006. While the Midwest ISO has billed Green Mountain Energy Trading (Green Mountain), the Midwest ISO customer responsible for the unpaid SECA charges, it has not yet received payment from that customer. The PJM transmission owners filed a motion on January 26, 2006, asking the FERC to use its civil enforcement powers to compel the defaulting Midwest ISO customer to comply with the Midwest ISO tariff and pay its allocated SECA charges. On November 9, 2007, PJM, the Indicated PJM Transmission Owners, the Midwest ISO and the Indicated Midwest ISO Transmission Owners submitted a motion for enforcement of effective Commission orders, approved provisions of the Midwest ISO Tariff and accepted contracts and rate schedules under which the Midwest ISO has assessed Green Mountain SECA charges.

On May 21, 2010, the Commission issued two orders. First, in the Order on Rehearing, the Commission denies all rehearing requests of the prior orders issued in this proceeding. Second, in the Order on Initial Decision the Commission reverses, in part, and affirms, in part, the initial decisions of the Administrative Law Judge. The Commission also approved three settlements that were certified as contested during the hearing and were held in abeyance pending action on the initial decisions and requests for rehearing. The Commission also approved a fourth settlement that was filed on October 29, 2009. The Commission in this order reverses the conclusion that the Midwest ISO properly assessed Green Mountain SECA charges as a customer under the Midwest ISO tariff. Instead, the Commission finds BP Energy (BP) is responsible for the SECA charges as the entity that took transmission service on behalf of Green Mountain through December 2005.

The Commission required the PJM Transmission Owners and the Midwest ISO Transmission Owners to submit revised SECA charges to reflect the adjustments adopted in its orders. Under the orders, these compliance filings are submitted by the Transmission Owners and accepted by the Commission, the Midwest ISO would begin collection of the BP SECA charges previously billed to Green Mountain. Once paid, the Midwest ISO would be required to remit the BP SECA payments to PJM for distribution to PJM's Transmission Owners. On October 18, 2010, however, protests were filed by several parties to the PJM Transmission Owners' and the Midwest ISO Transmission Owners' compliance filings and the FERC action is pending.

The receivable from the Midwest ISO is offset by the \$33.4 million payable by PJM to market participants for these SECA credits. Consequently, on a net basis, there are no amounts reported in the Company's Consolidated Statement of Financial Position related to these items. Although PJM management cannot determine the impact, if any, of the final disposition of the amounts not yet collected by the Midwest ISO from its market participants, the resolution will not have any impact on PJM's results of operations as PJM's Tariff only obligates PJM to disburse to its members the actual SECA charges collected.

### Legislative Activity

From time to time, the U. S. Congress considers matters pertaining to the restructuring of the electric industry and revises the existing regulatory scheme and the FERC's jurisdiction. A variety of proposals are presently under consideration for inclusion in possible energy legislation to be introduced this year. In the transmission area, these proposals are principally designed to reform the process for planning and allocating the costs of new transmission to serve renewable generation. Some of these proposals call for creation of new interconnection-wide planning entities that would receive information from individual regional plans and develop an interconnection-wide plan. Other proposals call for a national renewable portfolio standard. Additional proposals may be introduced through the legislative process in development of energy legislation this year. Although these proposals could have a material impact on the wholesale price of electricity in the PJM region, PJM does not believe these proposals, if enacted into law as they are presently described, will have a material adverse impact on PJM's operations.

### Third Party Relationships

PJM engages third parties as suppliers in arrangements to provide services in areas other than core competencies to ensure the service and support of members and timely product development. In particular, PJM is utilizing contractors and consultants in the development of AC<sup>2</sup>. Although PJM endeavors to establish strong working relationships with parties who share PJM's industry goals and have adequate resources to fulfill their responsibilities, these relationships lead to a number of risks. These suppliers may suffer financial or operational difficulties that may affect their performance, which could lead to delays in product development or timely completion of projects. Also, major companies from which PJM purchases components or services may be competitors in other areas, which could affect pricing, new product development or future performance. Finally, difficulties in coordinating activities may lead to gaps in delivery and performance of PJM services.

### Credit Risks

PJM bills and collects its operating expenses monthly from its members. Payment of all operating expense bills is due from PJM's members three business days after the month-end bill is issued by PJM, generally within the first two weeks of each month. During 2010 and 2009, approximately 70 percent of PJM's operating expenses were billed to 22 of its 660 members and 17 of its 564 members, respectively, each of which either has an investment-grade credit rating or has provided a guaranty from an affiliate with an investment-grade rating. In the event of default of any PJM members, PJM has the right to bill the remaining PJM members a ratable portion of the operating expenses previously billed to the defaulting member.

In accordance with PJM's credit policy, PJM obtains collateral from certain of its members in order to secure their credit positions. The collateral can be in the form of a cash deposit or letter of credit. Corporate guaranties are also accepted from creditworthy affiliates to fulfill credit requirements.

#### *Power Edge Default*

On April 16, 2008, PJM, in its own name and pursuant to authority granted by the PJM members, filed a civil complaint against Power Edge and its affiliates (collectively the Tower Affiliates), in the U.S. District Court for the District of Delaware (the Delaware Case). In the complaint, PJM sought to recover losses suffered by the PJM membership and damages for harm to the PJM markets arising out of Power Edge's default in the Financial Transmission Right market, the forfeiture of profits derived by the Tower Affiliates from the PJM markets, actual and punitive damages and the cost of the suit, plus interest.

On July 2, 2008, the Tower Affiliates filed a civil complaint against PJM in the Philadelphia County, Pennsylvania, Court of Common Pleas seeking return of the funds being withheld by PJM and compensatory and punitive damages for alleged interference with the Tower Affiliates' business relationships and defamation. PJM subsequently was able to remove the case to the United States District Court for the Eastern District of Pennsylvania (the Pennsylvania Case). On June 12, 2009, pursuant to an order of the U.S. District Court for the District of Delaware, the Delaware Case was transferred to the U.S. District Court for the Eastern District of Pennsylvania where, on July 13, 2009, it was consolidated with the Pennsylvania Case.

Effective July 15, 2010, PJM and the Tower Affiliates settled all claims between themselves within the Federal Court litigation and before the FERC. The Tower Affiliates executed a \$20 million promissory note in return for PJM withdrawing its civil complaint and the remainder of its complaint at the FERC related to this matter. The three-year promissory note executed on July 15, 2010 provided the Tower Affiliates the option to satisfy the note in full by prepaying \$18 million within 12 months or \$19 million within 24 months. The Tower Affiliates elected to prepay the note in full by paying PJM \$18 million on July 22, 2010. This amount was refunded to PJM market participants in August 2010. PJM has reported this activity on a net basis in the Company's Consolidated Statement of Financial Position and the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

#### *Lehman Brothers Commodities Services Default*

On and before September 15, 2008, the activity in the PJM markets of Lehman Brothers Commodities Services (LBCS), a PJM member, was supported by a guaranty issued by the parent company of LBCS, Lehman Brothers Holdings, Inc. (LBHI). On September 15, 2008, LBHI filed a petition in bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York. PJM issued a collateral call to LBCS on September 15, 2008, given the adverse change to LBCS's guarantor. LBCS did not meet its collateral call, and on September 18, 2008, LBCS was declared to be in default of its obligations, and its transaction rights in PJM were terminated. LBCS ultimately filed its own bankruptcy petition on October 3, 2008. LBCS did not pay their regular monthly invoices for market activity from August 2008 through and including May 2009, for a total of approximately \$18 million. The aggregate payment defaults were billed to non-defaulting members in accordance with the default allocation assessment formula in PJM's Operating Agreement. LBCS has not had any open positions with the Company since June 1, 2009. On September 18, 2009, PJM filed Proofs of Claim, along with supporting documentation, with the Bankruptcy Court setting forth PJM's creditor claim against both LBCS and LBHI.

Under the terms of the PJM Operating Agreement, any payment defaults may be billed and collected from PJM's other member companies. The outcome of any defaults is not anticipated to have a material adverse effect on PJM's financial position, results of operations or cash flow.

## Management's Responsibility for Financial Reporting

The management of PJM Interconnection, L.L.C. is responsible for the preparation and objectivity of the following consolidated financial statements and for their integrity. These financial statements have been prepared to conform to accounting principles generally accepted in the United States of America and, where required, include amounts that represent management's best judgments and estimates. PJM's management also is responsible for the preparation of other information in this annual report and for its accuracy and consistency with the financial statements.

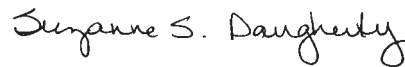
PJM has established a system of internal accounting and financial controls and procedures designed to provide reasonable assurance as to the integrity and reliability of financial reporting. Management continually reviews the effectiveness and efficiency of this system, and takes actions when opportunities for improvement are identified.

This system includes a separate Internal Audit Department, which monitors internal controls and reports directly to the Audit Committee of the Board of Managers. Management views the purpose of internal auditing to be an independent examination and assessment of PJM's activities related to compliance with policy, procedures and the law, as well as safeguarding of assets. The Audit Committee meets with management, internal auditors and the independent auditors on a regular basis to review financial information, internal controls and the internal audit process.

PJM's independent auditors, PricewaterhouseCoopers LLP, are engaged to conduct an independent audit of PJM's consolidated financial statements in accordance with generally accepted auditing standards.



Terry Boston  
President & Chief Executive Officer

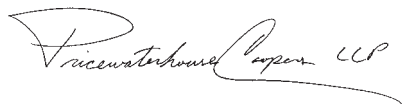


Suzanne S. Daugherty  
Vice President, Chief Financial Officer and Treasurer

## Report of Independent Auditors

To the Board of Managers of PJM Interconnection, L.L.C.:

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of income, comprehensive income and paid in capital, retained earnings and accumulated other comprehensive income and of cash flows present fairly, in all material respects, the financial position of PJM Interconnection, L.L.C. and its subsidiaries (the "Company") at December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



Philadelphia, PA

March 11, 2011

### Consolidated Statement of Financial Position

(\$ in thousands)	December 31,	
	2010	2009
<b>Assets</b>		
Current assets:		
Deposits on hand	\$ 744,237	\$ 547,349
Operating cash	87,838	47,665
Receivables	24,911	7,725
Study and interconnection receivables	12,318	16,637
Deferred FERC fees	-	1,338
Prepaid taxes	2,214	9,380
Prepaid expenses	5,377	5,393
Deferred income taxes, net of valuation allowance	7,236	4,649
Note receivable	1,295	1,768
	885,426	641,904
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of \$335,198 and \$314,454	92,446	79,534
Land	1,420	1,420
Projects in development	114,197	90,826
Deferred recovery of pension and postretirement costs	18,219	11,041
Deferred income taxes, net of valuation allowance	15,832	19,625
Note receivable	765	1,660
Other	5,606	1,112
	248,485	205,218
<b>Total assets</b>	<b>\$ 1,133,911</b>	<b>\$ 847,122</b>
<b>Liabilities, paid in capital, retained earnings and accumulated other comprehensive income</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 33,519	\$ 26,862
Member prepayment	100,274	21,510
Study and interconnection payables	16,145	22,869
Accrued payroll and benefits	19,732	19,371
Current portion of long-term debt	13,872	8,103
Deferred FERC fee liability	1,700	-
Deferred regulatory liability	14,185	7,050
Deferred revenue	2,431	1,914
Postretirement healthcare benefits liability	621	442
Other employee benefits	73	346
Deposits	744,237	547,349
	946,789	655,816
Non-current liabilities:		
Long-term debt	86,664	100,537
Deferred regulatory liability	6,000	13,703
Interest rate swap	1,410	131
Pension benefits liability	31,869	29,147
Postretirement healthcare benefits liability	48,919	41,375
Other employee benefits	8,701	3,331
	183,563	188,224
<b>Total liabilities</b>	<b>1,130,352</b>	<b>844,040</b>
Commitments and contingencies (Note 13)		
Paid in capital	722	722
Retained earnings	2,401	1,936
Accumulated other comprehensive income	436	424
<b>Total paid in capital, retained earnings and accumulated other comprehensive income</b>	<b>3,559</b>	<b>3,082</b>
<b>Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income</b>	<b>\$ 1,133,911</b>	<b>\$ 847,122</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statement of Income, Comprehensive Income and Paid in Capital,  
Retained Earnings and Accumulated Other Comprehensive Income**

(\$ in thousands)	For the Years Ended December 31,		
	2010	2009	2008
<b>Income</b>			
Revenue:			
Service fees	\$ 245,352	\$ 228,385	\$ 240,422
Deferred regulatory income	(49,743)	(64,840)	(63,143)
FERC fees reimbursement	44,780	39,590	37,473
Study and interconnection fees	2,559	3,453	2,814
Interest income	796	4,112	20,266
Membership fees	2,209	2,059	1,883
Other income	2,219	2,201	1,631
<b>Total revenue</b>	<b>248,172</b>	<b>214,960</b>	<b>241,346</b>
Expenses:			
Compensation	91,764	89,017	83,971
FERC fees	44,780	39,590	37,473
Outside services	41,493	40,095	40,877
Depreciation and amortization	20,815	18,996	15,181
Software licenses and fees	10,978	9,882	9,119
Computer maintenance and office supplies	8,543	7,979	7,203
Other expenses	8,097	11,174	11,145
Pension benefits	6,962	6,903	4,106
Postretirement healthcare benefits	4,603	5,684	6,564
Lease expenses	2,781	2,826	2,994
Interest expense	2,735	5,637	18,023
Study and interconnection services	2,559	3,453	2,814
<b>Total expenses</b>	<b>246,110</b>	<b>241,236</b>	<b>239,470</b>
Income (loss) before income taxes	2,062	(26,276)	1,876
Income tax expense (benefit)	1,597	(26,964)	1,224
<b>Net income</b>	<b>\$ 465</b>	<b>\$ 688</b>	<b>\$ 652</b>
Other comprehensive income (loss):			
Unrealized gain (loss) on securities, net	12	128	(115)
<b>Comprehensive income, net</b>	<b>\$ 477</b>	<b>\$ 816</b>	<b>\$ 537</b>
<b>Paid in capital, retained earnings and accumulated other comprehensive income</b>			
Beginning balance	\$ 3,082	\$ 2,266	\$ 1,729
Net income	465	688	652
Other comprehensive income (loss)	12	128	(115)
<b>Ending balance</b>	<b>\$ 3,559</b>	<b>\$ 3,082</b>	<b>\$ 2,266</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statement of Cash Flows**

(\$ in thousands)	For the Years Ended December 31,		
	2010	2009	2008
Cash flows from (used in) operating activities:			
Net income	\$ 465	\$ 688	\$ 652
Adjustments:			
Depreciation and amortization expense	20,815	18,996	15,181
Deferred income taxes, net of valuation allowance	1,206	(20,138)	2,033
Deferred recovery of pension and postretirement costs	(7,178)	15,808	(17,925)
Deferred regulatory liability	49,742	64,858	63,143
Employee benefit expense greater than (less than) funding	15,542	(9,314)	23,716
Net fair value changes related to interest rate swap	1,279	131	–
Changes in assets and liabilities:			
(Increase) decrease in receivables	(17,186)	(2,744)	20,528
Decrease (increase) in study and interconnection receivables	4,319	(12,161)	(94)
(Increase) decrease in prepaid expenses and other	(4,537)	(942)	349
Decrease (increase) in deferred FERC fees	1,338	(1,338)	–
Decrease (increase) in prepaid income taxes	7,166	(4,194)	(811)
Increase (decrease) in accounts payable and accrued expenses	8,673	(8,466)	(33,356)
(Decrease) increase in study and interconnection payables	(6,724)	17,043	1,243
Increase in accrued payroll and benefits	361	3,954	2,675
Increase (decrease) in deferred FERC fee liability	1,700	–	(6,133)
Increase in deferred revenue	517	61	175
Refunds to members	(50,310)	(72,770)	(101,414)
Net cash provided by (used in) by operating activities	27,188	(10,528)	(30,038)
Cash flows (used in) investing activities:			
Cost of projects in development	(59,043)	(65,654)	(58,659)
Note receivable	1,368	1,262	(4,690)
Net cash (used in) investing activities	(57,675)	(64,392)	(63,349)
Cash flows from (used in) financing activities:			
Borrowings under line of credit	115,000	269,000	20,000
Repayments under line of credit	(115,000)	(289,000)	–
Repayments of long-term debt	(8,104)	(1,360)	–
Borrowings under long-term debt	–	110,000	–
Repayments under long-term project debt	–	–	(967)
Repayments under non-recourse debt	–	(1,046)	(444)
Member prepayment received	100,274	21,510	44,069
Member prepayment utilized	(21,510)	(44,069)	–
Increase (decrease) in deposits	196,888	(333,947)	312,115
Net cash provided by (used in) financing activities	267,548	(268,912)	374,773
Net increase (decrease) in cash and cash equivalents	237,061	(343,832)	281,386
Cash and cash equivalents balance (including customer deposits), beginning of year	595,014	938,846	657,460
Cash and cash equivalents balance (including customer deposits), end of year	\$ 832,075	\$ 595,014	\$ 938,846
Cash paid during the year for:			
Interest	\$ 5,545	\$ 6,600	\$ 18,051
Taxes	2,102	1,455	1,921
Noncash activity:			
Projects in development additions included in ending Accounts Payable and Accrued Expenses	\$ (2,016)	\$ (3,687)	\$ (1,704)

The accompanying notes are an integral part of these consolidated financial statements.

## Notes to the Consolidated Financial Statements December 31, 2010 (\$ in tables in thousands)

### 1. Company Overview

#### Background

PJM Interconnection, L.L.C. (PJM or Company) is a Regional Transmission Organization (RTO) responsible for the operation of wholesale electric markets and for centrally dispatching electric systems in the PJM region. PJM's services and the markets PJM operates are subject to regulation by the Federal Energy Regulatory Commission (FERC).

PJM is a limited liability, non-stock company incorporated in the state of Delaware. PJM's Board of Managers is constituted as an independent body, and PJM operates independently from its members.

#### Nature of Operations

The Company currently coordinates a pooled generating capacity of more than 164,000 megawatts and operates wholesale electricity markets. More than 660 companies are eligible to transact in the markets PJM administers. PJM enables the delivery of electric power to more than 54 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

PJM manages a sophisticated regional planning process for generation and transmission expansion to ensure continued reliability of the electric system. Using information technology, PJM provides real-time information to market participants to support their daily transactions and business decision-making. In addition to ensuring the reliable supply of electricity, PJM administers Internet-based bid markets in which participants buy and sell day-ahead and spot market energy, financial transmission rights, synchronized reserves and regulation services.

PJM Technologies, Inc. (PJM Tech) is a wholly owned subsidiary of PJM and is not a FERC-regulated entity. PJM Tech was formed to provide service and technology solutions pioneered by PJM to existing and emerging energy markets, system operators and RTOs.

PJM Environmental Information Services, Inc. (PJM EIS) is a wholly owned subsidiary of PJM Tech formed to provide environmental and emissions attributes reporting and tracking services to its subscribers in support of renewable portfolio standards and other disclosure requirements that may be implemented by governmental agencies. PJM EIS is not a FERC-regulated entity.

PJM EnviroTrade, Inc. (PJM EnviroTrade) is a wholly owned subsidiary of PJM Tech formed to provide an auction platform for trading solar renewable energy certificates across several states in the mid-Atlantic region. PJM EnviroTrade ran its first auction on July 6, 2010. PJM EnviroTrade is not a FERC-regulated entity.

During 2010, PJM filed with the FERC to create a new subsidiary to handle all of the credit, billing and settlement functions for PJM's members' transactions in the PJM markets and for transmission service. PJM received approval from the FERC on December 30, 2010 to begin operation of PJM Settlement, Inc. on January 1, 2011. PJM Settlement, Inc. is a Pennsylvania nonprofit corporation and is a FERC-regulated entity. As of January 1, 2011, PJM Settlement, Inc. acts as counterparty to members' pool transactions in the PJM markets for transmission service. For the pool transactions in the PJM market, flash title passes to PJM Settlement, Inc. at market clearing. This provides PJM the authority to continue to net a member's offsetting financial positions in PJM markets and also complies with the FERC guidance on credit policy requirements for grid operators.

### Tariff Cost Recovery

PJM recovers its administrative costs under its stated rate tariff effective June 1, 2006. The stated rate tariff has three elements.

The first component is a composite rate. PJM's Open Access Transmission Tariff (Tariff) establishes a four-step rate structure. Beginning June 1, 2007, the composite rate was 32 cents per megawatt-hour (MWh); beginning January 1, 2008, 31 cents per MWh; and beginning January 1, 2011, 30 cents per MWh.

The second element is a rider for the Advanced Second Control Center (AC<sup>2</sup>). The tariff establishes a specific mechanism for PJM to collect from its customers the actual costs to construct and operate AC<sup>2</sup>. The recovery of those costs is from a formula rate set forth in a separate schedule in the Tariff. The recovery is capped at the capitalized investment costs and operating costs of AC<sup>2</sup>. The rider will remain in effect until seven years from the in-service date of the AC<sup>2</sup> energy management system, which is projected to be during 2011. From June 2008 through December 2010, PJM placed into service certain assets at the AC<sup>2</sup> facility. PJM began to recover costs under this rider in July 2008. During 2010 and 2009, \$9.3 million and \$5.3 million were billed under this rider, respectively.

The third component provides for accumulation of a financial reserve and subsequent refunds to PJM's members, if applicable. See further discussion in Note 2.

PJM has the right to file with the FERC for prospective changes to these rates at any time, if necessary.

### Market Integrations

On August 17, 2009, FirstEnergy Service Company, on behalf of American Transmission Systems, Inc. (ATSI), its transmission affiliate, filed with the FERC to withdraw its transmission assets from the Midwest Independent System Operator (Midwest ISO) and to place them into PJM as of June 1, 2011. In addition to its ATSI transmission assets, the filing includes the ATSI Utilities, namely The Cleveland Electric Illuminating Company, Ohio Edison Company, The Toledo Edison Company, and Pennsylvania Power Company, as well as the generation affiliate FirstEnergy Solutions. The FERC approved this filing on December 17, 2009.

On June 25, 2010, Duke Energy Ohio, Inc. and Duke Energy Kentucky, Inc., subsidiaries of Duke Energy Corporation, filed with the FERC to withdraw their transmission assets from the Midwest ISO and to place them into PJM as of January 1, 2012. In addition to the Duke Ohio and Duke Kentucky transmission assets, the filing includes the integration of certain Duke-owned and jointly owned generation assets. The FERC approved this filing on October 21, 2010.

PJM is working with all of the companies listed above and interested stakeholders to ensure that these integrations are accomplished safely and reliably in accordance with all reliability standards and market rules.

## 2. Summary of Significant Accounting Policies and Selected Financial Information

### Basis of Presentation

The accompanying consolidated financial statements have been prepared on an accrual basis in accordance with generally accepted accounting principles (GAAP) and include the accounts of PJM Interconnection, L.L.C. and its wholly owned subsidiaries (collectively referred to herein as PJM or the Company). All intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. These estimates are based on management's best knowledge of current events and actions the Company may undertake in the future. Actual results may ultimately differ from estimates.

In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance intended to improve disclosures about fair value measurements. The guidance requires entities to disclose significant transfers in and out of fair value hierarchy levels and the reasons for the transfers and to present information about purchases, sales, issuances and settlements separately in the reconciliation of fair value measurements using significant unobservable inputs (Level 3). Additionally, the guidance clarifies that a reporting entity should provide fair value measurements for each class of assets and liabilities and disclose the inputs and valuation techniques used for fair value measurements using significant other observable inputs (Level 2) and significant unobservable inputs (Level 3). This guidance was effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the Level 3 reconciliation, which is effective for interim and annual periods beginning after December 15, 2010. As this guidance provided only disclosure requirements, the adoption of this standard did not impact the Company's results of operations, cash flows or financial positions.

PJM has performed an evaluation of subsequent events through March 11, 2011, which is the date the financial statements were issued.

### Study and Interconnection Activity

Under the Tariff, PJM's transmission provider role is to direct the operation and coordinate the maintenance of the transmission system and indicate, based on studies conducted by PJM, necessary enhancements or modifications to the transmission system. The modifications that are performed on the transmission system, such as network upgrades and generation additions, are conducted principally by third-party vendors at the request of transmission customers. In its system planning capacity as transmission service provider, PJM provides billing and collection services in the interconnection service agreement process. Billings and collections by PJM for work it performs as an agent for the counterparties to the specific interconnection agreements are reported on a net basis in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

### Cash Equivalents

Highly liquid investments with maturities of three months or less when purchased are considered cash equivalents.

### Concentration of Credit Risk

Financial instruments that subject PJM to credit risk consist primarily of accounts receivable relating to monthly operating expense billings. As provided in PJM's Operating Agreement, members are required to maintain either approved credit ratings or to post specified financial security to obtain credit within the PJM markets. During 2010 and 2009, approximately 70 percent of PJM's operating expenses were billed to 22 of its 660 members and 17 of its 564 members, respectively, each of which either has an investment-grade credit rating according to at least one of the three major rating services or has provided a guaranty from an affiliate with an investment-grade rating.

Under the terms of the PJM Operating Agreement, any payment defaults may be billed and collected from PJM's other member companies.

### Fixed Assets

PJM's fixed assets are comprised principally of software and capitalized software development costs, leasehold improvements, computer hardware, and buildings. The costs incurred to acquire and develop computer software for internal use, including financing costs, are capitalized. However, costs incurred prior to the determination of feasibility of developed software and costs incurred following the in-service date of developed software are expensed. Fixed assets are depreciated or amortized using the straight-line method over the useful lives of the assets as follows:

Software and capitalized software development costs	3 to 10 years
Computer hardware	3 to 5 years
Leasehold improvements	10 years
Furniture and fixtures	10 years
Buildings	25 years
Vehicles	5 years

### Deferred Recovery of Pension and Postretirement Costs

The Company recognizes the underfunded projected benefit obligation (PBO) of its defined benefit pension plan as a liability in the balance sheet. The PBO represents the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future salary increases. In addition to recording the underfunded PBO as a liability, PJM has recorded a regulatory asset pursuant to FASB guidance on accounting for the effects of certain types of regulation Accounting Standards Codification (ASC 980) to reflect the anticipated future recovery of the amounts to be funded in the future through the Company's rate structure. This regulatory asset, which will be amortized each quarter as the net periodic benefit cost of the underfunded liability is recognized, was \$18.2 million and \$11.0 million, at December 31, 2010 and 2009, respectively.

### Deferred FERC Fees and Deferred FERC Fee Liability

The FERC charges an annual assessment to all public utilities based on kilowatt-hours of interstate transmission service provided. PJM recovers from its members the annual charges from the FERC. At December 31, 2010, PJM had a \$1.7 million deferred FERC fee liability. This liability represents the difference between amounts collected from PJM members and amounts ultimately assessed by the FERC and is a factor considered in determining the FERC fee charges billed to PJM members during the subsequent year.

At December 31, 2009, PJM had a \$1.3 million deferred FERC fee asset that resulted from under-collections during 2009 and was reflected in amounts billed to PJM's members during 2010.

### Deferred Regulatory Liability

PJM recovers as service fees its administrative costs under its stated rate tariff.

The stated rate tariff provides for the accumulation of a financial reserve. PJM is permitted to maintain a reserve as a deferred regulatory liability in an amount up to six percent of its annual service fee revenues, less the expenses incurred under the AC<sup>2</sup> rider. The amount accumulated under those provisions is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. As the stated rate tariff was originally filed for the years 2006 through 2010, to the extent that such deferred regulatory liability exceeded six percent of PJM's revenues during any calendar year, PJM was to and did until 2008 refund such excess ratably over a nine-month period commencing April 1 of the following year. Refunds in any year were to be limited to amounts that would not reduce the regulatory liability balance below an amount equal to six percent of revenues collected in the previous year.

On January 31, 2008, PJM filed with the FERC a proposal to accelerate the stated rate refund mechanism for deferred regulatory liabilities accumulating in 2008 and forward. The FERC approved this proposal on March 12, 2008, with an effective date of April 1, 2008. PJM now refunds on a quarterly basis the deferred regulatory liability balance in excess of six percent of the annual revenue threshold. The quarterly refund rate is established after the financial close of each quarter, and refunds are distributed to the members on a prospective basis in the following quarter. For the three-month and 12-month periods ended December 31, 2010, PJM made refunds of \$20.3 million and \$50.3 million, respectively. In 2011 and every third year thereafter, refunds will reduce the non-current liability balance to \$6 million.

In accordance with the authoritative guidance for Regulatory Accounting (ASC 980), PJM recognizes deferred regulatory income or expense in the revenue section of the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income for the amount by which revenues pursuant to the stated rate tariff exceed expenses in the reporting period. The amount by which cumulative revenues under the stated rate tariff exceed cumulative expenses and stated rate refunds is reported as a deferred regulatory liability in the Consolidated Statement of Financial Position. Should there be periods in which revenues are less than expenses, PJM will reduce the deferred regulatory liability with an offset to deferred regulatory income.

At December 31, 2010, the deferred regulatory liability was \$20.2 million. At December 31, 2009, the deferred regulatory liability was \$20.8 million. At December 31, 2010 and December 31, 2009, the current portion of the deferred regulatory liability was \$14.2 million and \$7.1 million, respectively. The current balance at December 31, 2010, represents the amount to be refunded to members during the first quarter of 2011. The non-current portion of the deferred regulatory liability of \$6.0 million and \$13.7 million, respectively, represents the amount of PJM's reserve at December 31, 2010 and December 31, 2009.

### Deferred Revenue

PJM membership fees, billed and collected in advance of the year for which they apply, are amortized equally over the related annual membership period.

### Deposits

At December 31, 2010, the deposits balance was comprised of \$60.2 million received for study and interconnection fees and \$684.0 million held by PJM to support customer credit. At the end of 2009, PJM held deposits of \$53.7 million for study and interconnection fees and \$493.6 million for customer credit. These deposits are maintained in separate cash accounts that are not legally restricted.

## Income Taxes

PJM has elected to be taxed as a corporation for both federal and state income tax purposes. PJM and its subsidiaries file a consolidated federal income tax return. The Consolidated Financial Statements include prepaid income taxes, accrued income taxes and deferred income taxes. Prepaid income taxes relate to federal and state overpayments on deposit with taxing authorities. These overpayments will be applied to future federal and state income tax liabilities. Deferred income tax assets represent the temporary differences between the Company's financial statement basis and tax basis in existing assets and liabilities measured using presently enacted tax rates. A valuation allowance has been provided against certain deferred tax assets in which Management has concluded it is more likely than not the Company will be unable to recognize the income tax benefit associated with those future tax deductions.

Accounting for uncertainty in income taxes (ASC 740) requires the impact of a tax position be recognized if that position is more likely than not of being sustained upon examination by tax authorities, based on the technical merits of the position. This applies to all income tax positions taken on previously filed tax returns or expected to be taken on a future tax return. The pronouncement prescribes a benefit recognition model with a two-step approach; a more-likely-than-not recognition criterion; and a measurement attribute that measures the position as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon effective settlement.

## Fair Values of Financial Instruments

The carrying amounts reported in the Consolidated Statement of Financial Position for current financial assets and liabilities generally approximate their fair values.

## Benefit Plan Accounting

PJM accrues the costs of providing future employee benefits in accordance with the guidance of Employers' Accounting for Pensions and Postretirement Benefits Other than Pensions (ASC 715). Under this guidance, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Delayed recognition of differences between actual results and those assumed is a guiding principle of these standards. This approach allows for a relatively even recognition of changes in benefit obligations and plan performance over the working lives of the employees who benefit under the plans.

In addition to requiring employers to recognize the overfunded or underfunded PBO of a defined benefit pension plan as an asset or liability in the balance sheet, the FASB guidance also requires employers to recognize annual changes in gains or losses, prior service costs, or other credits that have not been recognized as a part of the liability in the Consolidated Statement of Financial Position. The Company adopted the FASB guidance, which establishes a new framework for accounting for Deferred Benefit Pension and Postretirement Plans. FASB guidance on Regulated Operations (ASC 980) requires that a corresponding regulatory asset, Deferred Pension and Postretirement Costs, be included in the Consolidated Statement of Financial Position.

PJM's selection of the discount rate, healthcare cost trend rate and expected rate of return on pension assets is based on its review of available current, historical and projected rates, as applicable.

## Derivatives

PJM currently has one interest rate swap that qualifies as a derivative instrument. The Company accounts for this derivative in accordance with authoritative guidance on Derivative Instruments and Hedging Activities (ASC 815), which requires that it be recognized as either an asset or liability at fair value in the Consolidated Statement of Financial Position with changes in fair value recorded through earnings. Refer to Note 9 for additional details related to PJM's interest rate swap.

## Revenue Recognition

PJM recognizes as revenue amounts billed and unbilled under PJM's stated rate tariff.

Revenues recorded as study and interconnection fees arise from billing and collection services in the interconnection service agreement process performed by PJM. These revenues are offset directly by the corresponding interconnection expenses.

PJM EIS recognizes as revenues amounts both billed and unbilled for the customers of the Generation Attributes Tracking System (GATS).

PJM EnviroTrade recognizes as revenues amounts billed for customers of the solar renewable energy auction.

**3. Accounts Receivable**

PJM's receivables at December 31, 2010 and 2009 consisted of the following:

	2010	2009
<b>Billed:</b>		
Membership fees	\$ 258	\$ 168
PJM EIS	415	514
	673	682
<b>Unbilled:</b>		
Service fees	24,103	6,923
PJM EIS	135	120
	24,238	7,043
	\$ 24,911	\$ 7,725

PJM's member companies are billed on a monthly basis for recovery of PJM's administrative costs under the Tariff. PJM bills members for services under eight distinct service categories and the AC<sup>2</sup> rider.

All study and interconnection receivables were billed at December 31, 2010 and 2009.

**4. Fixed Assets**

A summary of fixed assets by classification as of December 31, 2010 and 2009 follows:

	2010	2009
Buildings	\$ 18,812	\$ 18,812
Leasehold improvements	36,333	32,348
Software development	295,204	275,688
Computer hardware	76,487	66,372
Furniture and fixtures	768	768
Vehicles	40	-
Sub-total	427,644	393,988
Accumulated depreciation and amortization	(335,198)	(314,454)
Total fixed assets, net of accumulated depreciation and amortization	\$ 92,446	\$ 79,534

Amortization of software development costs for the years ended December 31, 2010 and 2009, were \$13.4 million and \$11.8 million, respectively.

Total interest costs incurred for the year ended December 31, 2010, were \$5.5 million of which \$2.8 million attributable to assets under construction was capitalized.

Total interest costs incurred for the year ended December 31, 2009, were \$7.4 million of which \$1.8 million attributable to assets under construction was capitalized.

## 5. Note Receivable

On March 21, 2008, the FERC approved the settlement to restructure the relationship between PJM and PJM's former Market Monitoring Unit (MMU). As part of the settlement, the MMU and its functions transitioned from being an internal PJM department to an external firm, Monitoring Analytics, LLC (MA). MA operates independent of PJM management and Board of Managers oversight. In order to facilitate the externalization of this function and as part of the settlement agreement approved by the FERC, PJM entered into a loan agreement on March 14, 2008, with MA. The purpose of the loan is to fund capital needs associated with MA's initial technology systems and working capital needs related to MA's responsibilities per Attachment M of the Tariff to monitor the markets administered by PJM. The loan is secured by MA's accounts receivable and future collections of accounts receivable. The loan matures no later than 80 months from the date that MA begins providing services to PJM pursuant to the Market Monitor Services Agreement, which was effective August 1, 2008. At December 31, 2010 and December 31, 2009, the outstanding balance due from MA recorded by PJM as a note receivable was \$2.1 million and \$3.4 million, respectively. At December 31, 2010 and December 31, 2009, the current portion of the note receivable was \$1.3 million and \$1.7 million, respectively. The current balance at December 31, 2010 represents the amount to be paid to PJM during 2011. The non-current portion of the note receivable is \$0.8 million and \$1.7 million at December 31, 2010 and December 31, 2009, respectively.

## 6. Short-Term Debt

PJM has a \$50 million revolving credit agreement with National Cooperative Services Corporation (NCSC). The revolving credit agreement has a five-year term and will expire in April 2011. The facility is unsecured and is available to fund short-term cash obligations. The FERC approval for borrowings under this facility must be requested biennially.

Under the loan covenants for the \$50 million revolving credit agreement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2010.

At December 31, 2010 and December 31, 2009, there were no outstanding borrowings under the revolving credit agreement. The interest rate on borrowings under this revolving credit agreement is based on NCSC's variable interest rate. This variable interest rate can change effective the first or 16th of any month. At December 31, 2010 and 2009, the interest rate was 6.05 percent.

During December 2010, PJM filed with the FERC to enter into a revolving line of credit agreement for \$65 million with a commercial bank. On January 31, 2011, the FERC approved PJM's application to enter into this new revolving line of credit agreement. This facility will replace the Company's current revolving line of credit agreement and the project development facility discussed in Note 7.

## 7. Long-Term Debt

### *NCSC Project Development Facility*

PJM has a \$110 million project development facility with NCSC. This facility is available for asset development and has a four-year drawdown period and a 10-year amortization period. The drawdown period under the long-term project development facility will expire in April 2011. The FERC approval for borrowings under this facility must be requested biennially. The facility is collateralized by all of PJM's tangible and intangible property other than the assets acquired pursuant to an agreement (the Facilities Agreement) between PJM and a subset of PJM's members (the Facility Owners).

Under the loan agreement for the \$110 million project development facility, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2010. As of December 31, 2010 and December 31, 2009, there were no outstanding borrowings under this facility. The interest rate on borrowings under this project development facility is based on NCSC's variable interest rate. The variable interest rate can change effective the first or 16th of any month. At December 31, 2010 and December 31, 2009, the interest rate was 6.05 percent.

***PNC Bank Loan Agreement***

On March 31, 2009, the FERC approved PJM's application to enter into a \$35 million loan agreement with PNC Bank (PNC). The loan has a seven-year term and is secured by the AC<sup>2</sup> property. The closing on this facility occurred on April 30, 2009. PJM incurred a total of \$0.2 million in closing costs to obtain this financing. These costs were capitalized and are being amortized on a straight-line basis over the seven-year term of the loan.

As of December 31, 2010 and December 31, 2009, outstanding borrowings under this loan were \$31.3 million and \$33.6 million, respectively. The interest rate is based on the London Interbank Offered Rate (LIBOR) in effect at each reset date plus a spread of 135 basis points. The reset date is monthly. As of December 31, 2010 and December 31, 2009, the interest rate was 1.6075 and 1.585 percent, respectively.

Under the loan agreement for the \$35 million loan, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of December 31, 2010.

Repayments of principal under the PNC Bank Loan Agreement are scheduled as follows:

<b>Year Ending December 31,</b>	
2011	\$ 2,333
2012	2,333
2013	2,333
2014	2,333
2015	2,333
2016	19,641
<b>Total</b>	<b>\$ 31,306</b>

***Private Placement Loan Agreement***

On March 28, 2008, the FERC approved PJM's application to borrow up to \$115 million under a private placement master note agreement. On September 15, 2009, PJM issued senior unsecured notes with a seven-year term totaling \$75 million. These notes bear interest at 3.60 percent per annum. Payments are due semi-annually on March 15 and September 15 with the first principal payment made on September 15, 2010. The notes mature on September 15, 2016. PJM incurred a total of \$0.3 million in closing costs to obtain this financing. These costs were capitalized and are being amortized on a straight-line basis over the seven-year term of the notes.

On April 2, 2010, the FERC approved PJM's application to utilize the remaining \$40 million under the private placement master note agreement, if needed.

As of December 31, 2010 and December 31, 2009, outstanding borrowings under the private placement were \$69.2 million and \$75 million, respectively. Under the loan agreement for the \$75 million private placement, PJM is required to meet certain non-financial covenants. PJM was in compliance with these covenants as of December 31, 2010.

Repayments of principal under the Private Placement Loan Agreement are scheduled as follows:

<b>Year Ending December 31,</b>	
2011	\$ 11,539
2012	11,538
2013	11,538
2014	11,538
2015	11,538
2016	11,539
<b>Total</b>	<b>\$ 69,230</b>

## 8. Non-Recourse Debt

On March 24, 2005, PJM EIS entered into a seven-year term loan for up to \$2.2 million with the New Jersey Board of Public Utilities. The loan was established to fund the GATS, which assists subscribers in tracking various data associated with promoting and advancing energy efficiency and renewable energy programs. Seven equal payments were due annually commencing October 1, 2006. The loan was comprised of a term loan for \$1.6 million for the capital costs of GATS and a \$0.6 million revolver to fund EIS' operating needs. The interest rate on the outstanding principal was fixed at 3.00 percent per year.

This loan was paid in full on December 18, 2009.

## 9. Derivative Financial Instrument

The Company is exposed to certain risks relating to ongoing business operations, including the effect of changes in interest rates. PJM manages interest rate risk on a portion of its variable rate debt using an interest rate swap, which is a derivative financial instrument. PJM accounts for its derivative activity in accordance with the derivative accounting guidance issued by the FASB (ASC 815). This guidance requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the Consolidated Statement of Financial Position.

To manage interest rate risk associated with the \$35 million loan agreement with PNC, the Company entered into an interest rate swap agreement with PNC on May 1, 2009. This interest rate swap agreement effectively fixes the interest payments on the Company's floating rate debt instrument at a rate of 4.45 percent through April 30, 2016. The term of the interest rate swap matches the term of the loan. While PJM has entered into an economic hedge of its interest rate, the Company has not elected to designate this instrument as a cash flow or fair value hedge for accounting purposes. Accordingly, the interest rate swap is carried at fair value in the Consolidated Statement of Financial Condition with changes in fair value recorded through earnings. At December 31, 2010 and December 31, 2009, the fair value of the swap of \$1.4 million and \$0.1 million, respectively, was reported as an interest rate swap in the non-current liability section of the Consolidated Statement of Financial Position. For the year ended December 31, 2010 and December 31, 2009, the unrealized loss of \$1.3 million and \$0.1 million, respectively, was recorded as interest expense in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income, respectively.

For the year ended December 31, 2010 and December 31, 2009, the amount of the derivative losses PJM recognized in earnings is provided in the table below:

	Year ended December 31, 2010	Year ended December 31, 2009
Unrealized mark-to-market losses	(\$ 1,279)	(\$ 131)
Total net mark-to-market losses	(\$ 1,279)	(\$ 131)

The Company does not hold or issue financial instruments for speculative or trading purposes.

## 10. Fair Value Disclosures

Effective January 1, 2008, PJM adopted the FASB guidance that established a framework for measuring fair value and expanded the required disclosures about fair value instruments (ASC 820).

Under this 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). In determining fair values, PJM 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. The authoritative guidance pertaining to fair value 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 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy defined by this guidance are 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 pricing data. Level 2 also includes those financial instruments that are valued using internally developed 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, 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.

PJM does not have any instruments valued based on Level 3 pricing inputs.

PJM utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. PJM is able to classify fair value balances based on the observability of the inputs. In accordance with the authoritative guidance, financial assets and liabilities are classified in their entirety based on the lowest level of observability for an input that is significant to the fair value measurement. PJM'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. At December 31, 2010, those financial assets and liabilities measured at fair value using Level 1 inputs were deposits on hand, operating cash and short-term debt. PJM's interest rate swap agreement associated with the loan from PNC of \$35 million was accounted for at fair value on a recurring basis based on Level 2 inputs within the fair value hierarchy.

## 11. Income Taxes

Income tax expense shown on the Consolidated Statement of Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income consisted of the following:

Year ended December 31,	2010	2009	2008
Federal income taxes:			
Current	\$ 290	\$ (7,121)	\$ (3,010)
Deferred	304	(1,669)	4,605
Valuation allowance	16	(13,894)	(384)
	610	(22,684)	1,211
State income taxes:			
Current	131	383	(1,673)
Deferred	205	(3,190)	1,982
Valuation allowance	651	(1,473)	(296)
	987	(4,280)	13
<b>Income tax expense (benefit)</b>	<b>\$ 1,597</b>	<b>\$(26,964)</b>	<b>\$ 1,224</b>

As discussed in Note 12, during 2009, PJM revised the Other Post Retirement Benefits (OPEB) Plan to limit the amount of benefit employees will receive in the future as well as closing the Plan to new hires beginning January 1, 2010. Along with the revisions in benefits, PJM will begin funding future benefits through a 401(h) plan. Due to these changes, PJM reassessed the recoverability of certain deferred tax assets related to OPEB. Management concluded it was more likely than not the income tax benefit related to these future tax deductions would be realized and therefore released the valuation allowance previously established. Similarly, PJM released the valuation allowance associated with the Supplemental Executive Retirement Plan (SERP) because Management believes it is more likely than not deferred tax assets will be realized in the future. Consistent with the prior year, Management has concluded it is more likely than not due to enacted statutory restrictions that certain Pennsylvania net operating loss carry-forwards will expire before being utilized and, therefore, the Company continues to record a valuation allowance against these deferred tax assets and certain other deferred tax assets with an indefinite future reversal period.

The effects of temporary differences giving rise to deferred income tax assets at December 31, 2010 and 2009, consisted of the following:

	2010	2009
<b>Deferred tax liabilities:</b>		
Fixed assets	\$ (14,375)	\$ (10,969)
Deferred pension and postretirement costs	(7,516)	(4,482)
	(21,891)	(15,451)
<b>Deferred tax assets:</b>		
Pension	14,506	13,285
Postretirement healthcare	20,110	16,975
Deferred regulatory liability	2,435	5,562
Net operating loss carryforwards	7,640	4,620
Accrued expenses	6,233	4,802
	50,924	45,244
Net deferred income tax assets	29,033	29,793
Valuation allowance	(5,965)	(5,519)
<b>Deferred income tax assets, net</b>	<b>\$ 23,068</b>	<b>\$ 24,274</b>

The income tax rate on PJM's operating activities differed from the federal statutory rate as follows:

Year ended December 31,	2010	2009	2008
Income tax (benefit) at the federal statutory rate	\$ 701	\$ (8,934)	\$ 638
Increase (decrease) resulting from:			
Change in valuation allowance	16	(14,395)	150
Meals and entertainment	142	154	175
State income taxes, net of federal tax benefit	651	(2,824)	20
Other	87	(965)	241
<b>Income tax expense (benefit)</b>	<b>\$ 1,597</b>	<b>\$ (26,964)</b>	<b>\$ 1,224</b>

PJM has net operating loss carryforwards of \$77.2 million for Pennsylvania state tax purposes that begin expiring in 2021. PJM also has federal net operating loss carryforwards of \$6.1 million.

As of December 31, 2010, PJM has not recorded a (ASC 740) liability or receivable related to an uncertain income tax position.

PJM and its subsidiary file a U.S. consolidated federal income tax return and separate company tax returns in the state of Pennsylvania. The statute of limitations is in effect for tax years prior to 2007 for federal purposes and state purposes. There are no ongoing audits at this time.

## 12. Benefit Plans

### *Pension Plan*

PJM sponsors a defined benefit pension plan (the plan) that covers all regular full-time employees and part-time employees. Benefits under the plan are based on years of service and the employee's compensation. PJM's funding of the plan is determined according to the funding requirements set forth by the Employee Retirement Income Security Act of 1974 (ERISA). Plan assets are invested primarily in stocks and bonds and are monitored by PJM's Benefits Administration Committee.

### *Supplemental Executive Retirement Plan*

PJM also sponsors a SERP to provide certain members of senior management with benefits in excess of normal pension benefits. At December 31, 2010 and 2009, the actuarially computed benefit obligation of the SERP included in the other employee benefits liability amounted to \$3.9 million and \$3.6 million, respectively. Pension expense for this plan was \$0.6 million, \$0.5 million and \$0.4 million for each of the years ended December 31, 2010, 2009 and 2008, respectively. The SERP is not funded. However, PJM invested \$1.0 million in equity securities in January 2003 with the intention to use the proceeds to offset future obligations under the SERP. The investment is included in other non-current assets at its market value of \$0.7 million as of December 31, 2010, and \$1.0 million as of December 31, 2009.

**Deferred Compensation Plan**

PJM also sponsors a Deferred Compensation Plan to provide certain members of senior management the opportunity to defer a portion or all of their salary. At December 31, 2010 and 2009, the value of this employee liability amounted to \$4.9 million and \$4.3 million, respectively.

**Postretirement Benefits**

On June 24, 2009, the PJM Board of Managers approved changes to the Company's OPEB Plan. The OPEB Plan provides certain healthcare and other benefits to retired employees and their spouses and dependents. The revisions to the OPEB Plan were for post-65 medical coverage. The amount of benefit at retirement will henceforth be dependent upon the employee's age and years of service as of January 1, 2016. The OPEB Plan was closed to new hires as of January 1, 2010.

A revaluation of the OPEB Plan occurred on June 30, 2009. The underlying assumptions were reviewed at revaluation and the discount rate was changed to 6.20 percent at this revaluation date. The impact of the plan changes and assumptions was a reduction of \$11.3 million in the OPEB liability and related deferred pension and postretirement costs, which was recorded during the second quarter of 2009.

The schedules that follow show the changes in the benefit obligations, plan assets and funded status as of December 31, 2010 and 2009, and components of net periodic pension and postretirement healthcare costs of these plans for the years ended December 31, 2010, 2009 and 2008.

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2010	2009	As of December 31, 2010	2009	2010	2009
<b>CHANGE IN BENEFIT OBLIGATION</b>						
Net benefit obligation at beginning of year	\$ 85,694	\$ 74,915	\$ 3,580	\$ 2,697	\$ 41,817	\$ 50,761
Service cost	5,265	4,428	179	175	3,466	3,880
Interest cost	5,189	4,653	219	188	2,602	2,855
Plan participants' contributions	-	-	-	-	155	105
Plan amendments	-	-	-	112	-	(10,732)
Actuarial loss/(gain)	7,967	6,425	233	481	3,789	(4,505)
Gross benefits paid	(1,869)	(4,727)	(345)	(73)	(776)	(547)
<b>Net obligation at end of year</b>	<b>\$ 102,246</b>	<b>\$ 85,694</b>	<b>\$ 3,866</b>	<b>\$ 3,580</b>	<b>\$ 51,053</b>	<b>\$ 41,817</b>

PJM uses a measurement date of December 31 for all of its pension and postretirement benefit plans.

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31, 2010	2009	As of December 31, 2010	2009	2010	2009
<b>CHANGE IN PLAN ASSETS</b>						
Fair value of plan assets at beginning of year	\$ 56,547	\$ 44,537	\$ -	\$ -	\$ -	\$ -
Actual return on plan assets	8,699	9,737	-	-	13	-
Employer contributions	7,000	7,000	345	73	2,121	442
Plan participants' contributions	-	-	-	-	155	105
Gross benefits paid	(1,869)	(4,727)	(345)	(73)	(776)	(547)
Fair value of plan assets at end of year	70,377	56,547	-	-	1,513	-
Funded status at end of year	(31,869)	(29,147)	(3,866)	(3,580)	(49,540)	(41,817)
Unrecognized net actuarial loss	-	-	-	-	-	-
Unrecognized prior service cost	-	-	-	-	-	-
Unrecognized net transition obligation	-	-	-	-	-	-
<b>Net amount recognized at end of year and amounts recognized in the statement of financial position</b>	<b>\$ (31,869)</b>	<b>\$ (29,147)</b>	<b>\$ (3,866)</b>	<b>\$ (3,580)</b>	<b>\$ (49,540)</b>	<b>\$ (41,817)</b>

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31,		As of December 31,		2010	2009
	2010	2009	2010	2009	2010	2009
<b>AMOUNTS RECOGNIZED IN DEFERRED PENSION AND POSTRETIREMENT COSTS:</b>						
Net actuarial loss	\$ 24,355	\$ 21,801	\$ 681	\$ 455	\$ 1,953	\$ (1,823)
Prior service cost	(245)	(292)	424	587	(8,949)	(9,687)
Transition obligation		-	-	-	-	-
<b>Total</b>	<b>\$ 24,110</b>	<b>\$ 21,509</b>	<b>\$ 1,105</b>	<b>\$ 1,042</b>	<b>\$ (6,996)</b>	<b>\$ (11,510)</b>

	Pension Benefits				Other Postretirement Benefits	
	Qualified		SERP		As of December 31,	
	As of December 31,		As of December 31,		2010	2009
	2010	2009	2010	2009	2010	2009
Amounts recognized in the statement of financial position consist of:						
Current liability	\$ -	\$ -	\$ (73)	\$ (346)	\$ (621)	\$ (442)
Noncurrent liability	(31,869)	(29,147)	(3,793)	(3,234)	(48,919)	(41,375)
Accrued benefit cost	-	-	-	-	-	-
Additional minimum liability	-	-	-	-	-	-
Intangible asset	-	-	-	-	-	-
<b>Net amount recognized at end of year</b>	<b>\$ (31,869)</b>	<b>\$ (29,147)</b>	<b>\$ (3,866)</b>	<b>\$ (3,580)</b>	<b>\$ (49,540)</b>	<b>\$ (41,817)</b>

At the end of 2010 and 2009, the projected benefit obligation, the accumulated benefit obligation and the fair value of plan assets for all of PJM's pension and postretirement benefit plans are as follows:

	Qualified		SERP		Other Postretirement Benefits	
	2010	2009	2010	2009	2010	2009
<b>End of Year</b>						
Projected benefit obligation	\$102,246	\$ 85,694	\$ 3,866	\$ 3,580	\$ 49,540	\$ 41,817
Accumulated benefit obligation	74,956	63,078	2,459	2,598	51,053	41,817
Fair value of plan assets	70,377	56,547	-	-	1,513	-

Expected Cash Flows

Information about expected cash flows for the pension and postretirement benefit plans follows (amounts in thousands):

	Qualified Benefits	SERP Benefits	Other Postretirement Benefits
<b>Employer Contributions</b>			
Expected employer contributions for 2011 to plan trusts	\$ 4,000	N/A	\$ 1,500
Expected employer contributions in form of direct benefit payments for 2011	–	\$ 77	\$ 1,331
<b>Expected Benefit Payments</b>			
2011	4,208	77	1,331
2012	4,289	77	1,509
2013	4,935	76	1,702
2014	3,891	76	1,884
2015	4,494	1,379	2,015
2016-2020	29,869	879	14,238

The above table reflects the benefits expected to be paid from the plan or from PJM's assets for PJM's share of the benefit cost. The participants' share of the cost, which is funded by participant contributions to the plan, is not included in this table. Expected contributions to plan trusts reflect expected amounts to be contributed to the fund.

	Pension Benefits						Other Postretirement Benefits		
	Qualified			SERP			As of December 31,		
	As of December 31,			As of December 31,			As of December 31,		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
<b>COMPONENTS OF NET PERIODIC BENEFIT COST</b>									
Service cost	\$ 5,265	\$ 4,427	\$ 4,339	\$ 179	\$ 175	\$ 176	\$ 3,465	\$ 3,880	\$ 4,234
Interest cost	5,189	4,653	4,381	219	188	173	2,602	2,855	2,933
Expected return on assets	(4,315)	(3,291)	(4,290)	–	–	–	–	–	–
Amortization of:									
transition obligation (asset)	–	–	–	–	4	4	–	19	38
Prior service cost	(47)	(47)	(47)	163	140	50	(737)	(349)	39
Actuarial loss	1,029	1,376	–	7	–	–	–	–	–
<b>Total net periodic benefit cost</b>	<b>\$ 7,121</b>	<b>\$ 7,118</b>	<b>\$ 4,383</b>	<b>\$ 568</b>	<b>\$ 507</b>	<b>\$ 403</b>	<b>\$ 5,330</b>	<b>\$ 6,405</b>	<b>\$ 7,244</b>

For each of the years ended December 31, 2010, 2009 and 2008, \$1.4 million of total pension and postretirement benefits expense were included in capitalized project costs.

The following schedule shows the assumptions used to calculate the pension and postretirement benefit obligations for the years ended December 31, 2010, 2009 and 2008.

	Pension Benefits			Postretirement Benefits		
	2010	2009	2008	2010	2009	2008
Discount rate	5.90%	6.10%	6.20%	5.90%	6.30%	6.20%
Expected return on plan assets	7.50%	7.50%	7.75%	N/A	N/A	N/A
Rate of compensation increase	4.50%	4.50%	5.00%	N/A	N/A	N/A
Medical care cost trend rate						
Current				8.50%	9.25%	10.00%
Ultimate				5.00%	5.00%	5.00%
Years to ultimate				7	6	7

The effect of a 1 percent increase in the assumed healthcare cost trend rate from 8.50 percent to 9.50 percent would increase the postretirement benefit obligation as of December 31, 2010 by \$10.5 million and the current year postretirement benefit cost by approximately \$1.3 million. A 1 percent decrease in the assumed healthcare cost trend rate from 8.50 percent to 7.50 percent would decrease the accumulated postretirement benefit obligation by approximately \$8.2 million and would decrease the postretirement benefit cost by approximately \$1.0 million annually.

The asset allocation for PJM's pension plan at the end of 2010 and 2009, and the target allocation for 2010, by asset category, follow. The fair value of plan assets for this plan is \$70.3 million and \$56.5 million, at the end of 2010 and 2009, respectively. In addition, the expected long-term rate of return assumption on the plan assets was 7.50 percent in 2010 and 2009 and 7.75 percent in 2008.

Asset Category	Target Allocation	2010	2009
Equity Securities	55% - 65%	59.9%	59.9%
Debt Securities	35% - 45%	39.2%	39.2%
Other	0% - 2%	0.9%	0.9%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

The assets of the Trust shall be invested to provide a source of retirement income for participants and beneficiaries in the Plan. The financial objectives of the Trust have been established in conjunction with the comprehensive review of the current and projected financial requirements of the Plan. The financial objectives of the Trust are to maximize assets in order to consistently and materially exceed the accumulated benefit obligation under the Plan and to reduce contributions over time.

The assets of the Trust shall be invested in accordance with all relevant legislation and regulation, in a manner consistent with fiduciary standards of ERISA and other applicable law. Specifically, the investment program shall include such safeguards and diversity to which a prudent investor would adhere, and all transactions undertaken on behalf of the Trust shall be in the sole interest of plan participants and their beneficiaries.

### Fair Value Measurements

The following table presents PJM's pension assets measured at fair value and their respective levels within the fair value hierarchy as of December 31, 2010 and 2009:

As of December 31, 2010 (a)	Level 1	Level 2	Level 3	Total
<b>Pension Plan Assets:</b>				
Cash Equivalents	\$ 712	\$ –	\$ –	\$ 712
Commingled Funds	–	42,665	–	42,665 (b)
Fixed Income	–	27,000	–	27,000 (c)
<b>Total Pension Plan Assets</b>	<b>\$ 712</b>	<b>\$ 69,665</b>	<b>\$ –</b>	<b>\$ 70,377</b>

### As of December 31, 2009 (a)

<b>Pension Plan Assets:</b>				
Cash Equivalents	\$ 438	\$ –	\$ –	\$ 438
Commingled Funds	–	47,692	–	47,692 (b)
Fixed Income	–	8,417	–	8,417 (c)
<b>Total Pension Plan Assets</b>	<b>\$ 438</b>	<b>\$ 56,109</b>	<b>\$ –</b>	<b>\$ 56,547</b>

(a) See Note 10 for a description of levels within fair value hierarchy.

(b) The benefit plans own commingled funds that invest in equity and fixed income securities.

(c) This category predominantly represents diverse issues of domestic, investment-grade fixed securities.

### Valuation Techniques Used to Determine Fair Value

**Cash equivalents** - Investments with maturities of three months or less when purchased, including certain short-term fixed-income securities, are considered cash equivalents and are included in the recurring fair value measurements hierarchy as Level 1.

**Commingled funds** - Commingled funds are maintained by investment companies and hold certain investments in accordance with a stated set of fund objectives, which are consistent with PJM's overall investment strategy. The values of the majority of commingled funds are not publicly quoted and must trade through a broker. For equity and fixed-income commingled funds traded through a broker, the fund administrator values the fund using the net asset value per fund share, derived from quoted prices in active markets of the underlying securities. These funds have been categorized as Level 2.

**Fixed income** - For fixed income securities, multiple prices and price types are obtained from pricing vendors whenever possible, which enables cross-provider validations in addition to checks for unusual daily movements. A primary price source is identified based on asset type, class or issue for each security. Fidelity monitors prices supplied by pricing services and may use a supplemental price source or change the primary price source of a given security if the portfolio managers challenge an assigned price and Fidelity determines that another price source is considered to be preferable. The fixed income securities have been categorized as Level 2.

### Savings Plan

PJM also sponsors a 401(k) savings plan (the savings plan) for all eligible employees of the Company who have completed six months of service. The savings plan permits employees to contribute up to 15 percent of their gross compensation on a pretax basis, subject to limitations as described in the savings plan. PJM makes matching contributions equal to 100 percent of the employee's first 5 percent of gross salaries contributed. PJM contributions to the savings plan were approximately \$2.6 million, \$2.5 million and \$2.4 million for the years ended December 31, 2010, 2009 and 2008, respectively. This expense is included in compensation in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

### 13. Commitments and Contingencies

#### Leases

PJM leases office space, furniture, computer and copier equipment under operating leases with various vendors. These leases are noncancelable and expire during the period from 2011 to 2013.

Future minimum rentals under noncancelable lease agreements are as follows:

#### Year Ending December 31,

2011	\$ 2,307
2012	2,016
2013	555
Total	\$ 4,878

#### Regulatory Items

##### *Consolidated Edison Wheel Proceeding*

In 2001, Consolidated Edison Company of New York, Inc. (ConEd) filed a complaint with the FERC concerning the implementation by PJM, the New York Independent System Operator (NYISO), and Public Service Electric and Gas Company (PSEG) of certain contracts entered into in the 1970s between ConEd and PSEG. After the FERC issued a series of decisions, PJM, the NYISO, and PSEG filed with the FERC a set of operating protocols intended to resolve the proceeding and guide future operations under the contracts. In approving these protocols, the FERC required a series of post-implementation reports to be submitted. Subsequently, in reports submitted by ConEd on September 30, 2005, December 30, 2005, and January 19, 2007, ConEd has claimed that PJM and the NYISO had not properly implemented the approved protocols and had jointly caused alleged damage to ConEd and its customers of \$111 million, of which \$9.5 million are described as direct losses. ConEd asked the FERC to initiate further proceedings and to make a determination of the amount of refunds necessary to make ConEd whole for these alleged economic consequences. PJM and the NYISO responded to ConEd's allegations and denied ConEd's right to the refunds it seeks. On April 20, 2007, the FERC dismissed all of ConEd's requests for relief as procedurally insufficient, accepted all the informational reports filed and rejected ConEd's request that the FERC institute hearing and settlement procedures. On May 21, 2007, ConEd filed a Petition for Rehearing of the FERC's April 20, 2007 Order. PSEG and ConEd filed appeals with the D.C. Circuit Court of Appeals on June 18, 2007, and June 19, 2007, respectively.

On February 23, 2009, the parties to the complaint filed with the FERC a settlement offer to resolve all issues in this matter pending at the FERC and in the D.C. Circuit Court of Appeals. The settlement, if approved by the FERC, would provide "rolled over" service between ConEd and PSEG in accordance with transmission service agreements between PJM and ConEd and joint operating protocols between PJM and the NYISO. The filed settlement was contested. On February 19, 2010, the FERC found they are unable to approve the settlement because the current state of the record did not permit them to resolve the merits of some of the contested issues. Because these issues must be addressed before determining whether the settlement can be approved, the FERC ordered the parties to brief these issues. The parties filed the additional information required by the February 19, 2010 Order.

On September 16, 2010, the Commission issued an Order Approving Contested Settlement and Denying Rehearing and found that the settlement and the related non-conforming transmission service agreements and Joint Operating Agreement Protocol are just and reasonable. On October 18, 2010, the NRG Companies filed a Request for Rehearing appealing the September 16, 2010 Order. The outcome of this matter is not anticipated to have any material adverse impact on PJM's financial position, results of operations or cash flow.

***Reliability Pricing Model Buyers***

On May 30, 2008, 18 PJM Members, calling themselves the Reliability Pricing Model (RPM) Buyers, filed with the FERC a complaint against PJM asking the FERC to find that PJM's RPM, as implemented through the "transitional" base residual auctions, has produced unjust and unreasonable capacity prices and to order refunds from the PJM members that received RPM revenues. PJM filed its answer on July 11, 2008, requesting that the FERC dismiss the complaint because the requested relief violates the filed rate doctrine, represents a collateral attack on the FERC's prior RPM orders, and is contrary to the FERC's policy not to order the re-running of markets.

The FERC dismissed the RPM Buyers' complaint on September 19, 2008. On October 20, 2008, the RPM Buyers filed a request for rehearing at the FERC on this matter. On November 18, 2008, the FERC issued an order granting rehearing for further consideration for the limited purpose of giving itself additional time to consider the matters raised in the RPM Buyers' request for rehearing. Thereafter, the FERC issued an order on June 18, 2009, denying the RPM Buyers' request for rehearing, denying their request for oral argument, and reaffirming its September 19, 2008 order dismissing their complaint filed against PJM.

On August 14, 2009, two of the 18 RPM Buyers, the Maryland Public Service Commission and New Jersey Board of Public Utilities, filed a Petition for Review and Notice in the Fourth Circuit Court of Appeals to appeal the FERC's September 19, 2008 and June 18, 2009 orders. On November 12, 2009, an order was granted transferring the matter to the U.S. Court of Appeals for the District of Columbia Circuit Court. RPM Buyers, the FERC, PJM and interveners filed briefs with the District Court and oral arguments were held on November 15, 2010. On February 8, 2011, the District Court upheld the FERC's approval of PJM's RPM. The District Court ruled that the FERC had substantial basis on which to conclude that the RPM was an appropriate tool for increasing reliability in electricity markets, that the RPM did precisely what it was intended to do, including during the transitional period; and, the resulting capacity prices were attributable to legitimate causes, not any supplier's exercise of market power. The District Court also asserted that the FERC had adequately explained why the new rates were just and reasonable.

***Market Flow Modeling Discrepancy***

On June 26, 2009, PJM reported to the FERC that it discovered a Market Flow modeling discrepancy that affected the calculation of market-to-market coordination payments under the Joint Operating Agreement (JOA) between PJM and the Midwest ISO. As a result of this discrepancy, the market-to-market coordination payments from PJM to the Midwest ISO have been underpaid. The market flow modeling discrepancy was rectified prospectively effective June 2010.

PJM and the Midwest ISO initiated alternative dispute resolution under the JOA in September 2009. On September 15, 2009, this dispute was submitted to the FERC for dispute resolution by a settlement judge. The first settlement conferences were held on October 19 and October 20, 2009. Additional settlement conferences were held on December 10 and December 11, 2009 and during February 2010. The Midwest ISO subsequently terminated the settlement proceedings and on March 8, 2010, filed two complaints against PJM with the FERC. The first complaint sought damages in the amount of \$130 million plus interest for the market flow modeling discrepancy for the period 2005 – June 2009. The second complaint alleged that PJM was in violation of the JOA because PJM allegedly demanded resettlement of amounts related to the Midwest ISO's use of substitute flowgates in the market-to-market processes under the JOA. The Midwest ISO asked the FERC to order PJM to acknowledge the use of substitute flowgates under the JOA. The Midwest ISO is seeking reimbursement of \$5 million under the second complaint. PJM filed answers disagreeing with both complaints on April 12, 2010. Additionally, on April 12, 2010, PJM filed with the FERC a complaint against the Midwest ISO regarding the Midwest ISO's use of surrogate flowgates in market-to-market coordination in violation of the JOA seeking damages in excess of \$25 million for the period April 2005 to June 2009.

On June 29, 2010, after various answers, responses, motions and comments were filed by the parties to the complaints, the FERC issued an Order consolidating the three complaint proceedings discussed above. The FERC also established hearing and settlement judge procedures and denied all requests for summary disposition as to any complaints.

A settlement conference was held on August 4, 2010. During this conference, PJM and the Midwest ISO reported that an additional error in data provided by a third-party vendor concerning the firm flow entitlements had been identified that would impact the settlement negotiations. As a result, additional settlement conferences were held during fall 2010.

On November 3, 2010, the parties, including PJM and the Midwest ISO, came to a settlement agreement in principle that was filed on January 4, 2011. This Settlement includes revisions to the JOA but no payments by any party for damages or billing adjustments and resolves all issues in this proceeding without the need for an evidentiary hearing or further proceedings. The majority of the parties support the settlement, but comments were filed by a limited number of parties on specific issues in the settlement with which they disagree. Reply comments were required to be filed by February 3, 2011.

PJM cannot predict the outcome of this matter, but does not foresee any material adverse impact on PJM's operations or financial position.

## Other Items

### *Seams Elimination Cost Adjustments*

At March 31, 2009, PJM had a receivable due from the Midwest ISO of \$33.4 million for Seams Elimination Cost Adjustments (SECA) billed for the 11 months ended March 31, 2006. While the Midwest ISO has billed Green Mountain Energy Trading (Green Mountain), the Midwest ISO customer responsible for the unpaid SECA charges, it has not yet received payment from that customer. The PJM transmission owners filed a motion on January 26, 2006, asking the FERC to use its civil enforcement powers to compel the defaulting Midwest ISO customer to comply with the Midwest ISO tariff and pay its allocated SECA charges. On November 9, 2007, PJM, the Indicated PJM Transmission Owners, the Midwest ISO and the Indicated Midwest ISO Transmission Owners submitted a motion for enforcement of effective Commission orders, approved provisions of the Midwest ISO Tariff and accepted contracts and rate schedules under which the Midwest ISO has assessed Green Mountain SECA charges.

On May 21, 2010, the Commission issued two orders. First, in the Order on Rehearing, the Commission denies all rehearing requests of the prior orders issued in this proceeding. Second, in the Order on Initial Decision, the Commission reverses, in part, and affirms, in part, the initial decisions of the Administrative Law Judge. The Commission also approved three settlements that were certified as contested during the hearing and were held in abeyance pending action on the initial decisions and requests for rehearing. The Commission also approved a fourth settlement that was filed on October 29, 2009. The Commission in this order reverses the conclusion that the Midwest ISO properly assessed Green Mountain SECA charges as a customer under the Midwest ISO tariff. Instead, the Commission finds BP Energy (BP) is responsible for the SECA charges as the entity that took transmission service on behalf of Green Mountain through December 2005.

The Commission required the PJM Transmission Owners and the Midwest ISO Transmission Owners to submit revised SECA charges to reflect the adjustments adopted in its orders. Under the orders, those compliance filings are submitted by the Transmission Owners and accepted by the Commission; the Midwest ISO would begin collection of the BP SECA charges previously billed to Green Mountain. Once paid, the Midwest ISO would be required to remit the BP SECA payments to PJM for distribution to PJM's Transmission Owners. On October 18, 2010, however, protests were filed by several parties to the PJM Transmission Owners' and the Midwest ISO Transmission Owners' compliance filings and the FERC action is pending.

The receivable from the Midwest ISO is offset by the \$33.4 million payable by PJM to market participants for these SECA credits. Consequently, on a net basis, there are no amounts reported in the Company's Consolidated Statement of Financial Position related to these items. Although PJM management cannot determine the impact, if any, of the final disposition of the amounts not yet collected by the Midwest ISO from its market participants, the resolution will not have any impact on PJM's results of operations as PJM's Tariff only obligates PJM to disburse to its members the actual SECA charges collected.

### *Power Edge Default*

On April 16, 2008, PJM, in its own name and pursuant to authority granted by the PJM members, filed a civil complaint against Power Edge and its affiliates (collectively the Tower Affiliates), in the U.S. District Court for the District of Delaware (the Delaware Case). In the complaint, PJM sought to recover losses suffered by the PJM membership and damages for harm to the PJM markets arising out of Power Edge's default in the Financial Transmission Right market, the forfeiture of profits derived by the Tower Affiliates from the PJM markets, actual and punitive damages and the cost of the suit, plus interest.

On July 2, 2008, the Tower Affiliates filed a civil complaint against PJM in the Philadelphia County, Pennsylvania, Court of Common Pleas seeking return of the funds being withheld by PJM and compensatory and punitive damages for alleged interference with the Tower Affiliates' business relationships and defamation. PJM subsequently was able to remove the case to the United States District Court for the Eastern District of Pennsylvania (the Pennsylvania Case). On June 12, 2009, pursuant to an order of the U.S. District Court for the District of Delaware, the Delaware Case was transferred to the U.S. District Court for the Eastern District of Pennsylvania where, on July 13, 2009, it was consolidated with the Pennsylvania Case.

Effective July 15, 2010, PJM and the Tower Affiliates settled all claims between themselves within the Federal Court litigation and before the FERC. The Tower Affiliates executed a \$20 million promissory note in return for PJM withdrawing its civil complaint and the remainder of its complaint at the FERC related to this matter. The three-year promissory note executed on July 15, 2010 provided the Tower Affiliates the option to satisfy the note in full by prepaying \$18 million within 12 months or \$19 million within 24 months. The Tower Affiliates elected to prepay the note in full by paying PJM \$18 million on July 22, 2010. This amount was refunded to PJM market participants in August 2010. PJM has reported this activity on a net basis in the Company's Consolidated Statement of Financial Position and the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income.

***Lehman Brothers Commodities Services Default***

On and before September 15, 2008, the activity in the PJM markets of Lehman Brothers Commodities Services (LBCS), a PJM member, was supported by a guaranty issued by the parent company of LBCS, Lehman Brothers Holdings, Inc. (LBHI). On September 15, 2008, LBHI filed a petition in bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York. PJM issued a collateral call to LBCS on September 15, 2008, given the adverse change to LBCS's guarantor. LBCS did not meet its collateral call, and on September 18, 2008, LBCS was declared to be in default of its obligations, and its transaction rights in PJM were terminated. LBCS ultimately filed its own bankruptcy petition on October 3, 2008. LBCS did not pay their regular monthly invoices for market activity from August 2008 through and including May 2009, for a total of approximately \$18 million. The aggregate payment defaults were billed to non-defaulting members in accordance with the default allocation assessment formula in PJM's Operating Agreement. LBCS has not had any open positions with the Company since June 1, 2009. On September 18, 2009, PJM filed Proofs of Claim, along with supporting documentation, with the Bankruptcy Court setting forth PJM's creditor claim against both LBCS and LBHI.

Under the terms of the PJM Operating Agreement, any payment defaults may be billed and collected from PJM's other member companies. The outcome of any defaults is not anticipated to have a material adverse effect on PJM's financial position, results of operations or cash flow.

**Legal**

PJM is routinely involved in legal actions. In the opinion of management, none of these matters will have a material adverse effect, if any, on the financial position, results of operations or liquidity of PJM.

#### **14. Related Party Transactions**

PJM occupies two buildings that are owned by a subset of PJM's members. One of the buildings was purchased in 1992 at a cost of \$2.9 million. This building was subsequently renovated at a cost of \$2.9 million. A second building occupied by PJM and used as one of PJM's Control Centers was purchased in July 1995 at a cost of \$4.8 million. Through December 31, 2000, the Facilities Owners elected not to charge PJM rent for the use of these facilities. Effective January 1, 2001, PJM commenced paying a nominal rent of two dollars per year for the use of these facilities. PJM is responsible for facility maintenance, property taxes, insurance and other related costs associated with these two buildings. Estimated annual market rent for these two buildings is approximately \$1.6 million.

In accordance with PJM's policies, PJM allows for cash advances to relocating employees. There were no advances outstanding at December 31, 2010 or 2009, respectively.