

PJM INTERCONNECTION, L.L.C.
FOR THE QUARTER ENDED MARCH 31, 2011

INDEX

	PAGE
PART I – FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Statement of Financial Position	2
Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income	3
Consolidated Statement of Cash Flows	4
Notes to Consolidated Financial Statements	5
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	15

PART I . FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Financial Position
(\$ in thousands)

	<u>Unaudited</u> <u>March 31, 2011</u>	<u>December 31, 2010</u>
Assets		
Current assets:		
Deposits on hand	\$ 734,108	\$ 744,237
Operating cash	72,809	87,838
Receivables	7,772	24,911
Study and interconnection receivables	5,828	12,318
Prepaid income taxes	-	2,214
Prepaid expenses and other current assets	4,181	5,377
Deferred income taxes, net of valuation allowance	7,187	7,236
Note receivable	985	1,295
	<u>832,870</u>	<u>885,426</u>
Non-current assets:		
Fixed assets, net of accumulated depreciation and amortization of \$341,097 and \$335,198	89,327	92,446
Land	1,420	1,420
Projects in development	121,007	114,197
Deferred recovery of pension and postretirement costs	18,075	18,219
Deferred income taxes, net of valuation allowance	18,293	15,832
Note receivable	622	765
Other	5,760	5,606
	<u>254,504</u>	<u>248,485</u>
Total assets	<u>\$ 1,087,374</u>	<u>\$ 1,133,911</u>
Liabilities, paid in capital, retained earnings and accumulated other comprehensive income		
Current liabilities:		
Accounts payable and accrued expenses	\$ 31,377	\$ 33,519
Member prepayments	72,186	100,274
Study and interconnection payables	8,260	16,145
Accrued payroll and benefits	7,485	19,732
Revolving line of credit	25,000	-
Current portion of long-term debt	13,872	13,872
Deferred FERC fee liability	1,275	1,700
Deferred regulatory liability	1,864	14,185
Deferred revenue	1,890	2,431
Postretirement healthcare benefits liability	1,375	621
Other employee benefits	77	73
Deposits	734,108	744,237
	<u>898,769</u>	<u>946,789</u>
Non-current liabilities:		
Long-term debt	80,312	86,664
Deferred regulatory liability	14,100	6,000
Interest rate swap	1,167	1,410
Pension benefits liability	30,564	31,869
Postretirement healthcare benefits liability	49,731	48,919
Other employee benefits	8,911	8,701
	<u>184,785</u>	<u>183,563</u>
Total liabilities	<u>1,083,554</u>	<u>1,130,352</u>
Paid in capital	722	722
Retained earnings	2,636	2,401
Accumulated other comprehensive income	462	436
Total paid in capital, retained earnings and accumulated other comprehensive income	<u>3,820</u>	<u>3,559</u>
Total liabilities, paid in capital, retained earnings and accumulated other comprehensive income	<u>\$ 1,087,374</u>	<u>\$ 1,133,911</u>

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Income, Comprehensive Income and Paid in Capital,
Retained Earnings and Accumulated Other Comprehensive Income
(\$ in thousands)

	(Unaudited)	
	Three months ended March 31,	
	2011	2010
Income		
Revenues:		
Service fees	\$ 60,401	\$ 60,408
Deferred regulatory income	(11,694)	(12,976)
FERC fee reimbursement	11,030	11,635
Study and interconnection fees	727	680
Interest income	163	156
Membership fees	628	507
Other income	722	607
Total revenue	61,977	61,017
Expenses:		
Compensation	23,853	23,002
FERC fees	11,030	11,635
Outside services	9,625	9,393
Depreciation and amortization expense	5,920	4,943
Software licenses and fees	2,765	2,153
Computer maintenance and office supplies	2,071	2,009
Pension benefits	1,907	1,741
Postretirement healthcare benefits	1,332	1,204
Other expenses	1,092	2,519
Lease expenses	887	694
Study and interconnection services	727	680
Interest expense	190	723
Total expenses	61,399	60,696
Income before income taxes	578	321
Income tax expense	343	237
Net income	\$ 235	\$ 84
Other comprehensive income:		
Unrealized loss on securities, net of taxes of \$26 and \$0	26	-
Comprehensive income	\$ 261	\$ 84
Paid in capital, retained earnings and accumulated other comprehensive income		
Beginning balance	\$ 3,559	\$ 3,082
Net income	235	84
Other comprehensive (loss) income	26	-
Ending balance	\$ 3,820	\$ 3,166

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

PJM INTERCONNECTION, L.L.C.
Consolidated Statement of Cash Flows
(\$ in thousands)

(Unaudited)
Three months ended
March 31,

	2011	2010
Cash flows from operating activities:		
Net income	\$ 235	\$ 84
Adjustments:		
Depreciation and amortization expense	5,920	4,943
Deferred income taxes, net of valuation allowance	(2,386)	(391)
Deferred recovery of pension and postretirement costs	144	122
Deferred regulatory liability	11,694	12,976
Employee benefit expense greater than (less than) funding	475	(285)
Net fair value changes related to interest rate swap	(243)	412
Changes in assets and liabilities:		
Decrease (increase) in receivables	17,139	(12,459)
Decrease in interconnection receivables	6,490	7,581
Decrease in prepaid expenses and other	1,021	227
Decrease in prepaid income taxes	2,214	1,158
(Decrease) increase in accounts payable and accrued expenses	(2,142)	12,833
(Decrease) in interconnection payables	(8,412)	(12,971)
(Decrease) in accrued payroll and benefits	(12,247)	(12,068)
(Decrease) increase in deferred FERC fees	(425)	344
Decrease in deferred revenue	(541)	(344)
Refunds to members	(15,915)	(8,710)
Net cash provided by (used in) operating activities	<u>3,021</u>	<u>(6,548)</u>
Cash flows used in investing activities:		
Cost of projects in development	(9,063)	(10,748)
Note receivable	453	420
Net cash used in investing activities	<u>(8,610)</u>	<u>(10,328)</u>
Cash flows from financing activities:		
Repayments under long-term debt	(6,352)	(584)
Borrowings under line of credit	100,500	-
Repayments under line of credit	(75,500)	-
(Decrease) increase in deposits on hand	(10,129)	53,647
Member prepayments utilized	(28,088)	(21,510)
Net cash (used in) provided by financing activities	<u>(19,569)</u>	<u>31,553</u>
Net (decrease) increase in cash and cash equivalents	(25,158)	14,677
Cash and cash equivalents balance, beginning of period	<u>832,075</u>	<u>595,014</u>
Cash and cash equivalents balance, end of period	<u>\$ 806,917</u>	<u>\$ 609,691</u>
Noncash Activity:		
Plant additions included in ending Accounts Payable and Accrued Expenses	\$ 527	\$ 1,126

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

Notes to Consolidated Financial Statements
(dollars in tables in thousands)
(Unaudited)

1. Company Overview

Nature of Operations

During 2010, PJM filed with the Federal Energy Regulatory Commission (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, previously completed by PJM Interconnection L.L.C. PJM received approval from the FERC on December 30, 2010 to begin operation of PJM Settlement Inc. (PJM Settlement) on January 1, 2011. PJM Settlement is a Pennsylvania nonprofit corporation and is a FERC-regulated entity. As of January 1, 2011, PJM Settlement acts as a counterparty to members' pool transactions in the PJM markets. For the pool transactions in the PJM market, flash title passes through PJM Settlement immediately prior to passing to the ultimate buyer and seller of the product. This arrangement provides PJM the authority to continue to net a member's offsetting financial positions in PJM markets for credit and billing purposes; provides clarity in PJM Settlement's legal standing to pursue collection from a bankrupt member; and, also complies with the FERC guidance on credit policy requirements for competitive wholesale electricity markets.

2. Summary of Critical Accounting Policies

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.

The interim financial data as of March 31, 2011 and for the three-month periods ended March 31, 2011 and March 31, 2010 are unaudited; however, in the opinion of the Company, the interim data includes those adjustments of a normal recurring nature necessary for a fair statement of the results of the interim periods.

PJM has performed an evaluation of subsequent events through May 10, 2011 which is the date the financial statements were issued.

Net Presentation of Member Activity

Based on authoritative revenue recognition and netting accounting guidance addressing net vs. gross reporting in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income and the Consolidated Statement of Financial Position, the Company determined that although PJM Settlement has flash title to pooled transactions, all activity for which PJM Settlement is the central counterparty should be recorded on a net basis. The Company's determination is based on the fact that: (1) the member company, not PJM Settlement, is the primary obligor in each transaction; (2) PJM Settlement earns a fixed amount per transaction; and, (3) the member company has the credit risk, not PJM Settlement. As such, the Company will present member activity for which PJM Settlement is the central counterparty, including Accounts Receivable, Accounts Payable, Financial Transmission Rights (FTR), Revenue and Expense, on a net basis in its consolidated financial statements.

3. 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 revenue collected under the Advanced Second Control Center (AC²) rider. The amount accumulated under the financial reserve provisions is classified as a non-current liability in the Company's Consolidated Statement of Financial Position. PJM 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 periods ended March 31, 2011 and March 31, 2010, PJM made refunds of \$15.9 million and \$8.7 million, respectively.

There will not be a prior period adjustment; any under or over refund amounts will be reflected in the deferred regulatory liability activity in the following quarter. The refunds were higher during the first quarter of 2011 because beginning this year and every third year thereafter first quarter refunds will reduce the non-current liability balance to \$6 million. During the remainder of 2011, the non-current portion of the deferred regulatory liability may grow to as much as six percent of the annual revenue threshold.

For PJM Settlement, the deferred regulatory liability is defined in its rate schedule in the PJM Open Access Transmission Tariff (OATT) and is equal to revenues collected in excess of accrual-basis expenses. This balance is refunded quarterly. 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. There is not a financial reserve component to the PJM Settlement rate schedule. PJM Settlement will remit its first refunds during the second quarter of 2011.

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 rate schedules exceed applicable expenses in the reporting period. The amount by which cumulative revenues under the rate schedules exceed cumulative expenses and 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 March 31, 2011, the deferred regulatory liability was \$16.0 million. At December 31, 2010, the deferred regulatory liability was \$20.2 million. At March 31, 2011 and December 31, 2010, the current portion of the deferred regulatory liability was \$1.9 million and \$14.2 million, respectively. The current portion at March 31, 2011 represents the amount to be refunded to members in the second quarter of 2011. The non-current portion of the deferred regulatory liability of \$14.1 million and \$6.0 million represents the amount of PJM's reserve at both March 31, 2011 and December 31, 2010, respectively.

4. 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 the Board of Managers. 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 was to fund capital needs associated with MA's technology systems and working capital needs related to MA's responsibilities per Attachment M of the PJM Open Access Transmission tariff (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 began providing services to PJM pursuant to the Market Monitor Services Agreement, which was effective August 1, 2008. At March 31, 2011 and December 31, 2010, the outstanding balance due from MA recorded by PJM as a note receivable was \$1.6 million and \$2.1 million, respectively. At March 31, 2011 and December 31, 2010, the current portion of the note receivable was \$1.0 million and \$1.3 million, respectively. The current balance at March 31, 2011 represents the amount to be repaid in the next twelve months. The non-current portion of the note receivable is \$0.6 million and \$0.8 million at March 31, 2011 and December 31, 2010, respectively.

5. Short-Term Debt

NCSC Revolving Line of Credit

PJM had a \$50 million revolving credit agreement with National Cooperative Services Corporation (NCSC). The revolving credit agreement had a five-year term and terminated on March 31, 2011. The facility was unsecured and was available to fund short-term cash obligations.

At March 31, 2011 and December 31, 2010, there were no outstanding borrowings under this revolving credit agreement. At March 31, 2011 and December 31, 2010, the interest rate was 6.05 percent.

PNC Revolving Line of Credit

On January 31, 2011, the FERC approved PJM's application to enter into a \$65 million revolving credit agreement with PNC Bank (PNC). The revolving credit agreement has a five-year term and will expire on March 30, 2015. The facility is unsecured and is available to fund short-term cash obligations. FERC approval for borrowings under this facility must be requested biennially.

Under the loan covenants for the \$65 million revolving credit agreement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of March 31, 2011. At March 31, 2011, there was \$25 million outstanding under the revolving credit agreement. The interest rate on borrowings under this revolving credit agreement is based on the 30 day London Interbank Offered Rate (LIBOR). At March 31, 2011, the interest rate was 1.15 percent.

6. Long-term debt

NSCS Project Development Facility

PJM had a \$110 million project development facility with NCSC. This facility was available for asset development and had a four-year drawdown period and a 10-year amortization period. The drawdown period under the long-term project development facility terminated on March 31, 2011.

As of March 31, 2011 and December 31, 2010 there were no outstanding borrowings under this facility. At March 31, 2011 and December 31, 2010, the interest rate was 6.05 percent.

PNC Bank Loan Agreement

On March 31, 2009, 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 property at PJM's second control center. 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 March 31, 2011 and December 31, 2010, outstanding borrowings under this loan were \$30.7 million and \$31.3 million, respectively. The interest rate is based on the LIBOR in effect at each reset date plus a spread of 135 basis points. As of March 31, 2011 and December 31, 2010, the interest rate was 1.61 and 1.58 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 March 31, 2011 and December 31, 2010.

Private Placement Loan Agreement

On March 28, 2008, 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% 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 extended for two years PJM's authority to utilize the remaining \$40 million under the private placement master note agreement, if needed.

As of March 31, 2011 and December 31, 2010, outstanding borrowings under the private placement were \$63.5 million and \$69.2 million, respectively.

Under the loan agreement for the \$75 million private placement, PJM is required to meet certain financial and non-financial covenants. PJM was in compliance with these covenants as of March 31, 2011 and December 31, 2010.

7. Derivative Financial Instrument – Interest Rate Swap

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 Financial Accounting Standards Board (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% 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 Position with changes in fair value recorded through earnings. At March 31, 2011 and December 31, 2010, the fair value of the swap of \$1.2 million and \$1.4 million, respectively, was reported as an interest rate swap in the non-current liability section of the Consolidated Statement of Financial Position. For the three months ended March 31, 2011 and March 31, 2010, an unrealized gain of \$0.2 million and an unrealized loss of \$0.4 million, respectively, were included in interest expense in the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income, respectively.

For the three months ended March 31, 2011 and March 31, 2010, the amount of the derivative gains (losses) PJM recognized in earnings is provided in the table below:

	Three months ended March 31, 2011	Three months ended March 31, 2010
Unrealized mark-to-market gains (losses)	<u>\$ 243</u>	<u>(\$412)</u>
Total net mark-to-market gains (losses)	<u>\$ 243</u>	<u>(\$412)</u>

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

8. Derivative Financial Instrument – Financial Transmission Rights (FTRs)

Beginning January 1, 2011, PJM Settlement is the central counterparty to member's pool transactions. PJM Settlement now has flash title pass through them when markets settle and as charges / credits are assessed on pool transactions. Since FTRs have ongoing open positions at period end, the Company is disclosing information related to these derivative positions. An FTR is a financial instrument that enables market participants to reduce their congestion-related price risk when delivering or selling energy on the grid. It provides an economic hedging mechanism against congestion charges that can be transacted by our members separately from transmission service. Ultimately, PJM Settlement is neither the buyer nor seller of FTRs but, as FTR auctions clear and charges and credits accumulate, PJM Settlement believes it is temporarily the counterparty to both the FTR Buyer and the FTR Seller. For reporting purposes, these positions net to zero on the Consolidated Statement of Financial Position and the Consolidated Statement of Income, Comprehensive Income and Paid in Capital, Retained Earnings and Accumulated Other Comprehensive Income and do not represent a credit risk to PJM. As such, the Company does not designate these instruments as hedges.

The gross fair value of the derivatives assets and liabilities as of March 31, 2011 is \$1.8 billion. These derivatives are not designated as hedging instruments. A total of 267 members are FTR holders for a total of 1,642,997 megawatt hours. As of March 31, 2011, PJM held \$978.3 million in collateral for these FTR transactions. Note that the collateral is based on the calculated net value of the positions held in each member's FTR portfolio. The collateral can be in the form of cash or a letter of credit.

9. Fair Value Disclosures

PJM applies the FASB guidance that established a framework for measuring fair value and expanded the required disclosures about the fair value of financial 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 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 March 31, 2011, those financial assets and liabilities measured at fair value using level one 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 is accounted for at fair value on a recurring basis based on Level 2 inputs within the fair value hierarchy.

The fair value of FTR assets and liabilities for which PJM Settlement is the counterparty for an instant are determined on a recurring basis based on Level 3 inputs within the fair value hierarchy. The valuation model used is based on three year weighted average of historical Location Marginal Prices (LMPs) by month by node. The model also calculates separate historic values for on-peak, off-peak and 24-hour FTRs.

10. Benefit Plans

	Pension Benefits				Other Post	
	Qualified		SERP*		Retirement Benefits	
	2011	2010	2011	2010	2011	2010
Components of net periodic benefit cost for the period January 1 to March 31						
Service cost	\$ 1,522	\$ 1,280	\$ 51	\$ 41	\$ 1,011	\$ 884
Interest cost	1,475	1,330	56	54	755	667
Expected return on assets	(1,301)	(1,107)	-	-	(27)	-
Amortization of:						
Prior service cost	(12)	(12)	40	41	(184)	(184)
Actuarial loss	292	273	7	4	-	-
Total net periodic benefit cost	\$ 1,976	\$ 1,764	\$ 154	\$ 140	\$ 1,555	\$ 1,367

For each the of three months ended March 31, 2011 and March 31, 2010, \$0.4 million and \$0.3 million of total pension and postretirement benefits expense were included in capitalized project costs, respectively.

	Pension Benefits				Other Post	
	Qualified		SERP*		Retirement Benefits	
	2011	2010	2011	2010	2011	2010
Assumptions used to determine net periodic benefit cost as of March 31						
Discount rate	5.50%	5.90%	5.50%	5.90%	5.50%	5.90%
Expected return on plan assets	7.25%	7.50%	N/A	N/A	7.25%	N/A
Rate of compensation increase	4.50%	4.50%	4.50%	4.50%	N/A	N/A
Health care cost trend on covered charges:	N/A	N/A	N/A	N/A		
Current					8.50%	8.50%
Ultimate					5.00%	5.00%
Years to ultimate					7	7

*Supplemental Executive Retirement Plan

11. Income Taxes

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

	<u>Three months ended</u>	
	<u>March 31,</u>	
	<u>2011</u>	<u>2010</u>
Income tax at the federal statutory rate	\$ 202	\$ 109
Increase resulting from:		
State income taxes, net of federal tax benefit	46	38
Other	95	90
<u>Income tax expense</u>	<u>\$ 343</u>	<u>\$ 237</u>

Guidance for accounting for income taxes (ASC 740) requires that the impact of a tax position be recognized if that position is more likely than not of being sustained on tax authority audit, based on the technical merits of the position. As of March 31, 2011, PJM does not have a FIN 48 (ASC 740) liability or receivable recorded.

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 has expired for tax years prior to 2006 for Federal purposes and state purposes. There are no ongoing income tax audits at this time.

12. Commitment and Contingencies

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. Subsequently, ConEd 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.

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.

After providing additional FERC-requested data, 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. On April 18, 2011, the Commission issued an Order on Rehearing and Motions. In this order, the Commission denies with only limited exception NRG's filing for a rehearing of the September 16, 2010 Order issued in this proceeding, approving the contested settlement and related transmission service agreements filed by PJM on behalf of the settling parties. 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.

Market Flow Modeling Discrepancy

On June 26, 2009, PJM reported to the FERC that it discovered a Market Flow modeling discrepancy which 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 were underpaid. The market flow modeling discrepancy was rectified prospectively effective June 2010.

After unsuccessful settlement discussions, the Midwest ISO 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 and sought reimbursement of \$5 million. 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.

During settlement discussions, 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.

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 filed on February 3, 2011. The Settlement Judge issued a Report of Partially Contested Settlement on March 9, 2011. In accordance with the Commission's precedent and regulations, this report states that the Settlement is partially contested and is before the Commission for its consideration. The Settlement Judge also states in the Report that the majority of the stakeholders in the proceeding recommend that no changes be made to the Settlement and that the Commission approve the Settlement without modification. There is no time limit upon which the Commission must act and no opportunity to comment on the Judge's Report.

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, 2011, 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 had 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. From 2006 through 2010, the PJM Transmission Owners and the Midwest ISO Transmission Owners have submitted several filings with the Commission requesting enforcement of Green Mountain's obligation to pay its SECA charges to the Midwest ISO. In various orders, the Commission has found that 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 certain adjustments adopted in its orders. Under the orders, those compliance filings are submitted by the respective 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 are 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.

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.

PART I. FINANCIAL INFORMATION (continued)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, 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 (RTO) 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.

Results of Operations

Revenues

Total services fees remained flat at \$60.4 million for the three months ended March 31, 2011 as compared with the three months ended March 31, 2010. Transmission volumes were 188 terawatt hours (TWhs) for the three months ended March 31, 2011 as compared with 187 TWhs for the three months ended March 31, 2010.

Expenses

The following table summarizes the percentage of total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes:

	Three Months Ended	
	March 31,	
	2011	2010
Compensation expense	48%	48%
Outside services	19	20
Depreciation and amortization, net	12	10
Software licenses and fees	6	5
Computer maintenance and office supplies	4	4
Pension and postretirement benefit expense	7	7
Other expense	2	5
Lease expenses	2	1
Total	100%	100%

Total expenses, excluding FERC fees, study and interconnection services, interest expense and income taxes, increased \$1.8 million, or 4%, to \$49.5 million for the three months ended March 31, 2011 as compared with the three months ended March 31, 2010. The increase for the three-month period resulted primarily from an increase in depreciation and amortization expense as compared with prior periods.

Liquidity and Capital Resources

On January 31, 2011, the FERC approved PJM's application to enter into a revolving credit agreement with PNC Bank (PNC). PJM closed this \$65 million revolving line of credit facility with PNC on March 30, 2011. At March 31, 2011, PJM has \$40 million of capacity under this facility.

On March 31, 2009, 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 AC² property in Milford, PA. As of March 31, 2011, outstanding borrowings were \$30.7 million.

On March 28, 2008, 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. As of March 31, 2011, outstanding borrowings were \$63.5 million. The purpose of this borrowing is to fund the technology investment in AC². On April 2, 2010, the FERC extended for two years PJM's authority to utilize the remaining \$40 million under the private placement master note agreement, if needed.

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 risks and uncertainties, among others, should be considered in evaluating its outlook:

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. 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 financial position.

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. Subsequently, ConEd 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.

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.

After providing additional FERC-requested data, 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. On April 18, 2011, the Commission issued an Order on Rehearing and Motions. In this order, the Commission denies with only limited exception NRG's filing for a rehearing of the September 16, 2010 Order issued in this proceeding, approving the contested settlement and related transmission service agreements filed by PJM on behalf of the settling parties. 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.

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Credit Risks

PJM bills its service fees to its members monthly under the stated rate tariff. During the first three months of 2011, sixty-five percent of PJM's service fees were billed to eighteen of its members, each of which has an investment grade credit rating per the Standard & Poor's rating service. In the event of default by any PJM member(s), the remaining PJM members would be billed a ratable portion of the default.

In accordance with PJM's credit policy, PJM obtains collateral from its members 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.

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Under the terms of the PJM Operating Agreement, any payment defaults may be billed and collected from PJM's other member companies. Any subsequent collections on payment defaults, net of PJM's costs of collection, are refunded to PJM's members who paid the defaulting member's unpaid invoices. The outcome of any defaults is not anticipated to have an adverse effect on PJM's financial position, results of operations or cash flow.