2013 ANNUAL REPORT TO STOCKHOLDERS

Pepco Holdings, Inc

Pepco Holdings, Inc

Dear Valued Stockholders,

In 2013, Pepco Holdings, Inc. (PHI) focused on the key business metrics designed to measure our progress toward enhancing value for our stockholders and customers. I am pleased to report that we have made improvements in each of these areas, increasing our Power Delivery earnings by approximately 23 percent, growing our rate base by 10 percent, achieving one of our best reliability performances ever, and continuing customer satisfaction on an upward trend.

STRATEGIC VIEW

After a decade of evolution, PHI has become what it set out to be – a regulated utility company with a robust rate base growth plan focused on strengthening the reliability of our transmission and distribution infrastructure. To achieve this strategic focus, over the past several years we have taken some significant steps, including selling our generating operations, winding down our retail energy supply business and liquidating certain financial investments.

We have emerged better positioned to continue enhancing stockholder and customer value. We have a stronger balance sheet, a manageable financing plan and a solid business platform. In addition, as a recognized leader in smart grid deployment, we are well prepared to further evolve PHI by leveraging exciting opportunities provided by new energy-related technologies and the decentralization of generation sources.

SELECTED FINANCIAL DATA

(in millions, except per share data)	2013	2012
Net Income from Continuing Operations (GAAP)	$ 110	$ 218
Basic Earnings Per Share from Continuing Operations (GAAP)	0.45	0.95
Diluted Earnings Per Share from Continuing Operations (GAAP)	0.45	0.95
Adjusted Net Income from Continuing Operations (Non-GAAP)	$ 280	$ 225
Adjusted Earnings Per Share from Continuing Operations (Non-GAAP)	1.14	0.98
Total Operating Revenue	$ 4,666	$ 4,625
Total Operating Expenses	3,998	4,084
Operating Income	668	541
Capital Expenditures	$ 1,310	$ 1,216
Total Assets	14,848	15,794
Cash Dividends Per Share of Common Stock	$ 1.08	$ 1.08
Year-End Stock Price	19.13	19.61
Net Book Value Per Common Share	17.23	19.19
Weighted Average Common Shares Outstanding - Basic	246	229
Weighted Average Common Shares Outstanding - Diluted	246	230

Adjusted Earnings Per Share from Continuing Operations for 2013 excludes valuation allowances related to certain deferred tax assets ($0.41 per share), interest associated with a change in assessment of corporate tax benefits related to the cross-border energy lease investments ($0.27 per share) and impairment charges related to certain long-lived assets ($0.01 per share).

Adjusted Earnings Per Share from Continuing Operations for 2012 excludes impairment charges related to certain long-lived assets ($0.03 per share).

The presentation of earnings excluding special items and certain Non-GAAP adjustments and related per share data is intended to complement, and should not be considered as an alternative to, PHI's reported earnings in accordance with accounting principles generally accepted in the United States (GAAP). Management uses this information, and believes that such information is useful to investors, in evaluating PHI’s period-over-period performance.

FINANCIAL PERFORMANCE

In 2013, our core power delivery business performed well with earnings of $289 million compared to $235 million in 2012. Pepco Energy Services' earnings improved to $3 million in 2013 as compared to a loss of $8 million in 2012. We believe the prospects of our energy services business are positive, with Pepco Energy Services signing $66 million in energy efficiency contracts in 2013 as compared to $9 million in the prior year. In addition, W.A. Chester signed $111 million in underground transmission construction contracts in 2013 as compared to $47 million in 2012.

GAAP earnings from continuing operations were $110 million compared to $218 million in 2012, as detailed below. Challenges to our 2013 earnings performance included interest associated with changes in the assessment of corporate tax benefits related to our cross-border energy lease investments resulting in a charge to earnings of $66 million; the establishment of valuation allowances related to certain deferred tax assets of $101 million; and impairment charges related to Pepco Energy Services' long-lived assets of $3 million, as compared to impairment charges of $7 million in 2012. Excluding these items, our adjusted net income from continuing operations in 2013 was $280 million or $1.14 per share, compared to $225 million or $0.98 per share in 2012.

REGULATORY INITIATIVES

In 2013, we were very active in the regulatory arena, filing six distribution base rate cases that requested recovery of the investments we have made in our system. The four cases we have concluded provided for total increases of more than $75 million in annual revenues. We are awaiting final outcomes in our District of Columbia and Delaware rate cases, where we have requested a total increase of $83 million in annual revenues.

In 2014, we plan to file new electric distribution rate cases in our jurisdictions as we continue to seek alignment between our cost recovery and our investment in utility infrastructure, which is currently about $1.2 billion annually. Because filing multiple rate cases each year is expensive and time consuming, we have been exploring alternative ratemaking mechanisms for recovering our investment in a timelier manner.

For example, in our two Maryland jurisdictions, the public service commission approved a "grid resiliency charge" for investments made to improve performance on selected electric feeder lines on an accelerated schedule. Similarly, in the District of Columbia, legislation has been passed that will enable the Public Service Commission of the District of Columbia to approve a special surcharge to recover investments associated with an upcoming power line undergrounding project. And in Delaware, we filed a "forward-looking rate plan" that, if approved, will move the company toward a more efficient and performance-based ratemaking framework.

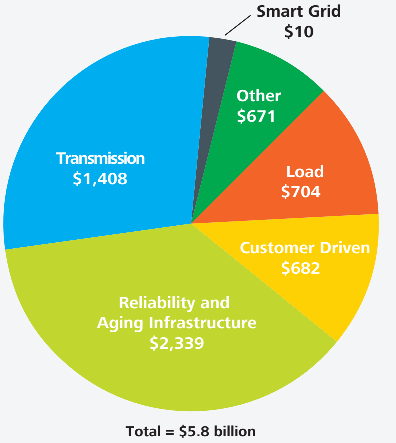
Clearly much work remains, but we are making progress.

RELIABILITY IMPROVEMENTS

Our commitment to improving the reliability of our electric system continues. Over the next five years, we plan to invest $5.8 billion in utility infrastructure. Of that total, approximately $2.3 billion will be spent to improve distribution reliability and approximately $600 million to improve transmission reliability. The remaining investments will be related to load growth, customer requirements, gas construction and supporting infrastructure needs.

Our performance metrics show that our investments are having a significant positive impact. The past two years have been the best reliability performing years in PHI's reporting history. Through the implementation of reliability enhancement initiatives, our electric distribution system is now considerably more resilient. I also am proud that our District of Columbia service area is expected to rank among the best nationally in terms of the average frequency of system outages in 2013. In addition, we met or exceeded the reliability standards in all of our regulatory jurisdictions, with the exception of our Delmarva Power Maryland service area, which experienced several storms that were not excludable for reporting purposes.

A Five-Year Plan to Invest in Infrastructure to Better Serve Our Customers (in millions)



Total = $5.8 billion
2014-2018

We expect our reliability performance in the District of Columbia to improve even further after we complete the $1 billion undergrounding project that was approved by legislation passed by the Council of the District of Columbia and is now subject to the 30-day Congressional review period. A power line undergrounding task force, formed by District Mayor Vincent Gray and co-led by Pepco and the city, recommended a multi-year program to underground up to 60 high-voltage distribution feeder lines that historically have been most impacted by severe storms and overhead related outages.

In a unique public/private partnership to improve grid resiliency, we anticipate funding for the project to be obtained through a combination of traditional utility financing, District government revenue bonds and District Department of Transportation capital improvement funds.

CUSTOMER SATISFACTION IMPROVEMENTS

Turning to customer satisfaction, we ended 2013 with continued progress as indicated by annual surveys conducted on our behalf. In particular, customer satisfaction in the Pepco region improved significantly, rising 19 points in the fall of 2013 compared to the summer of 2012. In the Atlantic City Electric region, overall satisfaction also rose substantially, moving the utility into the second quartile in peer benchmarking. For the same time period, overall customer satisfaction remained stable in the Delmarva Power region.

To further enhance customer satisfaction, we are offering a number of new energy management options. This past summer, we launched our inaugural Peak Energy Savings Credit program in Delaware and in portions of our Maryland service area, made possible by our deployment of smart meters in those jurisdictions. Through this program, participating customers collectively saved $4.5 million and 3.5 million kilowatt-hours of energy, by reducing their electricity usage on selected days of high energy demand. These are tangible benefits, and we hope to expand the program to our other jurisdictions in the near future as we complete the installation of remaining smart meters and gain additional program approvals.

In another major customer satisfaction initiative, we are in the process of developing a new customer relationship management and billing system called SolutionOne. Our two existing billing systems will be replaced with SolutionOne, which will serve all of our utility customers. This new system will offer multiple benefits by integrating with other internal and external PHI systems. During 2014, we will focus on system testing before launching SolutionOne in 2015.

In addition to serving our customers better, I am proud that PHI is a recognized leader in environmental sustainability. In the most recent report by the internationally respected Carbon Disclosure Project, PHI was ranked among the top three S&P 500 utilities for carbon management and performance. In addition, PHI was recognized for environmental leadership by GreenBiz Group and Trucost, which identified us as a 2014 Natural Capital Leader—a company that used natural resources most efficiently to generate revenue over the past year compared to sector peers. These awards attest to our commitment to lead by example, as we work to improve the sustainability of the communities we serve.

EMPLOYEE SAFETY

Tragically, despite achieving in 2013 the lowest number of recordable injuries since we formed PHI, two members of our PHI family died in on-the-job accidents since we published this report last year. At all levels of our company, we are committed to working safely and are focused on the fundamentals of management leadership and employee engagement around safety to ensure each employee returns home safely every day.

BOARD AND EXECUTIVE TRANSITIONS

Our stockholders benefit significantly from an engaged, dedicated and driven Board of Directors. In accordance with the Board retirement provisions of our Bylaws, Frank Heintz, George MacCormack, Frank Ross and Pauline Schneider will not seek reelection at our annual meeting of stockholders in May 2014. We are extremely grateful for their combined 40 plus years of outstanding service to PHI. In particular, I want to recognize Mr. Heintz, who has served as our Lead Independent Director for the past four years. His support and wise counsel have been invaluable to me personally and our leadership team. Although we will miss the contributions of these four individuals, our Board succession process has provided for a smooth transition.

In January of this year, I notified our Board of my plan to retire in 2015. I will step down as President and CEO near the end of 2014, following the selection of a successor, and remain as Executive Chairman of the Board until the 2015 annual meeting of stockholders. I am confident that the Board will select a talented and proven leader to continue our focus on executing a regulated utility strategy, improving reliability and customer satisfaction, enhancing stockholder value and ensuring our employees go home safely every day.

Serving as the CEO of PHI has been a unique and tremendous honor. The achievements that I have shared in this letter are the work of PHI's greatest assets—its people—and I am very proud of them. I want to thank our dedicated employees for their focus on safety and accountability, our deep and talented management team for their expertise and leadership, and our esteemed Board of Directors for their valuable guidance. We are aligned to our strategy and focused on our key results. I am confident in our future.

As PHI continues on its journey, you can be assured that the Board of Directors is committed to delivering increasing stockholder value, in part through our commitment to your dividend. PHI's future is bright. I thank you for your continued support and trust in PHI.

Regards,

Joe Rigby

Joseph M. Rigby
Chairman of the Board, President and Chief Executive Officer
March 25, 2014

2013 Annual Report to Stockholders

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CONSOLIDATED FINANCIAL HIGHLIGHTS

	2013	2012	2011	2010	2009
			(in millions, except per share data)		
Consolidated Operating Results					
Total Operating Revenue	$4,666	$4,625	$4,964	$5,407	$ 5,175
Net Income from Continuing Operations	110[(a)]	218	222	91[(b)]	163
Net (Loss) Income	(212)	285	257	32	235
Common Stock Information					
Basic Earnings Per Share of Common Stock from Continuing Operations	$ 0.45	$ 0.95	$ 0.98	$ 0.41	$ 0.74
Basic (Loss) Earnings Per Share of Common Stock	(0.86)	1.25	1.14	0.14	1.06
Weighted Average Shares Outstanding-Basic	246	229	226	224	221
Cash Dividends Per Share of Common Stock	1.08	1.08	1.08	1.08	1.08
Year-End Stock Price	19.13	19.61	20.30	18.25	16.85
Net Book Value Per Common Share [(c)]	17.23	19.19	18.92	18.65	19.00
Other Information					
Total Assets	14,848	15,794	15,001	14,654	16,074
Capitalization					
Short-term Debt	$ 565	$ 965	$ 732	$ 534	$ 530
Long-term Debt	4,053	3,648	3,794	3,629	4,470
Current Portion of Long-Term Debt and Project Funding	446	569	112	75	536
Transition Bonds issued by ACE Funding	214	256	295	332	368
Capital Lease Obligations due within one year	9	8	8	8	7
Capital Lease Obligations	60	70	78	86	92
Long-Term Project Funding	10	12	13	15	17
Non-controlling Interest	—	—	—	6	6
Common Shareholders' Equity [(c)]	4,315	4,414	4,304	4,198	4,224
Total Capitalization [(c)]	$9,672	$9,942	$9,336	$8,883	$10,250

(a) Includes a charge of $101 million to establish valuation allowances related to certain PCI deferred tax assets and a charge of $66 million to reflect the anticipated additional interest expense on estimated federal and state income tax obligations resulting from the change in assessment of the tax benefits associated with the cross-border energy lease investments.

(b) Includes a loss on extinguishment of debt of $189 million ($113 million after-tax).

(c) Amounts for net book value per common share, common shareholders' equity and total capitalization for 2009 to 2012 have been adjusted for a revision to prior period financial statements related to deferred income tax liabilities for PCI that reduced equity by $32 million, as shown below. Amounts for total equity as filed and as revised below exclude non-controlling interests of $6 million as of December 31, 2010 and 2009.

	Total Equity As Filed	Adjustment	Total Equity As Revised
		(millions of dollars)	
December 31, 2012	$4,446	$(32)	$4,414
December 31, 2011	$4,336	$(32)	$4,304
December 31, 2010	$4,230	$(32)	$4,198
December 31, 2009	$4,256	$(32)	$4,224

BUSINESS OF THE COMPANY

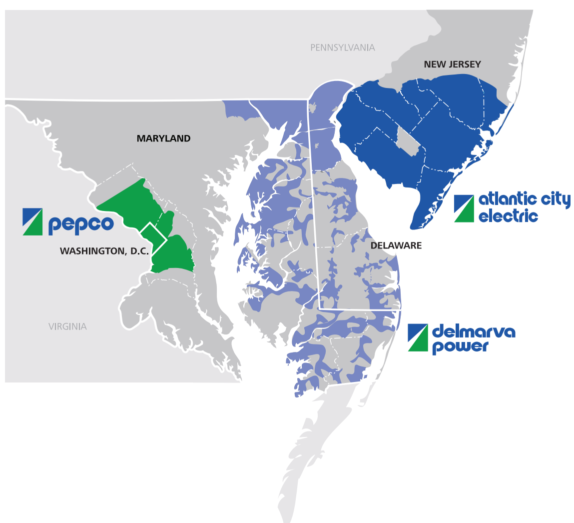
Overview

Pepco Holdings, Inc. (Pepco Holdings or PHI) is a holding company that was incorporated in Delaware in 2001. Through its regulated public utility subsidiaries, PHI is engaged primarily in the transmission, distribution and default supply of electricity, and, to a lesser extent, the distribution and supply of natural gas. The principal executive offices of PHI are located at 701 Ninth Street, N.W., Washington, D.C. 20068.

PHI's public utility subsidiaries are:

- Potomac Electric Power Company (Pepco)
- Delmarva Power & Light Company (DPL)
- Atlantic City Electric Company (ACE)

The service territories of each of Pepco Holdings' utilities are depicted in the map below:



PHI's three utility subsidiaries comprise a single operating segment for accounting purposes, which is referred to herein as "Power Delivery."

In addition to its regulated utility operations, Pepco Holdings, through Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services), is engaged in the following activities:

- providing energy savings performance contracting services principally to federal, state and local government customers;
- designing, constructing and operating combined heat and power, and thermal energy plants; and
- providing high voltage underground transmission construction and maintenance services and low voltage electric construction and maintenance services and streetlight construction services.

The operations of Pepco Energy Services collectively comprise a separate, second operating segment for accounting purposes.

Business Strategy

PHI's business objective is to be a top-performing, regulated power delivery company that delivers safe and reliable electric and natural gas service to its customers and through its regulatory proceedings, earns a just and reasonable rate of return on, and receives timely recovery of, its utility investments.

In seeking to achieve this objective, Pepco Holdings' business strategy is guided by its core values of safety, integrity and diversity and its mission of environmental stewardship, and is focused on the following initiatives:

- investing in its utilities' transmission and distribution infrastructure;
- building a smarter grid and implementing other technological enhancements designed to:
  - automate power delivery system functions and improve the reliability of the power distribution system;
  - enable its utilities to restore power more quickly and efficiently;
  - offer customers detailed information about, and options to help customers better manage, their energy usage; and
  - enhance the customer experience and PHI's communications with customers; and
- through Pepco Energy Services, providing comprehensive energy management solutions and developing, installing and operating renewable energy solutions.

In furtherance of its business strategy, PHI may from time to time enter into various transactions involving its businesses. These transactions may include joint ventures, the disposition of existing businesses or the acquisitions of new businesses. PHI also may from time to time refine components of its business strategy as it deems necessary or appropriate in response to business factors and other conditions, including regulatory requirements.

Power Delivery

PHI's Utility Subsidiaries

Each of PHI's utility subsidiaries owns and operates a network of wires, substations and other equipment that are classified as transmission facilities, distribution facilities or common facilities (which are used for both transmission and distribution). Transmission facilities carry wholesale electricity into, out of and across the utilities' service territories. Distribution facilities carry electricity from the transmission facilities to the customers located in the utilities' service territories.

Each utility subsidiary is responsible for the distribution of electricity to customers within its service territory or territories and for which it is paid tariff rates established by the applicable public service commissions. While the transmission and distribution of electricity is regulated, the law of each of these service territories allows for competition in the supply of electricity, which enables distribution customers to contract to purchase their electricity from a supplier approved by the applicable public service commission. PHI's utility subsidiaries supply electricity at regulated rates to customers who do not elect to purchase their electricity from a competitive supplier. These "default" supply services are referred to generally as Default Electricity Supply.

In addition, each utility subsidiary provides transmission services within the jurisdictions that encompass its electricity distribution service territory. In the aggregate, PHI owns approximately 4,600 miles of interconnected transmission lines with voltages ranging from 115 kilovolts (kV) to 500 kV. Under the Open Access Transmission Tariff adopted by the Federal Energy Regulatory Commission (FERC), each owner of transmission services is required to provide transmission customers with non-discriminatory access to its transmission facilities at tariff rates approved by FERC. The transmission facilities owned by Pepco, DPL and ACE are interconnected with the transmission facilities of contiguous utilities and are part of an interstate power transmission grid over which electricity is transmitted throughout a region encompassing the mid-Atlantic portion of the United States and parts of the Midwest.

Pepco is engaged in the transmission and distribution of electricity in the District of Columbia and major portions of Prince George's County and Montgomery County in suburban Maryland. Pepco also provides Default Electricity Supply. Pepco's service territory covers approximately 640 square miles and, as of December 31, 2013, had a population of approximately 2.2 million. As of December 31, 2013, Pepco distributed electricity to 801,000 customers, of which 264,000 were located in the District of Columbia and 537,000 were located in Maryland. As of December 31, 2013, approximately 57% of delivered electricity sales were to Maryland customers and approximately 43% were to District of Columbia customers.

DPL's electric distribution service territory consists of the state of Delaware, and Caroline, Cecil, Dorchester, Harford, Kent, Queen Anne's, Somerset, Talbot, Wicomico and Worcester counties in Maryland. DPL also provides Default Electricity Supply. DPL's electricity distribution service territory covers approximately 5,000 square miles and, as of December 31, 2013, had a population of approximately 1.4 million. As of December 31, 2013, DPL distributed electricity to 506,000 customers, of which 201,000 were located in Maryland and 305,000 were located in Delaware. As of December 31, 2013, approximately 66% of delivered electricity sales were to Delaware customers and approximately 34% were to Maryland customers.

DPL also supplies and distributes natural gas to retail customers and provides transportation-only services to retail customers who purchase natural gas from other suppliers. DPL's natural gas distribution service territory consists of a major portion of New Castle County in Delaware. This service territory covers approximately 275 square miles and, as of December 31, 2013, had a population of approximately 500,000. As of December 31, 2013, DPL delivered natural gas to 126,000 customers.

ACE's electric distribution service territory consists of Gloucester, Camden, Burlington, Ocean, Atlantic, Cape May, Cumberland and Salem counties in southern New Jersey. ACE also provides Default Electricity Supply. ACE's service territory covers approximately 2,700 square miles and, as of December 31, 2013, had a population of approximately 1.1 million. As of December 31, 2013, ACE delivered electricity to 545,000 customers.

Smart Grid Initiatives

PHI's utility subsidiaries are engaged in transforming the power grid that they own and operate into a "smart grid," a network of automated digital devices capable of collecting and communicating large amounts of real-time data. PHI believes that the smart grid benefits its customers by:

- improving service reliability of the energy distribution system;
- automating specific distribution system functions;
- enabling its utilities to restore energy to customers more quickly and efficiently;
- facilitating more efficient use of energy to meet the challenges of rising energy costs and governmental energy reduction goals;
- permitting its utilities to obtain and communicate to their customers timely and accurate information regarding energy usage and outages; and
- enhancing communications with its customers and the overall customer experience.

A central component of the smart grid is advanced metering infrastructure (AMI), a system that collects, measures and analyzes energy usage data from advanced digital meters, known as "smart meters." Also critical to the operation of the smart grid is distribution automation technology, which is comprised of automated devices that have internal intelligence and can be controlled remotely to better manage power flow and restore service quickly and more safely. Both the AMI system and distribution automation are enabled by advanced technology that communicates with devices installed on the energy delivery system and transmits energy usage data to the host utility. The implementation of the AMI system and distribution automation involves an integration of technologies provided by multiple vendors.

Pepco Energy Services

Pepco Energy Services is engaged in the following businesses:

- Energy savings performance contracting business: designing, constructing and operating energy efficiency projects and distributed generation equipment, including combined heat and power plants, principally for federal, state and local government customers;
- Underground transmission and distribution business: providing underground transmission and distribution construction and maintenance services for electric utilities in North America; and
- Thermal business: providing steam and chilled water under long-term contracts through systems owned and operated by Pepco Energy Services, primarily to hotels and casinos in Atlantic City, New Jersey.

Discontinued Operations

Through its wholly-owned subsidiary Potomac Capital Investment Corporation, PHI maintained a portfolio of cross-border energy lease investments. During the third quarter of 2013, PHI completed the termination of its interests in its cross-border energy lease investments. These activities, which previously comprised substantially all of the operations of the Other Non-Regulated segment, are being accounted for as discontinued operations. The remaining operations of the Other Non-Regulated segment, which no longer meet the definition of a separate segment for financial reporting purposes, are being included in Corporate and Other.

In 2013, Pepco Energy Services completed a previously announced wind-down of its retail electric and retail natural gas supply businesses. These operations are being accounted for as discontinued operations and are no longer a part of the Pepco Energy Services segment for financial reporting purposes.

For a full discussion of discontinued operations, see Note (19), "Discontinued Operations," to the consolidated financial statements.

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

General Overview

PHI, a Delaware corporation incorporated in 2001, is a holding company that, through its regulated public utility subsidiaries, is engaged primarily in the transmission, distribution and default supply of electricity, and, to a lesser extent, the distribution and supply of natural gas (Power Delivery). Through Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services), PHI provides energy savings performance contracting services, underground transmission and distribution construction and maintenance services and steam and chilled water under long-term contracts. For additional discussion, see "Pepco Energy Services" below.

Each of Power Delivery and Pepco Energy Services constitutes a separate segment for financial reporting purposes. Through its subsidiary Potomac Capital Investment Corporation (PCI), PHI maintained a portfolio of cross-border energy lease investments. PHI completed the termination of its interests in its cross-border energy lease investments during 2013. As a result, the cross-border energy lease investments, which comprised substantially all of the operations of the Other Non-Regulated segment, are being accounted for as discontinued operations. The remaining operations of the Other Non-Regulated segment, which no longer meet the definition of a separate segment for financial reporting purposes, are being included in Corporate and Other.

The following table sets forth the percentage contributions to consolidated operating revenue and operating income from continuing operations attributable to PHI segments for each of the preceding three years:

	2013	2012	2011
Percentage of Consolidated Operating Revenue			
Power Delivery	96%	95%	94%
Pepco Energy Services	4%	6%	7%
Corporate and Other	—	(1)%	(1)%
Percentage of Consolidated Operating Income			
Power Delivery	97%	98%	90%
Pepco Energy Services	—	(3)%	5%
Corporate and Other	3%	5%	5%
Percentage of Consolidated Operating Revenue—Power Delivery			
Power Delivery Electric	96%	96%	95%
Power Delivery Gas	4%	4%	5%

Power Delivery

Power Delivery Electric consists primarily of the transmission, distribution and default supply of electricity, and Power Delivery Gas consists of the delivery and supply of natural gas.

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

- Commercial activities in the region include banking and other professional and medical services, government and education, insurance, shopping malls, casinos, tourism and transportation.

- Industrial activities in the region include chemical, glass, pharmaceutical, steel manufacturing, food processing and oil refining.

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

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

The profitability of Power Delivery depends on its ability to recover costs and earn a reasonable return on its capital investments through the rates it is permitted to charge. Operating results also can be affected by economic conditions generally, the level of commercial activity affecting a region, industry or business sector within a service territory, energy prices, the impact of energy efficiency measures on customer usage of electricity and weather.

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

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

PHI's utility subsidiaries devote a substantial portion of their total capital expenditures to improving the reliability of their electrical transmission and distribution systems and replacing aging infrastructure throughout their service territories. These activities include:

- identifying and upgrading under-performing feeder lines;
- adding new facilities to support load;
- installing distribution automation systems on both the overhead and underground network systems; and
- rejuvenating and replacing underground residential cables.

PHI's capital expenditures for continuing reliability enhancement efforts are included in the table of projected capital expenditures within "Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Resources and Liquidity — Capital Requirements — Capital Expenditures."

Power Delivery Initiatives and Activities

Smart Grid Initiatives

PHI's utility subsidiaries are engaged in transforming the power grid that they own and operate into a "smart grid," a network of automated digital devices capable of collecting and communicating large amounts of real-time data.

A central component of the smart grid is AMI, a system that collects, measures and analyzes energy usage data from advanced digital meters, known as "smart meters." Also critical to the operation of the smart grid is distribution automation technology, which is comprised of automated devices that have internal intelligence and can be controlled remotely to better manage power flow and restore service quickly and more safely. Both the AMI system and distribution automation are enabled by advanced technology that communicates with devices installed on the energy delivery system and transmits energy usage data to the host utility. The implementation of the AMI system and distribution automation involves an integration of technologies provided by multiple vendors.

The DCPSC, the MPSC and the DPSC have approved the creation by PHI's utility subsidiaries of regulatory assets to defer AMI costs between rate cases and to accrue returns on the deferred costs. Thus, these costs will be recovered in the future through base rates; however, for AMI costs incurred by Pepco in Maryland with respect to test years after 2011, pursuant to an MPSC order, the recovery of such costs will be allowed when Pepco demonstrates that the AMI system is cost-effective. The MPSC's July 2013 order in Pepco's November 2012 electric distribution base rate application excluded the cost of AMI meters from Pepco's rate base until such time as Pepco demonstrates the cost effectiveness of the AMI system. As a result, costs for AMI meters incurred with respect to the 2012 test year and beyond will be treated as other incremental AMI costs incurred in conjunction with the deployment of the AMI system that are deferred and on which a return is earned, but only until such cost effectiveness has been demonstrated and such costs are included in rates.

In 2010, two of PHI's utility subsidiaries were granted cash awards in the aggregate amount of $168 million by the U.S. Department of Energy to support their smart grid initiatives.

- Pepco was awarded $149 million for AMI, direct load control, distribution automation and communications infrastructure, of which $145 million has been received through December 31, 2013.
- ACE was awarded $19 million for direct load control, distribution automation and communications infrastructure, of which $17 million has been received through December 31, 2013.

For a discussion of the projected capital expenditures of each utility subsidiary associated with PHI's smart grid initiatives over the period 2014 through 2018, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Resources and Liquidity — Capital Requirements."

Mitigation of Regulatory Lag

An important factor in the ability of PHI's utility subsidiaries to earn their authorized ROE is the willingness of applicable public service commissions to adequately address the shortfall in revenues in a utility's rate structure due to the delay in time or "lag" between when costs are incurred and when they are reflected in rates. This delay is commonly known as "regulatory lag." Pepco, DPL and ACE are currently experiencing significant regulatory lag because investments in rate base and operating expenses are increasing more rapidly than their revenue growth.

In an effort to minimize the effects of regulatory lag, PHI's utility subsidiaries are:

- filing electric distribution base rate cases every nine to twelve months in each of their jurisdictions,
- pursuing alternative ratemaking mechanisms,
- evaluating potential reductions in planned capital expenditures, and
- continuing outreach to the regulatory community and other stakeholders, to discuss the changing regulatory model economics that are causing regulatory lag.

Alternative mechanisms that may reduce regulatory lag include adjusting historic test periods in distribution base rate cases to recognize plant additions which are already being used to provide service to customers when new rates go into effect, grid resiliency charges to allow contemporaneous recovery of costs for infrastructure related to system reliability, and multi-year rate plans.

Each of PHI's utility subsidiaries will continue to seek cost recovery from applicable public service commissions to reduce the effects of regulatory lag and have an opportunity to earn its authorized ROE. There can be no assurance that any attempts by PHI's utility subsidiaries to mitigate regulatory lag will be approved or, that even if approved, the cost recovery mechanisms will fully mitigate the effects of regulatory lag.

MAPP Project

On August 24, 2012, the board of PJM terminated the MAPP project and removed it from PJM's regional transmission expansion plan. PHI had been directed to construct MAPP, a 152-mile high-voltage interstate transmission line, to address the reliability needs of the region's transmission system. In December 2012, PHI submitted a filing to FERC seeking recovery of $88 million of abandoned MAPP costs over a five-year period. The FERC filing addressed, among other things, the prudence of the recoverable costs incurred, the proposed period over which the abandoned costs are to be amortized and the rate of return on these costs during the recovery period.

In February 2013, FERC issued an order concluding that the MAPP project was cancelled for reasons beyond the control of Pepco and DPL, finding that the prudently incurred costs associated with the abandonment of the MAPP project are eligible to be recovered, and setting for hearing and settlement procedures the prudence of the abandoned costs and the amortization period for those costs.

In December 2013, PHI submitted a settlement agreement to FERC with respect to this matter. Under the terms of the proposed settlement agreement, Pepco and DPL would recover their abandoned MAPP costs over a three-year recovery period beginning June 1, 2013. The settlement agreement, which is subject to FERC approval, would resolve all issues concerning the recovery of abandonment costs associated with the cancellation of the MAPP project. The terms of this settlement, if approved, would not be subject to the pending formula rate or transmission ROE challenges at FERC or modification through any other FERC proceeding. PHI cannot predict the timing or results of a final FERC decision in this proceeding.

As of December 31, 2013, PHI had a regulatory asset related to the MAPP abandoned costs of approximately $68 million, representing the original filing amount of approximately $88 million of abandoned costs referred to above less: (i) approximately $2 million of disallowed costs written off in 2013; (ii) $4 million of materials transferred to inventories for use on other projects; and (iii) $14 million of amortization expense recorded in 2013. The regulatory asset balance includes the costs of land, land rights, engineering and design, environmental services, and project management and administration.

Transmission ROE Challenge

On February 27, 2013, the public service commissions and public advocates of the District of Columbia, Maryland, Delaware and New Jersey, as well as the Delaware Electric Municipal Corporation, Inc., filed a joint complaint with FERC against Pepco, DPL and ACE, as well as BGE. The complainants challenged the base ROE and the application of the formula rate process, each associated with the transmission service that PHI's utilities provide. The complainants support an ROE within a zone of reasonableness of 6.78% and 10.33%, and have argued for a base ROE of 8.7%. The base ROE currently authorized by FERC for PHI's utilities is (i) 11.3% for facilities placed into service after January 1, 2006, and (ii) 10.8% for facilities placed into service prior to 2006. As currently authorized, the 10.8% base ROE for facilities placed into service prior to 2006 is eligible for a 50-basis-point incentive adder for being a member of a regional transmission organization. PHI, Pepco, DPL and ACE believe the allegations in this complaint are without merit and are vigorously contesting it. On April 3, 2013, Pepco, DPL and ACE filed their answer to this complaint, requesting that FERC dismiss the complaint against them on the grounds that it failed to meet the required burden to demonstrate that the existing rates and protocols are unjust and unreasonable. PHI cannot predict when a final FERC decision in this proceeding will be issued.

Pepco Energy Services

Pepco Energy Services is focused on growing its energy savings business and its underground transmission and distribution construction business while managing its thermal assets in Atlantic City. The energy savings business focuses on developing, building and operating energy savings performance contracting solutions primarily for federal, state and local government customers. After a significant slowdown in 2012, the energy savings market improved in 2013, however the market has not returned to the level of activity prior to 2012. The market is expected to continue to improve as the long-term fundamentals of the energy savings business remain strong. Pepco Energy Services' underground transmission and distribution construction business focuses on providing construction and maintenance services for electric power utilities in North America.

PHI guarantees the obligations of Pepco Energy Services under certain contracts in its energy savings performance contracting business and underground transmission and distribution construction business. At December 31, 2013, PHI's guarantees of Pepco Energy Services' obligations under these contracts totaled $190 million.

During 2012, Pepco Energy Services deactivated its Buzzard Point and Benning Road oil-fired generation facilities. Pepco Energy Services placed the facilities into an idle condition termed a "cold closure." A cold closure requires that the utility service be disconnected so that the facilities are no longer operable and require only essential maintenance until they are completely decommissioned. During the third quarter of 2013, Pepco Energy Services determined that it would be more cost effective to pursue the demolition of the Benning Road generation facility and realization of the scrap metal salvage value of the facility instead of maintaining cold closure status. The demolition of the facility commenced in the fourth quarter of 2013 and is expected to be completed by the end of 2014. Pepco Energy Services will recognize the salvage proceeds associated with the scrap metals at the facility as realized.

Corporate and Other

Between 1990 and 1999, PCI, through various subsidiaries, entered into certain transactions involving investments in aircraft and aircraft equipment, railcars and other assets. In connection with these transactions, PCI recorded deferred tax assets in prior years of $101 million in the aggregate. Following events that took place during the first quarter of 2013, which included (i) court decisions in favor of the IRS with respect to both Consolidated Edison's cross-border lease transaction (discussed in "— Discontinued Operations — Cross-Border Energy Lease Investments" below) and another taxpayer's structured transactions, (ii) the change in PHI's tax position with respect to the tax benefits associated with its cross-border energy leases, and (iii) PHI's decision in March 2013 to begin to pursue the early termination of its remaining cross-border energy lease investments (which represented a substantial portion of the remaining assets within PCI) without the intent to reinvest these proceeds in income-producing assets, management evaluated the likelihood that PCI would be able to realize the $101 million of deferred tax assets in the future. Based on this evaluation, PCI established valuation allowances against these deferred tax assets totaling $101 million in the first quarter of 2013. Further, during the fourth quarter of 2013, in light of additional court decisions in favor of the IRS involving other taxpayers, and after consideration of all relevant factors, management determined that it would abandon the further pursuit of these deferred tax assets, and these assets totaling $101 million were charged off against the previously established valuation allowances. This charge is included in Corporate and Other, as presented in Note (5), "Segment Information," to the consolidated financial statements, because the remaining operations of the former Other Non-Regulated segment are now included in Corporate and Other.

Discontinued Operations

In this Management's Discussion and Analysis of Financial Condition and Results of Operations, all references to continuing operations exclude the following discontinued operations.

Cross-Border Energy Lease Investments

Through its subsidiary PCI, PHI held a portfolio of cross-border energy lease investments. During July 2013, PHI completed the termination of its interest in its cross-border energy lease investments. With the completion of the termination of the cross-border energy leases, the cross-border energy lease investments are being accounted for as discontinued operations.

As discussed in Note (15), "Commitments and Contingencies — PHI's Cross-Border Energy Lease Investments," to the consolidated financial statements, PHI is involved in ongoing litigation with the IRS concerning certain benefits associated with previously held investments in cross-border energy leases. On January 9, 2013, the U.S. Court of Appeals for the Federal Circuit issued an opinion in *Consolidated*

Edison Company of New York, Inc. & Subsidiaries v. United States (to which PHI is not a party) that disallowed tax benefits associated with Consolidated Edison's cross-border lease transaction. As a result of the court's ruling in this case, PHI determined in the first quarter of 2013 that its tax position with respect to the benefits associated with its cross-border energy leases no longer met the more-likely-than-not standard of recognition for accounting purposes, and PCI recorded non-cash charges of $323 million (after-tax) in the first quarter of 2013 and $6 million (after-tax) in the second quarter of 2013, consisting of the following components:

- A non-cash pre-tax charge of $373 million ($313 million after-tax) to reduce the carrying value of these cross-border energy lease investments under FASB guidance on leases (Accounting Standards Codification (ASC) 840). This pre-tax charge was originally recorded in the consolidated statements of (loss) income as a reduction in operating revenue and is now reflected in (loss) income from discontinued operations, net of income taxes.

- A non-cash charge of $16 million after-tax to reflect the anticipated additional net interest expense under FASB guidance for income taxes (ASC 740), related to estimated federal and state income tax obligations for the period over which the tax benefits may be disallowed. This after-tax charge was originally recorded in the consolidated statements of (loss) income as an increase in income tax expense and is now reflected in (loss) income from discontinued operations, net of income taxes. The after-tax interest charge for PHI on a consolidated basis was $70 million and this amount was allocated to each member of PHI's consolidated group as if each member was a separate taxpayer, resulting in the recognition of a $12 million interest benefit for the Power Delivery segment and interest expense of $16 million for PCI and $66 million for Corporate and Other, respectively.

Retail Electric and Natural Gas Supply Businesses of Pepco Energy Services

In December 2009, PHI announced the wind-down of the retail energy supply component of the Pepco Energy Services business which was comprised of the retail electric and natural gas supply businesses. Pepco Energy Services implemented the wind-down by not entering into any new retail electric or natural gas supply contracts while continuing to perform under its existing retail electric and natural gas supply contracts through their respective expiration dates. On March 21, 2013, Pepco Energy Services entered into an agreement whereby a third party assumed all the rights and obligations of the remaining retail natural gas supply customer contracts, and the associated supply obligations, inventory and derivative contracts. The transaction was completed on April 1, 2013. In addition, Pepco Energy Services completed the wind-down of its retail electric supply business in the second quarter of 2013 by terminating its remaining customer supply and wholesale purchase obligations beyond June 30, 2013.

The operations of Pepco Energy Services' retail electric and natural gas supply businesses have been classified as discontinued operations and are no longer a part of the Pepco Energy Services segment for financial reporting purposes.

Earnings Overview

Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

	2013	2012	Change
		(millions of dollars)	
Power Delivery	$ 289	$235	$ 54
Pepco Energy Services	3	(8)	11
Corporate and Other	(182)	(9)	(173)
Net Income from Continuing Operations	110	218	(108)
Discontinued Operations	(322)	67	(389)
Total PHI Net (Loss) Income	$ (212)	$285	$ (497)

Net income from continuing operations for the year ended December 31, 2013 was $110 million, or $0.45 per share, compared to $218 million, or $0.95 per share, for the year ended December 31, 2012.

Net income from continuing operations for the year ended December 31, 2013 included the charges set forth below in Corporate and Other, which are presented, where applicable, net of related federal and state income taxes and are in millions of dollars:

Charge to establish valuation allowances related to certain PCI deferred tax assets	$	101
Charge to reflect the anticipated additional interest expense on estimated federal and state income tax obligations allocated to Corporate and Other (as if it were a separate taxpayer) resulting from the change in assessment of the tax benefits associated with the cross-border energy lease investments ($102 million pre-tax)	$	66

Excluding the items listed above for the year ended December 31, 2013, net income from continuing operations would have been $277 million, or $1.13 per share. PHI discloses net income from continuing operations and related per share data excluding these items because management believes that these items are not representative of PHI's ongoing business operations. Management uses this information, and believes that such information is useful to investors, in evaluating PHI's period-over-period performance. The inclusion of this disclosure is intended to complement, and should not be considered as an alternative to, PHI's reported net income from continuing operations and related per share data in accordance with GAAP.

Net loss from discontinued operations for the year ended December 31, 2013 was $322 million, or $1.31 per share, compared to net income of $67 million, or $0.30 per share ($0.29 per share on a diluted basis), for the year ended December 31, 2012.

Discussion of Operating Segment Net Income Variances:

Power Delivery's $54 million increase in earnings was primarily due to the following:

- An increase of $64 million from electric distribution base rate increases (Pepco in the District of Columbia and Maryland, DPL in Maryland and Delaware and ACE in New Jersey).
- An increase of $16 million due to lower operation and maintenance expense, primarily associated with higher storm restoration and system maintenance in 2012, partially offset by recovery in 2012 of 2011 storm restoration costs and regulatory expenses.
- An increase of $4 million primarily due to higher sales from colder winter weather, partially offset by lower sales from milder summer weather.

- A decrease of $12 million due to higher depreciation and amortization expense associated primarily with regulatory assets and increases in plant investment, partially offset by lower depreciation rates.
- A decrease of $7 million due to higher interest expense resulting from an increase in outstanding debt.
- A decrease of $6 million associated with Default Electricity Supply margins for DPL Delaware, primarily due to favorable adjustments in 2012 related to the under-recognition of allowed returns on net uncollectible expense and regulatory taxes.

Pepco Energy Services' $11 million increase in earnings was primarily due to the following:

- An increase of $6 million primarily due to improved performance in the energy savings business and thermal business in Atlantic City, New Jersey, as well as lower compensation expenses.
- An increase of $5 million due to lower asset impairment charges.

Corporate and Other's $173 million increase in net loss was primarily due to the following:

- An after-tax charge of $101 million to establish valuation allowances against certain PCI deferred tax assets.
- An after-tax charge of $66 million to reflect the anticipated additional interest expense allocated to Corporate and Other related to changes in PHI's consolidated estimated federal and state income tax obligations resulting from the change in assessment regarding the tax benefits related to the cross-border energy lease investments.

Discussion of Discontinued Operations Variance:

Net earnings from discontinued operations for the year ended December 31, 2013 decreased by $389 million as a result of the following:

- An aggregate after-tax charge of $313 million recorded in 2013 to reduce the carrying value of PCI's cross-border energy lease investments ($373 million pre-tax).
- An after-tax charge of $16 million recorded in 2013 to reflect the anticipated additional interest expense on estimated federal and state income tax obligations allocated to PCI (as if it were a separate taxpayer) resulting from the change in assessment of the tax benefits associated with the cross-border energy lease investments ($25 million pre-tax).
- An after-tax gain of $9 million recorded in 2012 related to the early termination of certain cross-border energy leases ($39 million pre-tax) and an after-tax loss of $2 million recorded in 2013 ($3 million pre-tax), associated with the completion of the early termination of the remaining cross-border energy lease investments.
- A decrease of $27 million as a result of holding fewer cross-border energy leases in 2013.
- A decrease of $21 million as a result of lower sales volume in 2013 due to the wind-down of the retail electric and natural gas supply businesses.

Consolidated Results of Operations

The following results of operations discussion compares the year ended December 31, 2013 to the year ended December 31, 2012. All amounts in the tables (except sales and customers) are in millions of dollars.

Continuing Operations

Operating Revenue

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

	2013	2012	Change
Power Delivery	$4,472	$4,378	$ 94
Pepco Energy Services	203	256	(53)
Corporate and Other	(9)	(9)	—
Total Operating Revenue	$4,666	$4,625	$ 41

Power Delivery

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

	2013	2012	Change
Regulated T&D Electric Revenue	$2,146	$2,006	$ 140
Default Electricity Supply Revenue	2,075	2,124	(49)
Other Electric Revenue	60	65	(5)
Total Electric Operating Revenue	4,281	4,195	86
Regulated Gas Revenue	165	151	14
Other Gas Revenue	26	32	(6)
Total Gas Operating Revenue	191	183	8
Total Power Delivery Operating Revenue	$4,472	$4,378	$ 94

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

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

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

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

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

Regulated T&D Electric

	2013	2012	Change
Regulated T&D Electric Revenue			
Residential	$ 781	$ 722	$ 59
Commercial and industrial	970	923	47
Transmission and other	395	361	34
Total Regulated T&D Electric Revenue	$2,146	$2,006	$140

	2013	2012	Change
Regulated T&D Electric Sales (Gigawatt hour (GWh))			
Residential	17,168	17,150	18
Commercial and industrial	30,070	30,734	(664)
Transmission and other	259	258	1
Total Regulated T&D Electric Sales	47,497	48,142	(645)

	2013	2012	Change
Regulated T&D Electric Customers (in thousands)			
Residential	1,650	1,641	9
Commercial and industrial	200	198	2
Transmission and other	2	2	—
Total Regulated T&D Electric Customers	1,852	1,841	11

Regulated T&D Electric Revenue increased by $140 million primarily due to:

- An increase of $107 million due to distribution rate increases (Pepco in the District of Columbia effective October 2012, and in Maryland effective July 2013 and July 2012; DPL in Maryland effective July 2012 and September 2013, and in Delaware effective October 2013 and July 2012; ACE effective November 2012 and July 2013).
- An increase of $14 million in transmission revenue related to the recovery of MAPP abandonment costs, as approved by FERC (which is offset in Depreciation and Amortization).
- An increase of $14 million in transmission revenue rates effective June 1, 2012 and June 1, 2013 related to increases in transmission plant investment and operating expenses.
- An increase of $7 million in transmission revenue related to the resale by DPL of renewable energy in Delaware (which is substantially offset in Purchased Energy and Depreciation and Amortization).
- An increase of $6 million primarily due to a rate increase in the New Jersey Societal Benefit Charge (related to the New Jersey Societal Benefit Program, which is a New Jersey public interest program for low income customers) effective July 2012 (which is offset in Deferred Electric Service Costs).
- An increase of $6 million in transmission revenue primarily attributable to higher capacity as a result of expanding Maryland demand side management programs (which is partially offset in Depreciation and Amortization).
- An increase of $5 million primarily due to a Renewable Portfolio Surcharge in Delaware effective June 2012 (which is substantially offset in Fuel and Purchased Energy and Depreciation and Amortization).
- An increase of $3 million due to Pepco and DPL customer growth in 2013, primarily in the residential class.

The aggregate amount of these increases was partially offset by:

- A decrease of $13 million due to lower non-weather related average residential and commercial customer usage.
- A decrease of $6 million in transmission revenue associated with the change in FERC formula rate true-ups.
- A decrease of $4 million in distribution revenue due to lower pass-through revenue (which is substantially offset by a corresponding decrease in Other Taxes) primarily the result of a decrease in utility taxes collected by Pepco on behalf of Montgomery County, Maryland.
- A decrease of $1 million in transmission revenue primarily attributable to a peak-load rate decrease effective January 2013.

Default Electricity Supply

	2013	2012	Change
Default Electricity Supply Revenue			
Residential	$1,376	$1,467	$(91)
Commercial and industrial	542	542	—
Other	157	115	42
Total Default Electricity Supply Revenue	$2,075	$2,124	$(49)

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

	2013	2012	Change
Default Electricity Supply Sales (Gigawatt hours (GWh))			
Residential	13,743	14,245	(502)
Commercial and industrial	5,079	5,508	(429)
Other	55	55	—
Total Default Electricity Supply Sales	18,877	19,808	(931)

	2013	2012	Change
Default Electricity Supply Customers (in thousands)			
Residential	1,352	1,366	(14)
Commercial and industrial	125	128	(3)
Other	—	1	(1)
Total Default Electricity Supply Customers	1,477	1,495	(18)

Default Electricity Supply Revenue decreased by $49 million primarily due to:

- A decrease of $76 million due to lower sales, primarily as a result of customer migration to competitive suppliers.
- A decrease of $22 million due to lower ACE and DPL non-weather related average customer usage.

The aggregate amount of these decreases was partially offset by:

- An increase of $36 million in wholesale energy and capacity resale revenues primarily due to higher market prices for the resale of electricity and capacity purchased from NUGs.
- An increase of $6 million due to higher Pepco and DPL revenue from transmission enhancement credits.
- An increase of $4 million due to higher sales primarily as a result of colder weather during the 2013 fall months, as compared to 2012.
- A net increase of $2 million as a result of higher Pepco Default Electricity Supply rates, partially offset by lower DPL and ACE rates.

Regulated Gas

	2013	2012	Change
Regulated Gas Revenue			
Residential	$103	$ 94	$ 9
Commercial and industrial	52	47	5
Transportation and other	10	10	—
Total Regulated Gas Revenue	$165	$151	$14

	2013	2012	Change
Regulated Gas Sales (million cubic feet)			
Residential	7,861	6,428	1,433
Commercial and industrial	4,945	3,636	1,309
Transportation and other	6,990	6,751	239
Total Regulated Gas Sales	19,796	16,815	2,981

	2013	2012	Change
Regulated Gas Customers (in thousands)			
Residential	117	115	2
Commercial and industrial	9	10	(1)
Transportation and other	—	—	—
Total Regulated Gas Customers	126	125	1

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

- Commercial activities in the region include banking, government, insurance, shopping malls, casinos and tourism.
- Industrial activities in the region include chemical, pharmaceutical, steel manufacturing and oil refining.

Regulated Gas Revenue increased by $14 million primarily due to:

- An increase of $22 million due to higher sales primarily as a result of colder weather during the winter months of 2013 as compared to 2012.
- An increase of $7 million due to higher non-weather related average commercial customer usage.
- An increase of $4 million due to a revenue adjustment recorded in June 2012 for a reduction in the estimate of gas sold but not yet billed to customers (which is partially offset by an increase in Purchased Energy).
- An increase of $2 million due to a distribution rate increase effective July 2013.

The aggregate amount of these increases was partially offset by a decrease of $22 million due to a Gas Cost Rate (GCR) decrease effective November 2012.

Other Gas Revenue

Other Gas Revenue decreased by $6 million primarily due to lower average prices and lower volumes for off-system sales to electric generators and gas marketers.

Pepco Energy Services

Pepco Energy Services' operating revenue decreased by $53 million primarily due to:

- A decrease of $36 million primarily in energy savings construction activities.
- A decrease of $18 million associated with the retirement of the two remaining oil-fired generation facilities in the second quarter of 2012.

Operating Expenses

Fuel and Purchased Energy and Other Services Cost of Sales

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

	2013	2012	Change
Power Delivery	$2,070	$2,109	$ (39)
Pepco Energy Services	148	186	(38)
Corporate and Other	(2)	(2)	—
Total	$2,216	$2,293	$ (77)

Power Delivery

Power Delivery's Fuel and Purchased Energy consists of the cost of electricity and natural gas purchased by its utility subsidiaries to fulfill their respective Default Electricity Supply and Regulated Gas obligations and, as such, is recoverable from customers in accordance with the terms of public service commission orders. It also includes the cost of natural gas purchased for off-system sales. Fuel and Purchased Energy expense decreased by $39 million primarily due to:

- A decrease of $85 million primarily due to customer migration to competitive suppliers.
- A decrease of $20 million in deferred electricity expense primarily due to higher DPL Default Electricity Supply cost of service rates, which resulted in a lower rate of recovery of Default Electricity Supply costs.
- A decrease of $13 million from the settlement of financial hedges entered into as part of DPL's hedge program for the purchase of regulated natural gas.
- A decrease of $5 million in the cost of gas purchases for off-system sales as a result of lower volumes.

The aggregate amount of these decreases was partially offset by:

- A net increase of $45 million due to higher average electricity costs under Pepco and DPL Default Electricity Supply contracts, partially offset by lower ACE costs.
- An increase of $13 million in deferred electricity expense primarily due to a Renewable Portfolio Surcharge in Delaware effective June 2012 (which is substantially offset in Regulated T&D Electric Revenue and Depreciation and Amortization).
- An increase of $11 million in the cost of gas purchases for on-system sales as a result of higher average gas prices.
- An increase of $6 million due to higher electricity sales primarily as a result of colder weather during the 2013 fall months, as compared to 2012.
- An increase of $4 million in the costs associated with purchasing Renewable Energy Credits in Delaware (which is offset by a corresponding increase in Regulated T&D Electric Revenue).

- An increase of $4 million in the cost of gas purchases for on-system sales as a result of an adjustment recorded in June 2012 for a reduction in the estimate of gas sold but not yet billed to customers (which is offset by an increase in Regulated Gas Revenue).

- An increase of $2 million in the costs associated with purchases under wind power purchase agreements in Delaware (which is offset by a corresponding increase in Regulated T&D Electric Revenue).

Pepco Energy Services

Pepco Energy Services' Fuel and Purchased Energy and Other Services Cost of Sales decreased by $38 million primarily due to:

- A decrease of $30 million primarily due to lower energy savings construction activity.

- A decrease of $7 million due to lower purchases of capacity and lower fuel usage, both attributable to the retirement of the remaining oil-fired generation facilities in the second quarter of 2012.

Other Operation and Maintenance

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

	2013	2012	Change
Power Delivery	$871	$901	$(30)
Pepco Energy Services	42	58	(16)
Corporate and Other	(62)	(61)	(1)
Total	$851	$898	$(47)

Power Delivery

Other Operation and Maintenance expense for Power Delivery decreased by $30 million primarily due to:

- A decrease of $16 million in storm restoration costs.

- A decrease of $15 million associated with lower maintenance costs.

- A decrease of $9 million in customer service costs.

- A decrease of $1 million primarily due to 2012 total incremental storm restoration costs for major storm events as described in the following table:

	2013	2012	Change
Regulatory asset established for future recovery of January 2011 winter storm costs	$ —	$ (9)	$ 9
Costs associated with derecho storm (June 2012)	—	38	(38)
Regulatory assets established for future recovery of derecho storm costs	—	(34)	34
Costs associated with Hurricane Sandy (October 2012)	—	28	(28)
Regulatory assets established for future recovery of Hurricane Sandy costs	—	(22)	22
Total incremental major storm restoration costs	$ —	$ 1	$ (1)

- In January 2011, Pepco incurred incremental storm restoration costs of $10 million associated with a severe winter storm, all of which were expensed in 2011. In July 2012, the MPSC issued an order allowing for the deferral and recovery of $9 million of such costs over a five-year period.

- During 2012, Pepco, DPL and ACE incurred incremental storm restoration costs of $38 million associated with the June 2012 derecho which resulted in widespread damage to the electric distribution system in each of their service territories. PHI's utility subsidiaries deferred $34 million of these costs as regulatory assets to reflect the probable recovery of these storm restoration costs in Maryland and New Jersey. The MPSC approved the recovery of these costs in Maryland for both Pepco and DPL in its July 2013 and August 2013 rate orders, respectively, over a five-year period. ACE's stipulation of settlement approved by the NJBPU in June 2013 provides for recovery of these costs in New Jersey over a three-year period. The remaining costs of $4 million relate to repair work completed in Delaware and the District of Columbia which are not deferrable in those jurisdictions.

- In the fourth quarter of 2012, Pepco, DPL and ACE incurred incremental storm restoration costs of $28 million associated with Hurricane Sandy which resulted in widespread damage to the electric distribution system in each of their service territories. PHI's utility subsidiaries deferred $22 million of these costs as regulatory assets to reflect the probable recovery of these storm restoration costs in Maryland and New Jersey. The MPSC approved the recovery of these costs in Maryland for both Pepco and DPL in its July 2013 and August 2013 rate orders, respectively, over a five-year period. ACE's stipulation of settlement approved by the NJBPU in June 2013 provides for recovery of these costs in New Jersey over a three-year period. The remaining costs of $6 million relate to repair work completed in Delaware and the District of Columbia which are not deferrable in those jurisdictions.

The aggregate amount of these decreases was partially offset by:

- An increase of $6 million resulting from a 2012 deferred cost adjustment associated with DPL Default Electricity Supply. The deferred cost adjustments were primarily due to the under-recognition of allowed returns on net uncollectible expense and regulatory taxes.

- An increase of $3 million associated with the write-off of disallowed MAPP and associated transmission projects costs.

- An increase of $3 million in environmental remediation costs.

Pepco Energy Services

Other Operation and Maintenance expense for Pepco Energy Services decreased by $16 million primarily due to:

- A decrease of $5 million in personnel costs in its energy savings business primarily due to a reduction in the number of employees in the second half of 2012.

- A decrease of $4 million in contractual costs associated with the retirement of the two remaining oil-fired generation facilities in the second quarter of 2012.

- A decrease of $3 million in bid and proposal costs in its energy savings business.

- A decrease of $1 million associated with an accrual for an energy savings guarantee shortfall in 2012.

- A decrease of $1 million in operating, repairs and maintenance expenses at its combined heat and power thermal operations in Atlantic City.

Depreciation and Amortization

Depreciation and Amortization expense increased by $19 million to $473 million in 2013 from $454 million in 2012 primarily due to:

- An increase of $14 million in amortization of regulatory assets primarily related to recoverable AMI costs, major storm costs and rate case costs.

- An increase of $14 million in amortization of MAPP abandonment costs (which is offset in T&D Electric Revenue).

- An increase of $6 million in amortization due to the expiration in August 2013 of the excess depreciation reserve regulatory liability of ACE.

The aggregate amount of these increases was partially offset by:

- A decrease of $8 million due to the deactivation of Pepco Energy Services' oil-fired generating facilities in the second quarter of 2012 and a reduction in the Benning Road asset retirement obligation in 2013 resulting from the decision to pursue the demolition of the Benning Road oil-fired generating facility.

- A decrease of $7 million in the Delaware Renewable Energy Portfolio Standards deferral (which is substantially offset by a corresponding increase in Fuel and Purchased Energy).

Power Delivery depreciation reflected no change from 2012 due to an increase from higher plant investment offset by lower depreciation rates in Pepco and DPL, approved by the MPSC effective July 20, 2012.

Other Taxes

Other Taxes decreased by $4 million to $428 million in 2013 from $432 million in 2012. The decrease was primarily due to lower sales that resulted in a decrease in utility taxes that are collected and passed through by Power Delivery (substantially offset by a corresponding decrease in Regulated T&D Electric Revenue).

Deferred Electric Service Costs

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

Deferred Electric Service Costs increased by $31 million to an expense of $26 million in 2013 as compared to an expense reduction of $5 million in 2012 primarily due to an increase in deferred electricity expense as a result of higher Default Electricity Supply and New Jersey Societal Benefit Program revenue rates and lower electricity supply costs.

Impairment Losses

Impairment losses decreased by $8 million to $4 million in 2013 from $12 million in 2012. The decrease was primarily due to 2012 impairment losses of $12 million ($7 million after-tax) at Pepco Energy Services associated with the combustion turbines at Buzzard Point and certain landfill gas-fired electric generation facilities, partially offset by a 2013 impairment loss of $4 million ($3 million after-tax) associated with a landfill gas-fired electric generation facility.

Other Income (Expenses)

Other Expenses (which are net of Other Income) increased by $19 million to a net expense of $239 million in 2013 from a net expense of $220 million in 2012. The increase reflects a $16 million increase in interest expense primarily associated with higher long-term debt and $3 million associated with lower income related to the allowance for funds used during construction (AFUDC) that is applied to capital projects.

Income Tax Expense

PHI's income tax expense increased by $216 million to $319 million in 2013 from $103 million in 2012.

PHI's consolidated effective income tax rates for the years ended December 31, 2013 and 2012 were 74.4% and 32.1%, respectively.

The increase in the effective tax rate for the year ended December 31, 2013 occurred as a result of recording $56 million of changes in estimates and interest related to uncertain and effectively settled tax positions in the first quarter of 2013. In addition, the increase in the effective tax rate resulted from the establishment of valuation allowances of $101 million in the first quarter of 2013 against certain deferred tax assets in PCI, which is now included in Corporate and Other. Between 1990 and 1999, PCI, through various subsidiaries, entered into certain transactions involving investments in aircraft and aircraft equipment, railcars and other assets. In connection with these transactions, PCI recorded deferred tax assets in prior years of $101 million in the aggregate. Following events that took place during the first quarter of 2013, which included (i) court decisions in favor of the IRS with respect to both Consolidated Edison's cross-border lease transaction (as discussed in Note (19), "Discontinued Operations – Cross-Border Energy Lease Investments," to the consolidated financial statements) and another taxpayer's structured transactions, (ii) the change in PHI's tax position with respect to the tax benefits associated with its cross-border energy leases, and (iii) PHI's decision in March 2013 to begin to pursue the early termination of its remaining cross-border energy lease investments (which represented a substantial portion of the remaining assets within PCI) without the intent to reinvest these proceeds in income-producing assets, management evaluated the likelihood that PCI would be able to realize the $101 million of deferred tax assets in the future. Based on this evaluation, PCI established valuation allowances against these deferred tax assets totaling $101 million in the first quarter of 2013. Further, during the fourth quarter of 2013, in light of additional court decisions in favor of the IRS involving other taxpayers, and after consideration of the relevant factors, management determined that it would abandon the further pursuit of these deferred tax assets, and these assets totaling $101 million were charged off against the previously established valuation allowances.

The effective income tax rate for the year ended December 31, 2012 includes income tax benefits of $8 million related to uncertain and effectively settled tax positions, primarily due to the effective settlement with the IRS in the first quarter of 2012 with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position in Pepco.

The rate for the year ended December 31, 2012 also reflects an increase in deductible asset removal costs for Pepco in 2012 related to a higher level of asset retirements.

Discontinued Operations

PHI's (loss) income from discontinued operations, net of income taxes, is comprised of the following:

	2013	2012	Change
Cross-border energy lease investments	$(327)	$41	$(368)
Pepco Energy Services' retail electric and natural gas supply businesses	5	26	(21)
(Loss) income from discontinued operations, net of income taxes	$(322)	$67	$(389)

For the years ended December 31, 2013 and 2012, (loss) income from discontinued operations, net of income taxes, was a loss of $322 million and income of $67 million, respectively. The decrease of $389 million is comprised of a decrease of $368 million related to PHI's cross-border lease investments and a decrease of $21 million related to the retail electric and natural gas supply businesses at Pepco Energy Services.

The decrease in (loss) income from discontinued operations, net of income taxes, for PHI's cross-border energy lease investments is primarily due to after-tax non-cash charges of $323 million recorded in the first quarter of 2013 and $6 million in the second quarter of 2013, each related to a change in assessment regarding the tax benefits related to the cross-border energy lease investments and consisting of a $373 million pre-tax non-cash charge ($313 million after-tax) to reduce the carrying value of the investments and a $16 million after-tax non-cash charge to reflect the anticipated additional interest expense related to the change in PCI's estimated federal and state income tax obligations as if it were a separate taxpayer. The (loss) income from discontinued operations, net of income taxes, was reduced further by lower cross-border energy lease investment earnings as a result of terminating the cross-border lease investments in 2013, the loss recorded on the early termination of the remaining cross-border energy lease investments during 2013, and gains recorded on the early termination of certain leases within the cross-border energy lease portfolio in the third quarter of 2012.

The decrease in (loss) income from discontinued operations, net of income taxes, at Pepco Energy Services is due to a reduction in sales volume associated with the wind-down of the retail electric and natural gas supply businesses, a reduction in mark-to-market gains, and costs incurred to accelerate the wind-down of the retail electric supply business.

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

Continuing Operations

Operating Revenue

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

	2012	2011	Change
Power Delivery	$4,378	$4,650	$(272)
Pepco Energy Services	256	330	(74)
Corporate and Other	(9)	(16)	7
Total Operating Revenue	$4,625	$4,964	$(339)

Power Delivery

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

	2012	2011	Change
Regulated T&D Electric Revenue	$2,006	$1,891	$ 115
Default Electricity Supply Revenue	2,124	2,462	(338)
Other Electric Revenue	65	67	(2)
Total Electric Operating Revenue	4,195	4,420	(225)
Regulated Gas Revenue	151	183	(32)
Other Gas Revenue	32	47	(15)
Total Gas Operating Revenue	183	230	(47)
Total Power Delivery Operating Revenue	$4,378	$4,650	$(272)

Regulated T&D Electric Revenue includes revenue from the distribution of electricity, including the distribution of Default Electricity Supply, by PHI's utility subsidiaries to customers within their service territories at regulated rates. Regulated T&D Electric Revenue also includes transmission service revenue that PHI's utility subsidiaries receive as transmission owners from PJM at rates regulated by FERC. Transmission rates are updated annually based on a FERC-approved formula methodology.

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

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

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

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

Regulated T&D Electric

	2012	2011	Change
Regulated T&D Electric Revenue			
Residential	$ 722	$ 683	$ 39
Commercial and industrial	923	884	39
Transmission and other	361	324	37
Total Regulated T&D Electric Revenue	$2,006	$1,891	$115

	2012	2011	Change
Regulated T&D Electric Sales (GWh)			
Residential	17,150	17,728	(578)
Commercial and industrial	30,734	31,282	(548)
Transmission and other	258	256	2
Total Regulated T&D Electric Sales	48,142	49,266	(1,124)

	2012	2011	Change
Regulated T&D Electric Customers (in thousands)			
Residential	1,641	1,636	5
Commercial and industrial	198	198	—
Transmission and other	2	2	—
Total Regulated T&D Electric Customers	1,841	1,836	5

Regulated T&D Electric Revenue increased by $115 million primarily due to:

- An increase of $46 million due to distribution rate increases in all jurisdictions (Pepco in the District of Columbia effective October 2012, and in Maryland effective July 2012; DPL in Maryland effective July 2012 and July 2011, and in Delaware effective July 2012; ACE effective November 2012).
- An increase of $35 million in transmission revenue primarily attributable to higher Pepco and DPL rates effective June 1, 2012 and June 1, 2011 related to increases in transmission plant investment and operating expenses.
- An increase of $17 million due to EmPower Maryland (a demand-side management program) rate increases in February 2012 (which is substantially offset by a corresponding increase in Depreciation and Amortization).
- An increase of $15 million primarily due to a Renewable Portfolio Surcharge in Delaware effective June 2012 (which is substantially offset by a corresponding increase in Fuel and Purchased Energy and Depreciation and Amortization).
- An increase of $15 million primarily due to a rate increase in the New Jersey Societal Benefit Charge effective July 2012 (which is offset in Deferred Electric Service Costs).

- An increase of $7 million due to Pepco customer growth in 2012, primarily in the residential class.

The aggregate amount of these increases was partially offset by:

- A decrease of $13 million due to lower pass-through revenue (which is substantially offset by a corresponding decrease in Other Taxes) primarily the result of a decrease in Montgomery County, Maryland utility taxes that are collected by Pepco on behalf of the jurisdiction.
- A decrease of $6 million in Transitional Energy Facility Assessment (TEFA) rate revenue in New Jersey due to a rate decrease effective January 2012 (which is primarily offset by a corresponding decrease in Other Taxes).

Default Electricity Supply

	2012	2011	Change
Default Electricity Supply Revenue			
Residential	$1,467	$1,668	$(201)
Commercial and industrial	542	642	(100)
Other	115	152	(37)
Total Default Electricity Supply Revenue	$2,124	$2,462	$(338)

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

	2012	2011	Change
Default Electricity Supply Sales (GWh)			
Residential	14,245	15,545	(1,300)
Commercial and industrial	5,508	6,168	(660)
Other	55	73	(18)
Total Default Electricity Supply Sales	19,808	21,786	(1,978)

	2012	2011	Change
Default Electricity Supply Customers (in thousands)			
Residential	1,366	1,432	(66)
Commercial and industrial	128	137	(9)
Other	1	—	1
Total Default Electricity Supply Customers	1,495	1,569	(74)

Default Electricity Supply Revenue decreased by $338 million primarily due to:

- A decrease of $140 million due to lower sales, primarily as a result of customer migration to competitive suppliers.
- A net decrease of $100 million as a result of lower Pepco and DPL Default Electricity Supply rates, partially offset by higher ACE rates.
- A decrease of $38 million in wholesale energy and capacity resale revenues primarily due to lower market prices for the resale of electricity and capacity purchased from NUGs.
- A decrease of $35 million due to lower sales as a result of milder weather during the 2012 winter and spring months, as compared to 2011.
- A net decrease of $26 million due to lower Pepco and ACE non-weather related average residential customer usage, partially offset by higher DPL residential customer usage.

The aggregate amount of these decreases was partially offset by an increase of $5 million due to higher Pepco revenue from transmission enhancement credits.

Regulated Gas

	2012	2011	Change
Regulated Gas Revenue			
Residential	$ 94	$113	$(19)
Commercial and industrial	47	61	(14)
Transportation and other	10	9	1
Total Regulated Gas Revenue	$151	$183	$(32)

	2012	2011	Change
Regulated Gas Sales (million cubic feet)			
Residential	6,428	7,346	(918)
Commercial and industrial	3,636	4,442	(806)
Transportation and other	6,751	6,966	(215)
Total Regulated Gas Sales	16,815	18,754	(1,939)

	2012	2011	Change
Regulated Gas Customers (in thousands)			
Residential	115	115	—
Commercial and industrial	10	9	1
Transportation and other	—	—	—
Total Regulated Gas Customers	125	124	1

Regulated Gas Revenue decreased by $32 million primarily due to:

- A decrease of $14 million due to lower sales primarily as a result of milder weather during the winter months of 2012 as compared to 2011.
- A decrease of $9 million due to GCR decreases effective November 2011 and November 2012.
- A decrease of $5 million due to lower non-weather related average customer usage.
- A decrease of $4 million due to a revenue adjustment recorded in June 2012 for a reduction in the estimate of gas sold but not yet billed to customers (which is offset by a decrease in Fuel and Purchased Energy).

The aggregate amount of these decreases was partially offset by an increase of $1 million due to a distribution rate increase effective July 2011.

Other Gas Revenue

Other Gas Revenue decreased by $15 million primarily due to lower average prices and lower volumes for off-system sales to electric generators and gas marketers.

Pepco Energy Services

Pepco Energy Services' operating revenue decreased by $74 million primarily due to:

- A decrease of $55 million due to lower generation and capacity revenues attributable to the retirement of the remaining generation facilities in the second quarter of 2012.
- A decrease of $19 million primarily due to decreased energy savings construction activities.

Operating Expenses

Fuel and Purchased Energy and Other Services Cost of Sales

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

	2012	2011	Change
Power Delivery	$2,109	$2,490	$(381)
Pepco Energy Services	186	221	(35)
Corporate and Other	(2)	(2)	—
Total	$2,293	$2,709	$(416)

Power Delivery

Power Delivery's Fuel and Purchased Energy consists of the cost of electricity and natural gas purchased by its utility subsidiaries to fulfill their respective Default Electricity Supply and Regulated Gas obligations and, as such, is recoverable from customers in accordance with the terms of public service commission orders. It also includes the cost of natural gas purchased for off-system sales. Fuel and Purchased Energy expense decreased by $381 million primarily due to:

- A decrease of $158 million due to lower average electricity costs under Default Electricity Supply contracts.
- A decrease of $142 million primarily due to customer migration to competitive suppliers.
- A decrease of $29 million due to lower electricity sales primarily as a result of milder weather during the winter and spring months of 2012, as compared to the corresponding periods in 2011.
- A decrease of $21 million in the cost of gas purchases for on-system sales as a result of lower average gas prices and lower volumes purchased.
- A decrease of $18 million in deferred electricity expense primarily due to lower Pepco and DPL Default Electricity Supply revenue rates, which resulted in a lower rate of recovery of Default Electricity Supply costs.
- A decrease of $12 million in the cost of gas purchases for off-system sales as a result of lower average gas prices and lower volumes purchased.
- A decrease of $11 million from the settlement of financial hedges entered into as part of DPL's hedge program for the purchase of regulated natural gas.
- A decrease of $4 million in the cost of gas purchases for on-system sales as a result of an adjustment recorded in June 2012 for a reduction in the estimate of gas sold but not yet billed to customers (which is offset by a decrease in Regulated Gas Revenue).

The aggregate amount of these decreases was partially offset by:

- An increase of $6 million in deferred gas expense as a result of a higher rate of recovery of natural gas supply costs due to lower average gas prices.
- An increase of $6 million in costs to purchase Renewable Energy Credits in Delaware (which is offset by a corresponding increase in Regulated T&D Electric Revenue).

Pepco Energy Services

Pepco Energy Services' Fuel and Purchased Energy and Other Services Cost of Sales decreased by $35 million primarily due to:

- A decrease of $29 million due to lower purchases of capacity and lower fuel usage, both attributable to the retirement of the remaining generation facilities in the second quarter of 2012.
- A decrease of $7 million due to lower energy savings construction activity partially offset by higher costs associated with energy services and underground transmission construction activities.

Other Operation and Maintenance

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

	2012	2011	Change
Power Delivery	$901	$884	$17
Pepco Energy Services	58	62	(4)
Corporate and Other	(61)	(57)	(4)
Total	$898	$889	$ 9

Power Delivery

Other Operation and Maintenance expense for Power Delivery increased by $17 million primarily due to:

- An increase of $16 million in employee-related costs, primarily pension and other employee benefits.
- An increase of $10 million resulting from a decrease in deferred cost adjustments associated with DPL Default Electricity Supply. The deferred costs adjustments were primarily due to the under-recognition of allowed returns on working capital and administrative costs in 2011, partially offset by favorable adjustments in 2012 related to allowed returns on net uncollectible expense and recovery of regulatory taxes.
- An increase of $8 million in customer support service and system support costs.
- An increase of $5 million in New Jersey Societal Benefit Program costs that are deferred and recoverable.
- An increase of $4 million in expenses related to regulatory filings.
- An increase of $4 million in self-insurance reserves for general and auto liability claims.

The aggregate amount of these increases was partially offset by:

- A decrease of $15 million primarily due to a decrease in total incremental storm restoration costs for major storm events as described in the following table:

	2012	2011	Change
Costs associated with severe winter storm (January 2011)	$ —	$ 10	$ (10)
Regulatory asset established for future recovery of January 2011 winter storm costs	(9)	—	(9)
Costs associated with derecho storm (June 2012)	38	—	38
Regulatory asset established for future recovery of derecho storm costs	(34)	—	(34)
Costs associated with Hurricane Sandy (October 2012)	28	—	28
Regulatory asset established for future recovery of Hurricane Sandy costs	(22)	—	(22)
Costs associated with Hurricane Irene (August 2011)	—	28	(28)
Regulatory asset established for future recovery of Hurricane Irene costs	—	(22)	22
Total incremental major storm restoration costs	$ 1	$ 16	$ (15)

- In January 2011, Pepco incurred incremental storm restoration costs of $10 million associated with a severe winter storm, all of which were expensed in 2011. In July 2012, the MPSC issued an order allowing for the deferral and recovery of $9 million of such costs over a five-year period.

- During 2012, Pepco, DPL and ACE incurred incremental storm restoration costs of $38 million associated with the June 2012 derecho which resulted in widespread damage to the electric distribution system in each of their service territories. PHI's utility subsidiaries deferred $34 million of these costs as regulatory assets to reflect the probable recovery of these storm restoration costs in Maryland and New Jersey, and will be pursuing recovery of these incremental storm restoration costs in their respective jurisdictions in their electric distribution base rate cases. The remaining costs of $4 million primarily relate to repair work completed in Delaware and the District of Columbia which are not deferrable in those jurisdictions.

- In the fourth quarter of 2012, Pepco, DPL and ACE incurred incremental storm restoration costs of $28 million associated with Hurricane Sandy which resulted in widespread damage to the electric distribution system in each of their service territories. PHI's utility subsidiaries deferred $22 million of these costs as regulatory assets to reflect the probable recovery of these storm restoration costs in Maryland and New Jersey, and will be pursuing recovery of these incremental storm restoration costs in their respective jurisdictions in their electric distribution base rate cases. The remaining costs of $6 million primarily relate to repair work completed in Delaware and the District of Columbia which are not deferrable in those jurisdictions.

- During 2011, Pepco, DPL and ACE incurred incremental storm restoration costs of $28 million associated with Hurricane Irene which resulted in widespread damage to the electric distribution system in each of their service territories. PHI's utility subsidiaries deferred $22 million of these costs as regulatory assets to reflect the probable recovery of these storm restoration costs in Maryland and New Jersey. The MPSC approved the recovery of these costs in Maryland for both Pepco and DPL in its July 2012 rate orders over a five-year period. ACE's stipulation of settlement approved by the NJBPU in October 2012 provides for recovery of these costs in New Jersey over a three-year period. The remaining costs of $6 million relate to repair work completed in Delaware and the District of Columbia which are not deferrable in those jurisdictions.

- ➢ A decrease of $8 million in bad debt expenses.
- ➢ A decrease of $4 million associated with lower preventative maintenance and tree trimming costs due to accelerated efforts made in 2011 to improve reliability.
- ➢ A decrease of $3 million due to the deferral of distribution rate case costs previously charged to Other Operation and Maintenance expense. These deferrals were recorded in accordance with the MPSC rate order issued in July 2012 and the DCPSC rate order issued in September 2012, each allowing for the recovery of these costs.

Pepco Energy Services

Other Operation and Maintenance expense for Pepco Energy Services decreased by $4 million primarily due to the closing of the oil-fired generation facilities in the second quarter of 2012, partially offset by higher energy services expenses.

Depreciation and Amortization

Depreciation and Amortization expense increased by $29 million to $454 million in 2012 from $425 million in 2011 primarily due to:

- ➢ An increase of $22 million in amortization of regulatory assets primarily due to EmPower Maryland surcharge rate increases effective

February 2012 and expanding Demand Side Management Programs (which are substantially offset by corresponding increases in Regulated T&D Electric Revenue).

- An increase of $11 million in amortization of AMI projects.

- An increase of $5 million due to utility plant additions, partially offset by lower depreciation rates.

- An increase of $4 million in the Delaware Renewable Energy Portfolio Standards deferral associated with the over-recovery of renewable energy procurement costs (which is offset by a corresponding increase in Regulated T&D Electric Revenue).

The aggregate amount of these increases was partially offset by:

- A decrease of $12 million in amortization of stranded costs primarily as the result of lower revenue due to rate decreases effective October 2011 for the ACE Transition Bond Charge and Market Transition Charge Tax (revenue ACE receives and pays to ACE Funding to recover income taxes associated with Transition Bond Charge revenue) (partially offset in Default Electricity Supply Revenue).

- A decrease of $4 million primarily due to the deactivation of Pepco Energy Services generating facilities in May 2012.

The MPSC reduced the depreciation rates for Pepco and DPL in their most recent electric distribution base rate cases, which is expected to lower annual Depreciation and Amortization expense for PHI by approximately $31 million effective July 20, 2012.

Other Taxes

Other Taxes decreased by $19 million to $432 million in 2012 from $451 million in 2011. The decrease was primarily due to:

- A decrease of $10 million, primarily due to a decrease in utility taxes that are collected and passed through by Power Delivery (substantially offset by a corresponding decrease in Regulated T&D Electric Revenue).

- A decrease of $5 million in TEFA tax collections due to a rate decrease effective January 2012 (partially offset by a corresponding decrease in Regulated T&D Electric Revenue).

Deferred Electric Service Costs

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

Deferred Electric Service Costs increased by $58 million, to an expense reduction of $5 million in 2012 as compared to an expense reduction of $63 million in 2011, primarily due to an increase in deferred electricity expense as a result of higher Default Electricity Supply revenue rates, partially offset by higher electricity supply costs.

Impairment Losses

PHI's operating expenses for the year ended December 31, 2012, included impairment losses of $12 million ($7 million after-tax) at Pepco Energy Services associated with the combustion turbines at Buzzard Point and certain landfill gas-fired electric generation facilities.

Other Income (Expenses)

Other Expenses (which are net of Other Income) increased by $3 million to a net expense of $220 million in 2012 from a net expense of $217 million in 2011. The increase reflects a $14 million increase in interest expense primarily associated with higher long-term debt and lower capitalized interest. The increase was mostly offset by an increase of $10 million in other income primarily from losses and impairments on equity investments in 2011 that did not occur in 2012.

Income Tax Expense

PHI's income tax expense decreased by $11 million to $103 million in 2012 from $114 million in 2011.

PHI's consolidated effective income tax rates for the years ended December 31, 2012 and 2011 were 32.1% and 33.9%, respectively.

The effective income tax rate for the year ended December 31, 2012 includes income tax benefits of $10 million related to uncertain and effectively settled tax positions, primarily due to the effective settlement with the IRS in the first quarter of 2012 with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position in Pepco. During the year ended December 31, 2011, PHI recorded tax benefits of $17 million related to uncertain and effectively settled tax positions, primarily resulting from the settlement with the IRS on interest due on its 1996 through 2002 tax years.

The rate for the year ended December 31, 2012 also reflects an increase in deductible asset removal costs for Pepco in 2012 related to a higher level of asset retirements.

Discontinued Operations

PHI's income from discontinued operations, net of income taxes, is comprised of the following:

	2012	2011	Change
Cross-border energy lease investments	$ 41	$ 36	$ 5
Pepco Energy Services' retail electric and natural gas supply businesses	26	2	24
Conectiv Energy	—	(3)	3
Income from discontinued operations, net of income taxes	$ 67	$ 35	$ 32

Income from discontinued operations, net of income taxes, increased by $32 million to $67 million in 2012 from $35 million in 2011.

The increase of $5 million in income from discontinued operations, net of income taxes, attributable to PHI's cross-border energy lease investments was primarily due to higher gains recorded on the early termination of certain leases within the cross-border energy lease portfolio in 2012 as compared to 2011. The pre-tax gains were $39 million for each of the years ended December 31, 2012 and 2011, and the after-tax gains were $9 million and $3 million for the years ended December 31, 2012 and 2011, respectively.

The increase of $24 million in income from discontinued operations, net of income taxes, attributable to Pepco Energy Services' retail electric and natural gas supply businesses was primarily due to higher gross margins related to gains from mark-to-market accounting for derivatives used to manage commodity price risk and decreases in other operation and maintenance expenses. These increases were partially offset by reduced sales volumes associated with the ongoing wind-down of the retail electric and natural gas supply businesses.

The loss from discontinued operations, net of income taxes, for Conectiv Energy in 2011 resulted from the recognition of a loss related to the disposition of the remaining assets and businesses of Conectiv Energy not included in the sale of such assets and businesses to Calpine Corporation.

Capital Resources and Liquidity

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

Working Capital

At December 31, 2013, PHI's current assets on a consolidated basis totaled $1.4 billion and its consolidated current liabilities totaled $2.3 billion, resulting in a working capital deficit of $0.9 billion. PHI expects the working capital deficit at December 31, 2013 to be funded during 2014 in part through cash flows from operations and from the issuance of long-term debt. At December 31, 2012, PHI's current assets on a consolidated basis totaled $1.3 billion and its consolidated current liabilities totaled $2.5 billion, for a working capital deficit of $1.2 billion. The decrease of $361 million in the working capital deficit from December 31, 2012 to December 31, 2013 was primarily due to a decrease in short-term debt, the repayment of which was primarily funded with cash received from the early terminations of the cross-border energy leases, a decrease in the current portion of long-term debt, and an increase in income taxes receivable, partially offset by an increase in liabilities and accrued interest related to uncertain tax positions.

At December 31, 2013, PHI's consolidated cash and cash equivalents totaled $23 million, which consisted of cash and uncollected funds but excluded current Restricted Cash Equivalents (cash that is available to be used only for designated purposes) that totaled $13 million. At December 31, 2012, PHI's consolidated cash and cash equivalents totaled $25 million, which consisted of cash and uncollected funds but excluded current Restricted Cash Equivalents that totaled $10 million.

PHI's short-term debt balances and current portions of long-term debt and project funding balances are summarized below:

	As of December 31, 2013 (millions of dollars)							
Type	PHI Parent	Pepco	DPL	ACE	ACE Funding	Pepco Energy Services	PCI	PHI Consolidated
Variable Rate Demand Bonds	$ —	$ —	$ 105	$ 18	$ —	$ —	$ —	$ 123
Commercial Paper	24	151	147	120	—	—	—	442
Total Short-Term Debt	$ 24	$ 151	$ 252	$ 138	$ —	$ —	$ —	$ 565
Current Portion of Long-Term Debt and Project Funding	$ —	$ 175	$ 100	$ 107	$ 41	$ 12	$ 11	$ 446

	As of December 31, 2012 (millions of dollars)							
Type	PHI Parent	Pepco	DPL	ACE	ACE Funding	Pepco Energy Services	PCI	PHI Consolidated
Variable Rate Demand Bonds	$ —	$ —	$ 105	$ 23	$ —	$ —	$ —	$ 128
Commercial Paper	264	231	32	110	—	—	—	637
Term Loan Agreement	200	—	—	—	—	—	—	200
Total Short-Term Debt	$ 464	$ 231	$ 137	$ 133	$ —	$ —	$ —	$ 965
Current Portion of Long-Term Debt and Project Funding	$ —	$ 200	$ 250	$ 69	$ 39	$ 11	$ —	$ 569

Commercial Paper

PHI, Pepco, DPL and ACE maintain commercial paper programs to address short-term liquidity needs. As of December 31, 2013, the maximum capacity available under these programs was $875 million, $500 million, $500 million and $350 million, respectively, subject to available borrowing capacity under the unsecured syndicated credit facility described below.

The weighted average interest rate for commercial paper issued by PHI, Pepco, DPL and ACE during 2013 was 0.70%, 0.34%, 0.29% and 0.31%, respectively. The weighted average maturity of all commercial paper issued by PHI, Pepco, DPL and ACE during 2013 was five, five, three and four days, respectively.

Equity Forward Transaction

During 2012, PHI entered into an equity forward transaction in connection with a public offering of PHI common stock. Pursuant to the terms of this transaction, a forward counterparty borrowed 17,922,077 shares of PHI's common stock from third parties and sold them to a group of underwriters for $19.25 per share, less an underwriting discount equal to $0.67375 per share. Under the terms of the equity forward transaction, upon physical settlement thereof, PHI was required to issue and deliver shares of PHI common stock to the forward counterparty at the then applicable forward sale price. The forward sale price was initially determined to be $18.57625 per share at the time the equity forward transaction was entered into and was subject to reduction from time to time in accordance with the terms of the equity forward transaction. PHI believed that the equity forward transaction substantially eliminated future equity price risk because the forward sale price was determinable as of the date that PHI entered into the equity forward transaction and was only reduced pursuant to the contractual terms of the equity forward transaction through the settlement date, which reductions were not affected by a future change in the market price of the PHI common stock. On February 27, 2013, PHI physically settled the equity forward at the then applicable forward sale price of $17.39 per share. The proceeds of approximately $312 million were used to repay outstanding commercial paper, a portion of which had been issued in order to make capital contributions to the utilities, and for general corporate purposes.

Credit Facility

PHI, Pepco, DPL and ACE maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement which, on August 2, 2012, was amended to extend the term of the credit facility to August 1, 2017 and to amend the pricing schedule to decrease certain fees and interest rates payable to the lenders under the facility. On August 1, 2013, as permitted under the existing terms of the credit agreement, a request by PHI, Pepco, DPL and ACE to extend the credit facility termination date to August 1, 2018 was approved. All of the terms and conditions, as well as pricing, remained the same after such extension.

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

For additional discussion of the Credit Facility, see Note (10), “Debt,” to the consolidated financial statements.

Term Loan Agreements

PHI Term Loan Agreement

On March 28, 2013, PHI entered into a $250 million term loan agreement due March 27, 2014, pursuant to which PHI had borrowed $250 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to the London Interbank Offered Rate (LIBOR) with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.875%. PHI used the net proceeds of the loan under the loan agreement to repay its outstanding $200 million term loan obtained in 2012, and for general corporate purposes. On May 29, 2013, PHI repaid the $250 million term loan with a portion of the net proceeds from the early termination of the cross-border energy lease investments.

ACE Term Loan Agreement

On May 10, 2013, ACE entered into a $100 million term loan agreement, pursuant to which ACE has borrowed (and may not re-borrow) $100 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to the LIBOR with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.75%. ACE’s Eurodollar borrowings under the loan agreement may be converted into floating rate loans under certain circumstances, and, in that event, for so long as any loan remains a floating rate loan, interest would accrue on that loan at a rate per year equal to (i) the highest of (a) the prevailing prime rate, (b) the federal funds effective rate plus 0.5%, or (c) the one-month Eurodollar rate plus 1%, plus (ii) a margin of 0.75%. As of December 31, 2013, outstanding borrowings under the loan agreement bore interest at an annual rate of 0.92%, which is subject to adjustment from time to time. All borrowings under the loan agreement are unsecured, and the aggregate principal amount of all loans, together with any accrued but unpaid interest due under the loan agreement, must be repaid in full on or before November 10, 2014.

Under the terms of the term loan agreement, ACE must maintain compliance with specified covenants, including (i) the requirement that ACE maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the loan agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) a restriction on sales or other dispositions of assets, other than certain permitted sales and dispositions, and (iii) a restriction on the incurrence of liens (other than liens permitted by the loan agreement) on the assets of ACE. The loan agreement does not include any rating triggers. ACE was in compliance with all covenants under this loan agreement as of December 31, 2013.

Long-Term Project Funding

On October 24, 2013, Pepco Energy Services entered into an agreement with a lender to receive up to $8 million in construction financing at an interest rate of 4.68% for an energy savings project that is expected to be completed in 2014. The agreement includes a transfer of receivables from Pepco Energy Services to the lender after construction is completed, under which the customer would make contractual payments over a 23-year period to repay the financing. If there are shortfalls in Pepco Energy Services' energy savings guarantee or other performance obligations to the customer that reduce customer payments below the contractual payment amounts, then Pepco Energy Services would compensate the lender for the unpaid amounts. PHI has guaranteed the performance obligations of Pepco Energy Services under the financing agreement.

Cash and Credit Facility Available as of December 31, 2013

	Consolidated PHI	PHI Parent	Utility Subsidiaries
		(millions of dollars)	
Credit Facility (Total Capacity)	$ 1,500	$ 750	$ 750
Less: Letters of Credit issued	2	2	—
Commercial Paper outstanding	442	24	418
Remaining Credit Facility Available	1,056	724	332
Cash Invested in Money Market Funds and on hand [a]	7	7	—
Total Cash and Credit Facility Available	$ 1,063	$ 731	$ 332

[a] Cash and cash equivalents reported on the PHI consolidated balance sheet totaled $23 million, of which $7 million was invested in money market funds, and the balance was held in cash and uncollected funds.

PHI's Cross-Border Energy Lease Investments

PHI has an ongoing dispute with the IRS regarding the appropriateness of certain significant income tax benefits claimed by PHI related to its cross-border energy lease investments beginning with its 2001 federal income tax return. In the first quarter of 2013, PHI estimated that, in the event the IRS were to be fully successful in its challenge to PHI's tax position on the cross-border energy leases, PHI would have been obligated to pay $192 million in additional federal taxes and $50 million of interest on the additional federal taxes, totaling $242 million as of March 31, 2013. The estimate of additional federal taxes due includes PHI's estimate of the expected resolution of other uncertain and effectively settled tax positions unrelated to the leases, the carrying back or carrying forward of any existing net operating losses, and the application of certain amounts paid in advance to the IRS.

In order to mitigate PHI's ongoing interest costs associated with the $242 million estimate of additional taxes and interest, PHI made a $242 million advanced payment to the IRS for the estimated additional taxes and related interest in the first quarter of 2013. This advanced payment was funded from then currently available sources of liquidity and short-term borrowings. In March 2013, PHI began to pursue the early termination of its six remaining cross-border energy lease investments, which had a net carrying value of approximately $869 million as of March 31, 2013. During the second and third quarters of 2013, PHI terminated early all of its interests in the six remaining lease investments. PHI received aggregate net cash proceeds of $873 million (net of aggregate termination payments of $2.0 billion used to retire the non-recourse debt associated with the terminated leases) and recorded an aggregate pre-tax loss, including transaction costs, of approximately $3 million ($2 million after-tax), representing the excess of the carrying value of the terminated leases over the net cash proceeds received. A portion of the net cash proceeds from the terminated leases was used to repay borrowings utilized to fund the advanced payment discussed above.

Pension and Other Postretirement Benefit Plans

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

Under the Pension Protection Act, if a plan incurs a funding shortfall in the preceding plan year, there can be required minimum quarterly contributions in the current and following plan years. In 2014, PHI, Pepco, DPL and ACE do not expect to make discretionary tax-deductible contributions to the PHI Retirement Plan. Management expects that the current balance of the PHI Retirement Plan assets is at least equal to the funding target liability for 2014 under the Pension Protection Act. During 2013, PHI, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of $80 million, $10 million and $30 million, respectively. During 2012, Pepco, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of $85 million, $85 million and $30 million, respectively. PHI satisfied the minimum required contribution rules under the Pension Protection Act in 2013, 2012 and 2011. For additional discussion of PHI's Pension and Other Postretirement Benefits, see Note (9), "Pension and Other Postretirement Benefits," to the consolidated financial statements.

PHI provides certain postretirement health care and life insurance benefits for eligible retired employees. Most employees hired on January 1, 2005 or later will not have company subsidized retiree health care coverage; however, they will be able to purchase coverage at full cost through PHI.

In 2013 and 2012, Pepco contributed $6 million and $5 million, respectively, DPL contributed $3 million and $7 million, respectively, and ACE contributed $6 million and $7 million, respectively, to the other postretirement benefit plan. In 2013 and 2012, contributions of $7 million and $13 million, respectively, were made by other PHI subsidiaries.

Based on the results of the 2013 actuarial valuation, PHI's net periodic pension and other postretirement benefit (OPEB) costs were approximately $94 million in 2013 versus $110 million in 2012. The current estimate of benefit cost for 2014 is $67 million. The utility subsidiaries are responsible for substantially all of the total PHI net periodic pension and OPEB costs. Approximately 37% of net periodic pension and OPEB costs were capitalized in 2013. PHI estimates that its net periodic pension and OPEB expense will be approximately $40 million in 2014, as compared to $57 million in 2013 and $67 million in 2012.

Other Postretirement Benefit Plan Amendment

During 2013, PHI approved two amendments to its other postretirement benefits plan. These amendments impacted the retiree health care and retiree life insurance benefits, and were effective on January 1, 2014. As a result of the amendments, which were cumulatively significant, PHI remeasured its accumulated postretirement benefit obligation as of July 1, 2013. The remeasurement resulted in a $193 million reduction of the accumulated postretirement benefit obligation, which included recording a prior service credit of $124 million, which will be amortized over approximately ten years, and a $69 million reduction from a change in the discount rate from 4.10% as of December 31, 2012 to 4.95% as of July 1, 2013.

Cash Flow Activity

PHI's cash flows during 2013, 2012 and 2011 are summarized below:

	Cash Source (Use)		
	2013	2012	2011
		(millions of dollars)	
Operating Activities	$ 497	$ 592	$ 686
Investing Activities	(411)	(969)	(747)
Financing Activities	(88)	293	149
Net (decrease) increase in cash and cash equivalents	$ (2)	$ (84)	$ 88

Operating Activities

Cash flows from operating activities during 2013, 2012 and 2011 are summarized below:

	Cash Source (Use)		
	2013	2012	2011
		(millions of dollars)	
Net income from continuing operations	$ 110	$ 218	$ 222
Non-cash adjustments to net income	465	451	410
Pension contributions	(120)	(200)	(110)
Advanced payment made to taxing authority	(242)	—	—
Changes in cash collateral related to derivative activities	31	88	9
Changes in other assets and liabilities	206	60	90
Changes in net current assets held for disposition or sale	47	(25)	65
Net cash from operating activities	$ 497	$ 592	$ 686

Net cash from operating activities decreased $95 million for the year ended December 31, 2013, compared to the same period in 2012. The decrease was primarily due to a decrease in net income of $108 million and a $242 million advanced payment to the IRS for estimated additional taxes and related interest, partially offset by an $80 million decrease in pension contributions and a $72 million reduction in net current assets held for disposition or sale associated with the early termination of all cross-border energy lease investments and the wind-down of Pepco Energy Services' retail electric and natural gas supply businesses.

Net cash from operating activities decreased $94 million for the year ended December 31, 2012, compared to the same period in 2011. The decrease was due primarily to a $90 million increase in pension contributions compared to 2011, the disposition of substantially all of Conectiv Energy's remaining assets in 2011 and a $46 million increase in Pepco Energy Services net assets held for disposition. This was partially offset by a $79 million decrease in cash collateral related to derivative activities.

Investing Activities

Cash flows used by investing activities during 2013, 2012 and 2011 are summarized below:

	Cash (Use) Source		
	2013	2012	2011
		(millions of dollars)	
Investment in property, plant and equipment	$ (1,310)	$ (1,216)	$ (941)
DOE capital reimbursement awards received	22	40	52
Changes in restricted cash equivalents	1	(1)	(10)
Net other investing activities	3	6	(9)
Proceeds from disposal of assets held for disposition	873	202	161
Net cash used by investing activities	$ (411)	$ (969)	$ (747)

Net cash used by investing activities decreased $558 million for the year ended December 31, 2013, compared to the same period in 2012. The decrease was primarily due to proceeds from the early termination of all cross-border energy lease investments.

Net cash used by investing activities increased $222 million for the year ended December 31, 2012, compared to the same period in 2011. The increase was due primarily to a $275 million increase in capital expenditures associated with new customer services, distribution reliability and transmission. This increase was partially offset by $41 million in increased proceeds received from the early termination of certain cross-border energy lease investments.

Financing Activities

Cash flows from financing activities during 2013, 2012 and 2011 are summarized below:

	Cash (Use) Source		
	2013	2012	2011
		(millions of dollars)	
Dividends paid on common stock	$ (270)	$ (248)	$ (244)
Common stock issued for the Direct Stock Purchase and Dividend Reinvestment Plan (DRP) and employee-related compensation [(a)]	50	51	47
Issuances of common stock	324	—	—
Redemption of preferred stock of subsidiaries	—	—	(6)
Issuances of long-term debt	800	450	235
Reacquisitions of long-term debt	(558)	(176)	(70)
(Repayments) issuances of short-term debt, net	(200)	33	198
Issuances of term loans	250	200	—
Repayments of term loans	(450)	—	—
Cost of issuances	(23)	(9)	(10)
Net other financing activities	(11)	(8)	(1)
Net cash (used by) from financing activities	$ (88)	$ 293	$ 149

(a) Prior to October 1, 2013, the DRP was named the Shareholder Dividend Reinvestment Plan.

Net cash from financing activities decreased $381 million for the year ended December 31, 2013, compared to the same period in 2012. The decrease was primarily due to a net decrease of $400 million in term loans and an increase of $233 million in short-term debt repayments, partially offset by issuances of common stock of $324 million primarily due to the settlement of the equity forward transaction.

Net cash from financing activities increased $144 million for the year ended December 31, 2012 compared to the same period in 2011. The increase was due primarily to a $200 million term loan issuance and a $109 million net increase in long-term debt partially offset by a $165 million net decrease in short-term debt issuances.

Common Stock Dividends

Common stock dividend payments were $270 million in 2013, $248 million in 2012, and $244 million in 2011. The increase in common stock dividends paid in 2013 and 2012 was the result of additional shares outstanding, primarily shares issued upon settlement of the equity forward transaction in February 2013 and under the DRP.

Changes in Outstanding Common Stock

PHI issued approximately 1 million shares of common stock in each of 2013, 2012 and 2011 under PHI's long-term incentive plans.

Under the DRP, PHI issued 1.6 million shares of common stock in 2013, 1.7 million shares of common stock in 2012, and 1.6 million shares of common stock in 2011.

In February 2013, PHI issued 17.9 million shares of common stock pursuant to the settlement of the equity forward transaction discussed above.

Changes in Outstanding Long-Term Debt

Cash flows from issuances and reacquisitions of long-term debt in 2013, 2012 and 2011 are summarized in the tables below:

Issuances	2013	2012	2011
		(millions of dollars)	
Pepco			
3.05% First mortgage bonds due 2022	$ —	$ 200	$ —
4.15% First mortgage bonds due 2043	250	—	—
4.95% First mortgage bonds due 2043	150	—	—
	400	200	—
DPL			
0.75% Tax-exempt bonds due 2026 [(a)]	—	—	35
4.00% First mortgage bonds due 2042	—	250	—
3.50% First mortgage bonds due 2023	300	—	—
	300	250	35
ACE			
4.35% First mortgage bonds due 2021	—	—	200
Variable rate term loan due 2014	100	—	—
	100	—	200
Pepco Energy Services	—	—	—
	$ 800	$ 450	$ 235

(a) Consists of Pollution Control Refunding Revenue Bonds (DPL Bonds) issued by the Delaware Economic Development Authority (DEDA) for the benefit of DPL that were purchased by DPL in May 2011. See footnote (b) to the Reacquisitions table below. The DPL Bonds were resold to the public in June 2011. While DPL held the DPL Bonds, they remained outstanding as a contractual matter, but were considered extinguished for accounting purposes. In connection with the resale of the DPL Bonds, the interest rate on the bonds was adjusted from 4.90% to a fixed rate of 0.75%.

Reacquisitions	2013	2012	2011
		(millions of dollars)	
Pepco			
5.375% Tax-exempt bonds due 2024 [a]	$ —	$ 38	$ —
4.95% First mortgage bonds due 2013	200	—	—
	200	38	—
DPL			
4.90% Tax-exempt bonds due 2026 [b]	—	—	35
0.75% Tax-exempt bonds due 2026 [a]	—	35	—
1.80% Tax-exempt bonds due 2025 [c]	—	15	—
2.30% Tax-exempt bonds due 2028 [c]	—	16	—
5.20% Tax-exempt bonds due 2019	—	31	—
6.40% First mortgage bonds due 2013	250	—	—
	250	97	35
ACE			
Securitization bonds due 2011-2013	39	37	35
5.60% First mortgage bonds due 2025 [a]	—	4	—
6.625% First mortgage bonds due 2013	69	—	—
	108	41	35
	$ 558	$ 176	$ 70

(a) These bonds were secured by an outstanding series of collateral first mortgage bonds issued by the utility, which had maturity dates, optional and mandatory redemption provisions, interest rates and interest payment dates that are identical to the terms of the tax-exempt bonds. The collateral first mortgage bonds were automatically redeemed simultaneously with the redemption of the tax-exempt bonds.

(b) Repurchased by DPL in May 2011 pursuant to a mandatory purchase provision in the indenture for the bonds that was triggered by the expiration of the original interest period for the bonds. The bonds were resold by DPL in June 2011. See footnote (a) to the Issuances table above.

(c) Repurchased by DPL in June 2012 pursuant to a mandatory purchase obligation and then retired.

Tax Exempt Auction Rate and First Mortgage Bond Issuances

During 2013, Pepco issued $250 million of 4.15% first mortgage bonds due March 15, 2043 and $150 million of 4.95% first mortgage bonds due November 15, 2043. These bonds were issued under a Mortgage and Deed of Trust and are secured thereunder by a first lien, subject to certain leases, permitted liens and other exceptions, on substantially all of Pepco's properties, except for such property excluded from the lien of the Mortgage and Deed of Trust. Net proceeds from the issuance of the 4.15% bonds were used to repay Pepco's outstanding commercial paper and for general corporate purposes. The net proceeds from the 4.95% bonds were used to repay outstanding commercial paper, including commercial paper issued to repay in full at maturity $200 million of Pepco 4.95% senior notes due November 15, 2013, plus accrued but unpaid interest thereon. The senior notes were secured by a like principal amount of Pepco first mortgage bonds, which under Pepco's Mortgage and Deed of Trust were deemed to be satisfied with the repayment of the senior notes.

During 2013, DPL issued $300 million of 3.50% first mortgage bonds due November 15, 2023. These bonds were issued under a Mortgage and Deed of Trust and are secured thereunder by a first lien, subject to certain leases, permitted liens and other exceptions, on substantially all of DPL's properties, except for such property excluded from the lien of the Mortgage and Deed of Trust. The net proceeds from the issuance of the long-term debt were used to repay at maturity $250 million of DPL's 6.40% first mortgage bonds, plus accrued but unpaid interest thereon, to repay outstanding commercial paper and for general corporate purposes.

During 2012, Pepco issued $200 million of 3.05% first mortgage bonds due April 1, 2022. Net proceeds from the issuance of the long-term debt were used primarily (i) to repay Pepco's outstanding commercial paper that was issued to temporarily fund capital expenditures and working capital, (ii) to fund the redemption, prior to maturity, of all of the $38.3 million outstanding of the 5.375% pollution control revenue refunding bonds due in 2024 issued by the Industrial Development Authority of the City of Alexandria, Virginia (IDA), on Pepco's behalf and (iii) for general corporate purposes.

During 2012, DPL issued $250 million of 4.00% first mortgage bonds due June 1, 2042. Net proceeds from the issuance of the long-term debt were used primarily (i) to repay $215 million of DPL's outstanding commercial paper that was issued (a) to temporarily fund capital expenditures and working capital and (b) to fund the redemption in June 2012, prior to maturity, of $65.7 million in aggregate principal amount of three series of outstanding tax-exempt pollution control refunding revenue bonds issued by DEDA for DPL's benefit; (ii) to fund the redemption, prior to maturity, of $31 million of tax-exempt bonds issued by DEDA for DPL's benefit; and (iii) for general corporate purposes.

In 2011, DPL resold $35 million of Pollution Control Refunding Revenue Bonds (Delmarva Power & Light Company Project) Series 2001C due 2026 (the Series 2001C Bonds). The Series 2001C Bonds were issued for the benefit of DPL in 2001 and were repurchased by DPL on May 2, 2011, pursuant to a mandatory repurchase provision in the indenture for the Series 2001C Bonds triggered by the expiration of the original interest rate period specified by the Series 2001C Bonds. See footnote (b) to the Reacquisitions table above.

In connection with the issuance of the Series 2001C Bonds, DPL entered into a continuing disclosure agreement under which it is obligated to furnish certain information to the bondholders. At the time of the resale, the continuing disclosure agreement was amended and restated to designate the Municipal Securities Rulemaking Board as the sole repository for these continuing disclosure documents. The amendment and restatement of the continuing disclosure agreement did not change the operating or financial data that are required to be provided by DPL under such agreement.

In 2011, ACE issued $200 million of 4.35% first mortgage bonds due April 1, 2021. The net proceeds were used to repay short-term debt and for general corporate purposes.

Tax Exempt Auction Rate and First Mortgage Bond Redemptions

During 2013, Pepco repaid at maturity $200 million of its 4.95% senior notes, which were secured by a like principal amount of Pepco's first mortgage bonds as previously discussed.

During 2013, DPL repaid at maturity $250 million of its 6.40% first mortgage bonds.

During 2013, ACE repaid at maturity $69 million of its 6.625% non-callable first mortgage bonds. ACE also funded the redemption, prior to maturity, of $4 million of outstanding weekly rate pollution control revenue refunding bonds due 2017, issued by the Pollution Control Financing Authority of Salem County, New Jersey for ACE's benefit.

During 2012, all of the $38.3 million of the outstanding 5.375% pollution control revenue refunding bonds issued by IDA for Pepco's benefit were redeemed. In connection with the redemption, Pepco redeemed all of the $38.3 million outstanding of its 5.375% first mortgage bonds due in 2024 that secured the obligations under the pollution control bonds.

During 2012, DPL funded the redemption by DEDA, prior to maturity, of $65.7 million of outstanding tax-exempt pollution control refunding revenue bonds issued by DEDA for DPL's benefit, as described above. Of the pollution control refunding revenue bonds redeemed, $34.5 million in aggregate principal amount bore interest at 0.75% per year and matured in 2026, $15.0 million in aggregate principal amount bore interest at 1.80% per year and matured in 2025, and $16.2 million in aggregate principal amount bore interest at 2.30% per year and matured in 2028. In connection with such redemption, on June 1, 2012, DPL redeemed, prior to maturity, all of the $34.5 million in aggregate principal amount outstanding of its 0.75% first mortgage bonds due 2026 that secured the obligations under one of the series of pollution control refunding revenue bonds redeemed by DEDA.

During 2012, DPL redeemed, prior to maturity, $31 million of 5.20% tax-exempt pollution control refunding revenue bonds due 2019, issued by DEDA for DPL's benefit. Contemporaneously with this redemption, DPL redeemed $31 million of its outstanding 5.20% first mortgage bonds due 2019 that secured the obligations under the pollution control bonds.

During 2012, ACE redeemed, prior to maturity, $4 million of 5.60% tax-exempt pollution control revenue bonds due 2025 issued by the Industrial Pollution Control Financing Authority of Salem County, New Jersey for ACE's benefit. Contemporaneously with this redemption, ACE redeemed, prior to maturity, $4 million of its outstanding 5.60% first mortgage bonds due 2025 that secured the obligations under the pollution control bonds.

Changes in Short-Term Debt

As of December 31, 2013, PHI had a total of $442 million of commercial paper outstanding as compared to $637 million and $586 million of commercial paper outstanding at December 31, 2012 and 2011, respectively.

On March 28, 2013, PHI entered into a $250 million term loan agreement, pursuant to which PHI had borrowed (and was not permitted to re-borrow) $250 million. PHI used the net proceeds of the loan under the loan agreement to repay its outstanding $200 million term loan made in 2012, and for general corporate purposes. On May 29, 2013, PHI repaid the $250 million term loan with a portion of the net proceeds from the early termination of the cross-border energy lease investments.

Capital Requirements

Capital Expenditures

Pepco Holdings' capital expenditures for the year ended December 31, 2013 totaled $1,310 million, an increase of $94 million from $1,216 million in 2012. Capital expenditures in 2013 were $576 million for Pepco, $357 million for DPL, $261 million for ACE, $4 million for Pepco Energy Services and $112 million for Corporate and Other. The Power Delivery expenditures were primarily related to capital costs associated with new customer services, distribution reliability and transmission. Corporate and Other capital expenditures primarily consisted of hardware and software expenditures that will be allocated to Power Delivery when the assets are placed in service.

The table below shows the projected capital expenditures for Power Delivery, Pepco Energy Services and Corporate and Other for the five-year period 2014 through 2018. PHI expects to fund these expenditures through internally generated cash and external financing.

	For the Year Ended December 31,					
	2014	2015	2016	2017	2018	Total
	(millions of dollars)					
Power Delivery						
Distribution	$ 774	$ 707	$ 771	$ 729	$ 744	$3,725
Distribution – Smart Grid (AMI)	2	—	—	—	8	10
Transmission	318	290	260	255	285	1,408
Gas Delivery	29	28	28	28	29	142
Other	167	102	99	96	65	529
Total for Power Delivery	1,290	1,127	1,158	1,108	1,131	5,814
Pepco Energy Services	6	6	7	6	3	28
Corporate and Other	6	6	6	6	6	30
Total PHI	$1,302	$1,139	$1,171	$1,120	$1,140	$5,872

Transmission and Distribution

The projected capital expenditures listed in the table for distribution (other than the smart grid), transmission and gas delivery are primarily for facility replacements and upgrades to accommodate customer growth and service reliability, including capital expenditures for continuing reliability enhancement efforts. For a more detailed discussion of these efforts, see "General Overview – Power Delivery."

DOE Capital Reimbursement Awards

In 2009, the U.S. Department of Energy (DOE) announced awards under the American Recovery and Reinvestment Act of 2009 of:

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

Of the total $168 million in DOE awards, $130 million is being used for the smart grid and other capital expenditures of Pepco and ACE. The remaining $38 million is being used to offset incremental expenditures associated with direct load control and other Pepco and ACE programs. During 2013, Pepco and ACE received award payments of $30 million and $4 million, respectively. The cumulative award payments received by Pepco and ACE as of December 31, 2013, were $145 million and $17 million, respectively.

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

Dividends

Pepco Holdings' annual dividend rate on its common stock is determined by the Board of Directors on a quarterly basis and takes into consideration, among other factors, current and possible future developments that may affect PHI's income and cash flows. In 2013, PHI's Board of Directors declared quarterly dividends of 27 cents per share of common stock payable on March 28, 2013, June 28, 2013, September 30, 2013 and December 31, 2013.

On January 23, 2014, the Board of Directors declared a dividend on common stock of 27 cents per share payable March 31, 2014, to shareholders of record on March 10, 2014.

PHI, on a stand-alone basis, generates no operating income of its own. Accordingly, its ability to pay dividends to its shareholders depends on dividends received from its subsidiaries. In addition to their future financial performance, the ability of each of PHI's direct and indirect subsidiaries to pay dividends is subject to limits imposed by: (i) state corporate laws, which impose limitations on the funds that can be used to pay dividends and when such dividends can be paid, and, in the case of ACE, the regulatory requirement that it obtain the prior approval of the NJBPU before dividends can be paid if its equity as a percent of its total capitalization, excluding securitization debt, falls below 30%; (ii) the prior rights of holders of existing and future mortgage bonds and other long-term debt issued by the subsidiaries, and any preferred stock that may be issued by the subsidiaries in the future, (iii) any other restrictions imposed in connection with the incurrence of liabilities; and (iv) certain provisions of ACE's charter that impose restrictions on payment of common stock dividends for the benefit of preferred stockholders. None of Pepco, DPL or ACE currently have shares of preferred stock outstanding. Currently, the capitalization ratio limitation to which ACE is subject and the restriction in the ACE charter do not limit ACE's ability to pay common stock dividends. PHI had approximately $595 million and $1,077 million of retained earnings free of restrictions at December 31, 2013 and 2012, respectively. These amounts represent the total retained earnings balances at those dates.

Contractual Obligations and Commercial Commitments

Summary information about Pepco Holdings' consolidated contractual obligations and commercial commitments at December 31, 2013, is as follows:

Contractual Obligations	Total	Contractual Maturity Less than 1 Year	2-3 Years	4-5 Years	After 5 Years
	(millions of dollars)				
Variable rate demand bonds	$ 123	$ 123	$ —	$ —	$ —
Commercial paper	442	442	—	—	—
Long-term debt [(a)]	4,725	444	747	419	3,115
Long-term project funding	12	2	3	3	4
Interest payments on debt	3,579	241	441	378	2,519
Capital leases, including interest	91	15	30	30	16
Operating leases	540	44	81	73	342
Estimated OPEB and SERP plan contributions	12	12	—	—	—
Non-derivative power purchase contracts [(b)]	2,712	278	562	486	1,386
Total [(c)]	$12,236	$ 1,601	$ 1,864	$ 1,389	$ 7,382

(a) Includes transition bonds issued by ACE Funding.

(b) Excludes contracts for the purchase of electricity to satisfy Default Electricity Supply load service obligations which have neither a fixed commitment amount nor a minimum purchase amount. In addition, costs are recoverable from customers.

(c) Excludes $606 million of net current and non-current liabilities related to uncertain tax positions due to uncertainty in the timing of the associated cash payments.

Guarantees, Indemnifications and Off-Balance Sheet Arrangements

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

PHI guarantees the obligations of Pepco Energy Services under certain contracts in its energy savings performance contracting business and underground transmission and distribution construction business. At December 31, 2013, PHI's guarantees of Pepco Energy Services' obligations under these contracts totaled $190 million. PHI also guarantees the obligations of Pepco Energy Services under surety bonds obtained by Pepco Energy Services for construction projects in these businesses. These guarantees totaled $229 million at December 31, 2013.

In addition, PHI guarantees certain obligations of Pepco, DPL and ACE under surety bonds obtained by these subsidiaries, for construction projects and self-insured workers compensation matters. These guarantees totaled $29 million at December 31, 2013.

For additional discussion of PHI's third party guarantees, indemnifications, obligations and off-balance sheet arrangements, see Note (15), "Commitments and Contingencies – Third Party Guarantees, Indemnifications, and Off-Balance Sheet Arrangements," to the consolidated financial statements.

Contractual Arrangements with Credit Rating Triggers or Margining Rights

Under certain contractual arrangements entered into by PHI's subsidiaries, the subsidiary may be required to provide cash collateral or letters of credit as security for its contractual obligations if the credit ratings of PHI or the subsidiary are downgraded. In the event of a downgrade, the amount required to be posted would depend on the amount of the underlying contractual obligation existing at the time of the downgrade. Based on contractual provisions in effect at December 31, 2013, a downgrade in the unsecured debt credit ratings of PHI and each of its rated subsidiaries to below "investment grade" would increase the collateral obligation of PHI and its subsidiaries by up to $78 million. This amount is attributable primarily to energy services contracts and accounts payable to independent system operators and distribution companies. PHI believes that it and its subsidiaries currently have sufficient liquidity to fund their operations and meet their financial obligations.

Many of the contractual arrangements entered into by PHI's subsidiaries in connection with Default Electricity Supply activities include margining rights pursuant to which the PHI subsidiary or a counterparty may request collateral if the market value of the contractual obligations reaches levels in excess of the credit thresholds established in the applicable arrangements. Pursuant to these margining rights, the affected PHI subsidiary may receive, or be required to post, collateral due to energy price movements. PHI believes that it and its subsidiaries currently have sufficient liquidity to fund their operations and meet their financial obligations.

Environmental Remediation Obligations

PHI's accrued liabilities for environmental remediation obligations as of December 31, 2013 totaled approximately $30 million, of which approximately $4 million is expected to be incurred in 2014, for potential environmental cleanup and related costs at sites owned or formerly owned by an operating subsidiary where an operating subsidiary is a potentially responsible party or is alleged to be a third-party contributor. For further information concerning the remediation obligations associated with these sites, see Note (15), "Commitments and Contingencies – Environmental Matters," to the consolidated financial statements. The most significant environmental remediation obligations as of December 31, 2013, are for the following items:

- Environmental investigation and remediation costs payable by Pepco with respect to the Benning Road site.

- Amounts payable by Pepco in connection with a January 2011 mineral oil release at Pepco's Potomac River substation in Alexandria, Virginia.

- Estimated costs for implementation of a closure plan and cap on a Pepco right-of-way that traverses the GenOn MD Ash Management, LLC fly ash disposal site in Brandywine, Prince George's County, Maryland. PHI and Pepco believe that the costs incurred in this matter will be recoverable from GenOn under a 2000 asset purchase and sale agreement, the terms of which specify that the buyer of Pepco's generation assets assumed environmental liability for hazardous substances, including ash, which remain on or have been removed from the land on which the acquired generating stations are situated.

- Costs associated with investigation and resolution of potential impacts from a September 2013 mineral oil release from a Pepco underground feeder to Watts Branch.

- Amounts payable by DPL in accordance with a 2001 consent agreement reached with the Delaware Department of Natural Resources and Environmental Control, for remediation, site restoration, natural resource damage compensatory projects and other costs associated with environmental contamination that resulted from an oil release at the Indian River power plant, which DPL sold in June 2001.

- Potential compliance remediation costs under New Jersey's Industrial Site Recovery Act payable by PHI associated with the retained environmental exposure from the sale of the Conectiv Energy wholesale power generation business.

- Amounts payable by DPL in connection with the Wilmington Coal Gas South site located in Wilmington, Delaware, to remediate residual material from the historical operation of a manufactured gas plant.

Sources of Capital

PHI's sources to meet its long-term funding needs, such as capital expenditures, dividends, and new investments, and its short-term funding needs, such as working capital and the temporary funding of long-term funding needs, include internally generated funds, issuances by PHI, Pepco, DPL and ACE under their commercial paper programs, securities issuances, medium- and short-term loans, and bank financing under new or existing facilities. PHI's ability to generate funds from its operations and to access capital and credit markets is subject to risks and uncertainties. Volatile and deteriorating financial market conditions, diminished liquidity and tightening credit may affect access to certain of PHI's potential funding sources.

Cash Flow from Operations

Cash flow generated by regulated utility subsidiaries in Power Delivery is the primary source of PHI's cash flow from operations. Additional cash flows are generated by the business of Pepco Energy Services and from the occasional sale of non-core assets.

Short-Term Funding Sources

Pepco Holdings and its regulated utility subsidiaries have traditionally used a number of sources to fulfill short-term funding needs, such as commercial paper, short-term notes and bank term loans and lines of credit. Proceeds from short-term borrowings are used primarily to meet working capital needs but may also be used to temporarily fund long-term capital requirements. For additional discussion of PHI's short-term debt, see Note (10), "Debt," to the consolidated financial statements.

Long-Term Funding Sources

The sources of long-term funding for PHI and its subsidiaries are the issuance of debt and equity securities and borrowing under long-term credit agreements. Proceeds from long-term financings are used primarily to fund long-term capital requirements, such as capital expenditures and new investments, and to repay or refinance existing indebtedness.

Regulatory Restrictions on Financing Activities

The issuance of debt securities by PHI's principal subsidiaries requires the approval of either FERC or one or more state public utility commissions. Neither FERC approval nor state public utility commission approval is required as a condition to the issuance of securities by PHI.

State Financing Authority

Pepco's long-term financing activities (including the issuance of securities and the incurrence of long-term debt) are subject to authorization by the DCPSC and MPSC. DPL's long-term financing activities are subject to authorization by the MPSC and the DPSC. ACE's long-term and short-term (consisting of debt instruments with a maturity of one year or less) financing activities are subject to authorization by the NJBPU. Each utility, through periodic filings with the state public service commission(s) having jurisdiction over its financing activities, has maintained standing authority sufficient to cover its projected financing needs over a multi-year period.

FERC Financing Authority

Under the Federal Power Act (FPA), FERC has jurisdiction over the issuance of long-term and short-term securities of public utilities, but only if the issuance is not regulated by the state public utility commission in which the public utility is organized and operating. Under these provisions, FERC has jurisdiction over the issuance of short-term debt by Pepco and DPL. Pepco and DPL have obtained FERC authority for the issuance of short-term debt. Because Pepco Energy Services also qualifies as a public utility under the FPA and is not regulated by a state utility commission, FERC also has jurisdiction over the issuance of securities by Pepco Energy Services. Pepco Energy Services has obtained the requisite FERC financing authority in its market-based rate orders.

Money Pool

Pepco Holdings operates a system money pool under a blanket authorization adopted by FERC. The money pool is an unsecured cash management mechanism used by Pepco Holdings to manage the short-term investment and borrowing requirements of its subsidiaries that participate in the money pool. Pepco Holdings may invest in but not borrow from the money pool. Eligible subsidiaries with surplus cash may deposit those funds in the money pool. Deposits in the money pool are guaranteed by Pepco Holdings. Eligible subsidiaries with cash requirements may borrow from the money pool. Depositors in the money pool receive, and borrowers from the money pool pay, an interest rate based primarily on Pepco Holdings' short-term borrowing rate. Pepco Holdings deposits funds in the money pool to the extent that the pool has insufficient funds to meet the borrowing needs of its participants, which may require Pepco Holdings to borrow funds for deposit from external sources.

Regulatory and Other Matters

Rate Proceedings

Distribution

The rates that each of Pepco, DPL and ACE is permitted to charge for the retail distribution of electricity and natural gas to its various classes of customers are based on the principle that the utility is entitled to generate an amount of revenue sufficient to recover the cost of providing the service, including a reasonable rate of return on its invested capital. These "base rates" are intended to cover all of each utility's reasonable and prudent expenses of constructing, operating and maintaining its distribution facilities (other than costs covered by specific cost-recovery surcharges).

A change in base rates in a jurisdiction requires the approval of the public service commission. In the rate application submitted to the public service commission, the utility specifies an increase in its "revenue requirement," which is the additional revenue that the utility is seeking authorization to earn. The "revenue requirement" consists of (i) the allowable expenses incurred by the utility, including operation and maintenance expenses, taxes and depreciation, and (ii) the utility's cost of capital. The compensation of the utility for its cost of capital takes the form of an overall "rate of return" allowed by the public service commission on the utility's distribution "rate base" to compensate the utility's investors for their debt and equity investments in the company. The rate base is the aggregate value of the investment in property used by the utility in providing electricity and natural gas distribution services and generally consists of plant in service net of accumulated depreciation and accumulated deferred taxes, plus cash working capital, material and operating supplies and, depending on the jurisdiction, construction work in progress. Over time, the rate base is increased by utility property additions and reduced by depreciation and property retirements and write-offs.

In addition to its base rates, some of the costs of providing distribution service are recovered through the operation of surcharges. Examples of costs recovered by PHI's utility subsidiaries through surcharges, which vary depending on the jurisdiction, include: a surcharge to reimburse the utility for the cost of purchasing electricity from NUGs (New Jersey); surcharges to reimburse the utility for costs of public interest programs for low income customers and for demand-side management programs (New Jersey, Maryland, Delaware and the District of Columbia); a surcharge to pay the Transitional Bond Charge (New Jersey); surcharges to reimburse the utility for certain environmental costs (Delaware and Maryland); and surcharges related to the BSA (Maryland and the District of Columbia). Each utility subsidiary regularly reviews its distribution rates in each jurisdiction of its service territory, and files applications to adjust its rates as necessary in an effort to ensure that its revenues are sufficient to cover its operating expenses and its cost of capital. The timing of future rate filings and the change in the distribution rate requested will depend on a number of factors, including changes in revenues and expenses and the incurrence or the planned incurrence of capital expenditures. PHI's utility subsidiaries currently plan to, among other things, file electric distribution base rate cases every 9 to 12 months and evaluate potential reductions in planned capital expenditures in an effort to mitigate the effects of regulatory lag. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – General Overview – Power Delivery Initiatives and Activities – Mitigation of Regulatory Lag."

In general, a request for new distribution rates is made on the basis of "test year" balances for rate base allowable operating expenses and a requested rate of return. The test year amounts used in the filing may be historical or partially projected. The public service commission may, however, select a different test period than that proposed by the applicable utility. Although the approved tariff rates are intended to be forward-looking, and therefore provide for the recovery of some future changes in rate base and operating costs, they typically do not reflect all of the changes in costs for the period in which the new rates are in effect.

The following table shows, for each of the PHI utility subsidiaries, the authorized return on equity as determined in the most recently concluded base rate proceeding and the effective date of the authorized return:

	Authorized Return on Equity	Rate Effective Date
Pepco:		
District of Columbia (electricity)	9.50%	October 2012
Maryland (electricity)	9.36%	July 2013
DPL:		
Delaware (electricity)	9.75%	July 2012
Maryland (electricity)	9.81% [(a)]	September 2013
Delaware (natural gas)	9.75% [(b)]	November 2013
ACE:		
New Jersey (electricity)	9.75%	July 2013

[(a)] ROE has not been determined by any proceeding and is specified only for the purposes of calculating the AFUDC and regulatory asset carrying costs.

[(b)] ROE has not been determined by any proceeding and is specified only for reporting purposes and for calculating the AFUDC, construction work in progress (CWIP), regulatory asset carrying costs and other accounting metrics.

Transmission

The rates Pepco, DPL and ACE are permitted to charge for the transmission of electricity are regulated by FERC and are based on each utility's transmission rate base, transmission operating expenses and an overall rate of return that is approved by FERC. For each utility subsidiary, FERC has approved a formula for the calculation of the utility transmission rate, which is referred to as a "formula rate." The formula rates include both fixed and variable elements. Certain of the fixed elements, such as the return on equity and depreciation rates, can be changed only in a FERC transmission rate proceeding. The variable elements of the formula, including the utility's rate base and operating expenses, are updated annually, effective June 1 of each year, with data from the utility's most recent annual FERC Form 1 filing. In addition to its formula rate, each utility's return on equity is supplemented by incentive rates, sometimes referred to as "adders," and other incentives, which are authorized by FERC to promote capital investment in transmission infrastructure. The base ROE currently authorized by FERC for PHI's utilities is (i) 11.3% for facilities placed into service after January 1, 2006, and (ii) 10.8% for facilities placed into service prior to 2006. As currently authorized, the 10.8% base ROE for PHI's utilities for facilities placed into service prior to 2006 is eligible for a 50-basis-point incentive adder for being a member of a regional transmission organization. In addition, ROE adders are in effect for each of Pepco, DPL and ACE relating to specific transmission upgrades and improvements, as well as in consideration for each utility's continued membership in PJM. As members of PJM, the transmission rates of Pepco, DPL and ACE are set out in PJM's Open Access Transmission Tariff.

For a discussion of pending state public utility commission and FERC transmission rate and other regulatory proceedings, see Note (7), "Regulatory Matters," to the consolidated financial statements.

Legal Proceedings and Regulatory Matters

For a discussion of legal proceedings, see Note (15), "Commitments and Contingencies," to the consolidated financial statements and for a discussion of regulatory matters, see Note (7), "Regulatory Matters," to the consolidated financial statements.

Critical Accounting Policies

General

PHI has identified the following critical accounting policies that result in having to make certain estimates that, as a result of the judgments, uncertainties, uniqueness and complexities of the underlying accounting standards and estimates involved, could result in material changes in its financial condition or results of operations under different conditions or using different assumptions. PHI has discussed the development, selection and disclosure of each of these policies with the Audit Committee of the Board of Directors.

Goodwill Impairment Evaluation

Substantially all of PHI's goodwill was generated by Pepco's acquisition of Conectiv in 2002 and is allocated entirely to the Power Delivery reporting unit for purposes of assessing impairment under FASB guidance on goodwill and other intangibles (ASC 350). PHI has identified Power Delivery as a single reporting unit because its components have similar economic characteristics, similar products and services, similar distribution methods and support processes, and operate in a similar regulatory environment.

PHI tests its goodwill for impairment annually as of November 1 and whenever an event occurs or circumstances change in the interim that would more likely than not (that is, a greater than 50% chance) reduce the estimated fair value of a reporting unit below the carrying amount of its net assets.

Factors that may result in an interim impairment test include, but are not limited to: an adverse change in business conditions; a protracted decline in stock price causing market capitalization to fall significantly below book value; an adverse regulatory action; impairment of long-lived assets in the reporting unit; or a change in identified reporting units.

The first step of the goodwill impairment test compares the estimated fair value of the reporting unit with its carrying amount, including goodwill. PHI uses its best judgment to make reasonable projections of future cash flows and selection of a discount rate for the associated risk with those cash flows when estimating the reporting unit's fair value. These judgments are inherently uncertain, and actual results could vary from those used in PHI's estimates. The impact of such variations could significantly alter the results of a goodwill impairment test, which could materially impact the estimated fair value of Power Delivery and potentially the amount of any impairment recorded in the financial statements.

PHI's November 1, 2013 annual impairment test indicated that its goodwill was not impaired. See Note (6), "Goodwill," to the consolidated financial statements.

In order to estimate the fair value of the Power Delivery reporting unit, PHI prepares an analysis of traditional valuation techniques: an income approach and a market approach. The income approach estimates fair value based on a discounted future cash flow analysis and a terminal value that is consistent with Power Delivery's long-term view of the business. This approach uses a discount rate based on the estimated weighted average cost of capital (WACC) for the reporting unit. PHI determines the estimated WACC by considering appropriate market-based information for the cost of equity and cost of debt as of the measurement date. The market approach estimates fair value based on a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA) that PHI believes is consistent with EBITDA multiples for comparable utilities. PHI has consistently used this valuation technique to estimate the fair value of Power Delivery.

The estimation of fair value is dependent on a number of factors including but not limited to interest rates, growth assumptions, returns on rate base, operating and capital expenditure requirements, and other factors, changes in which could materially impact the results of impairment testing. Assumptions used were consistent with historical experience, including assumptions concerning the recovery of operating costs and capital expenditures, and current market-based information. A hypothetical 10 percent decrease in estimated fair value of the Power Delivery reporting unit at November 1, 2013 would not have resulted in the Power Delivery reporting unit failing the first step of the impairment test, as defined in the guidance, as the estimated fair value of the reporting unit would have been above its carrying value. Sensitive, interrelated and uncertain variables that could decrease the estimated fair value of the Power Delivery reporting unit include utility sector market performance, sustained adverse business conditions, change in forecasted revenues, higher operating and maintenance capital expenditure requirements, a significant increase in the weighted average cost of capital, and other factors.

PHI believes that the estimates involved in its goodwill impairment evaluation process represent "Critical Accounting Estimates" because they are subjective and susceptible to change from period to period as PHI makes assumptions and judgments, and the impact of a change in such assumptions and estimates could be material to financial results.

Long-Lived Assets Impairment Evaluation

PHI believes that the estimates involved in its long-lived asset impairment evaluation process represent "Critical Accounting Estimates" because (i) they are highly susceptible to change from period to period because PHI is required to make assumptions and judgments about when events indicate the carrying value may not be recoverable and how to estimate undiscounted and discounted future cash flows and fair values, which are inherently uncertain, (ii) actual results could vary from those used in PHI's estimates and the impact of such variations could be material, and (iii) the impact that recognizing an impairment would have on PHI's assets as well as the net loss related to an impairment charge could be material. The primary assets subject to a long-lived asset impairment evaluation are property, plant, and equipment.

The FASB guidance on the accounting for the impairment or disposal of long-lived assets (ASC 360), requires that certain long-lived assets must be tested for recoverability whenever events or circumstances indicate that the carrying amount may not be recoverable, such as (i) a significant decrease in the market price of a long-lived asset or asset group, (ii) a significant adverse change in the extent or manner in which a long-lived asset or asset group is being used or in its physical condition, (iii) a significant adverse change in legal factors or in the business climate, including an adverse action or assessment by a regulator, (iv) an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset or asset group, (v) a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset or asset group, and (vi) a current expectation that, more likely than not, a long-lived asset or asset group will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

An impairment loss may only be recognized if the carrying amount of an asset is not recoverable and the carrying amount exceeds its estimated fair value. The asset is deemed not to be recoverable when its carrying amount exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of the asset. PHI uses reasonable estimates in making these evaluations of an asset's future cash flows and considers various factors, including forward price curves for energy, related fuel costs, legislative initiatives, operating costs, and historical cash flows.

Accounting for Derivatives

PHI believes that the estimates involved in accounting for its derivative instruments represent "Critical Accounting Estimates" because PHI exercises judgment in the following areas, any of which could have a material impact on its financial statements: (i) the application of the definition of a derivative to contracts to identify embedded or free-standing derivatives, (ii) the election of the normal purchases and normal sales exception from derivative accounting, (iii) the application of cash flow hedge accounting, and (iv) the estimation of fair value used in the measurement of derivatives and hedged items, which are highly susceptible to changes in value over time due to market trends or, in certain circumstances, significant uncertainties in modeling techniques used to measure fair value that could result in actual results being materially different from PHI's estimates. See Note (2), "Significant Accounting Policies - Accounting for Derivatives," and Note (13), "Derivative Instruments and Hedging Activities," to the consolidated financial statements.

PHI and its subsidiaries may use derivative instruments primarily to manage risk associated with commodity prices and interest rates. The definition of a derivative in the FASB guidance on derivatives (ASC 815) results in PHI having to exercise judgment, such as whether there is a notional amount or net settlement provision in contracts. PHI assesses a number of factors before determining whether it can designate derivatives for the normal purchase or normal sale exception from derivative accounting, including whether it is probable that the contracts will physically settle with delivery of the underlying commodity. The application of cash flow hedge accounting often requires judgment in the prospective and retrospective assessment and measurement of hedge effectiveness as well as whether it is probable that the forecasted transaction will occur. The fair value of derivatives is determined using quoted exchange prices where available. For instruments that are not traded on an exchange, external broker quotes may also be used to determine fair value. For some custom and complex instruments, internal models use market-based information when external broker quotes are not available. For certain long-dated instruments, broker or exchange data are extrapolated, or capacity prices are forecasted, for future periods where information is limited. Models are also used to estimate volumes for certain transactions. The same valuation methods are used for risk management purposes to determine the value of non-derivative, commodity exposure.

Pension and Other Postretirement Benefit Plans

PHI believes that the estimates involved in reporting the costs of providing pension and OPEB benefits represent Critical Accounting Estimates because (i) they are based on an actuarial calculation that includes a number of assumptions which are subjective in nature, (ii) they are dependent on numerous factors resulting from actual plan experience and assumptions of future experience, and (iii) changes in assumptions could impact PHI's expected future cash funding requirements for the benefit plans and would have an impact on the benefit obligations, which affect the reported amount of net periodic pension and OPEB cost on the consolidated income statement.

Assumptions about the future, including the discount rate applied to benefit obligations, the expected long-term rate of return on plan assets, the anticipated rate of increase in health care costs, average remaining service period and life expectancy, and participant compensation have a significant impact on net periodic pension and OPEB costs.

The discount rate for determining the pension benefit obligation was 5.05% and 4.15% as of December 31, 2013 and 2012, respectively. The discount rate for determining the postretirement benefit obligation was 5.00% and 4.10% as of December 31, 2013 and 2012, respectively. PHI utilizes an analytical tool developed by its actuaries to select the discount rate. The analytical tool utilizes a high-quality bond portfolio with cash flows that match the benefit payments expected to be made under the plans.

The expected long-term rate of return on pension and postretirement benefit plan assets used to determine net periodic pension and OPEB cost was 7.00% and 7.25% for 2013 and 2012, respectively. PHI uses a building block approach to estimate the expected rate of return on plan assets. Under this approach, the percentage of plan assets in each asset class according to PHI's target asset allocation, at the measurement date of net periodic cost, is applied to the expected asset return for the related asset class. PHI incorporates long-term assumptions for real returns, inflation expectations, volatility, and correlations among asset classes to determine expected returns for the related asset class. The pension and postretirement benefit plan assets consist of equity, fixed income, real estate and private equity investments.

The average remaining service periods for participating employees of the benefit plans was approximately 11 years for both 2013 and 2012. PHI utilizes plan census data to estimate these average remaining service periods. PHI uses the IRS prescribed mortality tables to estimate the average life expectancy. The IRS prescribed tables for 2013 and 2012 were used to determine net periodic pension and OPEB cost for the same respective years. The tables for 2014 and 2013 were used for determining the benefit obligations as of December 31, 2013 and 2012, respectively.

The following table reflects the effect on the projected benefit obligation for the pension plans and the accumulated benefit obligation for the OPEB plan, as well as the net periodic cost, if there were changes in these critical actuarial assumptions while holding all other actuarial assumptions constant:

(in millions, except percentages)	Change in Assumptions	Impact on Benefit Obligation	Projected Increase in 2013 Net Periodic Cost
Pension Plans			
Discount rate	(0.25)%	$ 77	$ 6
Expected return	(0.25)%	—	5
Postretirement Benefit Plan[a]			
Discount rate	(0.25)%	16	1
Expected return	(0.25)%	—	1
Health care cost trend rate	1.00%	17	2

[a] The impact on benefit obligation and the projected increase in 2013 net periodic cost were determined assuming that the plan amendments that were effective July 1, 2013 were put into effect on January 1, 2014.

The impact of changes in assumptions and the difference between actual and expected or estimated results on pension and postretirement benefit obligations is generally recognized over the average remaining service period of the employees who benefit under the plans rather than immediate recognition in the statement of income.

For additional discussion, see Note (9), "Pension and Other Postretirement Benefits," to the consolidated financial statements.

Accounting for Regulated Activities

FASB guidance on the accounting for regulated operations (ASC 980), applies to Power Delivery and can result in the deferral of costs or revenue that would otherwise be recognized by non-regulated entities. PHI defers the recognition of costs and records regulatory assets when it is probable that those costs will be recovered in future customer rates. PHI defers the recognition of revenues and records regulatory liabilities when it is probable that it will refund payments received from customers in the future or that it will incur future costs related to the payments currently received from customers. PHI believes that the judgments involved in accounting for its regulated operations represent "Critical Accounting Estimates" because (i) PHI must interpret laws and regulatory commission orders to assess the probability of the recovery of costs in customer rates or the return of revenues to customers when determining whether those costs or revenues should be deferred, (ii) decisions made by regulatory commissions or legislative changes at a later date could vary from earlier interpretations made by PHI and the impact of such variations could be material, and (iii) the elimination of a regulatory asset because deferred costs are no longer probable of recovery in future customer rates could have a material negative impact on PHI's assets and earnings.

PHI's most significant judgment is whether to defer costs or revenues when there is not a current regulatory order specific to the item being considered for deferral. In those cases, PHI considers relevant historical precedents of the regulatory commissions, the results of recent rate orders, and any new information from its more current interactions with the regulatory commissions on that item. PHI regularly evaluates whether it should defer costs or revenues and reviews whether adjustments to its previous conclusions regarding its regulatory assets and liabilities are necessary based on the current regulatory and legislative environment as well as recent rate orders.

For additional discussion, see Note (7), "Regulatory Matters," to the consolidated financial statements.

Unbilled Revenue

Unbilled revenue represents an estimate of revenue earned from services rendered by PHI's utility operations that have not yet been billed. PHI's utility operations calculate unbilled revenue using an output-based methodology. The calculation is based on the supply of electricity or natural gas distributed to customers but not yet billed, adjusted for estimated line losses (estimates of electricity and gas expected to be lost in the process of a utility's transmission and distribution to customers).

PHI estimates involved in its unbilled revenue process represent “Critical Accounting Estimates” because PHI is required to make assumptions and judgments about factors to the unbilled revenue calculation. Specifically, the determination of estimated line losses is inherently uncertain. Estimated line losses is defined as the estimates of electricity and natural gas expected to be lost in the process of its transmission and distribution to customers. A change in estimated line losses can change the output available for sale which is a factor in the unbilled revenue calculation. Certain factors can influence the estimated line losses such as weather and a change in customer mix. These factors may vary between companies due to geography and density of service territory, and the impact of changes in these factors could be material. PHI seeks to reduce the risk of an inaccurate estimate of unbilled revenue through corroboration of the estimate with historical information and other output-based observable metrics.

Accounting for Income Taxes

PHI exercises significant judgment about the outcome of income tax matters in its application of the FASB guidance on accounting for income taxes (ASC 740) and believes it represents a “Critical Accounting Estimate” because: (i) it records a current tax liability for estimated current tax expense on its federal and state tax returns; (ii) it records deferred tax assets for temporary differences between the financial statement and tax return determination of pre-tax income and the carrying amount of assets and liabilities that are more likely than not going to result in tax deductions in future years; (iii) it determines whether a valuation allowance is needed against deferred tax assets if it is more likely than not that some portion of the future tax deductions will not be realized; (iv) it records deferred tax liabilities for temporary differences between the financial statement and tax return determination of pre-tax income and the carrying amount of assets and liabilities if it is more likely than not that they are expected to result in tax payments in future years; (v) the measurement of deferred tax assets and deferred tax liabilities requires it to estimate future effective tax rates and future taxable income on its federal and state tax returns; (vi) it must consider the effect of newly enacted tax law on its estimated effective tax rate and in measuring deferred tax balances; and (vii) it asserts that tax positions in its tax returns or expected to be taken in its tax returns are more likely than not to be sustained assuming that the tax positions will be examined by taxing authorities with full knowledge of all relevant information prior to recording the related tax benefit in the financial statements.

Assumptions, judgment and the use of estimates are required in determining if the more-likely-than-not measurement threshold (that is, the cumulative result for a greater than 50% chance of being realized) has been met when developing the provision for current and deferred income taxes and the associated current and deferred tax assets and liabilities. PHI’s assumptions, judgments and estimates take into account current tax laws and regulations, interpretation of current tax laws and regulations, the impact of newly enacted tax laws and regulations, developments in case law, settlements of tax positions, and the possible outcomes of current and future investigations conducted by tax authorities. PHI has established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. Although PHI believes that these assumptions, judgments and estimates are reasonable, changes in tax laws and regulations or its interpretation of tax laws and regulations as well as the resolutions of the current and any future investigations or legal proceedings could significantly impact the financial results from applying the accounting for income taxes in the consolidated financial statements. PHI reviews its application of the more-likely-than-not measurement threshold quarterly.

PHI also evaluates quarterly the probability of realizing deferred tax assets by reviewing a forecast of future taxable income and prudent and feasible tax planning strategies that can be implemented, if necessary, to realize deferred tax assets. Failure to achieve forecasted taxable income or successfully implement tax planning strategies may affect the realization of deferred tax assets and the amount of any associated valuation allowance. The forecast of future taxable income is dependent on a number of factors that can change over time, including growth assumptions, business conditions, returns on rate base, operating and capital expenditures, cost of capital, tax laws and regulations, the legal structure of entities and other factors, which could materially impact the realizability of deferred tax assets and the associated financial results in the consolidated financial statements.

New Accounting Standards and Pronouncements

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Risk management policies for PHI and its subsidiaries are determined by PHI's Corporate Risk Management Committee (CRMC), the members of which are PHI's Chief Risk Officer, Executive Vice President (Power Delivery), Chief Financial Officer, General Counsel, Chief Information Officer and other senior executives. The CRMC monitors interest rate fluctuation, commodity price fluctuation, and credit risk exposure, and sets risk management policies that establish limits on unhedged risk and determine risk reporting requirements. For information about PHI's derivative activities, other than the information otherwise disclosed herein, refer to Note (2), "Significant Accounting Policies - Accounting For Derivatives," and Note (13), "Derivative Instruments and Hedging Activities," of the consolidated financial statements.

Pepco Holdings, Inc.

Interest Rate Risk

Pepco Holdings and its subsidiaries' variable or floating rate debt is subject to the risk of fluctuating interest rates in the normal course of business. Pepco Holdings manages interest rate risk through the use of fixed and, to a lesser extent, variable rate debt. The effect of a hypothetical 10% change in interest rates on the annual interest costs for short-term and variable rate debt was less than $1 million as of December 31, 2013.

Potomac Electric Power Company

Interest Rate Risk

Pepco's debt is subject to the risk of fluctuating interest rates in the normal course of business. Pepco manages interest rate risk through the use of fixed and, to a lesser extent, variable rate debt. The effect of a hypothetical 10% change in interest rates on the annual interest costs for short-term debt and variable rate debt was less than $1 million as of December 31, 2013.

Delmarva Power & Light Company

Commodity Price Risk

DPL uses derivative instruments (for example, forward contracts, futures, swaps, and exchange-traded and over-the-counter options) primarily to reduce natural gas commodity price volatility. DPL also manages commodity risk with capacity contracts that do not meet the definition of derivatives. The primary goal of these activities is to reduce the exposure of its regulated retail natural gas customers to natural gas price spikes. All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all gains and losses on the natural gas hedging activity, are fully recoverable through the GCR clause included in DPL's natural gas tariff rates approved by the DPSC and are deferred until recovered. At December 31, 2013, after the effects of cash collateral and netting of derivative assets and liabilities available to be offset under master netting arrangements, DPL had no net derivative assets or liabilities. At December 31, 2012, after the effects of cash collateral and netting of derivative assets and liabilities available to be offset under master netting arrangements, DPL had a net derivative liability of $4 million, offset by a $4 million regulatory asset.

Interest Rate Risk

DPL's debt is subject to the risk of fluctuating interest rates in the normal course of business. DPL manages interest rate risk through the use of fixed and, to a lesser extent, variable rate debt. The effect of a hypothetical 10% change in interest rates on the annual interest costs for short-term debt and variable rate debt was less than $1 million as of December 31, 2013.

Atlantic City Electric Company

Interest Rate Risk

ACE's debt is subject to the risk of fluctuating interest rates in the normal course of business. ACE manages interest rate risk through the use of fixed and, to a lesser extent, variable rate debt. The effect of a hypothetical 10% change in interest rates on the annual interest costs for short-term debt and variable rate debt was less than $1 million as of December 31, 2013.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Pepco Holdings, Inc. (Pepco Holdings) is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) under the Exchange Act. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management of Pepco Holdings assessed Pepco Holdings' internal control over financial reporting as of December 31, 2013 based on the framework in *Internal Control — Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the management of Pepco Holdings concluded that Pepco Holdings' internal control over financial reporting was effective as of December 31, 2013.

PricewaterhouseCoopers LLP, the independent registered public accounting firm that audited the consolidated financial statements of Pepco Holdings included in this Annual Report on Form 10-K, has also issued its attestation report on the effectiveness of Pepco Holdings' internal control over financial reporting, which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Pepco Holdings, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of (loss) income, comprehensive (loss) income, equity and cash flows present fairly, in all material respects, the financial position of Pepco Holdings, Inc. and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Washington, D.C.
February 27, 2014

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

For the Year Ended December 31,	2013	2012	2011
	(millions of dollars, except per share data)		
Operating Revenue	$ 4,666	$ 4,625	$ 4,964
Operating Expenses			
Fuel and purchased energy	2,070	2,123	2,537
Other services cost of sales	146	170	172
Other operation and maintenance	851	898	889
Depreciation and amortization	473	454	425
Other taxes	428	432	451
Deferred electric service costs	26	(5)	(63)
Impairment losses	4	12	—
Total Operating Expenses	3,998	4,084	4,411
Operating Income	668	541	553
Other Income (Expenses)			
Interest and dividend income	—	1	1
Interest expense	(273)	(256)	(242)
Gain (loss) from equity investments	2	1	(3)
Impairment losses	—	(1)	(5)
Other income	32	35	32
Total Other Expenses	(239)	(220)	(217)
Income from Continuing Operations Before Income Tax Expense	429	321	336
Income Tax Expense Related to Continuing Operations	319	103	114
Net Income from Continuing Operations	110	218	222
(Loss) Income from Discontinued Operations, net of Income Taxes	(322)	67	35
Net (Loss) Income	$ (212)	$ 285	$ 257
Basic Share Information			
Weighted average shares outstanding-Basic (millions)	246	229	226
Earnings per share of common stock from Continuing Operations—Basic	$ 0.45	$ 0.95	$ 0.98
(Loss) earnings per share of common stock from Discontinued Operations—Basic	(1.31)	0.30	0.16
(Loss) earnings per share—Basic	$ (0.86)	$ 1.25	$ 1.14
Diluted Share Information			
Weighted average shares outstanding-Diluted (millions)	246	230	226
Earnings per share of common stock from Continuing Operations—Diluted	$ 0.45	$ 0.95	$ 0.98
(Loss) earnings per share of common stock from Discontinued Operations—Diluted	(1.31)	0.29	0.16
(Loss) earnings per share—Diluted	$ (0.86)	$ 1.24	$ 1.14

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

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

For the Year Ended December 31,	2013	2012	2011
		(millions of dollars)	
Net (Loss) Income	$ (212)	$ 285	$ 257
Other Comprehensive Income (Loss) from Continuing Operations			
Losses on treasury rate locks reclassified into income	1	—	1
Pension and other postretirement benefit plans	13	(14)	(11)
Other comprehensive income (loss), before income taxes	14	(14)	(10)
Income tax expense (benefit) related to other comprehensive income	6	(6)	(4)
Other comprehensive income (loss) from continuing operations, net of income taxes	8	(8)	(6)
Other Comprehensive Income from Discontinued Operations, Net of Income Taxes	6	23	49
Comprehensive (Loss) Income	$ (198)	$ 300	$ 300

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS	December 31, 2013	December 31, 2012
	(millions of dollars)	
CURRENT ASSETS		
Cash and cash equivalents	$ 23	$ 25
Restricted cash equivalents	13	10
Accounts receivable, less allowance for uncollectible accounts of $38 million and $34 million, respectively	835	804
Inventories	148	153
Prepayments of income taxes	40	59
Deferred income tax assets, net	51	28
Income taxes receivable	234	69
Prepaid expenses and other	53	81
Assets held for disposition	1	38
Total Current Assets	1,398	1,267
OTHER ASSETS		
Goodwill	1,407	1,407
Regulatory assets	2,087	2,614
Income taxes receivable	67	217
Restricted cash equivalents	14	17
Assets and accrued interest related to uncertain tax positions	8	18
Derivative assets	—	8
Other	163	163
Assets held for disposition	—	1,237
Total Other Assets	3,746	5,681
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	14,567	13,625
Accumulated depreciation	(4,863)	(4,779)
Net Property, Plant and Equipment	9,704	8,846
TOTAL ASSETS	$ 14,848	$ 15,794

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

LIABILITIES AND EQUITY	December 31, 2013	December 31, 2012
	(millions of dollars, except shares)	
CURRENT LIABILITIES		
Short-term debt	$ 565	$ 965
Current portion of long-term debt and project funding	446	569
Accounts payable	215	196
Accrued liabilities	301	357
Capital lease obligations due within one year	9	8
Taxes accrued	56	75
Interest accrued	47	47
Liabilities and accrued interest related to uncertain tax positions	397	9
Derivative liabilities	—	4
Other	276	272
Liabilities associated with assets held for disposition	1	41
Total Current Liabilities	2,313	2,543
DEFERRED CREDITS		
Regulatory liabilities	399	501
Deferred income tax liabilities, net	2,928	3,208
Investment tax credits	17	20
Pension benefit obligation	116	449
Other postretirement benefit obligations	206	454
Liabilities and accrued interest related to uncertain tax positions	28	15
Derivative liabilities	—	11
Other	189	191
Liabilities associated with assets held for disposition	—	2
Total Deferred Credits	3,883	4,851
OTHER LONG-TERM LIABILITIES		
Long-term debt	4,053	3,648
Transition bonds issued by ACE Funding	214	256
Long-term project funding	10	12
Capital lease obligations	60	70
Total Other Long-Term Liabilities	4,337	3,986
COMMITMENTS AND CONTINGENCIES (NOTE 15)		
EQUITY		
Common stock, $.01 par value — 400,000,000 shares authorized, 250,324,898 and 230,015,427 shares outstanding, respectively	3	2
Premium on stock and other capital contributions	3,751	3,383
Accumulated other comprehensive loss	(34)	(48)
Retained earnings	595	1,077
Total Equity	4,315	4,414
TOTAL LIABILITIES AND EQUITY	$ 14,848	$ 15,794

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

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

For the Year Ended December 31,	2013	2012	2011
	(millions of dollars)		
OPERATING ACTIVITIES			
Net (loss) income	$ (212)	$ 285	$ 257
Loss (income) from discontinued operations, net of income taxes	322	(67)	(35)
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	473	454	425
Deferred income taxes	458	312	178
Losses on treasury rate locks reclassified into income	1	—	1
Impairment losses	4	12	—
Other	(13)	(15)	(16)
Changes in:			
Accounts receivable	(46)	(2)	56
Inventories	5	(28)	(8)
Prepaid expenses	17	(12)	(4)
Regulatory assets and liabilities, net	(121)	(174)	(148)
Accounts payable and accrued liabilities	1	43	(53)
Pension contributions	(120)	(200)	(110)
Pension benefit obligation, excluding contributions	65	65	53
Cash collateral related to derivative activities	31	88	9
Income tax-related prepayments, receivables and payables	(182)	(160)	(27)
Advanced payment made to taxing authority	(242)	—	—
Other assets and liabilities	9	16	43
Net current assets held for disposition or sale	47	(25)	65
Net Cash From Operating Activities	497	592	686
INVESTING ACTIVITIES			
Investment in property, plant and equipment	(1,310)	(1,216)	(941)
Department of Energy capital reimbursement awards received	22	40	52
Changes in restricted cash equivalents	1	(1)	(10)
Net other investing activities	3	6	(9)
Proceeds from disposal of assets held for disposition	873	202	161
Net Cash Used By Investing Activities	(411)	(969)	(747)

NOTE: Continued on next page.

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

For the Year Ended December 31,	2013	2012	2011
		(millions of dollars)	
FINANCING ACTIVITIES			
Dividends paid on common stock	$ (270)	$ (248)	$ (244)
Common stock issued for the Direct Stock Purchase and Dividend Reinvestment Plan and employee-related compensation	50	51	47
Issuances of common stock	324	—	—
Redemption of preferred stock of subsidiaries	—	—	(6)
Issuances of long-term debt	800	450	235
Reacquisitions of long-term debt	(558)	(176)	(70)
(Repayments) issuances of short-term debt, net	(200)	33	198
Issuances of term loans	250	200	—
Repayments of term loans	(450)	—	—
Cost of issuances	(23)	(9)	(10)
Net other financing activities	(11)	(8)	(1)
Net Cash (Used By) From Financing Activities	(88)	293	149
Net (Decrease) Increase In Cash and Cash Equivalents	(2)	(84)	88
Cash and Cash Equivalents at Beginning of Year	25	109	21
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 23	$ 25	$ 109
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid for interest (net of capitalized interest of $7 million, $8 million and $11 million, respectively)	$ 260	$ 253	$ 240
Cash paid for income taxes	228	—	4
Non-cash activities:			
Reclassification of property, plant and equipment to regulatory assets	—	88	—
Reclassification of asset removal costs regulatory liability to accumulated depreciation	—	61	—

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

PEPCO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY

(millions of dollars, except shares)	Common Stock Shares	Common Stock Par Value	Premium on Stock	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total
Balance as of December 31, 2010	225,082,252	$ 2	$ 3,275	$ (106)	$ 1,027	$4,198
Net Income	—	—	—	—	257	257
Other comprehensive income	—	—	—	43	—	43
Dividends on common stock ($1.08 per share)	—	—	—	—	(244)	(244)
Issuance of common stock:						
Original issue shares, net	854,124	—	17	—	—	17
Shareholder DRP original shares	1,563,814	—	30	—	—	30
Net activity related to stock-based awards	—	—	3	—	—	3
Balance as of December 31, 2011	227,500,190	2	3,325	(63)	1,040	4,304
Net Income	—	—	—	—	285	285
Other comprehensive income	—	—	—	15	—	15
Dividends on common stock ($1.08 per share)	—	—	—	—	(248)	(248)
Issuance of common stock:						
Original issue shares, net	854,060	—	19	—	—	19
Shareholder DRP original shares	1,661,177	—	32	—	—	32
Net activity related to stock-based awards	—	—	7	—	—	7
Balance as of December 31, 2012	230,015,427	2	3,383	(48)	1,077	4,414
Net Loss	—	—	—	—	(212)	(212)
Other comprehensive income	—	—	—	14	—	14
Dividends on common stock ($1.08 per share)	—	—	—	—	(270)	(270)
Issuance of common stock:						
Original issue shares, net	18,734,128	1	331	—	—	332
Shareholder DRP original shares	1,575,343	—	30	—	—	30
Net activity related to stock-based awards	—	—	7	—	—	7
Balance as of December 31, 2013	250,324,898	$ 3	$ 3,751	$ (34)	$ 595	$4,315

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) ORGANIZATION

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

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

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

Through Pepco Energy Services, Inc. and its subsidiaries (collectively, Pepco Energy Services), PHI provides energy savings performance contracting services, underground transmission and distribution construction and maintenance services, and steam and chilled water under long-term contracts.

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

Power Delivery

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

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

Pepco Energy Services

Pepco Energy Services is engaged in the following businesses:

- Energy savings performance contracting business: designing, constructing and operating energy efficiency projects and distributed generation equipment, including combined heat and power plants, principally for federal, state and local government customers;
- Underground transmission and distribution business: providing underground transmission and distribution construction and maintenance services for electric utilities in North America; and
- Thermal business: providing steam and chilled water under long-term contracts through systems owned and operated by Pepco Energy Services, primarily to hotels and casinos in Atlantic City, New Jersey.

During 2012, Pepco Energy Services deactivated its Buzzard Point and Benning Road oil-fired generation facilities. Pepco Energy Services placed the facilities into an idle condition termed a "cold closure." A cold closure requires that the utility service be disconnected so that the facilities are no longer operable and require only essential maintenance until they are completely decommissioned. During the third quarter of 2013, Pepco Energy Services determined that it would be more cost effective to pursue the demolition of the Benning Road generation facility and realization of the scrap metal salvage value of the facility instead of maintaining cold closure status. As a result of this change in intent, Pepco Energy Services reduced its asset retirement obligation related to the facility by $2 million. The demolition of the facility commenced in the fourth quarter of 2013 and is expected to be completed by the end of 2014. Pepco Energy Services will recognize the salvage proceeds associated with the scrap metals at the facility as realized.

Other Non-Regulated

Between 1990 and 1999, PCI, through various subsidiaries, entered into certain transactions involving investments in aircraft and aircraft equipment, railcars and other assets. In connection with these transactions, PCI recorded deferred tax assets in prior years of $101 million in the aggregate. Following events that took place during the first quarter of 2013, which included (i) court decisions in favor of the Internal Revenue Service (IRS) with respect to both Consolidated Edison's cross-border lease transaction and another taxpayer's structured transactions (see additional discussion at "- Discontinued Operations – Cross-Border Energy Lease Investments" below), (ii) the change in PHI's tax position with respect to the tax benefits associated with its cross-border energy leases, and (iii) PHI's decision in March 2013 to begin to pursue the early termination of its remaining cross-border energy lease investments (which represented a substantial portion of the remaining assets within PCI) without the intent to reinvest these proceeds in income-producing assets, management evaluated the likelihood that PCI would be able to realize the $101 million of deferred tax assets in the future. Based on this evaluation, PCI established valuation allowances against these deferred tax assets totaling $101 million in the first quarter of 2013. Further, during the fourth quarter of 2013, in light of additional court decisions in favor of the IRS involving other taxpayers, and after consideration of all relevant factors, management determined that it would abandon the further pursuit of these deferred tax assets, and these assets totaling $101 million were charged off against the previously established valuation allowances.

Discontinued Operations

<u>Cross-Border Energy Lease Investments</u>

Through its subsidiary PCI, PHI held a portfolio of cross-border energy lease investments. During July 2013, PHI completed the termination of its interest in its cross-border energy lease investments. With the completion of the termination of the cross-border energy leases, the cross-border energy lease investments are being accounted for as discontinued operations.

As discussed in Note (15), "Commitments and Contingencies – PHI's Cross-Border Energy Lease Investments," PHI is involved in ongoing litigation with the IRS concerning certain benefits associated with previously held investments in cross-border energy leases. On January 9, 2013, the U.S. Court of Appeals for the Federal Circuit issued an opinion in *Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States* (to which PHI is not a party) that disallowed tax benefits associated with Consolidated Edison's cross-border lease transaction. As a result of the court's ruling in this case, PHI determined in the first quarter of 2013 that its tax position with respect to the benefits associated with its cross-border energy leases no longer met the more-likely-than-not standard of recognition for accounting purposes, and PCI recorded non-cash charges of $323 million (after-tax) in the first quarter of 2013 and $6 million (after-tax) in the second quarter of 2013, consisting of the following components:

- A non-cash pre-tax charge of $373 million ($313 million after-tax) to reduce the carrying value of these cross-border energy lease investments under Financial Accounting Standards Board (FASB) guidance on leases (Accounting Standards Codification (ASC) 840). This pre-tax charge was originally recorded in the consolidated statements of (loss) income as a reduction in operating revenue and is now reflected in (loss) income from discontinued operations, net of income taxes.

- A non-cash charge of $16 million after-tax to reflect the anticipated additional net interest expense under FASB guidance for income taxes

(ASC 740), related to estimated federal and state income tax obligations for the period over which the tax benefits may be disallowed. This after-tax charge was originally recorded in the consolidated statements of (loss) income as an increase in income tax expense and is now reflected in (loss) income from discontinued operations, net of income taxes. The after-tax interest charge for PHI on a consolidated basis was $70 million and this amount was allocated to each member of PHI's consolidated group as if each member was a separate taxpayer, resulting in the recognition of a $12 million interest benefit for the Power Delivery segment and interest expense of $16 million for PCI and $66 million for Corporate and Other, respectively.

Pepco Energy Services

In December 2009, PHI announced the wind-down of the retail energy supply component of the Pepco Energy Services business which was comprised of the retail electric and natural gas supply businesses. Pepco Energy Services implemented the wind-down by not entering into any new retail electric or natural gas supply contracts while continuing to perform under its existing retail electric and natural gas supply contracts through their respective expiration dates. On March 21, 2013, Pepco Energy Services entered into an agreement whereby a third party assumed all the rights and obligations of the remaining retail natural gas supply customer contracts, and the associated supply obligations, inventory and derivative contracts. The transaction was completed on April 1, 2013. In addition, Pepco Energy Services completed the wind-down of its retail electric supply business in the second quarter of 2013 by terminating its remaining customer supply and wholesale purchase obligations beyond June 30, 2013.

The operations of Pepco Energy Services' retail electric and natural gas supply businesses have been classified as discontinued operations and are no longer a part of the Pepco Energy Services segment for financial reporting purposes.

(2) SIGNIFICANT ACCOUNTING POLICIES

Consolidation Policy

The accompanying consolidated financial statements include the accounts of Pepco Holdings and its wholly owned subsidiaries. All material intercompany balances and transactions between subsidiaries have been eliminated. Pepco Holdings uses the equity method to report investments, corporate joint ventures, partnerships, and affiliated companies in which it holds an interest and can exercise significant influence over the operations and policies of the entity. Certain transmission and other facilities currently held, are consolidated in proportion to PHI's percentage interest in the facility.

Consolidation of Variable Interest Entities

PHI assesses its contractual arrangements with variable interest entities to determine whether it is the primary beneficiary and thereby has to consolidate the entities in accordance with FASB ASC 810. The guidance addresses conditions under which an entity should be consolidated based upon variable interests rather than voting interests. See Note (16), "Variable Interest Entities," for additional information.

Use of Estimates

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

Significant matters that involve the use of estimates include the assessment of contingencies, the calculation of future cash flows and fair value amounts for use in asset and goodwill impairment calculations, fair value calculations for derivative instruments, pension and other postretirement benefit assumptions, the assessment of the probability of recovery of regulatory assets, accrual of storm restoration costs, accrual of unbilled revenue, recognition of changes in network service transmission rates for prior service year costs, accrual of loss contingency liabilities for general and auto liability claims, accrual of interest related to income taxes, the recognition of lease income and income tax benefits for investments in finance leases held in trust associated with PHI's portfolio of cross-border energy lease investments (see Note (19), "Discontinued Operations – Cross-Border Energy Lease Investments"), and income tax provisions and reserves. Additionally, PHI is subject to legal, regulatory and other proceedings and claims that arise in the ordinary course of its business. PHI records an estimated liability for these proceedings and claims when it is probable that a loss has been incurred and the loss is reasonably estimable.

Revenue Recognition

Regulated Revenue

Power Delivery recognizes revenue upon distribution of electricity and natural gas to its customers, including unbilled revenue for services rendered but not yet billed. PHI's unbilled revenue was $177 million and $182 million as of December 31, 2013 and 2012, respectively, and these amounts are included in Accounts receivable. PHI's utility subsidiaries calculate unbilled revenue using an output-based methodology. This methodology is based on the supply of electricity or natural gas intended for distribution to customers. The unbilled revenue process requires management to make assumptions and judgments about input factors such as customer sales mix, temperature and estimated line losses (estimates of electricity and natural gas expected to be lost in the process of its transmission and distribution to customers). The assumptions and judgments are inherently uncertain and susceptible to change from period to period, and if the actual results differ from the projected results, the impact could be material.

Taxes related to the consumption of electricity and natural gas by the utility customers, such as fuel, energy, or other similar taxes, are components of the tariff rates charged by PHI's utility subsidiaries and, as such, are billed to customers and recorded in Operating revenue. Accruals for the remittance of these taxes are recorded in Other taxes.

Pepco Energy Services Revenue

Revenue for Pepco Energy Services' energy savings performance construction business is recognized using the percentage-of-completion method which recognizes revenue as work is completed on its contracts. Revenues from its operation and maintenance activities and measurement and verification activities in its energy savings business are recognized when earned.

Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions

Taxes included in PHI's gross revenues were $346 million, $356 million and $378 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Accounting for Derivatives

PHI and its subsidiaries may use derivative instruments primarily to manage risk associated with commodity prices and interest rates. Risk management policies are determined by PHI's Corporate Risk Management Committee (CRMC). The CRMC monitors interest rate fluctuation, commodity price fluctuation and credit risk exposure, and sets risk management policies that establish limits on unhedged risk.

PHI accounts for its derivative activities in accordance with FASB guidance on derivatives and hedging. Derivatives are recorded on the consolidated balance sheets as Derivative assets or Derivative liabilities and measured at fair value.

Changes in the fair value of derivatives held by DPL that do not qualify for hedge accounting or are not designated as hedges are presented on the consolidated statements of (loss) income as Fuel and purchased energy expense or Operating revenue, respectively. Changes in the fair value of derivatives held by DPL are deferred as regulatory assets or liabilities under the accounting guidance for regulated operations.

The gain or loss on a derivative that qualifies as a cash flow hedge of an exposure to variable cash flows of a forecasted transaction is initially recorded in accumulated other comprehensive loss (AOCL) (a separate component of equity) to the extent that the hedge is effective and is subsequently reclassified into earnings, in the same category as the item being hedged, when the gain or loss from the forecasted transaction occurs. If it is probable that a forecasted transaction will not occur, the deferred gain or loss in AOCL is immediately reclassified to earnings. Gains or losses related to any ineffective portion of cash flow hedges are also recognized in earnings immediately.

Changes in the fair value of derivatives designated as fair value hedges, as well as changes in the fair value of the hedged asset, liability or firm commitment, are recorded in the consolidated statements of (loss) income.

The impact of derivatives that are marked to market through current earnings, the ineffective portion of cash flow hedges, and the portion of fair value hedges that flows to current earnings are presented on a net basis in the consolidated statements of (loss) income as Operating revenue or as Fuel and purchased energy expense. When a hedging gain or loss is realized, it is presented on a net basis in the same line item as the underlying item being hedged. Unrealized derivative gains and losses are presented gross on the consolidated balance sheets except where contractual netting agreements are in place with individual counterparties.

The fair value of derivatives is determined using quoted exchange prices where available. For instruments that are not traded on an exchange, pricing services and external broker quotes may also be used to determine fair value. For some custom and complex instruments, internal models use market-based information when external broker quotes are not available. For certain long-dated instruments, broker or exchange data are extrapolated, or capacity prices are forecasted, for future periods where information is limited. Models are also used to estimate volumes for certain transactions.

PHI may enter into master netting arrangements to mitigate credit risk related to its derivatives. Under FASB guidance on offsetting of balance sheet accounts (ASC 210-20), amounts recognized for derivative assets and liabilities and the fair value amounts recognized for any related collateral positions executed with the same counterparty under such master netting agreements are offset.

See Note (13), "Derivative Instruments and Hedging Activities," for more information about the types of derivatives employed by PHI, the components of any unrealized and realized gains and losses and Note (14), "Fair Value Disclosures," for the methodologies used to value them.

Stock-Based Compensation

PHI recognizes compensation expense for stock-based awards, modifications or cancellations based on the grant-date fair value. Compensation expense is recognized over the requisite service period. A deferred tax asset and deferred tax benefit are also recognized concurrently with compensation expense for the tax effect of the deduction of stock options and restricted stock awards, which are deductible only upon exercise and vesting.

Historically, PHI's compensation awards had included both time-based restricted stock awards that vest over a three-year service period and performance-based restricted stock units that were earned based on performance over a three-year period. Beginning in 2011, stock-based compensation awards have been granted primarily in the form of restricted stock units. The compensation expense associated with these awards is calculated based on the estimated fair value of the awards at the grant date and is recognized over the service or performance period.

PHI estimated the fair value of stock option awards on the date of grant using the Black-Scholes-Merton option pricing model. This model used assumptions related to expected term, expected volatility, expected dividend yield, and the risk-free interest rate. PHI used historical data to estimate award exercises and employee terminations within the valuation model; groups of employees that have similar historical exercise behavior were considered separately for valuation purposes.

PHI's current policy is to issue new shares to satisfy vested awards of restricted stock units.

Income Taxes

PHI and the majority of its subsidiaries file a consolidated federal income tax return. Federal income taxes are allocated among PHI and the subsidiaries included in its consolidated group pursuant to a written tax sharing agreement, which was approved by the Securities and Exchange Commission (SEC) in 2002 in connection with the establishment of PHI as a public utility holding company. Under this tax sharing agreement, PHI's consolidated federal income tax liability is allocated based upon PHI's and its subsidiaries' separate taxable income or loss amounts.

The consolidated financial statements include current and deferred income taxes. Current income taxes represent the amount of tax expected to be reported on PHI's and its subsidiaries' federal and state income tax returns. Deferred income tax assets and liabilities represent the tax effects of temporary differences between the financial statement basis and tax basis of existing assets and liabilities, and they are measured using presently enacted tax rates. See Note (11), "Income Taxes," for a listing of primary deferred tax assets and liabilities. The portions of Pepco's, DPL's and ACE's deferred tax liabilities applicable to their utility operations that have not been recovered from utility customers represent income taxes recoverable in the future and are included in Regulatory Assets on the consolidated balance sheets. See Note (7), "Regulatory Matters – Regulatory Assets and Regulatory Liabilities," for additional information.

PHI recognizes interest on underpayments and overpayments of income taxes, interest on uncertain tax positions and tax-related penalties in income tax expense. Deferred income tax expense generally represents the net change during the reporting period in the net deferred tax liability and deferred recoverable income taxes.

Investment tax credits are amortized to income over the useful lives of the related property.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash invested in money market funds and commercial paper held with original maturities of three months or less.

Restricted Cash Equivalents

The Restricted cash equivalents included in Current assets and the Restricted cash equivalents included in Other assets consist of (i) cash held as collateral that is restricted from use for general corporate purposes and (ii) cash equivalents that are specifically segregated based on management's intent to use such cash equivalents for a particular purpose. The classification as current or non-current conforms to the classification of the related liabilities.

Accounts Receivable and Allowance for Uncollectible Accounts

PHI's Accounts receivable balances primarily consist of customer accounts receivable arising from the sale of goods and services to customers within PHI's service territories, other accounts receivable, and accrued unbilled revenue. Accrued unbilled revenue represents revenue earned in the current period but not billed to the customer until a future date (usually within one month after the receivable is recorded).

PHI maintains an allowance for uncollectible accounts and changes in the allowance are recorded as an adjustment to Other operation and maintenance expense in the consolidated statements of (loss) income. PHI determines the amount of the allowance based on specific identification of material amounts at risk by customer and maintains a reserve based on its historical collection experience. The adequacy of this allowance is assessed on a quarterly basis by evaluating all known factors, such as the aging of the receivables, historical collection experience, the economic and competitive environment and changes in the creditworthiness of its customers. Accounts receivable are written off in the period in which the receivable is deemed uncollectible and collection efforts have been exhausted. Recoveries of Accounts receivable previously written off are recorded when it is probable they will be recovered. Although PHI believes its allowance is adequate, it cannot anticipate with any certainty the changes in the financial condition of its customers. As a result, PHI records adjustments to the allowance for uncollectible accounts in the period in which the new information that requires an adjustment to the reserve becomes known.

Inventories

Inventory is valued at the lower of cost or market value. Included in Inventories are generation, transmission and distribution materials and supplies, natural gas and fuel oil.

PHI utilizes the weighted average cost method of accounting for inventory items. Under this method, an average price is determined for the quantity of units acquired at each price level and is applied to the ending quantity to calculate the total ending inventory balance. Materials and supplies are recorded in Inventory when purchased and then expensed or capitalized to plant, as appropriate, when installed.

The cost of natural gas, including transportation costs, is included in Inventory when purchased and charged to Fuel and Purchased Energy expense when used.

Goodwill

Goodwill represents the excess of the purchase price of an acquisition over the fair value of the net assets acquired at the acquisition date. PHI tests its goodwill for impairment annually as of November 1 and whenever an event occurs or circumstances change in the interim that would more likely than not (that is, a greater than 50% chance) reduce the estimated fair value of a reporting unit below the carrying amount of its net assets. Factors that may result in an interim impairment test include, but are not limited to: a change in the identified reporting units; an adverse change in business conditions; a protracted decline in PHI's stock price causing market capitalization to fall significantly below book value; an adverse regulatory action; or an impairment of long-lived assets in the reporting unit. PHI performed its most recent annual impairment test as of November 1, 2013, and its goodwill was not impaired as described in Note (6), "Goodwill."

Regulatory Assets and Regulatory Liabilities

The operations of Pepco are regulated by the District of Columbia Public Service Commission (DCPSC) and the Maryland Public Service Commission (MPSC). The operations of DPL are regulated by the Delaware Public Service Commission (DPSC) and the MPSC. DPL's interstate transportation and wholesale sale of natural gas are regulated by the Federal Energy Regulatory Commission (FERC). The operations of ACE are regulated by the New Jersey Board of Public Utilities (NJBPU). The transmission of electricity by Pepco, DPL and ACE is regulated by FERC.

The FASB guidance on regulated operations (ASC 980) applies to Power Delivery. It allows regulated entities, in appropriate circumstances, to defer the income statement impact of certain costs that are expected to be recovered in future rates through the establishment of regulatory assets and defer certain revenues that are expected to be refunded to customers through the establishment of regulatory liabilities. Management's assessment of the probability of recovery of regulatory assets requires judgment and interpretation of laws, regulatory commission orders and other factors. If management subsequently determines, based on changes in facts or circumstances, that a regulatory asset is not probable of recovery, then the regulatory asset would be eliminated through a charge to earnings.

Effective June 2007, the MPSC approved a bill stabilization adjustment (BSA) mechanism for retail customers of Pepco and DPL. Effective November 2009, the DCPSC approved a BSA for Pepco's retail customers. For customers to whom the BSA applies, Pepco and DPL recognize distribution revenue based on an approved distribution charge per customer. From a revenue recognition standpoint, the BSA has the effect of decoupling the distribution revenue recognized in a reporting period from the amount of power delivered during that period. Pursuant to this mechanism, Pepco and DPL recognize either (i) a positive adjustment equal to the amount by which revenue from Maryland and the District of Columbia retail distribution sales falls short of the revenue that Pepco and DPL are entitled to earn based on the approved distribution charge per customer, or (ii) a negative adjustment equal to the amount by which revenue from such distribution sales exceeds the revenue that Pepco and DPL are entitled to earn based on the approved distribution charge per customer (a Revenue Decoupling Adjustment). A net positive Revenue Decoupling Adjustment is recorded as a regulatory asset and a net negative Revenue Decoupling Adjustment is recorded as a regulatory liability.

Leasing Activities

Pepco Holdings' lease transactions include plant, office space, equipment, software, vehicles and elements of power purchase agreements (PPAs). In accordance with FASB guidance on leases (ASC 840), these leases are classified as either leveraged leases, operating leases or capital leases.

Leveraged Leases

Income from investments in leveraged lease transactions, in which PHI is an equity participant, was accounted for using the financing method. In accordance with the financing method, investments in leased property were recorded as a receivable from the lessee to be recovered through the collection of future rentals. Income was recognized over the life of the lease at a constant rate of return on the positive net investment. Each quarter, PHI reviewed the carrying value of each lease, which included a review of the underlying financial assumptions, the timing and collectibility of cash flows, and the credit quality of the lessee. Changes to the underlying assumptions, if any, were accounted for in accordance with FASB guidance on leases and reflected in the carrying value of the lease effective for the quarter within which they occurred.

Operating Leases

An operating lease in which PHI or a subsidiary is the lessee generally results in a level income statement charge over the term of the lease, reflecting the rental payments required by the lease agreement. If rental payments are not made on a straight-line basis, PHI's policy is to recognize rent expense on a straight-line basis over the lease term unless another systematic and rational allocation basis is more representative of the time pattern in which the leased property is physically employed.

Capital Leases

For ratemaking purposes, capital leases in which PHI or a subsidiary is the lessee are treated as operating leases; therefore, in accordance with FASB guidance on regulated operations (ASC 980), the amortization of the leased asset is based on the recovery of rental payments through customer rates. Investments in equipment under capital leases are stated at cost, less accumulated depreciation. Depreciation is recorded on a straight-line basis over the equipment's estimated useful life.

Arrangements Containing a Lease

PPAs contain a lease if the arrangement conveys the right to control the use of property, plant or equipment. If so, PHI determines the appropriate lease accounting classification.

Property, Plant and Equipment

Property, plant and equipment is recorded at original cost, including labor, materials, asset retirement costs and other direct and indirect costs including capitalized interest. The carrying value of Property, plant and equipment is evaluated for impairment whenever circumstances indicate the carrying value of those assets may not be recoverable. Upon retirement, the cost of regulated property, net of salvage, is charged to Accumulated depreciation. For non-regulated property, the cost and accumulated depreciation of the property, plant and equipment retired or otherwise disposed of are removed from the related accounts and included in the determination of any gain or loss on disposition.

The annual provision for depreciation on electric and natural gas property, plant and equipment is computed on a straight-line basis using composite rates by classes of depreciable property. Accumulated depreciation is charged with the cost of depreciable property retired, less salvage and other recoveries. Non-operating and other property is generally depreciated on a straight-line basis over the useful lives of the assets. The table below provides system-wide composite annual depreciation rates for the years ended December 31, 2013, 2012 and 2011.

	Transmission and Distribution			Generation		
	2013	2012	2011	2013	2012	2011
Pepco	2.2%	2.5%	2.6%	—	—	—
DPL	2.6%	2.7%	2.8%	—	—	—
ACE	2.8%	3.0%	3.0%	—	—	—
Pepco Energy Services [a]	—	—	—	0.4%	6.4%	10.2%

[a] Percentages reflect accelerated depreciation of the Benning Road and Buzzard Point generating facilities retired during 2012.

In 2010, subsidiaries of PHI received awards from the U.S. Department of Energy (DOE) under the American Recovery and Reinvestment Act of 2009. Pepco was awarded $149 million from DOE to fund a portion of the costs incurred for the implementation of an advanced metering infrastructure (AMI) system (a system that collects, measures and analyzes energy usage data from advanced digital meters known as smart meters), direct load control, distribution automation and communications infrastructure in its Maryland and District of Columbia service territories. ACE was awarded $19 million from DOE to fund a portion of the costs incurred for the implementation of direct load control, distribution automation and communications infrastructure in its New Jersey service territory. PHI has elected to recognize the award proceeds as a reduction in the carrying value of the assets acquired rather than grant income over the service period.

Long-Lived Asset Impairment Evaluation

PHI evaluates long-lived assets to be held and used, such as generating property and equipment, and real estate, for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Examples of such events or changes include a significant decrease in the market price of a long-lived asset or a significant adverse change in the manner in which an asset is being used or its physical condition. A long-lived asset to be held and used is written down to its estimated fair value if the expected future undiscounted cash flow from the asset is less than its carrying value.

For long-lived assets held for sale, an impairment loss is recognized to the extent that the asset's carrying value exceeds its estimated fair value including costs to sell.

Capitalized Interest and Allowance for Funds Used During Construction

In accordance with FASB guidance on regulated operations (ASC 980), PHI's utility subsidiaries can capitalize the capital costs of financing the construction of plant and equipment as allowance for funds used during construction (AFUDC). This results in the debt portion of AFUDC being recorded as a reduction of Interest expense and the equity portion of AFUDC being recorded as an increase to Other income in the accompanying consolidated statements of (loss) income.

Pepco Holdings recorded AFUDC for borrowed funds of $7 million, $7 million and $11 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Pepco Holdings recorded amounts for the equity component of AFUDC of $11 million, $14 million and $15 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Amortization of Debt Issuance and Reacquisition Costs

Pepco Holdings defers and amortizes debt issuance costs and long-term debt premiums and discounts over the lives of the respective debt issuances.

When PHI utility subsidiaries refinance existing debt or redeem existing debt, any unamortized premiums, discounts and debt issuance costs, as well as debt redemption costs, are classified as Regulatory assets and are amortized over the life of the original or new issue.

Asset Removal Costs

In accordance with FASB guidance, asset removal costs are recorded by PHI utility subsidiaries as Regulatory liabilities. At December 31, 2013 and 2012, $275 million and $324 million, respectively, of asset removal costs are included in Regulatory liabilities in the accompanying consolidated balance sheets.

Pension and Postretirement Benefit Plans

PHI sponsors the PHI Retirement Plan, a non-contributory, defined benefit pension plan that covers substantially all employees of Pepco, DPL, ACE and certain employees of other PHI subsidiaries. PHI also provides supplemental retirement benefits to certain eligible executives and key employees through nonqualified retirement plans and provides certain postretirement health care and life insurance benefits for eligible retired employees. Most employees hired after January 1, 2005 will not have retiree health care coverage.

Net periodic benefit cost is included in Other operation and maintenance expense, net of the portion of the net periodic benefit cost capitalized as part of the cost of labor for internal construction projects. After intercompany allocations, the three utility subsidiaries are responsible for substantially all of the total PHI net periodic benefit cost.

PHI accounts for the PHI Retirement Plan, the nonqualified retirement plans, and the retirement health care and life insurance benefit plans in accordance with FASB guidance on retirement benefits (ASC 715).

See Note (9), "Pension and Other Postretirement Benefits," for additional information.

Reclassifications and Adjustments

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

Income Tax Expense Related to Continuing Operations

During 2013, Pepco recorded certain adjustments to correct prior period errors related to income taxes. These adjustments resulted from the completion of additional analysis of deferred tax balances and resulted in an increase in Income tax expense of $4 million, for the year ended December 31, 2013.

During 2011, PHI recorded adjustments to correct certain income tax errors related to prior periods associated with the interest on uncertain tax positions. The adjustment resulted in an increase in Income tax expense of $2 million for the year ended December 31, 2011.

Pepco Energy Services Derivative Accounting Adjustment

During 2011, PHI recorded an adjustment associated with an increase in the value of certain derivatives from October 1, 2010 to December 31, 2010, which had been erroneously recorded in other comprehensive income at December 31, 2010. This adjustment resulted in a decrease in Loss from discontinued operations, net of income taxes of $1 million for the year ended December 31, 2011.

DPL Operating Revenue Adjustment

During 2012, DPL recorded an adjustment to correct an overstatement of unbilled revenue in its natural gas distribution business related to prior periods. The adjustment resulted in a decrease in Operating revenue of $1 million for the year ended December 31, 2012.

DPL Default Electricity Supply Revenue and Cost Adjustments

During 2011, DPL recorded adjustments to correct certain errors associated with the accounting for Default Electricity Supply revenue and costs. These adjustments primarily arose from the under-recognition of allowed returns on the cost of working capital and resulted in a pre-tax decrease in Other operation and maintenance expense of $11 million for the year ended December 31, 2011.

ACE BGS Deferred Electric Service Costs Adjustments

In 2012, ACE recorded an adjustment to correct errors associated with its calculation of deferred electric service costs. This adjustment resulted in an increase of $3 million to deferred electric service costs, all of which relates to periods prior to 2012.

Revision to Prior Period Financial Statements

PCI Deferred Income Tax Liability Adjustment

Since 1999, PCI had not recorded a deferred tax liability related to a temporary difference between the financial reporting basis and the tax basis of an investment in a wholly owned partnership. In the second quarter of 2013, PHI re-evaluated this accounting treatment and found it to be in error, requiring an adjustment related to prior periods. PHI determined that the cumulative adjustment required, representing a charge to earnings of $32 million, related to a period prior to the year ended December 31, 2009 (the earliest period for which selected consolidated financial data is presented in the table entitled "Consolidated Financial Highlights" in this Annual Report). Consistent with PHI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, the accompanying consolidated financial statements reflect the correction of this error as an adjustment to shareholders' equity for the earliest period presented. The adjustment to correct the error did not affect PHI's consolidated statements of (loss) income, comprehensive (loss) income and cash flows for each of the three years in the period ended December 31, 2013, and only affected PHI's reported balances of deferred income tax liabilities and retained earnings as reflected in the consolidated balance sheets as of December 31, 2013 and 2012 and the reported balances of retained earnings and total equity as reflected in the consolidated statements of equity for each of the three years in the period ended December 31, 2013. The adjustment is not considered to be material to PHI's reported balances of retained earnings and total equity reflected in the consolidated financial statements included in this Annual Report. The table below illustrates the effects of the revision on reported balances in PHI's consolidated financial statements.

	As Filed	Adjustment	As Revised
		(millions of dollars)	
December 31, 2012			
Deferred income tax liabilities, net	$ 3,176	$ 32	$ 3,208
Total deferred credits	4,819[(a)]	32	4,851
Retained earnings	1,109	(32)	1,077
Total equity	4,446	(32)	4,414
December 31, 2011			
Deferred income tax liabilities, net	$ 2,863	$ 32	$ 2,895
Total deferred credits	4,549[(a)]	32	4,581
Retained earnings	1,072	(32)	1,040
Total equity	4,336	(32)	4,304
December 31, 2010			
Retained earnings	$ 1,059	$ (32)	$ 1,027
Total equity	4,230[(b)]	(32)	4,198

(a) The amount of total deferred credits differs from the amount orginially reported in PHI's 2012 Form 10-K due to certain reclassifications.

(b) The amount represents total shareholders' equity, which excludes a non-controlling interest of $6 million.

(3) NEWLY ADOPTED ACCOUNTING STANDARDS

Balance Sheet (ASC 210)

In December 2011, the FASB issued new disclosure requirements for financial assets and financial liabilities, such as derivatives, that are subject to contractual netting arrangements. The new disclosure requirements include information about the gross exposure of the instruments and the net exposure of the instruments under contractual netting arrangements, how the exposures are presented in the financial statements, and the terms and conditions of the contractual netting arrangements. PHI adopted the new guidance during the first quarter of 2013 and concluded it did not have a material impact on its consolidated financial statements.

Comprehensive Income (ASC 220)

The new disclosure requirements for reclassifications from accumulated other comprehensive income were effective for PHI beginning with its March 31, 2013 consolidated financial statements and required PHI to present additional information about its reclassifications from accumulated other comprehensive income in a single footnote or on the face of its consolidated financial statements. The additional information required to be disclosed includes a presentation of the components of accumulated other comprehensive income that have been reclassified by source (e.g., commodity derivatives), and the income statement line item (e.g., Fuel and purchased energy) affected by the reclassification. PHI has provided the new required disclosures in Note (17), "Accumulated Other Comprehensive Loss."

(4) RECENTLY ISSUED ACCOUNTING STANDARDS, NOT YET ADOPTED

Joint and Several Liability Arrangements (ASC 405)

In February 2013, the FASB issued new recognition and disclosure requirements for certain joint and several liability arrangements where the total amount of the obligation is fixed at the reporting date. For arrangements within the scope of this standard, PHI will be required to include in its liabilities the additional amounts it expects to pay on behalf of its co-obligors, if any. PHI will also be required to provide additional disclosures including the nature of the arrangements with its co-obligors, the total amounts outstanding under the arrangements between PHI and its co-obligors, the carrying value of the liability, and the nature and limitations of any recourse provisions that would enable recovery from other entities.

The new requirements are effective retroactively beginning on January 1, 2014, with implementation required for prior periods if joint and several liability arrangement obligations exist as of January 1, 2014. PHI does not expect this new guidance to have a material impact on its consolidated financial statements.

Income Taxes (ASC 740)

In July 2013, the FASB issued new guidance that will require the netting of certain unrecognized tax benefits against a deferred tax asset for a loss or other similar tax carryforward that would apply upon settlement of the uncertain tax position. The new requirements are effective prospectively beginning with PHI's March 31, 2014 consolidated financial statements for all unrecognized tax benefits existing at the adoption date. Retrospective implementation and early adoption of the guidance are permitted. PHI does not expect this new guidance to have a material impact on its consolidated financial statements.

(5) SEGMENT INFORMATION

Pepco Holdings' management has identified its operating segments at December 31, 2013 as Power Delivery and Pepco Energy Services. In the tables below, the Corporate and Other column is included to reconcile the segment data with consolidated data and includes unallocated Pepco Holdings' (parent company) capital costs, such as financing costs. Through its subsidiary PCI, PHI maintained a portfolio of cross-border energy lease investments. PHI completed the termination of its interests in its cross-border energy lease investments during 2013. As a result, the cross-border energy lease investments, which comprised substantially all of the operations of the former Other Non-Regulated segment, are being accounted for as discontinued operations. The remaining operations of the former Other Non-Regulated segment, which no longer meet the definition of a separate segment for financial reporting purposes, are now included in Corporate and Other. Segment financial information for continuing operations at and for the years ended December 31, 2013, 2012 and 2011, is as follows:

	Year Ended December 31, 2013			
	Power Delivery	Pepco Energy Services	Corporate and Other [a]	PHI Consolidated
	(millions of dollars)			
Operating Revenue	$ 4,472	$ 203	$ (9)	$ 4,666
Operating Expenses [b]	3,828	201[e]	(31)	3,998
Operating Income	644	2	22	668
Interest Expense	228	1	44	273
Other Income	28	3	3	34
Income Tax Expense [c]	155	1	163[d]	319
Net Income (Loss) from Continuing Operations	289	3	(182)	110
Total Assets (excluding Assets Held for Disposition)	13,027	335	1,485	14,847
Construction Expenditures	$ 1,194	$ 4	$ 112	$ 1,310

(a) Total Assets in this column includes Pepco Holdings' goodwill balance of $1.4 billion, all of which is allocated to Power Delivery for purposes of assessing impairment. Total assets also include capital expenditures related to certain hardware and software expenditures which primarily benefit Power Delivery. These expenditures are recorded as incurred in Corporate and Other and are allocated to Power Delivery once the assets are placed in service. Corporate and Other includes intercompany amounts of $(10) million for Operating Revenue, $(9) million for Operating Expenses and $(5) million for Interest Expense.

(b) Includes depreciation and amortization expense of $473 million, consisting of $439 million for Power Delivery, $6 million for Pepco Energy Services and $28 million for Corporate and Other.

(c) Includes after-tax interest associated with uncertain and effectively settled tax positions allocated to each member of the consolidated group, including a $12 million interest benefit for Power Delivery and interest expense of $66 million for Corporate and Other.

(d) Includes non-cash charges of $101 million representing the establishment of valuation allowances against certain deferred tax assets of PCI included in Corporate and Other.

(e) Includes pre-tax impairment losses of $4 million ($3 million after-tax) at Pepco Energy Services associated with a landfill gas-fired electric generation facility.

	Year Ended December 31, 2012			
	Power Delivery	Pepco Energy Services	Corporate and Other [(a)]	PHI Consolidated
	(millions of dollars)			
Operating Revenue	$ 4,378	$ 256[(b)]	$ (9)	$ 4,625
Operating Expenses [(c)]	3,847	271[(b)(d)]	(34)	4,084
Operating Income (Loss)	531	(15)	25	541
Interest Income	1	1	(1)	1
Interest Expense	219	2	35	256
Impairment Losses	—	—	(1)	(1)
Other Income	32	1	3	36
Income Tax Expense (Benefit)	110	(7)	—	103
Net Income (Loss) from Continuing Operations	235	(8)	(9)	218
Total Assets (excluding Assets Held for Disposition)	12,149	342	2,028	14,519
Construction Expenditures	$ 1,168	$ 11	$ 37	$ 1,216

(a) Total Assets in this column includes Pepco Holdings' goodwill balance of $1.4 billion, all of which is allocated to Power Delivery for purposes of assessing impairment. Total assets also include capital expenditures related to certain hardware and software expenditures which primarily benefit Power Delivery. These expenditures are recorded as incurred in Corporate and Other and are allocated to Power Delivery once the assets are placed in service. Corporate and Other includes intercompany amounts of $(11) million for Operating Revenue, $(10) million for Operating Expenses, $(21) million for Interest Income and $(18) million for Interest Expense.

(b) Includes $9 million of intra-company revenues (and associated costs) previously eliminated in consolidation which will continue to be recognized from third parties subsequent to the completion of the wind-down of the Pepco Energy Services' retail electric and natural gas supply businesses.

(c) Includes depreciation and amortization expense of $454 million, consisting of $416 million for Power Delivery, $14 million for Pepco Energy Services and $24 million for Corporate and Other.

(d) Includes impairment losses of $12 million pre-tax ($7 million after-tax) at Pepco Energy Services associated primarily with investments in landfill gas-fired electric generation facilities, and the combustion turbines at Buzzard Point.

	Year Ended December 31, 2011			
	Power Delivery	Pepco Energy Services	Corporate and Other [(a)]	PHI Consolidated
	(millions of dollars)			
Operating Revenue	$ 4,650	$ 330[(b)]	$ (16)	$ 4,964
Operating Expenses [(c)]	4,150	301[(b)]	(40)	4,411
Operating Income	500	29	24	553
Interest Income	1	1	(1)	1
Interest Expense	208	2	32	242
Impairment Losses	—	—	(5)	(5)
Other Income (Expenses)	29	2	(2)	29
Income Tax Expense (Benefit) [(d)]	112	8	(6)	114
Net Income (Loss) from Continuing Operations	210	22	(10)	222
Total Assets (excluding Assets Held for Disposition)	11,008	529	1,988	13,525
Construction Expenditures	$ 888	$ 14	$ 39	$ 941

(a) Total Assets in this column includes Pepco Holdings' goodwill balance of $1.4 billion, all of which is allocated to Power Delivery for purposes of assessing impairment. Total assets also include capital expenditures related to certain hardware and software expenditures which primarily benefit Power Delivery. These expenditures are recorded as incurred in Corporate and Other and are allocated to Power Delivery once the assets are placed in service. Corporate and Other includes intercompany amounts of $(16) million for Operating Revenue, $(15) million for Operating Expense, $(22) million for Interest Income and $(22) million for Interest Expense.

(b) Includes $15 million of intra-company revenues (and associated costs) previously eliminated in consolidation which will continue to be recognized from third parties subsequent to the completion of the wind-down of the Pepco Energy Services' retail electric and natural gas supply businesses.

(c) Includes depreciation and amortization expense of $425 million, consisting of $394 million for Power Delivery, $16 million for Pepco Energy Services and $15 million for Corporate and Other.

(d) Includes tax benefits of $14 million for Power Delivery primarily associated with an interest benefit related to federal tax liabilities.

(6) GOODWILL

Substantially all of PHI's goodwill balance as of December 31, 2013 and 2012 was generated by Pepco's acquisition of Conectiv in 2002 and is allocated entirely to the Power Delivery reporting unit based on the aggregation of its regulated public utility company components for purposes of assessing impairment under FASB guidance on goodwill and other intangibles (ASC 350).

In order to estimate the fair value of the Power Delivery reporting unit, PHI uses two valuation techniques: an income approach and a market approach. The income approach estimates fair value based on a discounted future cash flow analysis and a terminal value that is consistent with Power Delivery's long-term view of the business. This approach uses a discount rate based on the estimated weighted average cost of capital (WACC) for the reporting unit. PHI determines the estimated WACC by considering appropriate market-based information for the cost of equity and cost of debt as of the measurement date. The market approach estimates fair value based on a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA) that management believes is consistent with EBITDA multiples for comparable utilities. PHI has consistently used this valuation technique to estimate the fair value of Power Delivery.

The estimation of fair value is dependent on a number of factors including but not limited to interest rates, growth assumptions, returns on rate base, operating and capital expenditure requirements, and other factors, changes in which could materially affect the results of impairment testing. Assumptions used were consistent with historical experience, including assumptions concerning the recovery of operating costs and capital expenditures and current market-based information. Sensitive, interrelated and uncertain variables that could decrease the estimated fair value of the Power Delivery reporting unit include utility sector market performance, sustained adverse business conditions, changes in forecasted revenues, higher operating and maintenance capital expenditure requirements, a significant increase in the weighted-average cost of capital and other factors.

In addition to estimating the fair value of its Power Delivery reporting unit, PHI estimated the fair value of its other reporting units at November 1, 2013. The sum of the estimated fair values of all reporting units was reconciled to PHI's market capitalization at November 1, 2013 to corroborate PHI's estimates of the fair values of its reporting units. The sum of the estimated fair values of all reporting units exceeded the market capitalization of PHI at November 1, 2013. PHI believes that the excess of the estimated fair value of PHI's reporting units as compared to PHI's market capitalization reflects a control premium that is reasonable when compared to control premiums observed in historical acquisitions in the utility industry and giving consideration to the current economic environment.

As of December 31, 2013 and 2012, PHI's goodwill balance was $1,407 million, which is net of accumulated impairment losses of $18 million.

(7) REGULATORY MATTERS

Regulatory Assets and Regulatory Liabilities

The components of Pepco Holdings' regulatory asset and liability balances at December 31, 2013 and 2012 are as follows:

	2013	2012
	(millions of dollars)	
Regulatory Assets		
Pension and OPEB costs	$ 667	$1,171
Securitized stranded costs [a]	350	416
Smart Grid costs [a]	251	230
Recoverable income taxes	225	177
Deferred energy supply costs [a]	136	183
Demand-side management costs [a]	125	57
Incremental storm restoration costs [a]	72	89
MAPP abandonment costs [a]	68	88
Deferred debt extinguishment costs [a]	47	53
Recoverable workers' compensation and long-term disability costs	26	31
Deferred losses on gas derivatives	—	4
Other	120	115
Total Regulatory Assets	$2,087	$2,614
Regulatory Liabilities		
Asset removal costs	$ 275	$ 324
Deferred energy supply costs	46	78
Deferred income taxes due to customers	45	45
Deferred gains on gas derivatives	1	—
Excess depreciation reserve	—	11
Other	32	43
Total Regulatory Liabilities	$ 399	$ 501

[a] A return is generally earned on these deferrals.

A description for each category of regulatory assets and regulatory liabilities follows:

Pension and OPEB Costs: Represents unrecognized net actuarial losses and prior service cost (credit) for Pepco Holdings' defined benefit pension and other postretirement benefit (OPEB) plans that are expected to be recovered by Pepco, DPL and ACE in rates. The utilities have historically included these items as a part of its cost of service in its customer rates. This regulatory asset is adjusted at least annually when the funded status of Pepco Holdings' defined benefit pension and OPEB plans are re-measured. See Note (9), "Pension and Other Postretirement Benefits," for more information about the components of the unrecognized pension and OPEB costs.

Securitized Stranded Costs: Certain contract termination payments under a contract between ACE and an unaffiliated non-utility generator (NUG) and costs associated with the regulated operations of ACE's electricity generation business are no longer recoverable through customer rates (collectively referred to as "stranded costs"). The stranded costs are amortized over the life of Transition Bonds issued by Atlantic City Electric Transition Funding LLC (ACE Funding) (Transition Bonds) to securitize the recoverability of these stranded costs. These bonds mature between 2014 and 2023. A customer surcharge is collected by ACE to fund principal and interest payments on the Transition Bonds.

Smart Grid Costs: Represents AMI costs associated with the installation of smart meters and the early retirement of existing meters throughout Pepco's and DPL's service territories that are recoverable from customers. AMI has not been approved by the NJBPU for ACE in New Jersey.

Recoverable Income Taxes: Represents amounts recoverable from Power Delivery's customers for tax benefits applicable to utility operations of Pepco, DPL and ACE previously recognized in income tax expense before the companies were ordered to account for the tax benefits as deferred income taxes. As the temporary differences between the financial statement basis and tax basis of assets reverse, the deferred recoverable balances are reversed.

Deferred Energy Supply Costs: The regulatory asset represents primarily deferred costs associated with a net under-recovery of Default Electricity Supply costs incurred by Pepco, DPL and ACE that are probable of recovery in rates. The regulatory liability represents primarily deferred costs associated with a net over-recovery of Default Electricity Supply costs incurred that will be refunded by Pepco, DPL and ACE to customers.

Demand-Side Management Costs: Represents recoverable costs associated with customer energy efficiency and conservation programs in Pepco's and DPL's Maryland jurisdictions.

Incremental Storm Restoration Costs: Represents total incremental storm restoration costs incurred for repair work due to major storm events in 2012 and 2011, including Hurricane Sandy, the June 2012 derecho, Hurricane Irene and the 2011 severe winter storm (for Pepco), that are recoverable from customers in the Maryland and New Jersey jurisdictions. Pepco's and DPL's costs related to Hurricane Sandy, the June 2012 derecho, Hurricane Irene and Pepco's costs related to the 2011 severe winter storm are being amortized and recovered in rates, each over a five-year period. ACE's costs related to Hurricane Sandy, the June 2012 derecho and Hurricane Irene are being amortized and recovered in rates, each over a three-year period.

MAPP Abandonment Costs: Represents the probable recovery of abandoned costs prudently incurred in connection with the Mid-Atlantic Power Pathway (MAPP) project which was terminated by PJM Interconnection, LLC (PJM) on August 24, 2012. The regulatory asset includes the costs of land, land rights, supplies and materials, engineering and design, environmental services, and project management and administration. The regulatory asset will be reduced as the result of sale or alternative use of these assets. As of December 31, 2013, these assets were earning a return of 12.8%. For additional information, see "MAPP Project" discussion below.

Deferred Debt Extinguishment Costs: Represents the costs of debt extinguishment of Pepco, DPL and ACE associated with issuances of debt for which recovery through regulated utility rates is considered probable, and if approved, will be amortized to interest expense during the authorized rate recovery period.

Recoverable Workers' Compensation and Long-Term Disability Costs : Represents accrued workers' compensation and long-term disability costs for Pepco, which are recoverable from customers when actual claims are paid to employees.

Deferred Losses on Gas Derivatives : Represents losses associated with hedges of natural gas purchases that are recoverable through the Gas Cost Rate approved by the DPSC.

Other: Represents miscellaneous regulatory assets that generally are being amortized over 1 to 20 years.

Asset Removal Costs: The depreciation rates for Pepco and DPL include a component for removal costs, as approved by the relevant federal and state regulatory commissions. Accordingly, Pepco and DPL have recorded regulatory liabilities for their estimate of the difference between incurred removal costs and the amount of removal costs recovered through depreciation rates.

Deferred Income Taxes Due to Customers: Represents the portions of deferred income tax assets applicable to utility operations of Pepco and DPL that have not been reflected in current customer rates for which future payment to customers is probable. As the temporary differences between the financial statement basis and tax basis of assets reverse, deferred recoverable income taxes are amortized.

Deferred Gains on Gas Derivatives : Represents gains associated with hedges of natural gas purchases that will be refunded to customers through the Gas Cost Rate approved by the DPSC.

Excess Depreciation Reserve: The excess depreciation reserve was recorded as part of an ACE New Jersey rate case settlement. This excess reserve is the result of a change in estimated depreciable lives and a change in depreciation technique from remaining life to whole life that caused an over-recovery for depreciation expense from customers when the remaining life method had been used. The excess was amortized as a reduction in Depreciation and amortization expense over an 8.25 year period, and expired in 2013.

Other: Includes miscellaneous regulatory liabilities.

Rate Proceedings

The following table shows, for each of PHI's utility subsidiaries, the electric distribution base rate cases currently pending. Additional information concerning each of these filings is provided in the discussion below.

Jurisdiction/Company	Requested Revenue Requirement Increase	Requested Return on Equity	Filing Date	Expected Timing of Decision
	(millions of dollars)			
DC – Pepco	$ 44.8[a]	10.25%	March 8, 2013	Q1, 2014
DE – DPL (Electric)	$ 39.0[b]	10.25%	March 22, 2013	Q2, 2014
MD – Pepco	$ 43.3	10.25%	December 4, 2013	Q3, 2014

(a) Reflects Pepco's updated revenue requirement as filed on December 3, 2013.

(b) Reflects DPL's updated revenue requirement as filed on September 20, 2013.

The following table shows, for each of PHI's utility subsidiaries, the distribution base rate cases completed in 2013. Additional information concerning each of these cases is provided in the discussion below.

Jurisdiction/Company	Approved Revenue Requirement Increase	Approved Return on Equity	Completion Date	Rate Effective Date
	(millions of dollars)			
NJ – ACE	$ 25.5	9.75%	June 21, 2013	July 1, 2013
MD – Pepco	$ 27.9	9.36%	July 12, 2013	July 12, 2013
MD – DPL	$ 15.0	9.81%[a]	August 30, 2013	September 15, 2013
DE – DPL (Gas)	$ 6.8	9.75%[b]	October 22, 2013	November 1, 2013

(a) Return on equity (ROE) has not been determined by any proceeding and is specified only for the purposes of calculating the AFUDC and regulatory asset carrying costs.

(b) ROE has not been determined by any proceeding and is specified only for reporting purposes and for calculating the AFUDC, construction work in process (CWIP), regulatory asset carrying costs and other accounting metrics.

Bill Stabilization Adjustment

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

- A BSA has been approved and implemented for Pepco and DPL electric service in Maryland and for Pepco electric service in the District of Columbia.
- A proposed modified fixed variable rate design (MFVRD) for DPL electric and natural gas service in Delaware was filed in 2009 for consideration by the DPSC and while there was little activity associated with this filing in 2013, the proceeding remains open.
- In New Jersey, a BSA proposed by ACE in 2009 was not approved and there is no BSA proposal currently pending.

Under the BSA, customer distribution rates are subject to adjustment (through a credit or surcharge mechanism), depending on whether actual distribution revenue per customer exceeds or falls short of the revenue-per-customer amount approved by the applicable public service commission. The MFVRD proposed in Delaware contemplates a fixed customer charge (i.e., not tied to the customer's volumetric consumption of electricity or natural gas) to recover the utility's fixed costs, plus a reasonable rate of return.

Delaware

Electric Distribution Base Rates

On March 22, 2013, DPL submitted an application with the DPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately $39 million (as adjusted by DPL on September 20, 2013), based on a requested ROE of 10.25%. The requested rate increase seeks to recover expenses associated with DPL's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service. The DPSC suspended the full proposed increase and, as permitted by state law, DPL implemented an interim increase of $2.5 million on June 1, 2013, subject to refund and pending final DPSC approval. On October 8, 2013, the DPSC approved DPL's request to implement an additional interim increase of $25.1 million, effective on October 22, 2013, bringing the total interim rates in effect subject to refund to $27.6 million. A final DPSC decision is expected by the second quarter of 2014.

Forward Looking Rate Plan

On October 2, 2013, DPL filed a multi-year rate plan, referred to as the Forward Looking Rate Plan (FLRP). As proposed, the FLRP would provide for annual electric distribution base rate increases over a four-year period in the aggregate amount of approximately $56 million. The FLRP as proposed provides the opportunity to achieve estimated earned ROEs of 7.41% and 8.80% in years one and two, respectively, and 9.75% in both years three and four of the plan.

In addition, DPL proposed that as part of the FLRP, in order to provide a higher minimum required standard of reliability for DPL's customers than that to which DPL is currently subject, the standards by which DPL's reliability is measured would be made more stringent in each year of the FLRP. In addition, DPL has offered to refund an aggregate of $500,000 to customers in each year of the FLRP that it fails to meet the proposed stricter minimum reliability standards.

On October 22, 2013, the DPSC opened a docket for the purpose of reviewing the details of the FLRP, but stated that it would not address the FLRP until the pending electric distribution base rate case discussed above was concluded. DPL expects that the FLRP will be updated and re-filed at the conclusion of the electric distribution base rate case. A schedule for the FLRP docket has not yet been established.

Gas Distribution Base Rates

On December 7, 2012, DPL submitted an application with the DPSC to increase its natural gas distribution base rates. The filing sought approval of an annual rate increase of approximately $12.0 million (as adjusted by DPL on July 15, 2013), based on a requested ROE of 10.25%. The requested rate increase sought to recover expenses associated with DPL's ongoing efforts to maintain safe and reliable gas service. On October 22, 2013, the DPSC approved a settlement entered into on August 27, 2013 by the DPSC Staff, the Delaware Division of the Public Advocate and DPL, which provides for an annual rate increase of $6.8 million. While the approved settlement provided that no understanding was reached concerning the appropriate ROE, it specified that for reporting purposes and for calculating the AFUDC, CWIP, regulatory asset carrying costs and other accounting metrics, the rate of 9.75% should be used. The new rates became effective on November 1, 2013.

The approved settlement also provides for a phase-in of the recovery of the deferred costs associated with DPL's deployment of the interface management unit (IMU). The IMU is part of its AMI and allows for the remote reading of gas meters. Recovery of such costs will occur through base rates over a two-year period, assuming specific milestones are met and pursuant to the following schedule: 50% of the IMU portion of DPL's AMI will be put into rates on May 1, 2014, and the remainder will be put into rates on March 1, 2015. DPL also agreed in the settlement that its next natural gas distribution base rate application may be filed with the DPSC no earlier than January 1, 2015.

Gas Cost Rates

DPL makes an annual Gas Cost Rate (GCR) filing with the DPSC for the purpose of allowing DPL to recover natural gas procurement costs through customer rates. On August 28, 2013, DPL made its 2013 GCR filing. The rates proposed in the 2013 GCR filing would result in a GCR decrease of approximately 5.5%. On September 26, 2013, the DPSC issued an order authorizing DPL to place the new rates into effect on November 1, 2013, subject to refund and pending final DPSC approval.

District of Columbia

On March 8, 2013, Pepco filed an application with the DCPSC to increase its annual electric distribution base rates by approximately $44.8 million (as adjusted by Pepco on December 3, 2013), based on a requested ROE of 10.25%. The requested rate increase seeks to recover expenses associated with Pepco's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service. Evidentiary hearings were held in November 2013 and a final DCPSC decision is expected in the first quarter of 2014.

Maryland

DPL Electric Distribution Base Rates

On March 29, 2013, DPL submitted an application with the MPSC to increase its electric distribution base rates by approximately $22.8 million, based on a requested ROE of 10.25%. The requested rate increase sought to recover expenses associated with DPL's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service. DPL also proposed a three-year Grid Resiliency Charge rider for recovery of costs totaling approximately $10.2 million associated with its plan to accelerate investments in electric distribution infrastructure in a condensed timeframe. Acceleration of resiliency improvements was one of several recommendations included in a September 2012 report from Maryland's Grid Resiliency Task Force (as discussed below under "Resiliency Task Forces"). Specific projects under DPL's Grid Resiliency Charge plan included accelerating its tree-trimming cycle and upgrading five additional feeders per year for two years. In addition, DPL proposed a reliability performance-based mechanism that would allow DPL to earn up to $500,000 as an incentive for meeting enhanced reliability goals in 2015, but provided for a credit to customers of up to $500,000 in total if DPL did not meet at least the minimum reliability performance targets. DPL requested that any credits or charges would flow through the proposed Grid Resiliency Charge rider.

On August 30, 2013, the MPSC issued a final order approving a settlement among DPL, the MPSC staff and the Maryland Office of People's Counsel (OPC). The approved settlement provides for an annual rate increase of approximately $15 million. While the settlement does not specify an overall ROE, the parties did agree that the ROE for purposes of calculating the AFUDC and regulatory asset carrying costs would be 9.81%. The approved settlement also provides for (i) recovery of storm restoration costs incurred as a result of recent major storm events, including the derecho storm in June 2012 and Hurricane Sandy in October 2012, by amortizing the related deferred operation and maintenance expenses of approximately $6 million over a five-year period with the unamortized balance included in rate base, and (ii) a Grid Resiliency Charge for recovery of costs totaling approximately $4.2 million associated with DPL's proposed plan to accelerate investments related to certain priority feeders, provided that before implementing the surcharge, DPL provides additional information to the MPSC related to performance objectives, milestones and costs, and makes annual filings with the MPSC thereafter concerning this project, which will permit the MPSC to establish the applicable Grid Resiliency Charge rider for the following year. The approved settlement does not provide for approval of a portion of the Grid Resiliency Charge related to the proposed acceleration of the tree-trimming cycle, or DPL's proposed reliability performance-based mechanism. The new rates became effective on September 15, 2013.

Pepco Electric Distribution Base Rates

In December 2011, Pepco submitted an application with the MPSC to increase its electric distribution base rates. The filing sought approval of an annual rate increase of approximately $68.4 million (subsequently reduced by Pepco to $66.2 million), based on a requested ROE of 10.75%. In July 2012, the MPSC issued an order approving an annual rate increase of approximately $18.1 million, based on an ROE of 9.31%. The order also reduced Pepco's depreciation rates, which lowered annual depreciation and amortization expenses by an estimated $27.3 million. The lower depreciation rates resulted from, among other things, the rebalancing of excess reserves for estimated future removal costs identified in a depreciation study conducted as part of the rate case filing. The identified excess reserves for estimated future removal costs, reported as Regulatory liabilities, were reclassified to Accumulated depreciation among various plant accounts. Among other things, the order additionally authorized Pepco to recover the actual cost of AMI meters installed during the 2011 test year and states that cost recovery for AMI deployment will be allowed in future rate cases in which Pepco demonstrates that the system is cost effective. The new revenue rates and lower depreciation rates were effective on July 20, 2012. The Maryland OPC has sought rehearing on the portion of the order allowing Pepco to recover the costs of AMI meters installed during the test year; that motion remains pending.

On November 30, 2012, Pepco submitted an application with the MPSC to increase its electric distribution base rates. The filing sought approval of an annual rate increase of approximately $60.8 million, based on a requested ROE of 10.25%. The requested rate increase sought to recover expenses associated with Pepco's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service. Pepco also proposed a three-year Grid Resiliency Charge rider for recovery of costs totaling approximately $192 million associated with its plan to accelerate investments in infrastructure in a condensed timeframe. Acceleration of resiliency improvements was one of several recommendations included in a September 2012 report from Maryland's Grid Resiliency Task Force (as discussed below under "Resiliency Task Forces"). Specific projects under Pepco's Grid Resiliency Charge plan included acceleration of its tree-trimming cycle, upgrade of 12 additional feeders per year for two years and undergrounding of six distribution feeders. In addition, Pepco proposed a reliability performance-based mechanism that would allow Pepco to earn up to $1 million as an incentive for meeting enhanced reliability goals in 2015, but provided for a credit to customers of up to $1 million in total if Pepco does not meet at least the minimum reliability performance targets. Pepco requested that any credits/charges would flow through the proposed Grid Resiliency Charge rider.

On July 12, 2013, the MPSC issued an order related to Pepco's November 30, 2012 application approving an annual rate increase of approximately $27.9 million, based on an ROE of 9.36%. The order provides for the full recovery of storm restoration costs incurred as a result of recent major storm events, including the derecho storm in June 2012 and Hurricane Sandy in October 2012, by including the related capital costs in the rate base and amortizing the related deferred operation and maintenance expenses of $23.6 million over a five-year period. The order excludes the cost of AMI meters from Pepco's rate base until such time as Pepco demonstrates the cost effectiveness of the AMI system; as a result, costs for AMI meters incurred with respect to the 2012 test year and beyond will be treated as other incremental AMI costs incurred in conjunction with the deployment of the AMI system that are deferred and on which a return is earned, but only until such cost effectiveness has been demonstrated and such costs are included in rates. However, the MPSC's July 2012 order in Pepco's previous electric distribution base rate case, which allowed Pepco to recover the costs of meters installed during the 2011 test year for that case, remains in effect, and the Maryland OPC's motion for rehearing in that case remains pending.

The order also approved a Grid Resiliency Charge for recovery of costs totaling approximately $24.0 million associated with Pepco's proposed plan to accelerate investments related to certain priority feeders, provided that, before implementing the surcharge, Pepco provides additional information to the MPSC related to performance objectives, milestones and costs, and makes annual filings with the MPSC thereafter concerning this project, which will permit the MPSC to establish the applicable Grid Resiliency Charge rider for each following year. The MPSC did not approve the proposed acceleration of the tree-trimming cycle or the undergrounding of six distribution feeders. The MPSC also rejected Pepco's proposed reliability performance-based mechanism. The new rates were effective on July 12, 2013.

On July 26, 2013, Pepco filed a notice of appeal of the July 12, 2013 order in the Circuit Court for the City of Baltimore. Other parties also have filed notices of appeal, which have been consolidated with Pepco's appeal. In its memorandum filed with the appeals court, Pepco asserts that the MPSC erred in failing to grant Pepco an adequate ROE, denying a number of other cost recovery mechanisms and limiting Pepco's test year data to no more than four months of forecasted data in future rate cases. The memoranda filed with the appeals court by the other parties primarily assert that the MPSC erred or acted arbitrarily and capriciously in allowing the recovery of certain costs by Pepco and refusing to reduce Pepco's rate base by known and measurable accumulated depreciation.

On December 4, 2013, Pepco submitted an application with the MPSC to increase its electric distribution base rates. The filing seeks approval of an annual rate increase of approximately $43.3 million, based on a requested ROE of 10.25%. The requested rate increase seeks to recover expenses associated with Pepco's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service. A decision is expected in the third quarter of 2014.

New Jersey

Electric Distribution Base Rates

On December 11, 2012, ACE submitted an application with the NJBPU, updated on January 4, 2013, to increase its electric distribution base rates by approximately $70.4 million (excluding sales-and-use taxes), based on a requested ROE of 10.25%. This proposed net increase was comprised of (i) a proposed increase to ACE's distribution rates of approximately $72.1 million and (ii) a net decrease to ACE's Regulatory Asset Recovery Charge (a customer charge to recover deferred, NJBPU-approved expenses incurred as part of ACE's public service obligation) in the amount of approximately $1.7 million. The requested rate increase seeks to recover expenses associated with ACE's ongoing investments in reliability enhancement improvements and efforts to maintain safe and reliable service and to recover system restoration costs associated with the derecho storm in June 2012 and Hurricane Sandy in October 2012. On June 21, 2013, the NJBPU approved a settlement of the parties providing for an increase in ACE's electric distribution base rates in the amount of $25.5 million, based on an ROE of 9.75%. The base distribution revenue increase includes full recovery of the approximately $70.0 million in incremental storm restoration costs incurred as a result of recent major storm events, including the derecho storm and Hurricane Sandy, by including the related capital costs of approximately $44.2 million in rate base and amortizing the related deferred operation and maintenance expenses of approximately $25.8 million over a three-year period. Rates were effective on July 1, 2013.

Update and Reconciliation of Certain Under-Recovered Balances

In February 2012 and March 2013, ACE submitted petitions with the NJBPU seeking to reconcile and update (i) charges related to the recovery of above-market costs associated with ACE's long-term power purchase contracts with the NUGs, (ii) costs related to surcharges for the New Jersey Societal Benefit Program (a statewide public interest program for low income customers) and ACE's uncollected accounts and (iii) operating costs associated with ACE's residential appliance cycling program. In June 2012, the NJBPU approved a stipulation of settlement related to ACE's February 2012 filing, which provided for an overall annual rate increase of $55.3 million that went into effect on July 1, 2012. In May 2013, the NJBPU approved a stipulation of settlement related to ACE's March 2013 filing, which provided for an overall annual rate increase of $52.2 million (in addition to the $55.3 million approved by the NJBPU in June 2012) that went into effect on June 1, 2013. These rate increases, which primarily provide for the recovery of above-market costs associated with the NUG contracts and will have no effect on ACE's operating income, were placed into effect provisionally and were subject to a review by the NJBPU of the final underlying costs for reasonableness and prudence. On February 19, 2014, the NJBPU approved a stipulation of settlement for both proceedings, which made final the provisional rates that went into effect on July 1, 2012 and June 1, 2013, respectively.

Service Extension Contributions Refund Order

On July 19, 2013, in compliance with a 2012 Superior Court of New Jersey Appellate Division (Appellate Division) court decision, the NJBPU released an order requiring utilities to issue refunds to persons or entities that paid non-refundable contributions for utility service extensions to certain areas described as "Areas Not Designated for Growth." The order is limited to eligible contributions paid between March 20, 2005 and December 20, 2009. ACE is processing the refund requests that meet the eligibility criteria established in the order as they are received. Although ACE believes it received approximately $11 million of contributions between March 20, 2005 and December 20, 2009, it is currently unable to reasonably estimate the amount that it may be required to refund using the eligibility criteria established by the order. At this time, ACE does not expect that any such amount refunded will have a material effect on its consolidated financial condition, results of operations or cash flows, as any amounts that may be refunded will generally increase the value of ACE's property, plant and equipment and may ultimately be recovered through depreciation and cost of service. It is anticipated that the NJBPU will commence a rulemaking proceeding to further implement the directives of the Appellate Division decision.

Generic Consolidated Tax Adjustment Proceeding

In January 2013, the NJBPU initiated a generic proceeding to examine whether a consolidated tax adjustment (CTA) should continue to be used, and if so, how it should be calculated in determining a utility's cost of service. Under the NJBPU's current policy, when a New Jersey utility is included in a consolidated group income tax return, an allocated amount of any reduction in the consolidated group's taxes as a result of losses by affiliates is used to reduce the utility's rate base, upon which the utility earns a return. Consequently, this policy has substantially reduced ACE's rate base and ACE's position is that the CTA should be eliminated. A stakeholder process has been initiated by the NJBPU to aid in this examination. No formal schedule has been set for the remainder of the proceeding or for the issuance of a decision.

Federal Energy Regulatory Commission

On October 17, 2013, the FERC issued a ruling on challenges filed by the Delaware Municipal Electric Corporation, Inc. (DEMEC) to DPL's 2011 and 2012 annual formula rate updates. In 2006, FERC approved a formula rate for DPL that is incorporated into the PJM tariff. The formula rate establishes the treatment of costs and revenues and the resulting rates for DPL. Pursuant to the protocols approved by FERC and after a period of discovery, interested parties have an opportunity to file challenges regarding the application of the formula rate. The FERC order sets various issues in this proceeding for hearing, including challenges regarding formula rate inputs, deferred income items, prepayments of estimated income taxes, rate base reductions, various administrative and general expenses and the inclusion in rate base of CWIP related to the MAPP project (which has been abandoned). Settlement discussions began in this matter on November 5, 2013 before an administrative law judge at FERC.

On December 12, 2013, DEMEC filed a formal challenge to the DPL 2013 annual formula rate update, including a request to consolidate the 2013 challenge with the two prior challenges. This challenge is pending at FERC. PHI cannot predict when a final FERC decision in this proceeding will be issued.

On February 27, 2013, the public service commissions and public advocates of the District of Columbia, Maryland, Delaware and New Jersey, as well as DEMEC, filed a joint complaint with FERC against Pepco, DPL and ACE, as well as Baltimore Gas and Electric Company (BGE). The complainants challenged the base ROE and the application of the formula rate process, each associated with the transmission service that PHI's utilities provide. The complainants support an ROE within a zone of reasonableness of 6.78% and 10.33%, and have argued for a base ROE of 8.7%. The base ROE currently authorized by FERC for PHI's utilities is (i) 11.3% for facilities placed into service after January 1, 2006, and (ii) 10.8% for facilities placed into service prior to 2006. As currently authorized, the 10.8% base ROE for facilities placed into service prior to 2006 is eligible for a 50-basis-point incentive adder for being a member of a regional transmission organization. PHI, Pepco, DPL and ACE believe the allegations in this complaint are without merit and are vigorously contesting it. On April 3, 2013, Pepco, DPL and ACE filed their answer to this complaint, requesting that FERC dismiss the complaint against them on the grounds that it failed to meet the required burden to demonstrate that the existing rates and protocols are unjust and unreasonable. PHI cannot predict when a final FERC decision in this proceeding will be issued.

MPSC New Generation Contract Requirement

In September 2009, the MPSC initiated an investigation into whether Maryland electric distribution companies (EDCs) should be required to enter into long-term contracts with entities that construct, acquire or lease, and operate, new electric generation facilities in Maryland. In April 2012, the MPSC issued an order determining that there is a need for one new power plant in the range of 650 to 700 megawatts (MWs) beginning in 2015. The order requires Pepco, DPL and BGE (collectively, the Contract EDCs) to negotiate and enter into a contract with the winning bidder of a competitive bidding process in amounts proportional to their relative SOS loads. Under the contract, the winning bidder will construct a 661 MW natural gas-fired combined cycle generation plant in Waldorf, Maryland, with an expected commercial operation date of June 1, 2015. The order acknowledged the Contract EDCs' concerns about the requirements of the contract and directed them to negotiate with the winning bidder and submit any proposed changes in the contract to the MPSC for approval. The order further specified that each of the Contract EDCs will recover its costs associated with the contract through surcharges on its respective SOS customers.

In April 2012, a group of generating companies operating in the PJM region filed a complaint in the U.S. District Court for the District of Maryland challenging the MPSC's order on the grounds that it violates the Commerce Clause and the Supremacy Clause of the U.S. Constitution. In May 2012, the Contract EDCs and other parties filed notices of appeal in circuit courts in Maryland requesting judicial review of the MPSC's order. The Maryland circuit court appeals were consolidated in the Circuit Court for Baltimore City.

On April 16, 2013, the MPSC issued an order approving a final form of the contract and directing the Contract EDCs to enter into the contract with the winning bidder in amounts proportional to their relative SOS loads. On June 4, 2013, Pepco and DPL each entered into identical contracts in accordance with the terms of the MPSC's order; however, under each contract's terms, it will not become effective, if at all, until all legal proceedings related to these contracts and the actions of the MPSC in the related proceeding have been resolved.

On September 30, 2013, the U.S. District Court for the District of Maryland issued a ruling that the MPSC's April 2012 order violated the Supremacy Clause of the U.S. Constitution by attempting to regulate wholesale prices. In contrast, on October 1, 2013, the Maryland Circuit Court for Baltimore City upheld the MPSC's orders requiring the Contract EDCs to enter into the contracts.

On October 24, 2013, the Federal district court issued an order ruling that the contracts are illegal and unenforceable. The Federal district court order and its associated ruling could impact the state circuit court appeal, to which the Contract EDCs are parties, although such impact, if any, cannot be determined at this time. The Contract EDCs, the Maryland Office of People's Counsel and one generating company have appealed the Maryland Circuit Court's decision to the Maryland Court of Special Appeals. In addition, in November 2013 both the winning bidder and the MPSC appealed the Federal district court decision to the U.S. Court of Appeals for the Fourth Circuit. These appeals remain pending.

Assuming the contracts, as currently written, were to become effective by the expected commercial operation date of June 1, 2015, PHI continues to believe that Pepco and DPL may be required to account for their proportional share of the contracts as a derivative instrument at fair value with an offsetting regulatory asset because they would recover any payments under the contracts from SOS customers. PHI, Pepco and DPL have concluded that any accounting for these contracts would not be required until all legal proceedings related to these contracts and the actions of the MPSC in the related proceeding have been resolved.

PHI, Pepco and DPL continue to evaluate these proceedings to determine, should the contracts be found to be valid and enforceable, (i) the extent of the negative effect that the contracts may have on PHI's, Pepco's and DPL's respective credit metrics, as calculated by independent rating agencies that evaluate and rate PHI, Pepco and DPL and their debt issuances, (ii) the effect on Pepco's and DPL's ability to recover their associated costs of the contracts if a significant number of SOS customers elect to buy their energy from alternative energy suppliers, and (iii) the effect of the contracts on the financial condition, results of operations and cash flows of each of PHI, Pepco and DPL.

ACE Standard Offer Capacity Agreements

In April 2011, ACE entered into three Standard Offer Capacity Agreements (SOCAs) by order of the NJBPU, each with a different generation company, as more fully described in Note (13), "Derivative Instruments and Hedging Activities." ACE and the other New Jersey EDCs entered into the SOCAs under protest, arguing that the EDCs were denied due process and that the SOCAs violate certain of the requirements under the New Jersey law under which the SOCAs were established (the NJ SOCA Law). On October 22, 2013, in light of the decision of the U.S. District Court for the District of New Jersey described below, the state appeals of the NJBPU implementation orders filed by the EDCs and generators, were dismissed without prejudice subject to the parties exercising their appellate rights in the Federal courts.

In February 2011, ACE joined other plaintiffs in an action filed in the U.S. District Court for the District of New Jersey challenging the NJ SOCA Law on the grounds that it violates the Commerce Clause and the Supremacy Clause of the U.S. Constitution. On October 11, 2013, the Federal district court issued a ruling that the NJ SOCA Law is preempted by the Federal Power Act and violates the Supremacy Clause, and is therefore null and void. On October 21, 2013 a joint motion to stay the Federal district court's decision pending appeal was filed by the NJBPU and one of the SOCA generation companies. In that motion, the NJBPU notified the Federal district court that it would take no action to force implementation of the SOCAs pending the appeal or such other action—such as FERC approval of the SOCAs—that would cure the constitutional issues to the Federal district court's satisfaction. On October 25, 2013, the Federal district court issued an order denying the joint motion to stay and ruling that the SOCAs are void, invalid and unenforceable. On October 31, 2013, one of the SOCA generation companies filed a notice of appeal of the October 25, 2013 Federal district court decision with the U.S. Court of Appeals for the Third Circuit (the Federal circuit court). On November 8, 2013, the other remaining SOCA generating company filed a motion to intervene in the proceedings and a notice of appeal of the October 25, 2013 Federal district court decision. On November 21, 2013, the NJBPU filed its notice of appeal of the October 25, 2013 Federal district court decision. On November 14, 2013, the Federal circuit court granted the motion to intervene and on December 13, 2013, the Federal circuit court issued an order consolidating the appeals filed by the NJBPU and the SOCA generating companies of the October 25, 2013 Federal district court decision. The matter has been placed on an expedited schedule and appeal proceedings remain pending. The Federal circuit court is tentatively scheduled to hear the appeal on March 27, 2014.

One of the three SOCAs was terminated effective July 1, 2013 because of an event of default of the generation company that was a party to the SOCA. The remaining two SOCAs were terminated effective November 19, 2013, as a result of a termination notice delivered by ACE after the Federal district court's October 25, 2013 decision.

In light of the Federal district court order (which has not been stayed pending appeal), ACE derecognized both the derivative assets (liabilities) for the estimated fair value of the SOCAs and the offsetting regulatory liabilities (assets) in the fourth quarter of 2013.

Resiliency Task Forces

In July 2012, the Maryland governor signed an Executive Order directing his energy advisor, in collaboration with certain state agencies, to solicit input and recommendations from experts on how to improve the resiliency and reliability of the electric distribution system in Maryland. The resulting Grid Resiliency Task Force issued its report in September 2012, in which it made 11 recommendations. The governor forwarded the report to the MPSC in October 2012, urging the MPSC to quickly implement the first four recommendations: (i) strengthen existing reliability and storm restoration regulations; (ii) accelerate the investment necessary to meet the enhanced metrics; (iii) allow surcharge recovery for the accelerated investment; and (iv) implement clearly defined performance metrics into the traditional ratemaking scheme. Pepco's electric distribution base rate case filed with the MPSC on November 30, 2012 and DPL's electric distribution base rate case filed with the MPSC on March 29, 2013, each attempted to address the Grid Resiliency Task Force recommendations. In July and August 2013, the MPSC issued orders in the Pepco and DPL Maryland electric distribution base rate cases, respectively, that only partially approved the proposed Grid Resiliency Charge. See "Rate Proceedings – Maryland" above for more information about these base rate cases.

In August 2012, the District of Columbia mayor issued an Executive Order establishing the Mayor's Power Line Undergrounding Task Force (the DC Undergrounding Task Force). The stated purpose of the DC Undergrounding Task Force was to pool the collective resources available in the District of

Columbia to produce an analysis of the technical feasibility, infrastructure options and reliability implications of undergrounding new or existing overhead distribution facilities in the District of Columbia. These resources included legislative bodies, regulators, utility personnel, experts and other parties who could contribute in a meaningful way to the DC Undergrounding Task Force. On May 13, 2013, the DC Undergrounding Task Force issued a written recommendation endorsing a $1 billion plan of the DC Undergrounding Task Force to underground 60 of the District of Columbia's most outage-prone power lines, which lines would be owned and maintained by Pepco. The legislation providing for implementation of the report's recommendations contemplates that: (i) Pepco would fund approximately $500 million of the $1 billion estimated cost to complete this project, recovering those costs through surcharges on the electric bills of Pepco District of Columbia customers; (ii) $375 million of the undergrounding project cost would be financed by the District of Columbia's issuance of securitized bonds, which bonds would be repaid through surcharges on the electric bills of Pepco District of Columbia customers (Pepco would not earn a return on or of the cost of the assets funded with the proceeds received from the issuance of the securitized bonds, but ownership and responsibility for the operation and maintenance of such assets would be transferred to Pepco for a nominal amount); and (iii) the remaining amount would be funded through the District of Columbia Department of Transportation's existing capital projects program. This legislation was approved in the Council of the District of Columbia on February 4, 2014 and is awaiting the signature of the Mayor of the District of Columbia. Once signed by the Mayor and transmitted to Congress, the legislation will undergo a 30-day Congressional review period before becoming law, which is expected to occur in the second quarter of 2014. The final step would be DCPSC approval of the underground project plan and financing orders required by the legislation to establish the customer surcharges contemplated by the legislation, a decision on which is expected during the fourth quarter of 2014.

MAPP Project

On August 24, 2012, the board of PJM terminated the MAPP project and removed it from PJM's regional transmission expansion plan. PHI had been directed to construct the MAPP project, a 152-mile high-voltage interstate transmission line, to address the reliability needs of the region's transmission system. In December 2012, PHI submitted a filing to FERC seeking recovery of approximately $88 million of abandoned MAPP costs over a five-year recovery period. The FERC filing addressed, among other things, the prudence of the recoverable costs incurred, the proposed period over which the abandoned costs are to be amortized and the rate of return on these costs during the recovery period.

In February 2013, FERC issued an order concluding that the MAPP project was cancelled for reasons beyond the control of Pepco and DPL, finding that the prudently incurred costs associated with the abandonment of the MAPP project are eligible to be recovered, and setting for hearing and settlement procedures the prudence of the abandoned costs and the amortization period for those costs.

On December 18, 2013, PHI submitted a settlement agreement to FERC, which provides for recovery of PHI's abandoned MAPP costs over a three-year recovery period beginning June 1, 2013. The settlement agreement, which is subject to FERC approval, would resolve all issues concerning the recovery of abandonment costs associated with the cancellation of the MAPP project. PHI cannot predict the timing or results of a final FERC decision in this proceeding.

As of December 31, 2013, PHI had a regulatory asset related to the MAPP abandoned costs of approximately $68 million, representing the original filing amount of approximately $88 million of abandoned costs referred to above less: (i) approximately $2 million of disallowed costs written off in 2013; (ii) $4 million of materials transferred to inventories for use on other projects; and (iii) $14 million of amortization expense recorded in 2013. The regulatory asset balance includes the costs of land, land rights, engineering and design, environmental services, and project management and administration.

(8) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is comprised of the following:

	Original Cost	Accumulated Depreciation	Net Book Value
		(millions of dollars)	
At December 31, 2013			
Generation	$ 105	$ 99	$ 6
Distribution	8,896	2,961	5,935
Transmission	2,991	908	2,083
Gas	481	142	339
Construction work in progress	677	—	677
Non-operating and other property	1,417	753	664
Total	$ 14,567	$ 4,863	$ 9,704
At December 31, 2012			
Generation	$ 107	$ 97	$ 10
Distribution	8,320	2,954	5,366
Transmission	2,783	866	1,917
Gas	458	137	321
Construction work in progress	692	—	692
Non-operating and other property	1,265	725	540
Total	$ 13,625	$ 4,779	$ 8,846

The non-operating and other property amounts include balances for general plant, intangible plant, distribution plant and transmission plant held for future use as well as other property held by non-utility subsidiaries. Utility plant is generally subject to a first mortgage lien.

Pepco Holdings' utility subsidiaries use separate depreciation rates for each electric plant account. The rates vary from jurisdiction to jurisdiction.

Jointly Owned Plant

PHI's consolidated balance sheets include its proportionate share of assets and liabilities related to jointly owned plant. At December 31, 2013 and 2012, PHI's subsidiaries had a net book value ownership interest of $12 million and $13 million, respectively, in transmission and other facilities in which various parties also have ownership interests. PHI's share of the operating and maintenance expenses of the jointly owned plant is included in the corresponding expenses in the consolidated statements of (loss) income. PHI is responsible for providing its share of the financing for the above jointly owned facilities.

Capital Leases

Pepco leases its consolidated control center, which is an integrated energy management center used by Pepco to centrally control the operation of its transmission and distribution systems. This lease is accounted for as a capital lease and was initially recorded at the present value of future lease payments, which totaled $152 million. The lease requires semi-annual payments of approximately $8 million over a 25-year period that began in December 1994, and provides for transfer of ownership of the system to Pepco for $1 at the end of the lease term. Under FASB guidance on regulated operations, the amortization of leased assets is modified so that the total interest expense charged on the obligation and amortization expense of the leased asset is equal to the rental expense allowed for rate-making purposes. The amortization expense is included within Depreciation and amortization in the consolidated statements of (loss) income. This lease is treated as an operating lease for rate-making purposes.

Capital lease assets recorded within Property, Plant and Equipment at December 31, 2013 and 2012, in millions of dollars, are comprised of the following:

	Original Cost		Accumulated Depreciation		Net Book Value	
			(millions of dollars)			
At December 31, 2013						
Transmission	$	76	$	41	$	35
Distribution		76		42		34
General		3		3		—
Total	$	155	$	86	$	69
At December 31, 2012						
Transmission	$	76	$	37	$	39
Distribution		76		37		39
General		3		3		—
Total	$	155	$	77	$	78

The approximate annual commitments under all capital leases are $15 million for each year 2014 through 2018, and $16 million thereafter.

Deactivation of Pepco Energy Services' Generating Facilities

During 2012, Pepco Energy Services deactivated its Buzzard Point and Benning Road oil-fired generation facilities. The facilities were located in Washington, D.C. and had a generating capacity of approximately 790 megawatts. During the years ended December 31, 2012 and 2011, PHI has recorded decommissioning costs of $3 million and $2 million, respectively, related to these generating facilities.

Pepco Energy Services placed the facilities into an idle condition termed a "cold closure." A cold closure requires that the utility service be disconnected so that the facilities are no longer operable and require only essential maintenance until they are completely decommissioned. During the third quarter of 2013, Pepco Energy Services determined that it would be more cost effective to pursue the demolition of the Benning Road generation facility and realization of the scrap metal salvage value of the facility instead of maintaining cold closure status. The demolition of the facility commenced in the fourth quarter of 2013 and is expected to be completed by the end of 2014. Pepco Energy Services will recognize the salvage proceeds associated with the scrap metals at the facility as realized.

Long-Lived Asset Impairment

For the years ended December 31, 2013 and 2012, PHI recorded impairment losses of $4 million ($3 million after-tax) and $12 million ($7 million after-tax), respectively, at Pepco Energy Services associated primarily with its investments in landfill gas-fired electric generation facilities. In 2012, the impairment loss also included the reduction in the estimated net realizable value of the combustion turbines at Buzzard Point. PHI performed a long-lived asset impairment test on the landfill generation facilities of Pepco Energy Services as a result of a sustained decline in energy prices and recent production levels. The asset value of the facilities was written down to their estimated fair value because the future expected cash flows of the facilities were not sufficient to provide recovery of the facilities' carrying value. PHI estimated the fair value of the facilities by calculating the present value of expected future cash flows using an appropriate discount rate. Both the expected future cash flows and the discount rate used primarily unobservable inputs.

Asset Retirement Obligations

PHI recognizes liabilities related to the retirement of long-lived assets in accordance with ASC 410. In connection with Pepco Energy Services' decommissioning of the Buzzard Point and Benning Road generation facilities, PHI has recorded an asset retirement obligation of $2 million and $9 million as of December 31, 2013 and 2012, respectively on its consolidated balance sheets.

During 2013, Pepco Energy Services determined that it would be more cost effective to pursue the demolition of the Benning Road generation facility instead of maintaining cold closure status. As a result of this change in intent, Pepco Energy Services reduced its asset retirement obligation related to the facility by $2 million.

The sale of the Conectiv Energy wholesale power generation business to Calpine Corporation (Calpine) did not include a coal ash landfill site located at the Edge Moor generating facility, which PHI intends to close. The preliminary estimate of the costs to PHI to close the coal ash landfill ranges from approximately $2 million to $3 million, plus annual post-closure operations, maintenance and monitoring costs for 30 years. PHI has recorded an asset retirement obligation of $6 million on its consolidated balance sheet related to the Edge Moor landfill.

(9) PENSION AND OTHER POSTRETIREMENT BENEFITS

The following table shows changes in the benefit obligation and plan assets for the years ended December 31, 2013 and 2012:

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
	(millions of dollars)			
Change in Benefit Obligation				
Benefit obligation as of January 1	$2,494	$2,124	$ 775	$ 750
Service cost	53	35	8	7
Interest cost	100	107	29	35
Amendments	3	—	(124)	—
Actuarial (gain) loss	(277)	341	(71)	24
Benefits paid [(a)]	(135)	(113)	(43)	(41)
Benefit obligation as of December 31	$2,238	$2,494	$ 574	$ 775
Change in Plan Assets				
Fair value of plan assets as of January 1	$2,039	$1,694	$ 321	$ 281
Actual return on plan assets	86	252	56	38
Company and participant contributions	126	206	34	43
Benefits paid [(a)]	(135)	(113)	(43)	(41)
Fair value of plan assets as of December 31	$2,116	$2,039	$ 368	$ 321
Funded Status at end of year (plan assets less plan obligations)	$ (122)	$ (455)	$ (206)	$ (454)

[(a)] Other Postretirement Benefits paid are net of Medicare Part D subsidy receipts of zero and $4 million in 2013 and 2012, respectively.

At December 31, 2013 and 2012, the PHI Retirement Plan's accumulated benefit obligation was approximately $2.1 billion and $2.3 billion, respectively. The accumulated benefit obligation differs from the pension benefit obligation presented in the table above in that the accumulated benefit obligation includes no assumption about future compensation levels.

The following table provides the amounts recorded in PHI's consolidated balance sheets as of December 31, 2013 and 2012:

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
	(millions of dollars)			
Regulatory asset	$ 664	$ 934	$ 3	$ 237
Current liabilities	(6)	(6)	—	—
Pension benefit obligation	(116)	(449)	—	—
Other postretirement benefit obligations	—	—	(206)	(454)
Deferred income tax liabilities, net	(217)	(216)	82	88
Accumulated other comprehensive loss, net of tax	25	32	—	—
Net amount recorded	$ 350	$ 295	$ (121)	$ (129)

Amounts included in AOCL (pre-tax) and Regulatory assets at December 31, 2013 and 2012, consist of:

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
	(millions of dollars)			
Unrecognized net actuarial loss	$ 694	$ 979	$ 117	$ 238
Unamortized prior service cost (credit)	10	9	(114)	(1)
Total	$ 704	$ 988	$ 3	$ 237
Accumulated other comprehensive loss ($25 million and $32 million, net of tax, at December 31, 2013 and 2012, respectively)	$ 40	$ 54	$ —	$ —
Regulatory assets	664	934	3	237
Total	$ 704	$ 988	$ 3	$ 237

Under FASB guidance on regulated operations, a portion of actuarial gains and losses and prior service costs (credits) are included in Regulatory assets (liabilities) in the consolidated balance sheets to reflect expected regulatory recovery of such amounts, which otherwise would be recorded to AOCL. The table below provides the changes in plan assets and benefit obligations recognized in AOCL and Regulatory assets for the years ended December 31, 2013, 2012 and 2011.

	Pension Benefits			Other Postretirement Benefits		
	2013	2012	2011	2013	2012	2011
	(millions of dollars)					
Amounts amortized during the year:						
Amortization of prior service (cost) credit	$ (2)	$ (1)	$ —	$ 11	$ 4	$ 5
Amortization of net actuarial (loss)	(67)	(64)	(47)	(12)	(14)	(14)
Amounts arising during the year:						
Current year prior service cost (credit)	3	—	19	(124)	—	6
Current year actuarial (gain) loss	(218)	220	177	(109)	4	53
Total recognized in AOCL and Regulatory assets for the year ended December 31	$(284)	$ 155	$ 149	$(234)	$ (6)	$ 50

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that will be amortized from AOCL or Regulatory assets into net periodic benefit cost over the next reporting year are $44 million and $2 million, respectively.

The estimated net actuarial loss and prior service credit for the OPEB plan that will be amortized from AOCL or Regulatory assets into net periodic benefit cost over the next reporting year are $6 million and $13 million, respectively.

The table below provides the components of net periodic benefit costs recognized for the years ended December 31, 2013, 2012 and 2011:

	Pension Benefits			Other Postretirement Benefits		
	2013	2012	2011	2013	2012	2011
	(millions of dollars)					
Service cost	$ 53	$ 35	$ 35	$ 8	$ 7	$ 5
Interest cost	100	107	107	29	35	37
Expected return on plan assets	(145)	(132)	(128)	(20)	(18)	(19)
Amortization of prior service cost (credit)	2	1	—	(11)	(4)	(5)
Amortization of net actuarial loss	67	64	47	12	14	14
Termination benefits	—	—	—	—	1	1
Net periodic benefit cost	$ 77	$ 75	$ 61	$ 18	$ 35	$ 33

The table below provides the split of the combined pension and other postretirement net periodic benefit costs among subsidiaries for the years ended December 31, 2013, 2012 and 2011:

	2013	2012	2011
	(millions of dollars)		
Pepco	$ 34	$ 39	$ 43
DPL	18	23	23
ACE	17	24	21
Other subsidiaries	26	24	7
Total	$ 95	$ 110	$ 94

The following weighted average assumptions were used to determine the benefit obligations at December 31:

	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
Discount rate	5.05%	4.15%	5.00%	4.10%
Rate of compensation increase	5.00%	5.00%	5.00%	5.00%
Health care cost trend rate assumed for current year – pre 65	—	—	7.00%	7.50%
Health care cost trend rate assumed for current year – post 65	—	—	5.60%	7.50%
Rate to which the cost trend rate is assumed to decline for all eligible retirees (the ultimate trend rate)	—	—	5.00%	5.00%
Year that the cost trend rate reaches the ultimate trend rate	—	—	2020	2018

Assumed health care cost trend rates may have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects, in millions of dollars:

	1-Percentage-Point Increase	1-Percentage-Point Decrease
Increase (decrease) in total service and interest cost	$ 1	$ (1)
Increase (decrease) in postretirement benefit obligation	$ 17	$ (19)

The following weighted average assumptions were used to determine the net periodic benefit cost for the years ended December 31:

	Pension Benefits			Other Postretirement Benefits		
	2013	2012	2011	2013	2012	2011
Discount rate	4.15%	5.00%	5.65%	4.10%/4.95%[(a)]	4.90%	5.60%
Expected long-term return on plan assets	7.00%	7.25%	7.75%	7.00%	7.25%	7.75%
Rate of compensation increase	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Health care cost trend rate	—	—	—	7.50%	8.00%	8.00%

(a) The discount rate was updated for remeasurement to 4.95% on July 1, 2013.

PHI utilizes an analytical tool developed by its actuaries to select the discount rate. The analytical tool utilizes a high-quality bond portfolio with cash flows that match the benefit payments expected to be made under the plans.

PHI uses a building block approach to estimate the expected rate of return on plan assets. Under this approach, the percentage of plan assets in each asset class according to PHI's target asset allocation, at the beginning of the year, is applied to the expected asset return for the related asset class. PHI incorporates long-term assumptions for real returns, inflation expectations, volatility and correlations among asset classes to determine expected returns for a given asset allocation. The pension and postretirement benefit plan assets consist of equity, fixed income, real estate and private equity investments. PHI periodically reviews its asset mix and rebalances assets to the target allocation.

The average remaining service periods for participating employees of the benefit plans was approximately 11 years for both 2013 and 2012. PHI utilizes plan census data to estimate these average remaining service periods. PHI uses the IRS prescribed mortality tables to estimate the average life expectancy. The IRS prescribed tables for 2013 and 2012 were used to determine net periodic pension and OPEB cost for the same respective years. The tables for 2014 and 2013 were used for determining the benefit obligations as of December 31, 2013 and 2012, respectively.

Benefit Plan Modifications

During 2013, PHI approved two amendments to its other postretirement benefits plan. These amendments impacted the retiree health care and the retiree life insurance benefits, and were effective on January 1, 2014. As a result of the amendments, which were cumulatively significant, PHI remeasured its accumulated postretirement benefit obligation for other postretirement benefits as of July 1, 2013. The remeasurement resulted in a $193 million reduction of the accumulated postretirement benefit obligation, which included recording a prior service credit of $124 million, which will be amortized over approximately ten years, and a $69 million reduction from a change in the discount rate from 4.10% as of December 31, 2012 to 4.95% as of July 1, 2013. The remeasurement resulted in a $17 million reduction in net periodic benefit cost for other postretirement benefits during 2013, when compared to 2012. Approximately 37% of net periodic other postretirement benefit costs were capitalized in 2013.

Plan Assets

Investment Policies and Strategies

In developing its allocation policy for the assets in the PHI Retirement Plan and the other postretirement benefit plan, PHI examined projections of asset returns and volatility over a long-term horizon. In connection with this analysis, PHI evaluated the risk and return tradeoffs of alternative asset classes and asset mixes given long-term historical relationships as well as prospective capital market returns. PHI also conducted an asset-liability study to match projected asset growth with projected liability growth to determine whether there is sufficient liquidity for projected benefit payments. PHI developed its asset mix guidelines by incorporating the results of these analyses with an assessment of its risk posture, and taking into account industry practices. PHI periodically evaluates its investment strategy to ensure that plan assets are sufficient to meet the benefit obligations of the plans. As part of the ongoing evaluation, PHI may make changes to its targeted asset allocations and investment strategy.

PHI's pension investment strategy is designed to meet the following investment objectives:

- Generate investment returns that, in combination with funding contributions from PHI, provide adequate funding to meet all current and future benefit obligations of the plan.
- Provide investment results that meet or exceed the assumed long-term rate of return, while maintaining the funded status of the plan at acceptable levels.
- Improve funded status over time.
- Decrease contribution and expense volatility as funded status improves.

To achieve these investment objectives, PHI's investment strategy divides the pension program into two primary portfolios:

Return-Seeking Assets — These assets are intended to provide investment returns in excess of pension liability growth and reduce existing deficits in the funded status of the plan. The category includes a diversified mix of U.S. large and small cap equities, non-U.S. developed and emerging market equities, real estate, and private equity.

Liability-Hedging Assets — These assets are intended to reflect the sensitivity of the plan's liabilities to changes in discount rates. This category includes a diversified mix of long duration, primarily investment grade credit and U.S. treasury securities.

PHI follows an asset-liability management strategy for PHI Retirement Plan assets in order to reduce the effects of future volatility of the fair value of its pension plan assets relative to its pension plan liabilities. For example, in 2013, this strategy uses a 66% target allocation to fixed income investments, primarily in high quality, longer-maturity fixed income securities. The PHI Retirement Plan asset allocations at December 31, 2013 and 2012, by asset category, were as follows:

	Plan Assets at December 31,		Target Plan Asset Allocation	
Asset Category	**2013**	**2012**	**2013**	**2012**
Equity	31%	30%	28%	32%
Fixed Income	62%	62%	66%	62%
Other (real estate, private equity)	7%	8%	6%	6%
Total	100%	100%	100%	100%

PHI's other postretirement benefit plan asset allocations at December 31, 2013 and 2012, by asset category, were as follows:

	Plan Assets at December 31,		Target Plan Asset Allocation	
Asset Category	**2013**	**2012**	**2013**	**2012**
Equity	63%	62%	60%	60%
Fixed Income	31%	36%	35%	35%
Cash	6%	2%	5%	5%
Total	100%	100%	100%	100%

PHI will rebalance the plan asset portfolios when the actual allocations fall outside the ranges outlined in the investment policy or as funded status improves over a reasonable period of time.

Risk Management

Pension and other postretirement benefit plan assets may be invested in separately managed accounts in which there is ownership of individual securities, shares of commingled funds or mutual funds, or limited partnerships. Commingled funds and mutual funds are subject to detailed policy guidelines set forth in the fund's prospectus or fund declaration, and limited partnerships are subject to the terms of the partnership agreement.

Separate account investment managers are responsible for achieving a level of diversification in their portfolio that is consistent with their investment approach and their role in PHI's overall investment structure. Separate account investment managers must follow risk management guidelines established by PHI unless authorized in writing by PHI.

Derivative instruments are permissible in an investment portfolio to the extent they comply with policy guidelines and are consistent with risk and return objectives. Under no circumstances may such instruments be used speculatively or to leverage the portfolio. Separately managed accounts are prohibited from holding securities issued by the following firms:

- PHI and its subsidiaries,
- PHI's pension plan trustee, its parent or its affiliates,
- PHI's pension plan consultant, its parent or its affiliates, and
- PHI's pension plan investment manager, its parent or its affiliates.

Fair Value of Plan Assets

As defined in the FASB guidance on fair value measurement and disclosures (ASC 820), 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. The FASB's fair value framework includes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Investments are classified within the fair value hierarchy as follows:

Level 1: Investments are valued using quoted prices in active markets for identical instruments.

Level 2: Investments are valued using other significant observable inputs (e.g., quoted prices for similar investments, interest rates, credit risks, etc).

Level 3: Investments are valued using significant unobservable inputs, including internal assumptions.

There were no significant transfers between level 1 and level 2 during the years ended December 31, 2013 and 2012.

The following tables present the fair values of PHI's pension and other postretirement benefit plan assets by asset category within the fair value hierarchy levels, as of December 31, 2013 and 2012:

Asset Category	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Fair Value Measurements at December 31, 2013 (millions of dollars)			
Pension Plan Assets:				
Equity				
Domestic [(a)]	$ 432	$ 185	$ 213	$ 34
International [(b)]	217	215	1	1
Fixed Income [(c)]	1,309	—	1,298	11
Other				
Private Equity	53	—	—	53
Real Estate	61	—	—	61
Cash Equivalents [(d)]	44	44	—	—
Pension Plan Assets Subtotal	2,116	444	1,512	160
Other Postretirement Plan Assets:				
Equity [(e)]	233	204	29	—
Fixed Income [(f)]	113	113	—	—
Cash Equivalents	22	22	—	—
Postretirement Plan Assets Subtotal	368	339	29	—
Total Pension and Other Postretirement Assets	$ 2,484	$ 783	$ 1,541	$ 160

(a) Predominantly includes domestic common stock and commingled funds.

(b) Predominantly includes foreign common and preferred stock and warrants.

(c) Predominantly includes corporate bonds, government bonds, municipal/provincial bonds, collateralized mortgage obligations and commingled funds.

(d) Predominantly includes cash investment in short-term investment funds.

(e) Includes domestic and international commingled funds.

(f) Includes fixed income commingled funds.

Asset Category	Fair Value Measurements at December 31, 2012 Total	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
Pension Plan Assets:				
Equity				
Domestic [a]	$ 367	$ 169	$ 170	$ 28
International [b]	254	250	1	3
Fixed Income [c]	1,256	—	1,243	13
Other				
Private Equity	56	—	—	56
Real Estate	74	—	—	74
Cash Equivalents [d]	32	32	—	—
Pension Plan Assets Subtotal	2,039	451	1,414	174
Other Postretirement Plan Assets:				
Equity [e]	199	171	28	—
Fixed Income [f]	115	115	—	—
Cash Equivalents	7	7	—	—
Postretirement Plan Assets Subtotal	321	293	28	—
Total Pension and Other Postretirement Plan Assets	$2,360	$ 744	$ 1,442	$ 174

(a) Predominantly includes domestic common stock and commingled funds.

(b) Predominantly includes foreign common and preferred stock and warrants.

(c) Predominantly includes corporate bonds, government bonds, municipal/provincial bonds, collateralized mortgage obligations and commingled funds.

(d) Predominantly includes cash investment in short-term investment funds.

(e) Includes domestic and international commingled funds.

(f) Includes fixed income commingled funds.

There were no significant concentrations of risk in pension and OPEB plan assets at December 31, 2013 and 2012.

Valuation Techniques Used to Determine Fair Value

Equity

Equity securities are primarily comprised of securities issued by public companies in domestic and foreign markets plus investments in commingled funds, which are valued on a daily basis. PHI can exchange shares of the publicly traded securities and the fair values are primarily sourced from the closing prices on stock exchanges where there is active trading, therefore they would be classified as level 1 investments. If there is less active trading, then the publicly traded securities would typically be priced using observable data, such as bid/ask prices, and these measurements would be classified as level 2 investments. Investments that are not publicly traded and valued using unobservable inputs would be classified as level 3 investments.

Commingled funds with publicly quoted prices and active trading are classified as level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the net asset value (NAV) per fund share, derived from the underlying securities' quoted prices in active markets, and are classified as level 2 investments. Investments in commingled funds with redemption restrictions that use NAV are classified as level 3 investments.

Fixed Income

Fixed inc ome investments are primarily comprised of fixed income securities and fixed income commingled funds. The prices for direct investments in fixed income securities are generated on a daily basis. Like the equity securities, fair values generated from active trading on exchanges are classified as level 1 investments. Prices generated from less active trading with wider bid/ask prices are classified as level 2 investments. If prices are based on uncorroborated and unobservable inputs, then the investments are classified as level 3 investments.

Commingled funds with publicly quoted prices and active trading are classified as level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV per fund share, derived from the underlying securities' quoted prices in active markets, and are classified as level 2 investments. Investments in commingled funds with redemption restrictions that use NAV are classified as level 3 investments.

Other – Private Equity and Real Estate

Investments in private equity and real estate funds are primarily invested in privately held real estate investment properties, trusts and partnerships, as well as equity and debt issued by public or private companies. As a practical expedient, PHI's interest in the fund or partnership is estimated at NAV. PHI's interest in these funds cannot be readily redeemed due to the inherent lack of liquidity and the primarily long-term nature of the underlying assets. Distribution is made through the liquidation of the underlying assets. PHI views these investments as part of a long-term investment strategy. These investments are valued by each investment manager based on the underlying assets. The majority of the underlying assets are valued using significant unobservable inputs and often require significant management judgment or estimation based on the best available information. Market data includes observations of the trading multiples of public companies considered comparable to the private companies being valued. The funds utilize valuation techniques consistent with the market, income and cost approaches to measure the fair value of certain real estate investments. As a result, PHI classifies these investments as level 3 investments.

The investments in private equity and real estate funds require capital commitments, which may be called over a specific number of years. Unfunded capital commitments as of December 31, 2013 and 2012 totaled $12 million and $15 million, respectively.

Reconciliations of the beginning and ending balances of PHI's fair value measurements using significant unobservable inputs (level 3) for investments in the pension plan for the years ended December 31, 2013 and 2012 are shown below:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)				
	Equity	Fixed Income	Private Equity	Real Estate	Total Level 3
	(millions of dollars)				
Balance as of January 1, 2013	$ 31	$ 13	$ 56	$ 74	$ 174
Transfer in (out) of Level 3	—	(3)	—	—	(3)
Purchases	—	—	2	2	4
Sales	(5)	(1)	—	(13)	(19)
Settlements	—	2	(4)	(10)	(12)
Unrealized gain/(loss)	7	—	(7)	7	7
Realized gain	2	—	6	1	9
Balance as of December 31, 2013	$ 35	$ 11	$ 53	$ 61	$ 160

	Equity	Fixed Income	Private Equity	Real Estate	Total Level 3
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)				
	(millions of dollars)				
Balance as of January 1, 2012	$ 27	$ 9	$ 64	$ 65	$ 165
Transfer in (out) of Level 3	—	2	—	—	2
Purchases	4	2	4	5	15
Sales	(4)	(1)	—	—	(5)
Settlements	(1)	1	(8)	(5)	(13)
Unrealized gain/(loss)	4	—	(11)	8	1
Realized gain	1	—	7	1	9
Balance as of December 31, 2012	$ 31	$ 13	$ 56	$ 74	$ 174

Cash Flows

Contributions—PHI Retirement Plan

PHI's funding policy with regard to the PHI Retirement Plan is to maintain a funding level that is at least equal to the target liability as defined under the Pension Protection Act of 2006. During 2013, PHI, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of $80 million, $10 million and $30 million, respectively, which brought the PHI Retirement Plan assets to the funding target level for 2013 under the Pension Protection Act. During 2012, Pepco, DPL and ACE made discretionary tax-deductible contributions to the PHI Retirement Plan in the amounts of $85 million, $85 million and $30 million, respectively, which brought plan assets to the funding target level for 2012 under the Pension Protection Act.

Contributions—Other Postretirement Benefit Plan

In 2013 and 2012, Pepco contributed $6 million and $5 million, respectively, DPL contributed $3 million and $7 million, respectively, and ACE contributed $6 million and $7 million, respectively, to the other postretirement benefit plan. In 2013 and 2012, contributions of $7 million and $13 million, respectively, were made by other PHI subsidiaries.

Expected Benefit Payments

Estimated future benefit payments to participants in PHI's pension and other postretirement benefit plans, which reflect expected future service as appropriate, are as follows:

Years	Pension Benefits	Other Postretirement Benefits
	(millions of dollars)	
2014	$ 159	$ 38
2015	136	39
2016	139	39
2017	142	40
2018	147	40
2019 through 2023	$ 795	$ 201

Medicare Prescription Drug Improvement and Modernization Act of 2003 (Medicare Act)

On December 8, 2003, the Medicare Act became effective. The Medicare Act introduced Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Pepco Holdings sponsors postretirement health care plans that provide prescription drug benefits that PHI plan actuaries have determined are actuarially equivalent to Medicare Part D. In 2012, Pepco Holdings received $4 million in federal Medicare prescription drug subsidies. PHI did not receive the Part D subsidy in 2013 and will not receive it in the future due to the implementation of an Employer Group Waiver Plan which is not eligible for Part D reimbursements.

Pepco Holdings Retirement Savings Plan

Pepco Holdings has a defined contribution retirement savings plan. Participation in the plan is voluntary. All participants are 100% vested and have a nonforfeitable interest in their own contributions and in the Pepco Holdings' company matching contributions, including any earnings or losses thereon. Pepco Holdings' matching contributions were $12 million, $12 million and $11 million for the years ended December 31, 2013, 2012 and 2011, respectively.

(10) DEBT

Long-Term Debt

The components of long-term debt are shown in the table below:

Interest Rate	Maturity	At December 31, 2013	At December 31, 2012
		(millions of dollars)	
First Mortgage Bonds			
Pepco:			
4.95% (a)(b)	2013	$ —	$ 200
4.65% (a)(b)	2014	175	175
3.05%	2022	200	200
6.20% (c)(d)	2022	110	110
5.75% (a)(b)	2034	100	100
5.40% (a)(b)	2035	175	175
6.50% (a)(c)	2037	500	500
7.90%	2038	250	250
4.15%	2043	250	—
4.95%	2043	150	—
ACE:			
6.63%	2013	—	69
7.63% (e)	2014	7	7
7.68% (e)	2015 - 2016	17	17
7.75%	2018	250	250
6.80% (b)(f)	2021	39	39
4.35%	2021	200	200
4.875% (c)(f)	2029	23	23
5.80% (b)(g)	2034	120	120
5.80% (b)(g)	2036	105	105
DPL:			
6.40%	2013	—	250
5.22% (h)	2016	100	100
3.50%	2023	300	—
4.00%	2042	250	250
Total First Mortgage Bonds		3,321	3,140
Unsecured Tax-Exempt Bonds			
DPL:			
5.40%	2031	78	78
Total Unsecured Tax-Exempt Bonds		$ 78	$ 78

NOTE: Schedule is continued on next page.

Interest Rate	Maturity	At December 31, 2013	2012
		(millions of dollars)	
Medium-Term Notes (unsecured)			
DPL:			
7.56% – 7.58%	2017	$ 14	$ 14
6.81%	2018	4	4
7.61%	2019	12	12
7.72%	2027	10	10
Total Medium-Term Notes (unsecured)		40	40
ACE Variable Rate Term Loan	2014	100	—
Recourse Debt			
PCI:			
6.59% – 6.69%	2014	11	11
Notes (secured)			
Pepco Energy Services:			
5.90% – 7.46%	2017-2024	14	15
Notes (unsecured)			
PHI:			
2.70%	2015	250	250
5.90%	2016	190	190
6.125%	2017	81	81
7.45%	2032	185	185
DPL:			
5.00%	2014	100	100
5.00%	2015	100	100
Total Notes (unsecured)		906	906
Total Long-Term Debt		4,470	4,190
Net unamortized discount		(14)	(13)
Current portion of long-term debt		(403)	(529)
Total Net Long-Term Debt		$4,053	$3,648

(a) Represents a series of Collateral First Mortgage Bonds securing a series of senior notes issued by Pepco.

(b) Represents a series of Collateral First Mortgage Bonds (as defined herein) which must be cancelled and released as security for the issuer's obligations under the corresponding series of issuer notes (as defined herein) or tax-exempt bonds, at such time as the issuer does not have any first mortgage bonds outstanding (other than its Collateral First Mortgage Bonds).

(c) Represents a series of Collateral First Mortgage Bonds which must be cancelled and released as security for the issuer's obligations under the corresponding series of issuer notes or tax-exempt bonds, at such time as the issuer does not have any first mortgage bonds outstanding (other than its Collateral First Mortgage Bonds), except that the issuer may not permit such release of collateral unless the issuer substitutes comparable obligations for such collateral.

(d) Represents a series of Collateral First Mortgage Bonds securing a series of senior notes issued by Pepco, which in turn secures a series of tax-exempt bonds issued for the benefit of Pepco.

(e) Represents a series of Collateral First Mortgage Bonds securing a series of medium term notes issued by ACE.

(f) Represents a series of Collateral First Mortgage Bonds securing a series of tax-exempt bonds issued for the benefit of ACE.

(g) Represents a series of Collateral First Mortgage Bonds securing a series of senior notes issued by ACE.

(h) Represents a series of Collateral First Mortgage Bonds securing a series of debt securities issued by DPL.

The outstanding first mortgage bonds issued by each of Pepco, DPL and ACE are issued under a mortgage and deed of trust and are secured by a first lien on substantially all of the issuing company's property, plant and equipment, except for certain property excluded from the lien of the respective mortgage.

PHI's long-term debt is subject to certain covenants. As of December 31, 2013, PHI and its subsidiaries were in compliance with all such covenants.

The table above does not separately identify $1,060 million, $100 million and $249 million in aggregate principal amount of senior notes, medium term notes and other debt securities (issuer notes) issued by each of Pepco, DPL and ACE, respectively, and $110 million and $62 million in aggregate principal amount of tax-exempt bonds issued for the benefit of Pepco and ACE, respectively. These issuer notes are secured by a like amount of first mortgage bonds (Collateral First Mortgage Bonds) of each respective issuer. In addition, these tax-exempt bonds are secured by a like amount of Collateral First Mortgage Bonds issued by the utility subsidiary for whose benefit the tax-exempt bonds were issued. The principal terms of each such series of issuer notes, or the issuer's obligations in respect of each such series of tax-exempt bonds, are identical to the same terms of the corresponding series of Collateral First Mortgage Bonds. Payments of principal and interest made on a series of such issuer notes, or the satisfaction of the issuer's obligations in respect of a series of such tax-exempt bonds, satisfy the corresponding obligations on the related series of Collateral First Mortgage Bonds. For these reasons, each such series of Collateral First Mortgage Bonds and the corresponding issuer notes and/or tax-exempt bonds together effectively represent a single financial obligation and are not identified in the table above separately.

<u>Bond Issuances</u>

During 2013, Pepco issued $250 million of 4.15% first mortgage bonds due March 15, 2043 and $150 million of 4.95% first mortgage bonds due November 15, 2043. Net proceeds from the issuance of the 4.15% bonds were used to repay Pepco's outstanding commercial paper and for general corporate purposes. The net proceeds from the 4.95% bonds were used to repay outstanding commercial paper, including commercial paper issued to repay in full at maturity $200 million of Pepco's 4.95% senior notes due November 15, 2013, plus accrued but unpaid interest thereon. The senior notes were secured by a like principal amount of Pepco's first mortgage bonds, which under Pepco's Mortgage and Deed of Trust were deemed to be satisfied with the repayment of the senior notes.

During 2013, DPL issued $300 million of 3.50% first mortgage bonds due November 15, 2023. The net proceeds from the issuance of the long-term debt were used to repay at maturity $250 million of DPL's 6.40% first mortgage bonds, plus accrued but unpaid interest thereon, to repay outstanding commercial paper and for general corporate purposes.

<u>Bond Redemptions</u>

During 2013, Pepco repaid at maturity $200 million of its 4.95% senior notes, which were secured by a like principal amount of its first mortgage bonds as previously discussed.

During 2013, DPL repaid at maturity $250 million of its 6.40% first mortgage bonds.

During 2013, ACE repaid at maturity $69 million of its 6.63% non-callable first mortgage bonds. ACE also funded the redemption, prior to maturity, of $4 million of outstanding weekly variable rate pollution control revenue refunding bonds due 2017, issued by the Pollution Control Financing Authority of Salem County, New Jersey for ACE's benefit.

<u>ACE Term Loan Agreement</u>

On May 10, 2013, ACE entered into a $100 million term loan agreement, pursuant to which ACE has borrowed (and may not re-borrow) $100 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to the London Interbank Offered Rate (LIBOR) with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.75%. ACE's Eurodollar borrowings under the loan agreement may be converted into floating rate loans under certain circumstances, and, in that event, for so long as any loan remains a floating rate loan, interest would accrue on that loan at a rate per year equal to (i) the highest of (a) the prevailing prime rate, (b) the federal funds effective rate plus 0.5%, or (c) the one-month Eurodollar rate plus 1%, plus (ii) a margin of 0.75%. As of December 31, 2013, outstanding borrowings under the loan agreement bore interest at an annual rate of 0.92%, which is subject to adjustment from time to time. All borrowings under the loan agreement are unsecured, and the aggregate principal amount of all loans, together with any accrued but unpaid interest due under the loan agreement, must be repaid in full on or before November 10, 2014.

Under the terms of the term loan agreement, ACE must maintain compliance with specified covenants, including (i) the requirement that ACE maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the loan agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) a restriction on sales or other dispositions of assets, other than certain permitted sales and dispositions, and (iii) a restriction on the incurrence of liens (other than liens permitted by the loan agreement) on the assets of ACE. The loan agreement does not include any rating triggers. ACE was in compliance with all covenants under this loan agreement as of December 31, 2013.

Transition Bonds Issued by ACE Funding

The components of transition bonds are shown in the table below:

Interest Rate	Maturity	At December 31, 2013	2012
		(millions of dollars)	
4.46%	2016	$ 8	$ 19
4.91%	2017	46	75
5.05%	2020	54	54
5.55%	2023	147	147
Total Transition Bonds		255	295
Net unamortized discount		—	—
Current portion of long-term debt		(41)	(39)
Total Net Long-Term Transition Bonds		$ 214	$ 256

For a description of the Transition Bonds, see Note (16), “Variable Interest Entities – ACE Funding.”

Maturities of PHI’s long-term debt and Transition Bonds outstanding at December 31, 2013 are $444 million in 2014, $409 million in 2015, $338 million in 2016, $133 million in 2017, $286 million in 2018 and $3,115 million thereafter.

Long-Term Project Funding

As of December 31, 2013 and 2012, Pepco Energy Services had total outstanding long-term project funding (including current maturities) of $12 million and $13 million, respectively, related to energy savings contracts performed by Pepco Energy Services. The aggregate amounts of maturities for the project funding debt outstanding at December 31, 2013, are $2 million for 2014, $2 million for 2015, $1 million for each year 2016 and 2017, $2 million for 2018, and $4 million thereafter.

Short-Term Debt

PHI and its regulated utility subsidiaries have traditionally used a number of sources to fulfill short-term funding needs, such as commercial paper, short-term notes, and bank lines of credit. Proceeds from short-term borrowings are used primarily to meet working capital needs, but may also be used to temporarily fund long-term capital requirements. The components of PHI’s short-term debt at December 31, 2013 and 2012 are as follows:

	2013	2012
	(millions of dollars)	
Commercial paper	$442	$637
Variable rate demand bonds	123	128
Term loan agreement	—	200
Total	$565	$965

Commercial Paper

PHI, Pepco, DPL and ACE maintain ongoing commercial paper programs to address short-term liquidity needs. As of December 31, 2013, the maximum capacity available under these programs was $875 million, $500 million, $500 million and $350 million, respectively, subject to available borrowing capacity under the credit facility.

PHI, Pepco, DPL and ACE had $24 million, $151 million, $147 million and $120 million, respectively, of commercial paper outstanding at December 31, 2013. The weighted average interest rate for commercial paper issued by PHI, Pepco, DPL and ACE during 2013 was 0.70%, 0.34%, 0.29% and 0.31%, respectively. The weighted average maturity of all commercial paper issued by PHI, Pepco, DPL and ACE during 2013 was five, five, three and four days, respectively.

PHI, Pepco, DPL and ACE had $264 million, $231 million, $32 million and $110 million, respectively, of commercial paper outstanding at December 31, 2012. The weighted average interest rate for commercial paper issued by PHI, Pepco, DPL and ACE during 2012 was 0.87%, 0.43%, 0.43% and 0.41%, respectively. The weighted average maturity of all commercial paper issued by PHI, Pepco, DPL and ACE in 2012 was ten, five, four and three days, respectively.

Variable Rate Demand Bonds

PHI's utility subsidiaries DPL and ACE, each have outstanding obligations in respect of Variable Rate Demand Bonds (VRDB). VRDBs are subject to repayment on the demand of the holders and, for this reason, are accounted for as short-term debt in accordance with GAAP. However, bonds submitted for purchase are remarketed by a remarketing agent on a best efforts basis. PHI expects that any bonds submitted for purchase will be remarketed successfully due to the creditworthiness of the issuer and, as applicable, the credit support, and because the remarketing resets the interest rate to the then-current market rate. The bonds may be converted to a fixed-rate, fixed-term option to establish a maturity which corresponds to the date of final maturity of the bonds. On this basis, PHI views VRDBs as a source of long-term financing. As of December 31, 2013, $105 million of VRDBs issued on behalf of DPL (of which $72 million were secured by Collateral First Mortgage Bonds issued by DPL) and $18 million of VRDBs issued on behalf of ACE were outstanding.

The VRDBs outstanding at December 31, 2013 mature as follows: 2014 to 2017 ($44 million), 2024 ($33 million) and 2028 to 2029 ($46 million). The weighted average interest rate for VRDBs was 0.24% during 2013 and 0.34% during 2012.

Credit Facility

PHI, Pepco, DPL and ACE maintain an unsecured syndicated credit facility to provide for their respective liquidity needs, including obtaining letters of credit, borrowing for general corporate purposes and supporting their commercial paper programs. On August 1, 2011, PHI, Pepco, DPL and ACE entered into an amended and restated credit agreement which, on August 2, 2012, was amended to extend the term of the credit facility to August 1, 2017 and to amend the pricing schedule to decrease certain fees and interest rates payable to the lenders under the facility. On August 1, 2013, as permitted under the existing terms of the credit agreement, a request by PHI, Pepco, DPL and ACE to extend the credit facility termination date to August 1, 2018 was approved. All of the terms and conditions as well as pricing remained the same.

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

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

In order for a borrower to use the facility, certain representations and warranties must be true and correct, and the borrower must be in compliance with specified financial and other covenants, including (i) the requirement that each borrowing company maintain a ratio of total indebtedness to total capitalization of 65% or less, computed in accordance with the terms of the credit agreement, which calculation excludes from the definition of total indebtedness certain trust preferred securities and deferrable interest subordinated debt (not to exceed 15% of total capitalization), (ii) with certain exceptions, a restriction on sales or other dispositions of assets, and (iii) a restriction on the incurrence of liens on the assets of a borrower or any of its significant subsidiaries other than permitted liens. The credit agreement contains certain covenants and other customary agreements and requirements that, if not complied with, could result in an event of default and the acceleration of repayment obligations of one or more of the borrowers thereunder. Each of the borrowers was in compliance with all covenants under this facility as of December 31, 2013.

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

As of December 31, 2013 and 2012, the amount of cash plus unused borrowing capacity under the credit facility available to meet the future liquidity needs of PHI and its utility subsidiaries on a consolidated basis totaled $1,063 million and $861 million, respectively. PHI's utility subsidiaries had combined cash and unused borrowing capacity under the credit facility of $332 million and $477 million at December 31, 2013 and 2012, respectively.

Other Financing Activities

PHI Term Loan Agreement

On March 28, 2013, PHI entered into a $250 million term loan agreement due March 27, 2014, pursuant to which PHI had borrowed $250 million at a rate of interest equal to the prevailing Eurodollar rate, which is determined by reference to the LIBOR with respect to the relevant interest period, all as defined in the loan agreement, plus a margin of 0.875%. PHI used the net proceeds of the loan under the loan agreement to repay its outstanding $200 million term loan obtained in 2012, and for general corporate purposes. On May 29, 2013, PHI repaid the $250 million term loan with a portion of the net proceeds from the early termination of the cross-border energy lease investments.

Long-Term Project Funding

On October 24, 2013, Pepco Energy Services entered into an agreement with a lender to receive up to $8 million in construction financing at an interest rate of 4.68% for an energy savings project that is expected to be completed in 2014. The agreement includes a transfer of receivables from Pepco Energy Services to the lender after construction is completed, under which the customer would make contractual payments over a 23-year period to repay the financing. If there are shortfalls in Pepco Energy Services' energy savings guarantee or other performance obligations to the customer that reduce customer payments below the contractual payment amounts, then Pepco Energy Services would compensate the lender for the unpaid amounts. PHI has guaranteed the performance obligations of Pepco Energy Services under the financing agreement.

(11) INCOME TAXES

PHI and the majority of its subsidiaries file a consolidated federal income tax return. Federal income taxes are allocated among PHI and the subsidiaries included in its consolidated group pursuant to a written tax sharing agreement that was approved by the SEC in 2002 in connection with the establishment of PHI as a public utility holding company. Under this tax sharing agreement, PHI's consolidated federal income tax liability is allocated based upon PHI's and its subsidiaries' separate taxable income or loss.

The provision for consolidated income taxes, reconciliation of consolidated income tax expense, and components of consolidated deferred tax liabilities (assets) are shown below.

Provision for Consolidated Income Taxes – Continuing Operations

	For the Year Ended December 31, 2013	2012	2011
	(millions of dollars)		
Current Tax (Benefit) Expense			
Federal	$(128)	$(166)	$ (72)
State and local	(9)	(40)	12
Total Current Tax (Benefit) Expense	(137)	(206)	(60)
Deferred Tax Expense (Benefit)			
Federal	393	254	163
State and local	65	58	15
Investment tax credit amortization	(2)	(3)	(4)
Total Deferred Tax Expense	456	309	174
Total Consolidated Income Tax Expense Related to Continuing Operations	$ 319	$ 103	$114

Reconciliation of Consolidated Income Tax Expense – Continuing Operations

	For the Year Ended December 31, 2013		2012		2011	
	(millions of dollars)					
Income tax at Federal statutory rate	$150	35.0%	$112	35.0%	$118	35.0%
Increases (decreases) resulting from:						
State income taxes, net of Federal effect	27	6.3%	19	6.0%	23	6.7%
Asset removal costs	(14)	(3.3)%	(11)	(3.4)%	(7)	(2.1)%
Change in estimates and interest related to uncertain and effectively settled tax positions	56	13.1%	(8)	(2.6)%	(5)	(1.6)%
Establishment of valuation allowances related to deferred tax assets	101	23.5%	—	—	—	—
Other, net	(1)	(0.2)%	(9)	(2.9)%	(15)	(4.1)%
Consolidated Income Tax Expense Related to Continuing Operations	$319	74.4%	$103	32.1%	$114	33.9%

Year ended December 31, 2013

PHI's consolidated effective income tax rate for the year ended December 31, 2013 of 74.4% reflects a charge of $56 million for changes in estimates and interest related to uncertain and effectively settled tax positions recorded in the first quarter of 2013 and the establishment of valuation allowances of $101 million in the first quarter of 2013 against certain deferred tax assets in PCI, which is now included in Corporate and Other. The income tax charge of $56 million is primarily related to the anticipated additional interest expense on estimated federal and state income tax obligations that was allocated to PHI's continuing operations resulting from a change in assessment of tax benefits associated with the former cross-border energy lease investments of PCI.

Between 1990 and 1999, PCI, through various subsidiaries, entered into certain transactions involving investments in aircraft and aircraft equipment, railcars and other assets. In connection with these transactions, PCI recorded deferred tax assets in prior years of $101 million in the aggregate. Following events that took place during the first quarter of 2013, which included (i) court decisions in favor of the IRS with respect to both Consolidated Edison's cross-border lease transaction (as discussed in Note (19), "Discontinued Operations – Cross-Border Energy Lease Investments") and another taxpayer's structured transactions, (ii) the change in PHI's tax position with respect to the tax benefits associated with its cross-border energy leases, and (iii) PHI's decision in March 2013 to begin to pursue the early termination of its remaining cross-border energy lease investments (which represented a substantial portion of the remaining assets within PCI) without the intent to reinvest these proceeds in income-producing assets, management evaluated the likelihood that PCI would be able to realize the $101 million of deferred tax assets in the future. Based on this evaluation, PCI established valuation allowances against these deferred tax assets totaling $101 million in the first quarter of 2013. Further, during the fourth quarter of 2013, in light of additional court decisions in favor of the IRS involving other taxpayers, and after consideration of all relevant factors, management determined that it would abandon the further pursuit of these deferred tax assets, and these assets totaling $101 million were charged off against the previously established valuation allowances.

Year ended December 31, 2012

PHI's consolidated effective income tax rate for the year ended December 31, 2012 of 32.1% includes income tax benefits totaling $8 million related to uncertain and effectively settled tax positions, primarily due to the effective settlement with the IRS in the first quarter of 2012 with respect to the methodology used historically to calculate deductible mixed service costs and the expiration of the statute of limitations associated with an uncertain tax position in Pepco. The rate for the year ended December 31, 2012 also reflects an increase in deductible asset removal costs for Pepco in 2012 related to a higher level of asset retirements.

Year ended December 31, 2011

PHI's consolidated effective income tax rate for the year ended December 31, 2011 of 33.9% includes income tax benefits totaling $5 million related to uncertain and effectively settled tax positions. In 2011, PHI reached a settlement with the IRS with respect to interest due on its federal tax liabilities related to the November 2010 audit settlement for years 1996 through 2002. In connection with this agreement, PHI reallocated certain amounts that have been on deposit with the IRS since 2006 among liabilities in the settlement years and subsequent years and recorded the tax benefits, primarily in the second quarter of 2011.

In addition, as discussed further in Note (15), "Commitments and Contingencies – District of Columbia Tax Legislation," on June 14, 2011, the Council of the District of Columbia approved the Fiscal Year 2012 Budget Support Act of 2011 (the Budget Support Act). The Budget Support Act includes a provision that requires corporate taxpayers in the District of Columbia to calculate taxable income allocable or apportioned to the District by reference to the income and apportionment factors applicable to commonly controlled entities organized within the United States that are engaged in a unitary business. Previously, only the income of companies with direct nexus to the District of Columbia was taxed. As a result of the change, during 2011 PHI recorded additional state income tax expense of $2 million.

Components of Consolidated Deferred Tax Liabilities (Assets)

	At December 31,	
	2013	2012
	(millions of dollars)	
Deferred Tax Liabilities (Assets)		
Depreciation and other basis differences related to plant and equipment	$2,628	$2,299
Deferred electric service and electric restructuring liabilities	91	110
Cross-border energy lease investments	(6)	756
Federal and state net operating losses	(350)	(394)
Valuation allowances on state net operating losses	21	21
Pension and other postretirement benefits	135	128
Deferred taxes on amounts to be collected through future rates	75	58
Other [a]	285	204[b]
Total Deferred Tax Liabilities, net	2,879	3,182[b]
Deferred tax assets included in Current Assets	51	28
Deferred tax liabilities included in Other Current Liabilities	(2)	(2)
Total Consolidated Deferred Tax Liabilities, net non-current	$2,928	$3,208[b]

[a] PCI established valuation allowances against certain of these other deferred taxes totaling $101 million in the first quarter of 2013. Management determined during the fourth quarter of 2013 to abandon the further pursuit of the related deferred tax assets and, accordingly, these assets were charged off against the valuation allowances.

[b] The amounts for Other, Total Deferred Tax Liabilities, net and Total Consolidated Deferred Tax Liabilities, net non-current, are presented after the effect of the revision to prior period financial statements discussed in Note (2), " Significant Accounting Policies – Revision to Prior Period Financial Statements."

The net deferred tax liability represents the tax effect, at presently enacted tax rates, of temporary differences between the financial statement basis and tax basis of assets and liabilities. The portion of the net deferred tax liability applicable to PHI's utility operations, which has not been reflected in current service rates, represents income taxes recoverable through future rates, net, and is recorded as a Regulatory asset on the balance sheet. Federal and state net operating losses generally expire over 20 years from 2029 to 2032.

The Tax Reform Act of 1986 repealed the investment tax credit for property placed in service after December 31, 1985, except for certain transition property. Investment tax credits previously earned on Pepco's, DPL's and ACE's property continue to be amortized to income over the useful lives of the related property.

Reconciliation of Beginning and Ending Balances of Unrecognized Tax Benefits

	2013	2012	2011
	(millions of dollars)		
Balance as of January 1,	$200	$357	$395
Tax positions related to current year:			
Additions	3	1	2
Reductions	—	—	—
Tax positions related to prior years:			
Additions	646[a]	79	20
Reductions	(12)	(235)[b]	(57)
Settlements	(6)	(2)	(3)
Balance as of December 31,	$831	$200	$357

[a] These additions of unrecognized tax benefits in 2013 primarily relate to the cross-border energy lease investments of PCI.

[b] These reductions of unrecognized tax benefits in 2012 primarily relate to a resolution reached with the IRS for determining deductible mixed service costs for additions to property, plant and equipment.

Unrecognized Benefits That, If Recognized, Would Affect the Effective Tax Rate

Unrecognized tax benefits are related to tax positions that have been taken or are expected to be taken in tax returns that are not recognized in the financial statements because management has either measured the tax benefit at an amount less than the benefit claimed or expected to be claimed, or has concluded that it is not more likely than not that the tax position will be ultimately sustained. For the majority of these tax positions, the ultimate deductibility is highly certain, but there is uncertainty about the timing of such deductibility.

Unrecognized tax benefits at December 31, 2013 included $9 million that, if recognized, would lower the effective tax rate.

Interest and Penalties

PHI recognizes interest and penalties relating to its uncertain tax positions as an element of income tax expense. For the years ended December 31, 2013, 2012 and 2011, PHI recognized $125 million of pre-tax interest expense ($75 million after-tax), $23 million of pre-tax interest income ($14 million after-tax), and $23 million of pre-tax interest income ($14 million after-tax), respectively, as a component of income tax expense related to continuing and discontinued operations. As of December 31, 2013, 2012 and 2011, PHI had accrued interest receivable of $2 million, accrued interest receivable of $10 million and accrued interest payable of $4 million, respectively, related to effectively settled and uncertain tax positions.

Possible Changes to Unrecognized Tax Benefits

It is reasonably possible that the amount of unrecognized tax benefits with respect to PHI's uncertain tax positions will significantly increase or decrease within the next 12 months. In order to mitigate the cost of continued litigation of tax matters related to the former cross-border energy lease investments, PHI and its subsidiaries have entered into discussions with the IRS with the intention of seeking a settlement of all tax issues for open tax years 2001 through 2011. PHI currently believes that it is possible that a settlement with the IRS may be reached in 2014, which could significantly impact the balances of unrecognized tax benefits and the related interest accruals. At this time, it is estimated that there will be a $700 million to $800 million decrease in unrecognized tax benefits within the next 12 months. See Note (15), "Commitments and Contingencies – PHI's Cross-Border Energy Lease Investments," for additional discussion.

Tax Years Open to Examination

PHI's federal income tax liabilities for Pepco legacy companies for all years through 2002, and for Conectiv legacy companies for all years through 2002, have been determined by the IRS, subject to adjustment to the extent of any net operating loss or other loss or credit carrybacks from subsequent years. PHI has not reached final settlement with the IRS with respect to the cross-border energy lease deductions. The open tax years for the significant states where PHI files state income tax returns (District of Columbia, Maryland, Delaware, New Jersey, Pennsylvania and Virginia) are the same as for the Federal returns.

Final IRS Regulations on Repair of Tangible Property

In September 2013, the IRS issued final regulations on expense versus capitalization of repairs with respect to tangible personal property. The regulations are effective for tax years beginning on or after January 1, 2014, and provide an option to early adopt the final regulations for tax years beginning on or after January 1, 2012. It is expected that the IRS will issue revenue procedures that will describe how taxpayers may implement the final regulations. The final repair regulations retain the operative rule that the Unit of Property for network assets is determined by the taxpayer's particular facts and circumstances except as provided in published guidance. In 2012, with the filing of its 2011 tax return, PHI filed a request for an automatic change in accounting method related to repairs of its network assets in accordance with IRS Revenue Procedure 2011-43. PHI does not expect the effects of the final regulations to be significant and will continue to evaluate the impact of the new guidance on its consolidated financial statements.

Other Taxes

Other taxes for continuing operations are shown below. The annual amounts include $422 million, $426 million and $445 million for the years ended December 31, 2013, 2012 and 2011, respectively, related to Power Delivery, which are recoverable through rates.

	2013	2012	2011
	(millions of dollars)		
Gross Receipts/Delivery	$ 133	$ 135	$ 145
Property	77	75	71
County Fuel and Energy	153	160	170
Environmental, Use and Other	65	62	65
Total	$ 428	$ 432	$ 451

(12) STOCK-BASED COMPENSATION, DIVIDEND RESTRICTIONS, AND CALCULATIONS OF EARNINGS PER SHARE OF COMMON STOCK

Stock-Based Compensation

Pepco Holdings maintains the 2012 Long-Term Incentive Plan (2012 LTIP), the successor plan to the Long-Term Incentive Plan (LTIP), the objective of which is to increase shareholder value by providing long-term and equity incentives to reward officers, key employees and non-employee directors of Pepco Holdings and its subsidiaries and to increase the ownership of Pepco Holdings common stock by such individuals. Any officer, key employee or non-employee director of Pepco Holdings or its subsidiaries may be designated as a participant. Under these plans, awards to officers, key employees and non-employee directors may be in the form of restricted stock, restricted stock units, stock options, performance shares and/or units, stock appreciation rights, unrestricted stock and dividend equivalents. At inception, 10 million and 8 million shares of common stock were authorized for issuance under the LTIP and the 2012 LTIP, respectively. The LTIP expired in accordance with its terms in 2012 and no new awards may be granted thereunder.

Total stock-based compensation expense recorded in the consolidated statements of (loss) income for the years ended December 31, 2013, 2012 and 2011 was $12 million, $11 million and $6 million, respectively, all of which was associated with restricted stock unit and unrestricted stock awards.

No material amount of stock compensation expense was capitalized for the years ended December 31, 2013, 2012 and 2011.

Restricted Stock and Restricted Stock Unit Awards

Description of Awards

A number of programs have been established under the LTIP and the 2012 LTIP involving the issuance of restricted stock and restricted stock unit awards, including awards of performance-based restricted stock units, time-based restricted stock and restricted stock units, and retention restricted stock and restricted stock units. A summary of each of these programs is as follows:

- Under the performance-based program, performance criteria are selected and measured over the specified performance period. Depending on the extent to which the performance criteria are satisfied, the participants are eligible to earn shares of common stock at the end of the performance period, ranging from 25% to 200% of the target award, and dividend equivalents accrued thereon.

- Generally, time-based restricted stock and restricted stock unit award opportunities have a requisite service period of up to three years and, with respect to restricted stock awards, participants have the right to receive dividends on the shares during the vesting period. Under restricted stock unit awards, dividends are credited quarterly in the form of additional restricted stock units, which are paid when vested at the end of the service period.

- In January, April and September 2012, four retention awards in the form of 150,330 time-based and performance-based restricted stock units and 5,305 shares of unrestricted stock were granted to certain PHI executives. In January and February 2013, two retention awards in the form of 45,444 performance-based restricted stock units were granted to certain PHI executives. The time-based retention awards vest at varying rates over a period of three years, and the performance-based retention awards have a one-year performance period and are subject to the continued employment of the executive at the end of the performance period.

- In 2013 and 2012, restricted stock units totaling 37,735 and 40,749, respectively, were granted to PHI's non-employee directors under the 2012 LTIP. These restricted stock units vest over a service period which ends upon the first to occur of (i) one year after the date of grant or (ii) the date of the next annual meeting of stockholders. These awards represent the equity portion of the annual retainer paid to non-employee directors for their service as a director of PHI.

Activity for the year

The 2013 activity for non-vested, time-based restricted stock, restricted stock units and performance-based restricted stock unit awards, including retention awards, is summarized in the table below.

For performance-based restricted stock unit awards, the table reflects awards projected, for purposes of computing the weighted average grant date fair value, to achieve 100% of targeted performance criteria for each outstanding award cycle.

	Number of Shares	Weighted Average Grant Date Fair Value
Balance as of January 1, 2013		
Time-based restricted stock	134,607	$ 16.56
Time-based restricted stock units	513,204	19.42
Performance-based restricted stock units	1,032,396	20.34
Total	1,680,207	
Granted during 2013		
Time-based restricted stock units	237,733	19.70
Performance-based restricted stock units	444,969	17.03
Total	682,702	
Vested during 2013		
Time-based restricted stock	(134,607)	16.56
Time-based restricted stock units	(123,021)	18.45
Performance-based restricted stock units	(314,995)	20.00
Total	(572,623)	
Forfeited during 2013		
Time-based restricted stock units	(44,362)	19.64
Performance-based restricted stock units	(92,540)	19.91
Total	(136,902)	
Balance as of December 31, 2013		
Time-based restricted stock	—	—
Time-based restricted stock units	583,554	19.34
Performance-based restricted stock units	1,069,830	19.06
Total	1,653,384	

Grants included in the table above reflect 2013 grants of performance-based and time-based restricted stock units, including retention awards. PHI recognizes compensation expense related to performance-based restricted stock unit awards and time-based restricted stock and restricted stock unit awards based on the fair value of the awards at date of grant. The fair value is based on the market value of PHI common stock at the date the award opportunity is granted. The estimated fair value of the performance-based awards is also a function of PHI's projected future performance relative to established performance criteria and the resulting payout of shares based on the achieved performance levels. PHI employed a Monte Carlo simulation to forecast PHI's performance relative to the performance criteria and to estimate the potential payout of shares under the performance-based awards.

The following table provides the weighted average grant date fair value per share of those awards granted during each of the years ended December 31, 2013, 2012 and 2011:

	2013	2012	2011
Weighted average grant-date fair value of each unrestricted stock award granted during the year	$ —	$18.85	$ —
Weighted average grant-date fair value of each time-based restricted stock unit award granted during the year	$19.70	$19.69	$18.87
Weighted average grant-date fair value of each performance-based restricted stock unit award granted during the year	$17.03	$21.13	$19.56

As of December 31, 2013, there was approximately $11 million of future compensation cost (net of estimated forfeitures) related to restricted stock unit awards granted under the LTIP and the 2012 LTIP that PHI expects to recognize over a weighted-average period of approximately two years.

Stock Options

Stock options to purchase shares of PHI's common stock granted under the LTIP and the 2012 LTIP must have an exercise price at least equal to the fair market value of the underlying stock on the grant date. Stock options generally become exercisable on a specified vesting date or dates. All stock options must have an expiration date of no greater than ten years from the date of grant. No options have been granted under the LTIP or the 2012 LTIP since 2002. As of December 31, 2012, all outstanding stock options under predecessor plans have vested or expired. Total intrinsic value and tax benefits recognized for stock options exercised in 2012 and 2011 were immaterial.

Directors' Deferred Compensation

Under the Pepco Holdings' Executive and Director Deferred Compensation Plan, Pepco Holdings non-employee directors may elect to defer all or part of their cash retainer and meeting fees. Deferred retainer or meeting fees, at the election of the director, can be credited with interest at the prime rate or the return on selected investment funds or can be deemed invested in phantom shares of Pepco Holdings common stock on which dividend equivalent accruals are credited when dividends are paid on the common stock (or a combination of these options). All deferrals are settled in cash. The amount deferred by directors for each of the years ended December 31, 2013, 2012 and 2011 was not material.

Compensation expense recognized in respect of dividends and the increase in fair value for each of the years ended December 31, 2013, 2012 and 2011 was not material. The deferred compensation balances under this program were approximately $2 million and $1 million at December 31, 2013 and 2012, respectively.

A separate deferral option under the 2012 LTIP gives non-employee directors the right to elect to defer the receipt of common stock upon vesting of restricted stock unit awards.

Dividend Restrictions

PHI, on a stand-alone basis, generates no operating income of its own. Accordingly, its ability to pay dividends to its shareholders depends on dividends received from its subsidiaries. In addition to their future financial performance, the ability of PHI's direct and indirect subsidiaries to pay dividends is subject to limits imposed by: (i) state corporate laws, which impose limitations on the funds that can be used to pay dividends and, in the case of ACE, the regulatory requirement that it obtain the prior approval of the NJBPU before dividends can be paid if its equity as a percent of its total capitalization, excluding securitization debt, falls below 30%; (ii) the prior rights of holders of mortgage bonds and other long-term debt issued by the subsidiaries, and any other restrictions imposed in connection with the incurrence of liabilities; and (iii) certain provisions of ACE's charter that impose restrictions on payment of common stock dividends for the benefit of preferred stockholders. Pepco, DPL and ACE have no shares of preferred stock outstanding at December 31, 2013. Currently, the capitalization ratio limitation to which ACE is subject and the restriction in the ACE charter do not limit ACE's ability to pay common stock dividends. PHI had approximately $595 million and $1,077 million of retained earnings free of restrictions at December 31, 2013 and 2012, respectively. These amounts represent the total retained earnings balances at those dates.

For the years ended December 31, 2013, 2012 and 2011, dividends paid by PHI's subsidiaries were as follows:

Subsidiary	2013	2012	2011
	(millions of dollars)		
Pepco (paid to PHI)	$ 46	$ 35	$ 25
DPL (paid to Conectiv)	30	—	60
ACE (paid to Conectiv)	60	35	—
Total	$ 136	$ 70	$ 85

Calculations of Earnings per Share of Common Stock

The numerator and denominator for basic and diluted earnings per share of common stock calculations are shown below.

	For the Years Ended December 31,		
	2013	2012	2011
	(millions of dollars, except per share data)		
Income (Numerator):			
Net income from continuing operations	$ 110	$ 218	$ 222
Net (loss) income from discontinued operations	(322)	67	35
Net (loss) income	$ (212)	$ 285	$ 257
Shares (Denominator) (in millions):			
Weighted average shares outstanding for basic computation:			
Average shares outstanding	246	229	226
Adjustment to shares outstanding	—	—	—
Weighted Average Shares Outstanding for Computation of Basic Earnings Per Share of Common Stock	246	229	226
Net effect of potentially dilutive shares [(a)]	—	1	—
Weighted Average Shares Outstanding for Computation of Diluted Earnings Per Share of Common Stock	246	230	226
Basic earnings per share of common stock from continuing operations	$ 0.45	$ 0.95	$ 0.98
Basic (loss) earnings per share of common stock from discontinued operations	(1.31)	0.30	0.16
Basic (loss) earnings per share	$ (0.86)	$ 1.25	$ 1.14
Diluted earnings per share of common stock from continuing operations	$ 0.45	$ 0.95	$ 0.98
Diluted (loss) earnings per share of common stock from discontinued operations	(1.31)	0.29	0.16
Diluted (loss) earnings per share	$ (0.86)	$ 1.24	$ 1.14

(a) The number of options to purchase shares of common stock that were excluded from the calculation of diluted earnings per share as they are considered to be anti-dilutive were zero, zero and 14,900 for the years ended December 31, 2013, 2012 and 2011, respectively.

Equity Forward Transaction

During 2012, PHI entered into an equity forward transaction in connection with a public offering of PHI common stock. Pursuant to the terms of this transaction, a forward counterparty borrowed 17,922,077 shares of PHI's common stock from third parties and sold them to a group of underwriters for $19.25 per share, less an underwriting discount equal to $0.67375 per share. Under the terms of the equity forward transaction, upon physical settlement thereof, PHI was required to issue and deliver shares of PHI common stock to the forward counterparty at the then applicable forward sale price. The forward sale price was initially determined to be $18.57625 per share at the time the equity forward transaction was entered into and was subject to reduction from time to time in accordance with the terms of the equity forward transaction. PHI believed that the equity forward transaction substantially eliminated future equity price risk because the forward sale price was determinable as of the date that PHI entered into the equity forward transaction and was only reduced pursuant to the contractual terms of the equity forward transaction through the settlement date, which reductions were not affected by a future change in the market price of the PHI common stock. On February 27, 2013, PHI physically settled the equity forward at the then applicable forward sale price of $17.39 per share. The proceeds of approximately $312 million were used to repay outstanding commercial paper, a portion of which had been issued in order to make capital contributions to the utilities, and for general corporate purposes.

Direct Stock Purchase and Dividend Reinvestment Plan

PHI maintains a Direct Stock Purchase and Dividend Reinvestment Plan (DRP) through which participants may reinvest cash dividends. In addition, participants can make purchases of shares of PHI common stock through the investment of not less than $25 per purchase nor more than $300,000 each calendar year. Shares of common stock purchased through the DRP may be new shares, treasury shares held by PHI, or, at the election of PHI, shares purchased in the open market. Approximately 2 million new shares were issued and sold under the DRP in each of 2013, 2012 and 2011.

Pepco Holdings Common Stock Reserved and Unissued

The following table presents Pepco Holdings' common stock reserved and unissued at December 31, 2013:

Name of Plan	Number of Shares
DRP	6,104,591
Pepco Holdings Long-Term Incentive Plan [(a)]	7,450,404
Pepco Holdings 2012 Long-Term Incentive Plan	7,971,832
Pepco Holdings Non-Management Directors Compensation Plan	457,211
Pepco Holdings Retirement Savings Plan	4,585,079
Total	26,569,117

(a) No further awards will be made under this plan.

(13) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Derivative Instruments

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

ACE was ordered to enter into the SOCAs by the NJBPU, and under the SOCAs, ACE would have received payments from or made payments to electric generation facilities based on (i) the difference between the fixed price in the SOCAs and the price for capacity that clears PJM and (ii) ACE's annual proportion of the total New Jersey load relative to the other EDCs in New Jersey. ACE began applying derivative accounting to two of its SOCAs as of June 30, 2012 because these generators cleared the 2015-2016 PJM capacity auction in May 2012. The fair value of the derivatives embedded in these SOCAs were deferred as regulatory assets or regulatory liabilities because the NJBPU allowed full recovery from ACE's distribution customers for any payments made by ACE, and ACE's distribution customers would be entitled to payments received by ACE. As further discussed in Note (7), "Regulatory Matters," in light of a Federal district court order, which ruled that the SOCAs are void, invalid and unenforceable, and ACE's subsequent termination of the SOCAs in the fourth quarter of 2013, ACE derecognized the derivative assets and derivative liabilities related to the SOCAs.

The tables below identify the balance sheet location and fair values of derivative instruments as of December 31, 2013 and 2012:

Balance Sheet Caption	Derivatives Designated as Hedging Instruments	Other Derivative Instruments	Gross Derivative Instruments	Effects of Cash Collateral and Netting	Net Derivative Instruments
	As of December 31, 2013				
	(millions of dollars)				
Derivative assets (current assets)	$ —	$ 1	$ 1	$ (1)	$ —
Total Derivative asset	$ —	$ 1	$ 1	$ (1)	$ —

Balance Sheet Caption	Derivatives Designated as Hedging Instruments	Other Derivative Instruments	Gross Derivative Instruments	Effects of Cash Collateral and Netting	Net Derivative Instruments
	As of December 31, 2012				
	(millions of dollars)				
Derivative assets (non-current assets)	$ —	$ 8	$ 8	$ —	$ 8
Total Derivative assets	—	8	8	—	8
Derivative liabilities (current liabilities)	—	(4)	(4)	—	(4)
Derivative liabilities (non-current liabilities)	—	(11)	(11)	—	(11)
Total Derivative liabilities	—	(15)	(15)	—	(15)
Net Derivative liability	$ —	$ (7)	$ (7)	$ —	$ (7)

All derivative assets and liabilities available to be offset under master netting arrangements were netted as of December 31, 2013 and 2012. The amount of cash collateral that was offset against these derivative positions is as follows:

	December 31, 2013	December 31, 2012
	(millions of dollars)	
Cash collateral received from counterparties with the obligation to return	$ (1)	$ —

As of December 31, 2013 and 2012, all PHI cash collateral pledged related to derivative instruments accounted for at fair value was entitled to be offset under master netting agreements.

Derivatives Designated as Hedging Instruments

Cash Flow Hedges

Power Delivery

All premiums paid and other transaction costs incurred as part of DPL's natural gas hedging activity, in addition to all of DPL's gains and losses related to hedging activities, are deferred under FASB guidance on regulated operations until recovered from customers based on the fuel adjustment clause approved by the DPSC. For the years ended December 31, 2013, 2012 and 2011, DPL had no net unrealized derivative losses and zero, zero and $5 million, respectively, of net realized losses associated with cash flow hedges recognized in the consolidated statements of (loss) income (through Fuel and purchased energy expense) that were deferred as Regulatory assets.

Cash Flow Hedges Included in Accumulated Other Comprehensive Loss

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

The tables below provide details regarding terminated cash flow hedges included in PHI's consolidated balance sheets as of December 31, 2013 and 2012. The data in the following tables indicate the cumulative net loss after-tax related to terminated cash flow hedges by contract type included in AOCL, the portion of AOCL expected to be reclassified to income during the next 12 months, and the maximum hedge or deferral term:

	As of December 31, 2013		
Contracts	**Accumulated Other Comprehensive Loss After-tax**	**Portion Expected to be Reclassified to Income during the Next 12 Months**	**Maximum Term**
	(millions of dollars)		
Interest rate	$ 9	$ 1	224 months
Total	$ 9	$ 1	

	As of December 31, 2012		
Contracts	**Accumulated Other Comprehensive Loss After-tax**	**Portion Expected to be Reclassified to Income during the Next 12 Months**	**Maximum Term**
	(millions of dollars)		
Interest rate	$ 10	$ 1	236 months
Total	$ 10	$ 1	

Other Derivative Activity

DPL and ACE have certain derivatives that are not in hedge accounting relationships and are not designated as normal purchases or normal sales. These derivatives are recorded at fair value on the consolidated balance sheets with the gain or loss for changes in fair value recorded in income. In accordance with FASB guidance on regulated operations, offsetting regulatory liabilities or regulatory assets are recorded on the consolidated balance sheets and the recognition of the derivative gain or loss is deferred because of the DPSC-approved fuel adjustment clause for DPL's derivatives and the NJBPU order (prior to the order in October 2013 of a Federal district court as described in Note (7), "Regulatory Matters" which caused ACE to derecognize the derivative assets and derivative liabilities related to the SOCAs in the fourth quarter of 2013) pertaining to the SOCAs within which ACE's capacity derivatives are embedded. The following table indicates the net unrealized and net realized derivative gains and (losses) arising during the period associated with these derivatives that were recognized in the consolidated statements of (loss) income (through Fuel and purchased energy expense) and that were also deferred as Regulatory assets for the years ended December 31, 2013, 2012 and 2011:

	For the Year Ended December 31,		
	2013	2012	2011
	(millions of dollars)		
Net unrealized gain (loss) arising during the period	$ 4	$ (6)	$ (13)
Net realized loss recognized during the period	(4)	(16)	(22)

As of December 31, 2013 and 2012, the quantities and positions of DPL's net outstanding natural gas commodity forward contracts and ACE's capacity derivatives associated with the SOCAs that did not qualify for hedge accounting were:

	December 31, 2013		December 31, 2012	
Commodity	Quantity	Net Position	Quantity	Net Position
DPL—Natural gas (one Million British Thermal Units (MMBtu))	3,977,500	Long	3,838,000	Long
ACE—Capacity (MWs)	—	—	180	Long

Contingent Credit Risk Features

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

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

The gross fair values of DPL's derivative liabilities with credit risk-related contingent features as of December 31, 2013 and 2012, were zero and $4 million, respectively, before giving effect to offsetting transactions or collateral under master netting agreements. As of December 31, 2013 and 2012, DPL had posted no cash collateral against its gross derivative liability. If DPL's debt ratings had been downgraded below investment grade as of December 31, 2013 and 2012, DPL's net settlement amounts, including both the fair value of its derivative liabilities and its normal purchase and normal sale contracts would have been approximately zero and $2 million, respectively, and DPL would have been required to post collateral with the counterparties of approximately zero and $2 million, respectively. The net settlement and additional collateral amounts reflect the effect of offsetting transactions under master netting agreements.

DPL's primary source for posting cash collateral or letters of credit is PHI's credit facility, under which DPL is a borrower. As of December 31, 2013 and 2012, the aggregate amount of cash plus borrowing capacity under the credit facility available to meet the future liquidity needs of PHI's utility subsidiaries was $332 million and $477 million, respectively.

(14) FAIR VALUE DISCLOSURES

Financial Instruments Measured at Fair Value on a Recurring Basis

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

The following tables set forth, by level within the fair value hierarchy, PHI's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2013 and 2012. As required by the guidance, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. PHI's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

	Fair Value Measurements at December 31, 2013			
Description	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1) [a]	Significant Other Observable Inputs (Level 2) [a]	Significant Unobservable Inputs (Level 3)
	(millions of dollars)			
ASSETS				
Derivative instruments [b]				
Natural gas [c]	$ 1	$ 1	$ —	$ —
Restricted cash and cash equivalents				
Treasury fund	34	34	—	—
Executive deferred compensation plan assets				
Money market funds	15	15	—	—
Life insurance contracts	66	—	47	19
	$ 116	$ 50	$ 47	$ 19
LIABILITIES				
Executive deferred compensation plan liabilities				
Life insurance contracts	$ 30	$ —	$ 30	$ —
	$ 30	$ —	$ 30	$ —

(a) There were no transfers of instruments between level 1 and level 2 valuation categories during the year ended December 31, 2013.

(b) The fair values of derivative assets and liabilities reflect netting by counterparty before the impact of collateral.

(c) Represents natural gas swaps purchased by DPL as part of a natural gas hedging program approved by the DPSC.

	Fair Value Measurements at December 31, 2012			
Description	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1) [a]	Significant Other Observable Inputs (Level 2) [a]	Significant Unobservable Inputs (Level 3)
	(millions of dollars)			
ASSETS				
Derivative instruments [b]				
Capacity [d]	$ 8	$ —	$ —	$ 8
Restricted cash equivalents				
Treasury fund	27	27	—	—
Executive deferred compensation plan assets				
Money market funds	17	17	—	—
Life insurance contracts	60	—	42	18
	$ 112	$ 44	$ 42	$ 26
LIABILITIES				
Derivative instruments [b]				
Natural gas [c]	$ 4	$ —	$ —	$ 4
Capacity [d]	11	—	—	11
Executive deferred compensation plan liabilities				
Life insurance contracts	28	—	28	—
	$ 43	$ —	$ 28	$ 15

(a) There were no transfers of instruments between level 1 and level 2 valuation categories during the year ended December 31, 2012.

(b) The fair values of derivative assets and liabilities reflect netting by counterparty before the impact of collateral.

(c) Represents natural gas options purchased by DPL as part of a natural gas hedging program approved by the DPSC.

(d) Represents derivatives associated with the ACE SOCAs.

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

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

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

Executive deferred compensation plan assets and liabilities categorized as level 2 consist of life insurance policies and certain employment agreement obligations. The life insurance policies are categorized as level 2 assets because they are valued based on the assets underlying the policies, which consist of short-term cash equivalents and fixed income securities that are priced using observable market data and can be liquidated for the value of the underlying assets as of December 31, 2013. The level 2 liability associated with the life insurance policies represents a deferred compensation obligation, the value of which is tracked via underlying insurance sub-accounts. The sub-accounts are designed to mirror existing mutual funds and money market funds that are observable and actively traded.

The value of certain employment agreement obligations (which are included with life insurance contracts in the tables above) is derived using a discounted cash flow valuation technique. The discounted cash flow calculations are based on a known and certain stream of payments to be made over time that are discounted to determine their net present value. The primary variable input, the discount rate, is based on market-corroborated and observable published rates. These obligations have been classified as level 2 within the fair value hierarchy because the payment streams represent contractually known and certain amounts and the discount rate is based on published, observable data.

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

Derivative instruments categorized as level 3 include natural gas options used by DPL as part of a natural gas hedging program approved by the DPSC and capacity under the SOCAs entered into by ACE:

- DPL applies a Black-Scholes model to value its options with inputs, such as forward price curves, contract prices, contract volumes, the risk-free rate and implied volatility factors that are based on a range of historical NYMEX option prices. DPL maintains valuation policies and procedures and reviews the validity and relevance of the inputs used to estimate the fair value of its options. As of December 31, 2013, all of these contracts classified as level 3 derivative instruments have settled.

- ACE used a discounted cash flow methodology to estimate the fair value of the capacity derivatives embedded in the SOCAs. ACE utilized an external valuation specialist to estimate annual zonal PJM capacity prices through the 2030-2031 auction. The capacity price forecast was based on various assumptions that impact the cost of constructing new generation facilities, including zonal load forecasts, zonal fuel and energy prices, generation capacity and transmission planning, and environmental legislation and regulation. ACE reviewed the assumptions and resulting capacity price forecast for reasonableness. ACE used the capacity price forecast to estimate future cash flows. A significant change in the forecasted prices would have a significant impact on the estimated fair value of the SOCAs. ACE employed a discount rate reflective of the estimated weighted average cost of capital for merchant generation companies since payments under the SOCAs are contingent on providing generation capacity. As further discussed in Note (7), "Regulatory Matters," ACE derecognized the derivative assets and derivative liabilities related to the SOCAs in the fourth quarter of 2013.

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

Type of Instrument	Fair Value at December 31, 2012	Valuation Technique	Unobservable Input	Range
	(millions of dollars)			
Natural gas options	$(4)	Option model	Volatility factor	1.57 - 2.00
Capacity contracts, net	(3)	Discounted cash flow	Discount rate	5% - 9%

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

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

Reconciliations of the beginning and ending balances of PHI's fair value measurements using significant unobservable inputs (Level 3) for the years ended December 31, 2013 and 2012 are shown below:

	Year Ended December 31, 2013			Year Ended December 31, 2012		
	Natural Gas	Life Insurance Contracts	Capacity	Natural Gas	Life Insurance Contracts	Capacity
	(millions of dollars)					
Balance as of January 1	$ (4)	$ 18	$ (3)	$ (15)	$ 17	$ —
Total gains (losses) (realized and unrealized):						
Included in income	—	4	—	—	4	—
Included in accumulated other comprehensive loss	—	—	—	—	—	—
Included in regulatory liabilities	—	—	3	(2)	—	(3)
Purchases	—	—	—	—	—	—
Issuances	—	(3)	—	—	(3)	—
Settlements	4	—	—	13	—	—
Transfers in (out) of level 3	—	—	—	—	—	—
Balance as of December 31	$ —	$ 19	$ —	$ (4)	$ 18	$ (3)

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

	Year Ended December 31,	
	2013	2012
	(millions of dollars)	
Total net gains included in income for the period	$ 4	$ 4
Change in unrealized gains relating to assets still held at reporting date	$ 4	$ 4

Other Financial Instruments

The estimated fair values of PHI's Long-term debt instruments that are measured at amortized cost in PHI's consolidated financial statements and the associated level of the estimates within the fair value hierarchy as of December 31, 2013 and 2012 are shown in the tables below. As required by the fair value measurement guidance, debt instruments are classified in their entirety within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. PHI's assessment of the significance of a particular input to the fair value measurement requires the exercise of judgment, which may affect the valuation of fair value debt instruments and their placement within the fair value hierarchy levels.

The fair value of Long-term debt and Transition Bonds categorized as level 2 is based on a blend of quoted prices for the debt and quoted prices for similar debt on the measurement date. The blend places more weight on current pricing information when determining the final fair value measurement. The fair value information is provided by brokers, and PHI reviews the methodologies and results.

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

	Fair Value Measurements at December 31, 2013			
Description	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
LIABILITIES				
Debt instruments				
Long-term debt [(a)]	$ 4,850	$ —	$ 4,289	$ 561
Transition Bonds [(b)]	284	—	284	—
Long-term project funding	12	—	—	12
	$5,146	$ —	$ 4,573	$ 573

(a) The carrying amount for Long-term debt is $4,456 million as of December 31, 2013.

(b) The carrying amount for Transition Bonds, including amounts due within one year, is $255 million as of December 31, 2013.

	Fair Value Measurements at December 31, 2012			
Description	Total	Quoted Prices in Active Markets for Identical Instruments (Level 1) [(a)]	Significant Other Observable Inputs (Level 2) [(a)]	Significant Unobservable Inputs (Level 3)
		(millions of dollars)		
LIABILITIES				
Debt instruments				
Long-term debt [(b)]	$5,004	$ —	$ 4,517	$ 487
Transition Bonds [(c)]	341	—	341	—
Long-term project funding	13	—	—	13
	$5,358	$ —	$ 4,858	$ 500

(a) Certain debt instruments that were categorized as level 1 at December 31, 2012, have been reclassified as level 2 to conform to the current period presentation.

(b) The carrying amount for Long-term debt is $4,177 million as of December 31, 2012.

(c) The carrying amount for Transition Bonds, including amounts due within one year, is $295 million as of December 31, 2012.

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

(15) <u>COMMITMENTS AND CONTINGENCIES</u>

General Litigation and Other Matters

From time to time, PHI and its subsidiaries are named as defendants in litigation, usually relating to general liability or auto liability claims that resulted in personal injury or property damage to third parties. PHI and each of its subsidiaries are self-insured against such claims up to a certain self-insured retention amount and maintain insurance coverage against such claims at higher levels, to the extent deemed prudent by management. In addition, PHI's contracts with its vendors generally require the vendors to name PHI and/or its subsidiaries as additional insureds for the amounts at least equal to PHI's self-insured retention. Further, PHI's contracts with its vendors require the vendors to indemnify PHI for various acts and activities that may give rise to claims against PHI. Loss contingency liabilities for both asserted and unasserted claims are recognized if it is probable that a loss will result from such a claim and if the amounts of the losses can be reasonably estimated. Although the outcome of the claims and proceedings cannot be predicted with any certainty, management believes that there are no existing claims or proceedings that are likely to have a material adverse effect on PHI's or its subsidiaries' financial condition, results of operations or cash flows. At December 31, 2013, PHI had loss contingency liabilities for general litigation totaling approximately $30 million (including amounts related to the matters specifically described below) and the portion of these loss contingency liabilities in excess of the self-insured retention amount was substantially offset by insurance receivables.

<u>Pepco Substation Injury Claim</u>

In May 2013, a contract worker erecting a scaffold at a Pepco substation came into contact with an energized station service feeder and suffered serious injuries. In August 2013, the individual filed suit against Pepco in the Circuit Court for Montgomery County, Maryland, seeking damages for medical expenses, loss of future earning capacity, pain and suffering and the cost of a life care plan aggregating to a maximum claim of approximately $28.1 million. Discovery is ongoing in the case and, if a settlement cannot be reached with respect to this matter, a trial is expected to begin in October 2014. Pepco has notified its insurers of the incident and believes that the insurance policies in force at the time of the incident, including the policies of the contractor performing the scaffold work (which name Pepco as an additional insured), will offset substantially all of Pepco's costs associated with the resolution of this matter, including Pepco's self-insured retention amount. At December 31, 2013, Pepco has concluded that a loss is probable with respect to this matter and has recorded an estimated loss contingency liability, which is included in the liability for general litigation referred to above as of December 31, 2013. Pepco has also concluded as of December 31, 2013 that realization of its insurance claims associated with this matter is probable and, accordingly, has recorded an estimated insurance receivable offsetting substantially all of the related loss contingency liability.

<u>ACE Asbestos Claim</u>

In September 2011, an asbestos complaint was filed in the New Jersey Superior Court, Law Division, against ACE (among other defendants) asserting claims under New Jersey's Wrongful Death and Survival statutes. The complaint, filed by the estate of a decedent who was the wife of a former employee of ACE, alleges that the decedent's mesothelioma was caused by exposure to asbestos brought home by her husband on his work clothes. New Jersey courts have recognized a cause of action against a premise owner in a so-called "take home" case if it can be shown that the harm was foreseeable. In this case, the complaint seeks recovery of an unspecified amount of damages for, among other things, the decedent's past medical expenses, loss of earnings, and pain and suffering between the time of injury and death, and asserts a punitive damage claim. At December 31, 2013, ACE has concluded that a loss is probable with respect to this matter and has recorded an estimated loss contingency liability, which is included in the liability for general litigation referred to above as of December 31, 2013. However, due to the inherent uncertainty of litigation, ACE is unable to estimate a maximum amount of possible loss because the damages sought are indeterminate and the matter involves facts that ACE believes are distinguishable from the facts of the "take-home" cause of action recognized by the New Jersey courts.

ACE Electrical Contact Injury Claims

In October 2010, a farm combine came into and remained in contact with a primary electric line in ACE's service territory in New Jersey. As a result, two individuals operating the combine received fatal electrical contact injuries. While attempting to rescue those two individuals, another individual sustained third-degree burns to his torso and upper extremities. In September 2012, the individual who received third-degree burns filed suit in New Jersey Superior Court, Salem County. In October 2012, additional suits were filed in the same court by or on behalf of the estates of the deceased individuals. Plaintiffs in each of the cases are seeking indeterminate damages and allege that ACE was negligent in the design, construction, erection, operation and maintenance of its poles, power lines, and equipment, and that ACE failed to warn and protect the public from the foreseeable dangers of farm equipment contacting electric lines. Discovery is ongoing in this matter and the litigation involves a number of other defendants and the filing of numerous cross-claims. ACE has notified its insurers of the incident and believes that the insurance policies in force at the time of the incident will offset ACE's costs associated with the resolution of this matter in excess of ACE's self-insured retention amount. At December 31, 2013, ACE has concluded that a loss is probable with respect to these claims and has recorded an estimated loss contingency liability, which is included in the liability for general litigation referred to above as of December 31, 2013. ACE has also concluded as of December 31, 2013 that realization of its insurance claims associated with this matter is probable and, accordingly, has recorded an estimated insurance receivable offsetting substantially all of the loss contingency liability in excess of ACE's self-insured retention amount.

Pepco Energy Services Billing Claims

During 2012, Pepco Energy Services received letters on behalf of two school districts in Maryland, which claim that invoices in connection with electricity supply contracts contained certain allegedly unauthorized charges, totaling approximately $7 million. The school districts also claim additional compounded interest totaling approximately $9 million. Although no litigation involving Pepco Energy Services related to these claims has commenced, in August and September 2013, Pepco Energy Services received correspondence from the Superintendent of each of the school districts advising of the intention to render a decision regarding an unresolved dispute between the school district and Pepco Energy Services. Pepco Energy Services filed timely answers to the Superintendents challenging the authority of the respective Superintendents to render decisions on the claims and also disputing the merits of the allegations regarding unauthorized charges as well as the claims of entitlement to compounded interest. To date, one of the two districts has submitted a late response to the answer of Pepco Energy Services maintaining that its Superintendent does have authority to render a decision but acknowledging the availability of administrative and judicial review of the merits of any decision. The response of the other district is overdue. As of December 31, 2013, Pepco Energy Services has concluded that a loss is reasonably possible with respect to these claims, but the amount of loss, if any, is not reasonably estimable.

Environmental Matters

PHI, through its subsidiaries, is subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of its operations, including air and water quality control, solid and hazardous waste disposal and limitations on land use. Although penalties assessed for violations of environmental laws and regulations are not recoverable from customers of PHI's utility subsidiaries, environmental clean-up costs incurred by Pepco, DPL and ACE generally are included by each company in its respective cost of service for ratemaking purposes. The total accrued liabilities for the environmental contingencies described below of PHI and its subsidiaries at December 31, 2013 are summarized as follows:

	Transmission and Distribution	Legacy Generation Regulated	Legacy Generation Non-Regulated	Other	Total
		(millions of dollars)			
Balance as of January 1	$ 15	$ 7	$ 5	$ 2	$ 29
Accruals	5	—	—	1	6
Payments	(1)	(1)	—	(3)	(5)
Balance as of December 31	19	6	5	—	30
Less amounts in Other Current Liabilities	3	1	—	—	4
Amounts in Other Deferred Credits	$ 16	$ 5	$ 5	$ —	$ 26

Conectiv Energy Wholesale Power Generation Sites

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

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

Franklin Slag Pile Site

In November 2008, ACE received a general notice letter from EPA concerning the Franklin Slag Pile site in Philadelphia, Pennsylvania, asserting that ACE is a potentially responsible party (PRP) that may have liability for clean-up costs with respect to the site and for the costs of implementing an EPA-mandated remedy. EPA's claims are based on ACE's sale of boiler slag from the B.L. England generating facility, then owned by ACE, to MDC Industries, Inc. (MDC) during the period June 1978 to May 1983. EPA claims that the boiler slag ACE sold to MDC contained copper and lead, which are hazardous substances under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), and that the sales transactions may have constituted an arrangement for the disposal or treatment of hazardous substances at the site, which could be a basis for liability under CERCLA. The EPA letter also states that, as of the date of the letter, EPA's expenditures for response measures at the site have exceeded $6 million. EPA's feasibility study for this site conducted in 2007 identified a range of alternatives for permanent remedial measures with varying cost estimates, and the estimated cost of EPA's preferred alternative is approximately $6 million.

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

Peck Iron and Metal Site

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

Ward Transformer Site

In April 2009, a group of PRPs with respect to the Ward Transformer site in Raleigh, North Carolina, filed a complaint in the U.S. District Court for the Eastern District of North Carolina, alleging cost recovery and/or contribution claims against a number of entities, including Pepco, DPL and ACE, based on their alleged sale of transformers to Ward Transformer, with respect to past and future response costs incurred by the PRP group in performing a removal action at the site. In a March 2010 order, the court denied the defendants' motion to dismiss. The litigation is moving forward with certain "test case" defendants (not including Pepco, DPL and ACE) filing summary judgment motions regarding liability. The case has been stayed as to the remaining defendants pending rulings upon the test cases. In a January 31, 2013 order, the Federal district court granted summary judgment for the test case defendant whom plaintiffs alleged was liable based on its sale of transformers to Ward Transformer. The Federal district court's order, which plaintiffs have appealed to the U.S. Court of Appeals for the Fourth Circuit, addresses only the liability of the test case defendant. PHI has concluded that a loss is reasonably possible with respect to this matter, but is unable to estimate an amount or range of reasonably possible losses to which it may be exposed. PHI does not believe that any of its three utility subsidiaries had extensive business transactions, if any, with the Ward Transformer site.

Benning Road Site

In September 2010, PHI received a letter from EPA identifying the Benning Road location, consisting of a generation facility operated by Pepco Energy Services until the facility was deactivated in June 2012, and a transmission and distribution facility operated by Pepco, as one of six land-based sites potentially contributing to contamination of the lower Anacostia River. The letter stated that the principal contaminants of concern are polychlorinated biphenyls and polycyclic aromatic hydrocarbons. In December 2011, the U.S. District Court for the District of Columbia approved a consent decree entered into by Pepco and Pepco Energy Services with the District of Columbia Department of the Environment (DDOE), which requires Pepco and Pepco Energy Services to conduct a RI/FS for the Benning Road site and an approximately 10 to 15 acre portion of the adjacent Anacostia River. The RI/FS will form the basis for DDOE's selection of a remedial action for the Benning Road site and for the Anacostia River sediment associated with the site. The consent decree does not obligate Pepco or Pepco Energy Services to pay for or perform any remediation work, but it is anticipated that DDOE will look to the companies to assume responsibility for cleanup of any conditions in the river that are determined to be attributable to past activities at the Benning Road site.

In December 2012, DDOE approved the RI/FS work plan. RI/FS field work commenced in January 2013 and is still in progress. In October 2013, Pepco and Pepco Energy Services submitted a work plan addendum for approval by DDOE identifying the location of groundwater monitoring wells to be installed at the site and sampled as the last phase of the field work. The work plan addendum has been revised in response to comments from DDOE, and it is expected that the addendum will be approved and the next phase of field work will commence before the end of the first quarter of 2014. Once all of the field work has been completed, Pepco and Pepco Energy Services will prepare RI/FS reports for review and approval by DDOE after solicitation and consideration of public comment. The next status report to the court is due on May 24, 2014.

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

Indian River Oil Release

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

Potomac River Mineral Oil Release

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

Beginning in March 2011, DDOE issued a series of compliance directives requiring Pepco to prepare an incident report, provide certain records, and prepare and implement plans for sampling surface water and river sediments and assessing ecological risks and natural resources damages. Pepco completed field sampling during the fourth quarter of 2011 and submitted sampling results to DDOE during the second quarter of 2012. Pepco is continuing discussions with DDOE regarding the need for any further response actions but expects that additional monitoring of shoreline sediments may be required.

In June 2012, Pepco commenced discussions with DDOE regarding a possible consent decree that would resolve DDOE's threatened enforcement action, including civil penalties, for alleged violation of the District's Water Pollution Control Law, as well as for damages to natural resources. Pepco and DDOE have reached an agreement in principle that would consist of a combination of a civil penalty and Supplemental Environmental Projects (SEPs) with a total cost to Pepco of approximately $1 million. DDOE has endorsed Pepco's proposed SEP involving the installation and operation of a trash collection system at a stormwater outfall that drains to the Anacostia River. DDOE and Pepco are completing negotiations on the text of a consent decree to document the settlement of DDOE's enforcement action and a written statement of work describing the details of the trash collection system SEP. It is expected that the consent decree will be filed with the District of Columbia Superior Court by the end of the first quarter of 2014, with a request that the court approve the consent decree following a period of at least 30 days for public comment. Discussions will proceed separately with DDOE and the federal resource trustees regarding the settlement of a natural resource damage (NRD) claim under federal law. Based on discussions to date, PHI and Pepco do not believe that the resolution of DDOE's enforcement action or the federal NRD claim will have a material adverse effect on their respective financial condition, results of operations or cash flows.

As a result of the mineral oil release, Pepco implemented certain interim operational changes to the secondary containment systems at the facility which involve pumping accumulated storm water to an aboveground holding tank for off-site disposal. In December 2011, Pepco completed the installation of a treatment system designed to allow automatic discharge of accumulated storm water from the secondary containment system. Pepco currently is seeking DDOE's and EPA's approval to commence operation of the new system on a pilot basis to demonstrate its effectiveness in meeting both secondary containment requirements and water quality standards related to the discharge of storm water from the facility. In the meantime, Pepco is continuing to use the aboveground holding tank to manage storm water from the secondary containment system. Pepco also is evaluating other technical and regulatory options for managing storm water from the secondary containment system as alternatives to the proposed treatment system discharge currently under discussion with EPA and DDOE.

The amount accrued for this matter is included in the table above in the column entitled "Transmission and Distribution."

Metal Bank Site

In the first quarter of 2013, the National Oceanic and Atmospheric Administration (NOAA) contacted Pepco and DPL on behalf of itself and other federal and state trustees to request that Pepco and DPL execute a tolling agreement to facilitate settlement negotiations concerning natural resource damages allegedly caused by releases of hazardous substances, including polychlorinated biphenyls, at the Metal Bank Superfund Site located in Philadelphia, Pennsylvania. Pepco and DPL have executed the tolling agreement and will participate in settlement discussions with the NOAA, the trustees and other PRPs.

The amount accrued for this matter is included in the table above in the column entitled "Transmission and Distribution."

Brandywine Fly Ash Disposal Site

In February 2013, Pepco received a letter from the Maryland Department of the Environment (MDE) requesting that Pepco investigate the extent of waste on a Pepco right-of-way that traverses the Brandywine fly ash disposal site in Brandywine, Prince George's County, Maryland, owned by GenOn MD Ash Management, LLC (GenOn). In July 2013, while reserving its rights and related defenses under a 2000 asset purchase and sale agreement covering the sale of this site, Pepco indicated its willingness to investigate the extent of, and propose an appropriate closure plan to address, ash on the right-of-way. Pepco submitted a schedule for development of a closure plan to MDE on September 30, 2013 and, by letter dated October 18, 2013, MDE approved the schedule.

PHI and Pepco have determined that a loss associated with this matter for PHI and Pepco is probable and have estimated that the costs for implementation of a closure plan and cap on the site are in the range of approximately $3 million to $6 million. PHI and Pepco believe that the costs incurred in this matter will be recoverable from GenOn under the 2000 sale agreement.

The amount accrued for this matter is included in the table above in the column entitled "Transmission and Distribution."

Watts Branch Insulating Fluid Release

On September 13, 2013, a Washington Metropolitan Area Transit Authority contractor damaged a Pepco underground transmission feeder while drilling a grout column for a subway tunnel under a city street. The damage caused the release of approximately 11,250 gallons of insulating fluid, a small amount of which reached the Watts Branch, a tributary of the Anacostia River. The U.S. Coast Guard (USCG) issued a notice of federal interest for an oil pollution incident, informing Pepco of its responsibility under the Oil Pollution Act of 1990 for removal costs and damages from the release. In addition, on September 25, 2013, DDOE issued a compliance directive that required Pepco to prepare an incident investigation report describing the events leading up to the release. The compliance directive also required Pepco to prepare work plans for sampling the insulating fluid and for developing and implementing a biological assessment and physical habitat quality assessment to be conducted in Watts Branch. Pepco prepared the incident investigation report and work plans and submitted them to DDOE and USCG. In December 2013, Pepco received and responded to an EPA information request regarding this incident.

PHI and Pepco believe that a loss in this matter is probable; however, the costs to resolve this matter are expected to be less than $1 million and are being expensed as incurred. PHI and Pepco further believe that the costs incurred will be recoverable from the party or parties responsible for the release.

On December 4, 2013, the USCG delivered a Notice of Violation with respect to this matter, which imposed a $3,000 penalty on Pepco, which Pepco has paid.

PHI's Cross-Border Energy Lease Investments

As discussed in Note (19), "Discontinued Operations – Cross-Border Energy Lease Investments," PHI held a portfolio of cross-border energy lease investments involving public utility assets located outside of the United States. Each of these investments was comprised of multiple leases and was structured as a sale and leaseback transaction commonly referred to by the IRS as a sale-in, lease-out, or SILO, transaction.

Since 2005, PHI's cross-border energy lease investments have been under examination by the IRS as part of the PHI federal income tax audits. In connection with the audit of PHI's 2001-2002 income tax returns, the IRS disallowed the depreciation and interest deductions in excess of rental income claimed by PHI for six of the eight lease investments and, in connection with the audits of PHI's 2003-2005 and 2006-2008 income tax returns, the IRS disallowed such deductions in excess of rental income for all eight of the lease investments. In addition, the IRS has sought to recharacterize each of the leases as a loan transaction in each of the years under audit as to which PHI would be subject to original issue discount income. PHI has disagreed with the IRS' proposed adjustments to the 2001-2008 income tax returns and has filed protests of these findings for each year with the Office of Appeals of the IRS. In November 2010, PHI entered into a settlement agreement with the IRS for the 2001 and 2002 tax years for the purpose of commencing litigation associated with this matter and subsequently filed refund claims in July 2011 for the disallowed tax deductions relating to the leases for these years. In January 2011, as part of this settlement, PHI paid $74 million of additional tax for 2001 and 2002, penalties of $1 million, and $28 million in interest associated with the disallowed deductions. Since the July 2011 refund claims were not approved by the IRS within the statutory six-month period, in January 2012 PHI filed complaints in the U.S. Court of Federal Claims seeking recovery of the tax payment, interest and penalties. The 2003-2005 and 2006-2011 income tax return audits continue to be in process with the IRS Office of Appeals and the IRS Exam Division, respectively, and are not presently a part of the U.S. Court of Federal Claims litigation discussed above.

On January 9, 2013, the U.S. Court of Appeals for the Federal Circuit issued an opinion in *Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States* (to which PHI is not a party) that disallowed tax benefits associated with Consolidated Edison's cross-border lease transaction. While PHI believes that its tax position with regard to its cross-border energy lease investments is appropriate, after analyzing the recent U.S. Court of Appeals ruling, PHI determined in the first quarter of 2013 that its tax position with respect to the tax benefits associated with the cross-border energy leases no longer met the more-likely-than-not standard of recognition for accounting purposes. Accordingly, PHI recorded a non-cash after-tax charge of $377 million in the first quarter of 2013 (as discussed in Note (19), "Discontinued Operations – Cross-Border Energy Lease Investments"), consisting of a charge to reduce the carrying value of the cross-border energy lease investments and a charge to reflect the anticipated additional interest expense related to changes in PHI's estimated federal and state income tax obligations for the period over which the tax benefits ultimately may be disallowed. PHI had also previously made certain business assumptions regarding foreign investment opportunities available at the end of the full lease terms. During the first quarter of 2013, management believed that its conclusions regarding these business assumptions were no longer supportable, and the tax effects of this change in conclusion were included in the charge. While the IRS could require PHI to pay a penalty of up to 20% of the amount of additional taxes due, PHI believes that it is more likely than not that no such penalty will be incurred, and therefore no amount for any potential penalty was included in the charge recorded in the first quarter of 2013.

In the event that the IRS were to be successful in disallowing 100% of the tax benefits associated with these lease investments and recharacterizing these lease investments as loans, PHI estimated that, as of March 31, 2013, it would have been obligated to pay approximately $192 million in additional federal taxes (net of the $74 million tax payment described above) and approximately $50 million of interest on the additional federal taxes. These amounts, totaling $242 million, were estimated after consideration of certain tax benefits arising from matters unrelated to the leases that would offset the taxes and interest due, including PHI's best estimate of the expected resolution of other uncertain and effectively settled tax positions, the carrying back and carrying forward of any existing net operating losses, and the application of certain amounts paid in advance to the IRS. In order to mitigate PHI's ongoing interest costs associated with the $242 million estimate of additional taxes and interest, PHI made an advanced payment to the IRS of $242 million in the first quarter of 2013. This advanced payment was funded from currently available sources of liquidity and short-term borrowings. A portion of the proceeds from lease terminations was used to repay the short-term borrowings utilized to fund the advanced payment.

In order to mitigate the cost of continued litigation related to the cross-border energy lease investments, PHI and its subsidiaries have entered into discussions with the IRS with the intention of seeking a settlement of all tax issues for open tax years 2001 through 2011, including the cross-border energy lease issue. PHI currently believes that it is possible that a settlement with the IRS may be reached in 2014. If a settlement of all tax issues or a standalone settlement on the leases is not reached, PHI may move forward with its litigation with the IRS. Further discovery in the case is stayed until April 24, 2014, pursuant to an order issued by the court on January 30, 2014.

District of Columbia Tax Legislation

In 2011, the Council of the District of Columbia approved the Budget Support Act which requires that corporate taxpayers in the District of Columbia calculate taxable income allocable or apportioned to the District of Columbia by reference to the income and apportionment factors applicable to commonly controlled entities organized within the United States that are engaged in a unitary business. In the aggregate, this new tax reporting method reduced pre-tax earnings for the year ended December 31, 2011 by $7 million ($5 million after-tax) as further discussed in Note (11), "Income Taxes," and Note (19), "Discontinued Operations." During 2012, the District of Columbia Office of Tax and Revenue adopted regulations to implement this reporting method. PHI has analyzed these regulations and determined that the regulations did not impact PHI's results of operations for the years ended December 31, 2013 and 2012.

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

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

As of December 31, 2013, PHI and its subsidiaries were parties to a variety of agreements pursuant to which they were guarantors for standby letters of credit, energy procurement obligations, and other commitments and obligations. The commitments and obligations, in millions of dollars, were as follows:

	Guarantor				
	PHI	Pepco	DPL	ACE	Total
	(millions of dollars)				
Energy procurement obligations of Pepco Energy Services [(a)]	$ 46	$ —	$ —	$ —	$ 46
Guarantees associated with disposal of Conectiv Energy assets [(b)]	13	—	—	—	13
Guaranteed lease residual values [(c)]	3	5	7	4	19
Total	$ 62	$ 5	$ 7	$ 4	$ 78

(a) PHI has continued contractual commitments for performance and related payments of Pepco Energy Services primarily to Independent System Operators and distribution companies.

(b) Represents guarantees by PHI of Conectiv Energy's derivatives portfolio transferred in connection with the disposition of Conectiv Energy's wholesale business. The derivative portfolio guarantee is currently $13 million and covers Conectiv Energy's performance prior to the assignment. This guarantee will remain in effect until the end of 2015.

(c) Represents the maximum potential obligation in the event that the fair value of certain leased equipment and fleet vehicles is zero at the end of the maximum lease term. The maximum lease term associated with these assets ranges from 3 to 8 years. The maximum potential obligation at the end of the minimum lease term would be $55 million, $10 million of which is a guarantee by PHI, $15 million by Pepco, $17 million by DPL and $13 million by ACE. The minimum lease term associated with these assets ranges from 1 to 4 years. Historically, payments under the guarantees have not been made and PHI believes the likelihood of payments being required under the guarantees is remote.

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

Energy Savings Performance Contracts

Pepco Energy Services has a diverse portfolio of energy savings performance contracts that are associated with the installation of energy savings equipment or combined heat and power facilities for federal, state and local government customers. As part of the energy savings contracts, Pepco Energy Services typically guarantees that the equipment or systems it installs will generate a specified amount of energy savings on an annual basis over a multiyear period. As of December 31, 2013, the remaining notional amount of Pepco Energy Services' energy savings guarantees over the life of the multiyear performance contracts on (i) completed projects was $252 million with the longest guarantee having a remaining term of 12 years; and, (ii) projects under construction was $187 million with the longest guarantee having a term of 23 years after completion of construction. On an annual basis, Pepco Energy Services undertakes a measurement and verification process to determine the amount of energy savings for the year and whether there is any shortfall in the annual energy savings compared to the guaranteed amount.

As of December 31, 2013, Pepco Energy Services had a performance guarantee contract associated with the production at a combined heat and power facility that is under construction totaling $15 million in notional value over 20 years.

Pepco Energy Services recognizes a liability for the value of the estimated energy savings or production shortfalls when it is probable that the guaranteed amounts will not be achieved and the amount is reasonably estimable. As of December 31, 2013, Pepco Energy Services had an accrued liability of $1 million for its energy savings contracts that it established during 2012. There was no significant change in the type of contracts issued during the year ended December 31, 2013 as compared to the year ended December 31, 2012.

Dividends

On January 23, 2014, Pepco Holdings' Board of Directors declared a dividend on common stock of 27 cents per share payable March 31, 2014, to stockholders of record on March 10, 2014.

Contractual Obligations

Power Purchase Contracts

As of December 31, 2013, Pepco Holdings' contractual obligations under non-derivative power purchase contracts were $278 million in 2014, $562 million in 2015 to 2016, $486 million in 2017 to 2018, and $1,386 million in 2019 and thereafter.

Lease Commitments

Rental expense for operating leases was $54 million, $52 million and $46 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Total future minimum operating lease payments for Pepco Holdings as of December 31, 2013, are $44 million in 2014, $42 million in 2015, $39 million in 2016, $36 million in 2017, $37 million in 2018 and $342 million thereafter.

(16) VARIABLE INTEREST ENTITIES

PHI is required to consolidate a variable interest entity (VIE) in accordance with FASB ASC 810 if PHI or a subsidiary is the primary beneficiary of the VIE. The primary beneficiary of a VIE is typically the entity with both the power to direct activities most significantly impacting economic performance of the VIE and the obligation to absorb losses or receive benefits of the VIE that could potentially be significant to the VIE. PHI performs a qualitative analysis to determine whether a variable interest provides a controlling financial interest in a VIE. Set forth below are the relationships with respect to which PHI conducted a VIE analysis as of December 31, 2013:

DPL Renewable Energy Transactions

DPL is subject to Renewable Energy Portfolio Standards (RPS) in the state of Delaware that require it to obtain renewable energy credits (RECs) for energy delivered to its customers. DPL's costs associated with obtaining RECs to fulfill its RPS obligations are recoverable from its customers by law. As of December 31, 2013, PHI, through its DPL subsidiary, is a party to three land-based wind PPAs in the aggregate amount of 128 MWs and one solar PPA with a 10 MW facility. Each of the facilities associated with these PPAs is operational, and DPL is obligated to purchase energy and RECs in amounts generated and delivered by the wind facilities and solar renewable energy credits (SRECs) from the solar facility up to certain amounts (as set forth below) at rates that are primarily fixed under the respective PPA. PHI and DPL have concluded that while VIEs exist under these contracts, consolidation is not required for any of these PPAs under the FASB guidance on the consolidation of variable interest entities as DPL is not the primary beneficiary. DPL has not provided financial or other support under these arrangements that it was not previously contractually required to provide during the periods presented, nor does DPL have any intention to provide such additional support.

Because DPL has no equity or debt interest in these renewable energy transactions, the maximum exposure to loss relates primarily to any above-market costs incurred for power or RECs. Due to unpredictability in amount of MW's ultimately purchased under the PPAs for purchased renewable energy and SRECs, PHI and DPL are unable to quantify the maximum exposure to loss. The power purchase and REC costs are recoverable from DPL's customers through regulated rates.

DPL is obligated to purchase energy and RECs from one of the wind facilities through 2024 in amounts not to exceed 50 MWs, from the second wind facility through 2031 in amounts not to exceed 40 MWs, and from the third wind facility through 2031 in amounts not to exceed 38 MWs. DPL's purchases under the three wind PPAs totaled $30 million, $27 million and $18 million for the years ended December 31, 2013, 2012 and 2011, respectively.

The term of the agreement with the solar facility is 20 years and DPL is obligated to purchase SRECs in an amount up to 70 percent of the energy output at a fixed price. DPL's purchases under the solar agreement were $3 million, $2 million and $1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

On October 18, 2011, the DPSC approved a tariff submitted by DPL in accordance with the requirements of the RPS specific to fuel cell facilities totaling 30 MWs to be constructed by a qualified fuel cell provider. The tariff and the RPS establish that DPL would be an agent to collect payments in advance from its distribution customers and remit them to the qualified fuel cell provider for each MW hour (MWh) of energy produced by the fuel cell facilities over 21 years. DPL has no obligation to the qualified fuel cell provider other than to remit payments collected from its distribution customers pursuant to the tariff. The RPS provides for a reduction in DPL's REC requirements based upon the actual energy output of the facilities. At December 31, 2013 and 2012, 15 MWs and 3 MWs of capacity were available from fuel cell facilities placed in service under the tariff, respectively. DPL billed $23 million and $4 million to distribution customers during the years ended December 31, 2013 and 2012, respectively. PHI and DPL have concluded that while a VIE exists under this arrangement, consolidation is not required for this arrangement under the FASB guidance on consolidation of variable interest entities as DPL is not the primary beneficiary.

ACE Power Purchase Agreements

PHI, through its ACE subsidiary, is a party to three PPAs with unaffiliated NUGs totaling 459 MWs. One of the agreements ends in 2016 and the other two end in 2024. PHI and ACE were not involved in the creation of these contracts and have no equity or debt invested in these entities. In performing its VIE analysis, PHI has been unable to obtain sufficient information to determine whether these three entities were variable interest entities or if ACE was the primary beneficiary. As a result, PHI has applied the scope exemption from the consolidation guidance.

Because ACE has no equity or debt invested in the NUGs, the maximum exposure to loss relates primarily to any above-market costs incurred for power. Due to unpredictability in the PPAs pricing for purchased energy, PHI and ACE are unable to quantify the maximum exposure to loss. The power purchase costs are recoverable from ACE's customers through regulated rates. Purchase activities with the NUGs, including excess power purchases not covered by the PPAs, for the years ended December 31, 2013, 2012 and 2011 were approximately $221 million, $206 million and $218 million, respectively, of which approximately $206 million, $201 million and $206 million, respectively, consisted of power purchases under the PPAs.

ACE Funding

In 2001, ACE established ACE Funding solely for the purpose of securitizing authorized portions of ACE's recoverable stranded costs through the issuance and sale of Transition Bonds. The proceeds of the sale of each series of Transition Bonds were transferred to ACE in exchange for the transfer by ACE to ACE Funding of the right to collect a non-bypassable Transition Bond Charge from ACE customers pursuant to bondable stranded costs rate orders issued by the NJBPU in an amount sufficient to fund the principal and interest payments on the Transition Bonds and related taxes, expenses and fees (Bondable Transition Property). The assets of ACE Funding, including the Bondable Transition Property, and the Transition Bond Charges (representing revenue ACE receives, and pays to ACE Funding, to fund the principal and interest payments on Transition Bonds and related taxes, expenses and fees) collected from ACE's customers, are not available to creditors of ACE. The holders of Transition Bonds have recourse only to the assets of ACE Funding. ACE owns 100 percent of the equity of ACE Funding, and PHI and ACE consolidate ACE Funding in their consolidated financial statements as ACE is the primary beneficiary of ACE Funding under the variable interest entity consolidation guidance.

(17) ACCUMULATED OTHER COMPREHENSIVE LOSS

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

	Year Ended December 31,		
	2013	2012	2011
Balance as of January 1	$ (48)	$ (63)	$ (106)
Treasury Lock			
Balance as of January 1	(10)	(10)	(11)
Amount of pre-tax loss reclassified to Interest expene	1	—	1
Income tax benefit	—	—	—
Balance as of December 31	(9)	(10)	(10)
Pension and Other Postretirement Benefits			
Balance as of January 1	(32)	(24)	(17)
Amount of amortization of net prior service cost and actuarial loss reclassified to Other operation and maintenance expense	5	5	3
Amount of net prior service cost and actuarial gain (loss) arising during the year	8	(19)	(14)
Income tax benefit (expense)	6	(6)	(4)
Balance as of December 31	(25)	(32)	(24)
Commodity Derivatives			
Balance as of January 1	(6)	(29)	(78)
Amount of net pre-tax loss reclassified to (Loss) income from discontinued operations before income tax	10	39	81
Income tax benefit	4	16	32
Balance as of December 31	—	(6)	(29)
Balance as of December 31	$ (34)	$ (48)	$ (63)

(18) QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The quarterly data presented below reflect all adjustments necessary in the opinion of management for a fair presentation of the interim results. Quarterly data normally vary seasonally because of temperature variations and differences between summer and winter rates. The totals of the four quarterly basic and diluted earnings per common share amounts may not equal the basic and diluted earnings per common share for the year due to changes in the number of shares of common stock outstanding during the year.

	2013				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
			(millions, except per share amounts)		
Total Operating Revenue	$ 1,180	$ 1,051	$ 1,344	$ 1,091	$ 4,666
Total Operating Expenses	1,047	906	1,109	936[(a)]	3,998
Operating Income	133	145	235	155	668
Other Expenses	(59)	(62)	(60)	(58)	(239)
Income From Continuing Operations Before Income Tax Expense	74	83	175	97	429
Income Tax Expense Related to Continuing Operations	185[(b)]	30	65	39	319
Net (Loss) Income From Continuing Operations	(111)	53	110	58	110
(Loss) Income from Discontinued Operations, net of taxes	(319)	(11)	8	—	(322)
Net (Loss) Income	$ (430)	$ 42	$ 118	$ 58	$ (212)
Basic and Diluted Earnings Per Share of Common Stock:					
(Loss) Earnings Per Share of Common Stock from Continuing Operations	(0.47)	0.21	0.44	0.23	0.45
(Loss) Earnings Per Share of Common Stock from Discontinued Operations	(1.35)	(0.04)	0.04	—	(1.31)
(Loss) Earnings Per Share of Common Stock	(1.82)	0.17	0.48	0.23	(0.86)
Cash Dividends Per Share of Common Stock	0.27	0.27	0.27	0.27	1.08

(a) Includes a pre-tax impairment loss of $4 million ($3 million after-tax) at Pepco Energy Services associated with a landfill gas-fired electric generation facility.

(b) Includes an income tax charge of $56 million (after-tax) primarily associated with interest on uncertain and effectively settled tax positions and an income tax charge of $101 million associated with the establishment of valuation allowances against certain deferred tax assets of PCI.

	2012				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	(millions, except per share amounts)				
Total Operating Revenue [a]	$ 1,123	$ 1,057	$ 1,389	$ 1,056	$ 4,625
Total Operating Expenses [a][b]	1,010	932	1,188	954	4,084
Operating Income	113	125	201	102	541
Other Expenses	(54)	(52)	(57)	(57)	(220)
Income From Continuing Operations Before Income Tax Expense	59	73	144	45	321
Income Tax Expense Related to Continuing Operations	9	26	57	11	103
Net Income From Continuing Operations	50	47	87	34	218
Income from Discontinued Operations, net of taxes	18	15	25	9	67
Net Income	$ 68	$ 62	$ 112	$ 43	$ 285
Basic Earnings Per Share of Common Stock:					
Earnings Per Share of Common Stock from Continuing Operations	0.22	0.20	0.38	0.15	0.95
Earnings Per Share of Common Stock from Discontinued Operations	0.08	0.07	0.11	0.03	0.30
Basic Earnings Per Share of Common Stock	0.30	0.27	0.49	0.18	1.25
Diluted Earnings Per Share of Common Stock:					
Earnings Per Share of Common Stock from Continuing Operations	0.22	0.20	0.38	0.15	0.95
Earnings Per Share of Common Stock from Discontinued Operations	0.08	0.07	0.11	0.03	0.29
Diluted Earnings Per Share of Common Stock	0.30	0.27	0.49	0.18	1.24
Cash Dividends Per Share of Common Stock	0.27	0.27	0.27	0.27	1.08

[a] Includes $9 million of intra-company revenues (and associated costs) previously eliminated in consolidation which will continue to be recognized from third parties subsequent to the completion of the wind-down of the Pepco Energy Services' retail electric and natural gas supply businesses.

[b] Includes impairment losses of $12 million pre-tax ($7 million after-tax) at Pepco Energy Services associated primarily with investments in landfill gas-fired electric generation facilities, and the combustion turbines at Buzzard Point.

(19) DISCONTINUED OPERATIONS

PHI's (loss) income from discontinued operations, net of income taxes, is comprised of the following:

	For the Year Ended December 31,		
	2013	2012	2011
	(millions of dollars)		
Cross-border energy lease investments	$ (327)	$ 41	$ 36
Pepco Energy Services' retail electric and natural gas supply businesses	5	26	2
Conectiv Energy	—	—	(3)
(Loss) income from discontinued operations, net of income taxes	$ (322)	$ 67	$ 35

Cross-Border Energy Lease Investments

Between 1994 and 2002, PCI entered into cross-border energy lease investments consisting of hydroelectric generation facilities, coal-fired electric generation facilities and natural gas distribution networks located outside of the United States. Each of these lease investments was structured as a sale and leaseback transaction commonly referred to as a sale-in, lease-out, or SILO, transaction. As of December 31, 2013 and 2012, the lease portfolio consisted of zero investments and six investments, respectively, with a net investment value of zero and $1,237 million, respectively.

During the second and third quarters of 2013, PHI terminated early all of its interests in the six remaining lease investments. PHI received aggregate net cash proceeds from these early terminations of $873 million (net of aggregate termination payments of $2.0 billion used to retire the non-recourse debt associated with the terminated leases) and recorded an aggregate pre-tax loss, including transaction costs, of approximately $3 million ($2 million after-tax), representing the excess of the carrying value of the terminated leases over the net cash proceeds received. As a result, PHI has reported the results of operations of the cross-border energy lease investments as discontinued operations in all periods presented in the accompanying consolidated statements of (loss) income. Further, the assets and liabilities related to the cross-border energy lease investments are reported as held for disposition as of each date in the accompanying consolidated balance sheets.

Operating Results

The operating results for the cross-border energy lease investments are as follows:

	For the Year Ended December 31,		
	2013	2012	2011
	(millions of dollars)		
Operating revenue from PHI's cross-border energy lease investments	$ 7	$ 50	$ 55
Non-cash charge to reduce carrying value of PHI's cross-border energy lease investments	(373)	—	(7)
Total operating revenue	$ (366)	$ 50	$ 48
(Loss) income from operations of discontinued operations, net of income taxes [(a)]	$ (325)	$ 32	$ 33
Net (losses) gains associated with the early termination of the cross-border energy lease investments, net of income taxes[(b)]	(2)	9	3
(Loss) income from discontinued operations, net of income taxes	$ (327)	$ 41	$ 36

(a) Includes income tax (benefit) expense of approximately $(44) million, $5 million and $(2) million for the years ended December 31, 2013, 2012 and 2011, respectively.

(b) Includes income tax (benefit) expense of approximately $(1) million, $30 million and $36 million for the years ended December 31, 2013, 2012 and 2011, respectively.

On January 9, 2013, the U.S. Court of Appeals for the Federal Circuit issued an opinion in *Consolidated Edison Company of New York, Inc. & Subsidiaries v. United States* (to which PHI is not a party) that disallowed tax benefits associated with Consolidated Edison's cross-border lease transaction. As a result of the court's ruling in this case, PHI determined in the first quarter of 2013 that its tax position with respect to the benefits associated with its cross-border energy leases no longer met the more-likely-than-not standard of recognition for accounting purposes, and PCI recorded after-tax non-cash charges of $323 million in the first quarter of 2013 and $6 million in the second quarter of 2013, consisting of the following components:

- A non-cash pre-tax charge of $373 million ($313 million after-tax) to reduce the carrying value of these cross-border energy lease investments under FASB guidance on leases (ASC 840). This pre-tax charge was originally recorded in the consolidated statements of (loss) income as a reduction in operating revenue and is now reflected in (loss) income from discontinued operations, net of income taxes.

- A non-cash charge of $16 million after-tax to reflect the anticipated additional net interest expense under FASB guidance for income taxes (ASC 740) related to estimated federal and state income tax obligations for the period over which the tax benefits may be disallowed. This after-tax charge was originally recorded in the consolidated statements of (loss) income as an increase in income tax expense and is now reflected in (loss) income from discontinued operations, net of income taxes. The after-tax interest charge for PHI on a consolidated basis was $70 million and this amount was allocated to each member of PHI's consolidated group as if each member was a separate taxpayer, resulting in the recognition of a $12 million interest benefit for the Power Delivery segment, and interest expense of $16 million for PCI and $66 million for Corporate and Other, respectively.

PHI had also previously made certain business assumptions regarding foreign investment opportunities available at the end of the full lease terms. In view of the change in PHI's tax position with respect to the tax benefits associated with the cross-border energy lease investments and PHI's resulting decision to pursue the early termination of these investments, management concluded in the first quarter of 2013 that these business assumptions were no longer supportable and the tax effects of this conclusion were reflected in the after-tax charge of $313 million described above.

PHI accrued no penalties associated with its reassessment of the likely outcome of tax positions associated with the cross-border energy lease investments. While the IRS could require PHI to pay a penalty of up to 20% of the amount of additional taxes due, PHI believes that it is more likely than not that no such penalty will be incurred, and therefore no amount for any potential penalty was included in the charge.

During 2012, PHI entered into early termination agreements with two lessees involving all of the leases comprising one of the original eight lease investments. The early terminations of the leases were negotiated at the request of the lessees. PHI received net cash proceeds of $202 million (net of a termination payment of $520 million used to retire the non-recourse debt associated with the terminated leases) and recorded a pre-tax gain of $39 million, representing the excess of the net cash proceeds over the carrying value of the lease investments.

During 2011, PHI entered into early termination agreements with two lessees involving all of the leases comprising one of the original eight lease investments and a small portion of the leases comprising a second lease investment. The early terminations of the leases were negotiated at the request of the lessees. PHI received net cash proceeds of $161 million (net of a termination payment of $423 million used to retire the non-recourse debt associated with the terminated leases) and recorded a pre-tax gain of $39 million, representing the excess of the net cash proceeds over the carrying value of the lease investments.

With respect to the leases terminated in 2012 and 2011, PHI had previously made certain business assumptions regarding foreign investment opportunities available at the end of the full lease terms. Because the leases were terminated in each case earlier than full term, management decided not to pursue these opportunities and recognized the related tax consequences by recording income tax charges in the amounts of $16 million and $22 million for the years ended December 31, 2012 and 2011, respectively. The after-tax gains on the lease terminations were $9 million and $3 million for the years ended December 31, 2012 and 2011, respectively, including the income tax charges discussed above and an income tax provision at the statutory Federal rate of $14 million for each early lease termination. As of December 31, 2012, PHI had no intent to terminate early any other leases in the lease portfolio and maintained its assertion that the foreign earnings recognized at the end of the lease term with respect to certain of these remaining leases will remain invested abroad. See Note (15), "Commitments and Contingencies – PHI's Cross-Border Energy Lease Investments," regarding a subsequent change in management's intent.

PHI was required to assess on a periodic basis the likely outcome of tax positions relating to its cross-border energy lease investments and, if there was a change or a projected change in the timing of the tax benefits generated by the transactions, PHI was required to recalculate the value of its net investment. In that regard, PHI modified its tax cash flow assumptions in 2011 and recorded a non-cash pre-tax charge of $7 million to reduce the carrying value of its net investment. The tax cash flow assumptions changed in 2011 as a result of the enactment of tax regulations in the District of Columbia to implement the mandatory unitary combined reporting method. The charge was recorded as a reduction in cross-border energy lease investment revenue in 2011.

For additional information concerning these cross-border energy lease investments, see Note (15), "Commitments and Contingencies – PHI's Cross-Border Energy Lease Investments."

Balance Sheet Information

As of December 31, 2013 and 2012, the assets held for disposition and liabilities associated with assets held for disposition related to the cross-border energy lease investments are:

	2013	2012
	(millions of dollars)	
Scheduled lease payments to PHI, net of non-recourse debt	$ —	$ 1,852
Less: Unearned and deferred income	—	(615)
Assets held for disposition	$ —	$ 1,237
Liabilities associated with assets held for disposition	$ —	$ 1

To ensure credit quality, PHI regularly monitored the financial performance and condition of the lessees under the former cross-border energy lease investments. Changes in credit quality were assessed to determine whether they affected the carrying value of the leases. PHI compared each lessee's performance to annual compliance requirements set by the terms and conditions of the leases and compared published credit ratings to minimum credit rating requirements in the leases for lessees with public credit ratings. In addition, PHI routinely met with senior executives of the lessees to discuss their company and asset performance. If the annual compliance requirements or minimum credit ratings were not met, remedies would have been available under the leases.

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

Lessee Rating [a]	2013	2012
	(millions of dollars)	
Rated Entities		
AA/Aa and above	$ —	$ 766
A	—	471
Total	$ —	$ 1,237

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

Retail Electric and Natural Gas Supply Businesses of Pepco Energy Services

On March 21, 2013, Pepco Energy Services entered into an agreement whereby a third party assumed all the rights and obligations of the remaining natural gas supply customer contracts, and the associated supply obligations, inventory and derivative contracts. The transaction was completed on April 1, 2013. In addition, in the second quarter of 2013, Pepco Energy Services completed the wind-down of its retail electric supply business by terminating its remaining customer supply and wholesale purchase obligations beyond June 30, 2013. As a result, PHI has reported the results of operations of Pepco Energy Services' retail electric and natural gas supply businesses as discontinued operations in all periods presented in the accompanying consolidated statements of (loss) income. Further, the assets and liabilities of Pepco Energy Services' retail electric and natural gas supply businesses are reported as held for disposition as of each date presented in the accompanying consolidated balance sheets.

Operating Results

The operating results for the retail electric and natural gas supply businesses of Pepco Energy Services are as follows:

	For the Year Ended December 31,		
	2013	2012	2011
		(millions of dollars)	
Operating revenue	$ 84	$ 415	$ 954
Income from operations of discontinued operations, net of income taxes	$ 4	$ 26	$ 2
Net gains associated with accelerated disposition of retail electric and natural gas contracts, net of income taxes	1	—	—
Income from discontinued operations, net of income taxes [a]	$ 5	$ 26	$ 2

[a] Includes income tax expense of approximately $3 million, $18 million and $1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Balance Sheet Information

As of December 31, 2013 and 2012, the retail electric and natural gas supply businesses of Pepco Energy Services had net accounts receivable of zero and $33 million, respectively, inventory assets of $1 million and $3 million, respectively, gross derivative assets of zero and $1 million respectively, other current assets of zero and $1 million, respectively, accrued liabilities of $1 million and $20 million, respectively, gross derivative liabilities of zero and $21 million, respectively, exclusive of the collateral pledged by Pepco Energy Services against the derivative liabilities, and other current liabilities of zero and $1 million, respectively. As of December 31, 2012, the derivative assets were considered level 1 within the fair value hierarchy, and $11 million and $10 million of the derivative liabilities were considered levels 1 and 2, respectively, within the fair value hierarchy.

Derivative Instruments and Hedging Activities

Derivatives were used by the retail electric and natural gas supply businesses of Pepco Energy Services to hedge commodity price risk.

The retail electric and natural gas supply businesses of Pepco Energy Services entered into energy commodity contracts in the form of natural gas futures, swaps, options and forward contracts to hedge commodity price risk in connection with the purchase of physical natural gas and electricity for distribution to customers. The primary risk management objective was to manage the spread between retail sales commitments and the cost of supply used to service those commitments to ensure stable cash flows and lock in favorable prices and margins when they became available. There were no derivatives for Pepco Energy Services as of December 31, 2013.

Commodity contracts held by the retail electric and natural gas supply businesses of Pepco Energy Services that were not designated for hedge accounting, did not qualify for hedge accounting, or did not meet the requirements for normal purchase and normal sale accounting, were marked to market through current earnings. Forward contracts that met the requirements for normal purchase and normal sale accounting were recorded on an accrual basis.

The table below identifies the balance sheet location and fair values of the retail electric and natural gas supply businesses' derivative instruments as of December 31, 2012:

Balance Sheet Caption	Derivatives Designated as Hedging Instruments [a]	Other Derivative Instruments	Gross Derivative Instruments	Effects of Cash Collateral and Netting	Net Derivative Instruments
	As of December 31, 2012				
	(millions of dollars)				
Assets held for disposition (current assets)	$ —	$ 1	$ 1	$ —	$ 1
Total Derivative assets	—	1	1	—	1
Liabilities associated with assets held for disposition (current liabilities)	(10)	(9)	(19)	16	(3)
Liabilities associated with assets held for disposition (non-current liabilities)	(1)	(1)	(2)	2	—
Total Derivative liabilities	(11)	(10)	(21)	18	(3)
Net Derivative (liability) asset	$ (11)	$ (9)	$ (20)	$ 18	$ (2)

[a] Amounts included in Derivatives Designated as Hedging Instruments primarily consist of derivatives that were designated as cash flow hedges prior to Pepco Energy Services' election to discontinue cash flow hedge accounting for these derivatives.

Under FASB guidance on the offsetting of balance sheet accounts (ASC 210-20), the retail electric and natural gas supply businesses of Pepco Energy Services offset the fair value amounts recognized for derivative instruments and the fair value amounts recognized for related collateral positions executed with the same counterparty under master netting agreements. No derivative assets or liabilities were available to be offset under master netting agreements as of December 31, 2012. Cash collateral pledged to counterparties with the right to reclaim of $18 million (including cash deposits on commodity brokerage accounts) was offset against these derivative positions.

As of December 31, 2013 and 2012, all cash collateral pledged by the retail electric and natural gas supply businesses related to derivative instruments accounted for at fair value was entitled to be offset under master netting agreements.

Derivatives Designated as Hedging Instruments

At December 31, 2012, the cumulative net pre-tax loss related to effective cash flow hedges of the retail electric and natural gas supply businesses of Pepco Energy Services included in AOCL was $10 million ($6 million after-tax). With the assumption by a third party, on April 1, 2013, of all the rights and obligations of the derivative contracts associated with the retail natural gas supply business, and the completion of the wind-down of the retail electric supply business in the second quarter of 2013, all of the losses deferred in AOCL associated with derivatives that Pepco Energy Services had previously designated as cash flow hedges were reclassified into income. As a result, a loss of $10 million ($6 million after-tax) was reclassified from AOCL to (Loss) income from discontinued operations, net of income taxes, for the year ended December 31, 2013.

Other Derivative Activity

The retail electric and natural gas supply businesses of Pepco Energy Services held certain derivatives that were not in hedge accounting relationships and were not designated as normal purchases or normal sales. These derivatives were recorded at fair value on the balance sheet with the gain or loss for changes in fair value recorded through (Loss) income from discontinued operations, net of income taxes.

For the years ended December 31, 2013, 2012, and 2011, the amount of the derivative gain (loss) for the retail electric and natural gas supply businesses of Pepco Energy Services recognized in (Loss) income from discontinued operations, net of income taxes is provided in the table below:

	For the Year Ended December 31,		
	2013	2012	2011
	(millions of dollars)		
Reclassification of mark-to-market to realized on settlement of contracts	$ 10	$ 27	$ —
Unrealized mark-to-market loss	—	(3)	(30)
Total net gain (loss)	$ 10	$ 24	$ (30)

As of December 31, 2013, the retail electric and natural gas supply businesses of Pepco Energy Services had no outstanding commodity forward contracts or derivative positions.

As of December 31, 2012, the retail electric and natural gas supply businesses of Pepco Energy Services had the following net outstanding commodity forward contract quantities and net position on derivatives that did not qualify for hedge accounting:

	December 31, 2012	
Commodity	Quantity	Net Position
Financial transmission rights (MWh)	181,008	Long
Electricity (MWh)	261,240	Long
Natural gas (MMBtu)	2,867,500	Long

As of December 31, 2013, Pepco Energy Services had posted net cash collateral of $3 million and letters of credit of less than $1 million. As December 31, 2012, Pepco Energy Services had posted net cash collateral of $25 million and letters of credit of less than $1 million.

Conectiv Energy

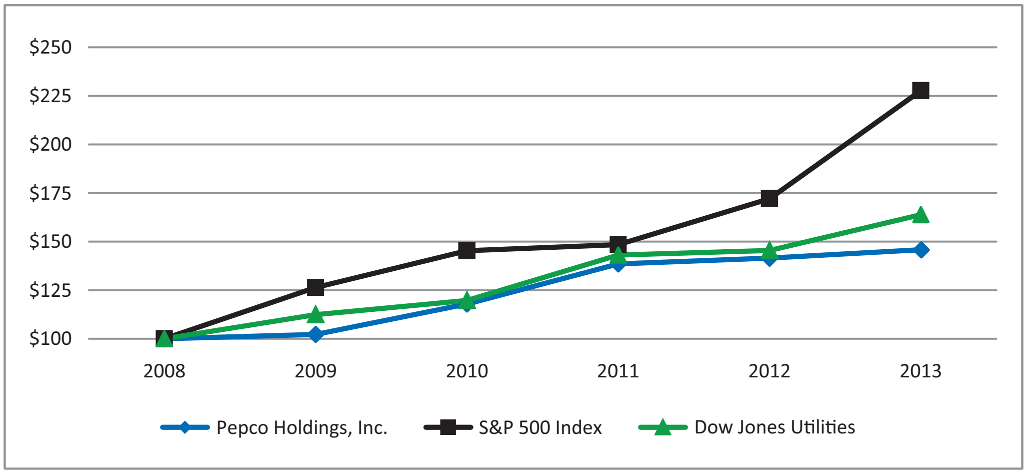
In April 2010, the Board of Directors approved a plan for the disposition of PHI's competitive wholesale power generation, marketing and supply business, which had been conducted through Conectiv Energy. On July 1, 2010, PHI completed the sale of Conectiv Energy's wholesale power generation business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

Conectiv Energy's loss from discontinued operations, net of income taxes, for the years ended December 31, 2013, 2012 and 2011, was zero, zero and $3 million, respectively. Conectiv Energy's other comprehensive income from discontinued operations, net of income taxes, for each of the years ended December 31, 2013, 2012 and 2011, was zero.

FIVE-YEAR PERFORMANCE GRAPH

The following chart compares the five-year cumulative total return to stockholders of Pepco Holdings, Inc. consisting of the change in stock price and reinvestment of dividends with the five-year cumulative total return on the Standard & Poor's 500 Stock Index (the "S&P 500 Index") and the Dow Jones Utilities Index, assuming an investment in each of $100.00 on December 31, 2008 with dividends reinvested quarterly.

Comparison of Five-Year Cumulative Total Return*
Among Pepco Holdings, Inc., the S&P 500 Index and the Dow Jones Utilities Index



	Cumulative Total Return at December 31,					
	2008	2009	2010	2011	2012	2013
Pepco Holdings, Inc.	$ 100.00	$ 102.28	$ 117.84	$ 138.55	$ 141.51	$ 145.76
S&P 500 Index	$ 100.00	$ 126.36	$ 145.34	$ 148.41	$ 172.04	$ 227.64
Dow Jones Utilities	$ 100.00	$ 112.42	$ 119.66	$ 143.10	$ 145.38	$ 163.80

*Source: Bloomberg

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Annual Report with respect to PHI, Pepco, DPL and ACE, including each of their respective subsidiaries (each, a Reporting Company), are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the Securities Act of 1933, as amended, and are subject to the safe harbor created thereby under the Private Securities Litigation Reform Act of 1995.

These statements include declarations regarding the intents, beliefs, estimates and current expectations of PHI or its subsidiaries. In some cases, you can identify forward-looking statements by terminology such as "may," "might," "will," "should," "could," "expects," "intends," "assumes," "seeks to," "plans," "anticipates," "believes," "projects," "estimates," "predicts," "potential," "future," "goal," "objective," or "continue" or the negative of such terms or other variations thereof or comparable terminology, or by discussions of strategy that involve risks and uncertainties.

Forward-looking statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that may cause PHI or its subsidiaries' actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Therefore, forward-looking statements are not guarantees or assurances of future performance, and actual results could differ materially from those indicated by the forward-looking statements.

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

- Changes in governmental policies and regulatory actions affecting the energy industry or PHI specifically, including allowed rates of return, industry and rate structure, acquisition and disposal of assets and facilities, operation and construction of transmission and distribution facilities and the recovery of purchased power expenses;
- The outcome of pending and future rate cases and other regulatory proceedings, including (i) challenges to the base ROE and the application of the formula rate process previously established by the Federal Energy Regulatory Commission (FERC) for transmission services provided by Pepco, DPL and ACE; (ii) challenges to DPL's 2011, 2012 and 2013 annual FERC formula rate updates; and (iii) other possible disallowances of recovery of costs and expenses or delays in the recovery of such costs;
- The resolution of outstanding tax matters with the Internal Revenue Service and the funding of any additional taxes, interest or penalties that may be due;
- The expenditures necessary to comply with regulatory requirements, including regulatory orders, and to implement reliability enhancement, emergency response and customer service improvement programs;
- Possible fines, penalties or other sanctions assessed by regulatory authorities against PHI or its subsidiaries;
- The impact of adverse publicity and media exposure which could render PHI or its subsidiaries vulnerable to negative customer perception and could lead to increased regulatory oversight or other sanctions;
- Weather conditions affecting usage and emergency restoration costs;
- Population growth rates and changes in demographic patterns;
- Changes in customer energy demand due to, among other things, conservation measures and the use of renewable energy and other energy-efficient products, as well as the impact of net metering and other issues associated with the deployment of distributed generation and other new technologies;

- General economic conditions, including the impact on energy use caused by an economic downturn or recession, or by changes in the level of commercial activity in a particular region or service territory, or affecting a particular business or industry located therein;
- Changes in and compliance with environmental and safety laws and policies;
- Changes in tax rates or policies;
- Changes in rates of inflation;
- Changes in accounting standards or practices;
- Unanticipated changes in operating expenses and capital expenditures;
- Rules and regulations imposed by, and decisions of, federal and/or state regulatory commissions, PJM Interconnection, LLC, the North American Electric Reliability Corporation and other applicable electric reliability organizations;
- Legal and administrative proceedings (whether civil or criminal) and settlements that affect PHI's or its subsidiaries' business and profitability;
- Pace of entry into new markets;
- Interest rate fluctuations and the impact of credit and capital market conditions on the ability to obtain funding on favorable terms; and
- Effects of geopolitical and other events, including the threat of terrorism or cyber attacks.

Any forward-looking statements speak only as to the date of this Annual Report, and PHI undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statements are made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for PHI to predict all such factors. Furthermore, it may not be possible to assess the impact of any such factor on PHI or its subsidiaries' business (viewed independently or together with the business or businesses of some or all of PHI's subsidiaries), or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. The foregoing factors should not be construed as exhaustive.

GLOSSARY OF TERMS

The following is a glossary of terms, abbreviations and acronyms that are used in this Annual Report. The terms, abbreviations and acronyms used have the meanings set forth below, unless the context requires otherwise.

Term	Definition
2012 LTIP	Pepco Holdings, Inc. 2012 Long-Term Incentive Plan
ACE	Atlantic City Electric Company
ACE Funding	Atlantic City Electric Transition Funding LLC
AFUDC	Allowance for funds used during construction
AOCL	Accumulated Other Comprehensive Loss
AMI	Advanced metering infrastructure
ASC	Accounting Standards Codification
BGE	Baltimore Gas and Electric Company
BGS	Basic Generation Service (the supply of electricity by ACE to retail customers in New Jersey who have not elected to purchase electricity from a competitive supplier)
BSA	Bill Stabilization Adjustment
Calpine	Calpine Corporation
Conectiv	Conectiv, LLC, a wholly owned subsidiary of PHI and the parent of DPL and ACE
Conectiv Energy	Subsidiaries of Conectiv Energy Holding Company, a disposition plan for which was approved by PHI's Board of Directors in April 2010 and has been completed
CTA	Consolidated tax adjustment
CWIP	Construction work in progress
DCPSC	District of Columbia Public Service Commission
DDOE	District of Columbia Department of the Environment
Default Electricity Supply	The supply of electricity by PHI's electric utility subsidiaries at regulated rates to retail customers who do not elect to purchase electricity from a competitive supplier, and which, depending on the jurisdiction, is also known as Standard Offer Service or BGS
DPL	Delmarva Power & Light Company
DEDA	Delaware Economic Development Authority
DOE	U.S. Department of Energy
DPSC	Delaware Public Service Commission
DRP	Direct Stock Purchase and Dividend Reinvestment Plan
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EDC	Electricity Distribution Company
EmPower Maryland	A Maryland demand-side management program for Pepco and DPL
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
GAAP	Accounting principles generally accepted in the United States of America

Term	Definition
GCR	Gas Cost Rate
GWh	Gigawatt hour
IMU	Interface management unit
IRS	Internal Revenue Service
LIBOR	London Interbank Offered Rate
LTIP	Pepco Holdings, Inc. Long-Term Incentive Plan
MAPP	Mid-Atlantic Power Pathway
MMBtu	One Million British Thermal Units
MPSC	Maryland Public Service Commission
MW	Megawatt
MWh	Megawatt hour
NAV	Net Asset Value
NJBPU	New Jersey Board of Public Utilities
NUGs	Non-utility generators
OPEB	Other postretirement benefit
PCI	Potomac Capital Investment Corporation and its subsidiaries
Pepco	Potomac Electric Power Company
Pepco Energy Services	Pepco Energy Services, Inc. and its subsidiaries
Pepco Holdings or PHI	Pepco Holdings, Inc.
PJM	PJM Interconnection, LLC
PJM RTO	PJM regional transmission organization
Power Delivery	The transmission, distribution and default supply of electricity and, to a lesser extent, the distribution and supply of natural gas, conducted through Pepco, DPL and ACE, PHI's regulated public utility subsidiaries
PPA	Power purchase agreement
PRP	Potentially responsible party
RECs	Renewable energy credits
Regulated T&D Electric Revenue	Revenue from the transmission and the distribution of electricity to PHI's customers within its service territories at regulated rates
Regulatory Asset Recovery Charge	Costs associated with deferred, NJBPU-approved expenses incurred as part of ACE's obligation to serve the public
Revenue Decoupling Adjustment	An adjustment equal to the amount by which revenue from distribution sales differs from the revenue that Pepco and DPL are entitled to earn based on the approved distribution charge per customer
RI/FS	Remedial investigation and feasibility study
ROE	Return on equity
RPS	Renewable Energy Portfolio Standards
SEC	Securities and Exchange Commission
SOCA	Standard Offer Capacity Agreement required to be entered into by ACE pursuant to the NJ SOCA Law
SOS	Standard Offer Service, how Default Electricity Supply is referred to in Delaware, the District of Columbia and Maryland

Term	Definition
T&D	Transmission and distribution
TEFA	Transitional Energy Facility Assessment, a New Jersey tax surcharge providing a gradual transition from the previous franchise and gross receipts tax eliminated in 1997, to its new total liability under the corporation business tax and the sales-and-use tax (this surcharge was eliminated in 2013)
Transition Bond Charge	Revenue ACE receives, and pays to ACE Funding, to fund the principal and interest payments on Transition Bonds and related taxes, expenses and fees
Transition Bonds	Transition Bonds issued by ACE Funding

BOARD OF DIRECTORS AND EXECUTIVE OFFICERS

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The Dayton Power and Light Company

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(*Law*)

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Bailey Capital Corporation
Washington, D.C.
(*Private investment company*)

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Baltimore Gas and Electric Company

Barbara J. Krumsiek[2,5]
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(Investment firm)

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Dupont

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Bethesda, Maryland
(Real estate and construction)

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GlaxoSmithKline Pharmaceuticals

Joseph M. Rigby[4]
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Pepco Holdings, Inc.

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Retired Managing Partner
Washington, D.C. office, KPMG LLP;
Visiting Professor
Howard University
Washington, D.C.

Pauline A. Schneider[4,5,7]
Partner
Ballard Spahr, LLP
Washington, D.C. (*Law*)

Lester P. Silverman[2,4,5]
Director Emeritus
McKinsey & Company, Inc.

Executive Officers

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David M. Velazquez
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Power Delivery

Kevin C. Fitzgerald
Executive Vice President and General Counsel

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Senior Vice President and Chief Financial Officer

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Vice President, People Strategy and Human Resources

Laura L. Monica
Vice President, Corporate Communications

PHI Service Company

Hallie M. Reese
Vice President, Customer Care

Pepco Energy Services, Inc.

John U. Huffman
President and Chief Executive Officer

[1] Member of the Audit Committee of which Ms. Oelrich is Chairman.

[2] Member of the Compensation/Human Resources Committee of which Dr. Harker is Chairman.

[3] Member of the Corporate Governance/Nominating Committee of which Mr. MacCormack is Chairman.

[4] Member of the Executive Committee of which Mr. Heintz is Chairman.

[5] Member of the Finance Committee of which Mr. Silverman is Chairman.

[6] Lead Independent Director.

[7] Not standing for re-election at the 2014 Annual Meeting due to Board retirement provision of PHI's bylaws.

INVESTOR INFORMATION

Fiscal Agents

Common Stock

In writing:
American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn, NY 11219-9821

By telephone:
Toll free 1-866-254-6502

Via e-mail:
pepco@amstock.com

For inquiries concerning your Pepco Holdings, Inc. shareholdings (such as status of your account, dividend payments, change of address, lost certificates or transfer of ownership of shares), or to enroll in the direct stock purchase and dividend reinvestment plan or direct deposit of dividends, contact American Stock Transfer & Trust Company as listed above.

A copy of Pepco Holdings' Annual Report on Form 10-K for the year ended December 31, 2013, is available without charge by contacting American Stock Transfer & Trust Company as listed above.

Pepco Holdings, Inc. Notes, Potomac Electric Power Company Bonds, and Atlantic City Electric Company Bonds

In writing:
The Bank of New York Mellon
101 Barclay Street, 8W
New York, NY 10286

By telephone:
Toll Free: 1-800-548-5075

Delmarva Power & Light Company Bonds

In writing:
The Bank of New York Mellon Trust Company, NA
Global Corporate Trust Services
Bondholder Relations
2001 Bryan Street
Dallas, TX 75201

By telephone:
Toll free 1-800-275-2048

Investor Relations Contact

Donna J. Kinzel, Vice President and Treasurer
Telephone: 302-429-3004
E-mail: *Donna.Kinzel@pepcoholdings.com*

Stock Market Information

2013	High	Low	Dividend
1st Quarter	$21.43	$18.82	$ 0.27
2nd Quarter	$22.72	$19.35	$ 0.27
3rd Quarter	$ 20.90	$18.04	$ 0.27
4th Quarter	$19.62	$18.19	$ 0.27

Close on December 31, 2013: $19.13

2012	High	Low	Dividend
1st Quarter	$20.48	$18.63	$ 0.27
2nd Quarter	$19.63	$18.14	$ 0.27
3rd Quarter	$20.30	$18.67	$ 0.27
4th Quarter	$20.06	$18.80	$ 0.27

Close on December 31, 2012: $19.61

Close on March 21, 2014: $19.97

Number of Registered Holders at December 31, 2013: 46,871

New York Stock Exchange Ticker Symbol: POM

Other Information

For historical stock prices (Pepco Holdings, Inc., Potomac Electric Power Company, Conectiv, Delmarva Power & Light Company and Atlantic Energy, Inc.), and other Pepco Holdings, Inc. company information, including our Corporate Governance Guidelines, Corporate Business Policies (which in their totality constitute our code of business conduct and ethics) and Board Committee Charters, please visit our Web site at www.pepcoholdings.com

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