PUBLIC SERVICE ENTERPRISE GROUP INC
Form DEFR14A
June 13, 2005

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

**Section 240.14a-101 Schedule 14A.**
**Information required in proxy statement.**

# SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No. 1)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to §240.14a-12 or Section 240.14a-12

**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

**Explanatory Note**

This Amendment No. 1 to the Schedule 14A filed June 8, 2005 is being filed for the sole purpose of adding to the form of proxy, the following proposal to be voted on at the Annual Meeting of Shareholders that will be held July 19, 2005:

4. Approval to adjourn or postpone Annual Meeting.

The proposal numbers have been revised accordingly. The form of proxy included with Schedule 14A filed June 8, 2005 was not mailed or distributed. No other changes have been made to the proxy materials filed on June 8, 2005. The revised proxy is as follows:

# Joint Proxy Statement and Prospectus

**for the**

# 2005 Annual Meetings of Shareholders

# Including Action on the Proposed Merger of PSEG and Exelon

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## MERGER PROPOSAL YOUR VOTE IS IMPORTANT

On behalf of the boards of directors and management of both Exelon Corporation and Public Service Enterprise Group Incorporated, we are pleased to deliver our joint proxy statement/prospectus for the merger involving Exelon and PSEG. We believe this merger will create a strong combined company that will deliver important benefits to our shareholders, to our customers and to the communities we serve.

**If the merger is completed, PSEG shareholders will receive 1.225 shares of Exelon common stock for each share of PSEG common stock held. The exchange ratio is fixed and will not be adjusted to reflect stock price changes prior to the completion of the merger.** Based on the closing price of Exelon common stock on the New York Stock Exchange on December 15, 2004, the last full trading day prior to a significant increase in trading volume from the average trading volume of Exelon and PSEG common stock and inquiries from *The Wall Street Journal* regarding whether Exelon and PSEG were in advanced merger discussions, the exchange ratio represented approximately $53.14 in value for each share of PSEG common stock. Based on the closing price of Exelon common stock on the New York Stock Exchange on December 16, 2004, the last full trading day prior to the publication of news articles reporting that Exelon and PSEG were in advanced merger discussions, the exchange ratio represented approximately $52.19 in value for each share of PSEG common stock. Based on the closing price of Exelon common stock on the New York Stock Exchange on December 17, 2004, the last full trading day prior to our public announcement of the merger, the exchange ratio represented approximately $51.28 in value for each share of PSEG common stock. Based on the closing price of Exelon common stock on the New York Stock Exchange on May 31, 2005, of $46.85, the exchange ratio represented approximately $57.39 in value for each share of PSEG common stock. **The value of the consideration to be received by PSEG shareholders will fluctuate with changes in the price of Exelon common stock. We urge you to obtain current market quotations for Exelon and PSEG common stock.**

Exelon shareholders will continue to own their existing Exelon shares. We estimate that Exelon may issue up to approximately 313 million shares of Exelon common stock to PSEG shareholders as contemplated by the merger agreement, which includes approximately 7.2 million shares of Exelon common stock issuable pursuant to PSEG stock options and other equity-based awards to be assumed by Exelon and substituted with options to purchase Exelon common stock and other Exelon equity-based awards. Upon completion of the merger, Exelon's shareholders immediately prior to the merger will own approximately 68% of Exelon's outstanding common stock on a fully diluted basis and former PSEG shareholders will own approximately 32% of Exelon's outstanding common stock on a fully diluted basis. Upon completion of the merger, Exelon will change its name from Exelon Corporation to Exelon Electric & Gas Corporation. Exelon common stock will continue to be listed on the New York Stock Exchange.

**For a discussion of the United States federal income tax consequences of the merger, see "The Merger Material United States Federal Income Tax Consequences of the Merger" beginning on page 109 of this joint proxy statement/prospectus.**

We urge you to read this joint proxy statement/prospectus, which includes important information about the merger and our annual meetings. **In particular, see the section titled "Risk Factors" on pages 21 through 34 of this joint proxy statement/prospectus which contains a description of the risks that you should consider in evaluating the merger.**

Exelon asks that, in addition to the other matters to be considered at the Exelon annual meeting, Exelon shareholders approve the issuance of shares of Exelon common stock as contemplated by the merger agreement. Exelon's annual meeting will be held at the following time and place:

*July 22, 2005*
*9:30 a.m., local time*
*PECO Energy Headquarters*
*2301 Market Street*
*Philadelphia, Pennsylvania*

**Exelon's board of directors has reviewed and considered the terms of the merger and the merger agreement and has unanimously determined that the merger, including the issuance of shares of Exelon common stock as contemplated by the merger agreement, is advisable, fair to and in the best interests of Exelon and its shareholders and unanimously recommends that Exelon shareholders vote FOR the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement.**

PSEG asks that, in addition to the other matters to be considered at the PSEG annual meeting, PSEG shareholders approve the merger agreement and thereby approve the merger. PSEG's annual meeting will be held at the following time and place:

*July 19, 2005*
*2:00 p.m., local time*
*The New Jersey Performing Arts Center*
*One Center Street*
*Newark, New Jersey*

**PSEG's board of directors has reviewed and considered the terms of the merger and the merger agreement and has unanimously determined that the merger is advisable, fair to and in the best interests of PSEG and its shareholders and unanimously recommends that PSEG shareholders vote FOR the proposal to approve the merger agreement and thereby approve the merger.**

We cannot complete the merger unless the Exelon shareholders approve the issuance of shares of Exelon common stock as contemplated by the merger agreement and the PSEG shareholders approve the merger agreement. **Your vote is important.**

| John W. Rowe | E. James Ferland |
|---|---|
| *Chairman of the Board,* | *Chairman of the Board,* |
| *President and Chief Executive Officer* | *President and Chief Executive Officer* |
| *Exelon Corporation* | *Public Service Enterprise Group Incorporated* |

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the securities to be issued under this joint proxy statement/prospectus or determined if this joint proxy statement/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.**

This joint proxy statement/prospectus is dated May 31, 2005 and is first being mailed to Exelon and PSEG shareholders on or about June 10, 2005.

## REFERENCES TO ADDITIONAL INFORMATION

This joint proxy statement/prospectus incorporates important business and financial information about Exelon and PSEG from other documents that are not included in or delivered with this joint proxy statement/prospectus. This information is available to you without charge upon your written or oral request. You can obtain copies of the documents incorporated by reference into this joint proxy statement/prospectus through the Securities and Exchange Commission website at *www.sec.gov* or by requesting them in writing or by telephone from the appropriate company at the following addresses and telephone numbers:

| *if you are an Exelon shareholder:* | *if you are a PSEG shareholder:* |
|---|---|
| Exelon Corporation<br>Exelon Shareholder Services<br>10 South Dearborn Street, Chicago, IL 60603<br>(312) 394-2345 | Public Service Enterprise Group Incorporated<br>PSEG Investor Relations<br>80 Park Plaza, 6th Floor Newark, NJ 07101<br>(973) 430-6565 |

*If you would like to request documents from PSEG, please do so by July 12, 2005, in order to receive them before the PSEG annual meeting. If you would like to request documents from Exelon, please do so by July 15, 2005, in order to receive them before the Exelon annual meeting.*

See "Where You Can Find More Information" beginning on page 243 of this joint proxy statement/prospectus.

## VOTING BY TELEPHONE, BY THE INTERNET OR BY MAIL

Exelon shareholders of record may submit their proxies:

- by telephone, by calling the toll-free number (877) 779-8683 in the United States, Canada or Puerto Rico on a touch-tone phone and following the recorded instructions;
- by accessing the Internet website at *www.eproxyvote.com/exc* and following the instructions on the website; or
- by mail, by indicating your voting preference on the proposals on each proxy card you receive, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

PSEG shareholders of record may submit their proxies:

- by telephone, by calling the toll-free number (866) 242-0618 in the United States, Canada or Puerto Rico on a touch-tone phone and following the recorded instructions;
- by accessing the Internet website at *www.proxyvotenow.com/pseg* and following the instructions on the website; or
- by mail, by indicating your voting preference on the proposals on each proxy card you receive, signing and dating each proxy card and returning each proxy card in the prepaid envelope that accompanied that proxy card.

If you hold your shares through a bank, broker, custodian or other recordholder, please refer to your proxy card or voting instruction form or the information forwarded by your bank, broker, custodian or other recordholder to see which options are available to you.

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**
**OF EXELON CORPORATION**

TO THE SHAREHOLDERS OF EXELON CORPORATION:

Exelon will hold the annual meeting of Exelon shareholders on July 22, 2005, at 9:30 a.m., local time, at PECO Energy Headquarters, 2301 Market Street, Philadelphia, Pennsylvania.

The purpose of the annual meeting is to consider and take action on the following:

1. A proposal to approve the issuance of shares of Exelon common stock as contemplated by the Agreement and Plan of Merger, dated as of December 20, 2004, between Exelon Corporation and Public Service Enterprise Group Incorporated. A copy of the merger agreement is attached as *Annex A* to the joint proxy statement/prospectus accompanying this notice. In the merger, each share of PSEG common stock outstanding immediately prior to completion of the merger will be converted into the right to receive 1.225 shares of Exelon common stock.

2. The election of five Class II directors: Edward A. Brennan, Bruce DeMars, Nelson A. Diaz, John W. Rowe and Ronald Rubin, each for a term of three years.

3. A proposal to approve an amendment to Exelon's Amended and Restated Articles of Incorporation to increase the number of authorized shares of Exelon common stock from 1,200,000,000 to 2,000,000,000.

4. A proposal to ratify PricewaterhouseCoopers LLP as Exelon's independent accountants for the year 2005.

5. A proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan.

6. A proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries.

7. Any proposal of the Exelon board of directors to adjourn or postpone the annual meeting.

8. Any other business that properly comes before the annual meeting and any adjournment or postponement thereof.

Shareholders of record of Exelon common stock at the close of business on May 2, 2005 will be entitled to vote at the annual meeting and any adjournment or postponement of that meeting. As of the record date, there were 669,137,081 shares of Exelon common stock outstanding. Each share of common stock is entitled to one vote on each matter properly brought before the meeting.

You are cordially invited to attend the meeting; however, whether or not you expect to attend in person, you can be sure your shares are represented at the meeting by promptly voting and submitting your proxy by phone, by Internet or by completing, signing, dating and returning the enclosed proxy card in the enclosed prepaid envelope.

If you plan on attending the annual meeting, please bring your admission ticket and a photo ID along with you. The portion of your proxy card marked "Admission Ticket" or voting instruction form will serve as your admission ticket.

**Your board of directors unanimously recommends that you vote for the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement, which is described in detail in the joint proxy statement/prospectus accompanying this notice, and for proposals two through seven in this notice.**

By Order of the Board of Directors

Katherine K. Combs
Vice President, Corporate Secretary
and Deputy General Counsel

**YOUR VOTE IS IMPORTANT**

**WE URGE YOU TO VOTE YOUR SHARES AS PROMPTLY AS POSSIBLE BY (1) CALLING THE TOLL-FREE NUMBER (877) 779-8683, (2) ACCESSING THE INTERNET WEBSITE AT *www.eproxyvote.com/exc* OR (3) COMPLETING, SIGNING, DATING AND RETURNING THE ENCLOSED PROXY CARD.**

**Public Service Enterprise Group Incorporated**
**80 Park Plaza, P.O. Box 1171**
**Newark, New Jersey 07101-1171**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**
**OF PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**

TO THE SHAREHOLDERS OF PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED:

PSEG will hold the annual meeting of PSEG shareholders on July 19, 2005, at 2:00 p.m., local time, at The New Jersey Peforming Arts Center, One Center Street, Newark, New Jersey.

The purpose of the annual meeting is to consider and take action on the following:

1. A proposal to approve the Agreement and Plan of Merger, dated as of December 20, 2004, between Exelon Corporation and Public Service Enterprise Group Incorporated. A copy of the merger agreement is attached as *Annex A* to the joint proxy statement/prospectus accompanying this notice. In the merger, each share of PSEG common stock outstanding immediately prior to completion of the merger will be converted into the right to receive 1.225 shares of Exelon common stock.

2. To elect three members of Class III of the PSEG board of directors: Conrad K. Harper, Shirley Ann Jackson and Thomas A. Renyi.

3. To consider and act upon the ratification of the appointment of Deloitte & Touche LLP as PSEG's independent auditor for the year 2005.

4. To consider and act upon any proposal by the PSEG board of directors to adjourn or postpone the PSEG annual meeting.

5. To consider and act upon a shareholder proposal related to executive compensation, if presented at the meeting.

6. Any other business that properly comes before the annual meeting and any adjournment or postponement thereof.

Shareholders of record of PSEG common stock at the close of business on May 27, 2005 will be entitled to vote at the annual meeting and any adjournment or postponement of that meeting. As of the record date, there were 238,731,592 shares of PSEG common stock outstanding. Each share of common stock is entitled to one vote on each matter properly brought before the meeting, except for the proposal relating to the election of directors, on which PSEG shareholders are entitled to cumulative voting.

You are cordially invited to attend the meeting; however, whether or not you expect to attend in person, you can be sure your shares are represented at the meeting by promptly voting and submitting your proxy by phone, by Internet or by completing, signing, dating and returning the enclosed proxy card in the enclosed prepaid envelope.

If you plan on attending the annual meeting, please bring your admission ticket and a photo ID along with you. The portion of your proxy card marked "Admission Ticket" or voting instruction form will serve as your admission ticket.

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**Your board of directors unanimously recommends that you vote for the proposal to approve the merger agreement and thereby approve the merger, which is described in detail in the joint proxy statement/prospectus accompanying this notice, and for proposals two through four in this notice and against proposal five in this notice.**

By Order of the Board of Directors

EDWARD J. BIGGINS, JR.
*Secretary*

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**YOUR VOTE IS IMPORTANT**

**WE URGE YOU TO VOTE YOUR SHARES AS PROMPTLY AS POSSIBLE BY (1) CALLING THE TOLL-FREE NUMBER (866) 242-0618, (2) ACCESSING THE INTERNET WEBSITE AT *www.proxyvotenow.com/pseg* OR (3) COMPLETING, SIGNING, DATING AND RETURNING THE ENCLOSED PROXY CARD.**

**PLEASE DO NOT SEND YOUR COMMON STOCK CERTIFICATES AT THIS TIME. IF THE MERGER IS COMPLETED, YOU WILL BE SENT INSTRUCTIONS REGARDING THE SURRENDER OF YOUR CERTIFICATES.**

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# CHAPTER ONE
# THE INTRODUCTION

## QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETINGS

**Q:**

**Why am I receiving this document?**

A:

We are delivering this document to you because it is serving as both a joint proxy statement of Exelon and PSEG and a prospectus of Exelon. It is a joint proxy statement because it is being used by our boards of directors to solicit proxies of our shareholders. It is a prospectus because Exelon is offering shares of its common stock in exchange for shares of PSEG common stock if the merger is completed.

**Q:**

**What do I need to do now?**

A:

After you carefully read this joint proxy statement/prospectus, please respond by submitting your proxy by telephone or the Internet or by completing, signing, dating and returning your signed proxy card(s) in the enclosed prepaid return envelope, as soon as possible, so that your shares may be represented at your annual meeting. In order to assure that your vote is recorded, please vote your proxy as instructed on your proxy card even if you currently plan to attend your annual meeting in person.

**Q:**

**Why is my vote important?**

A:

Exelon shareholders are being asked to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement and to take action on the other proposals in the Exelon notice. PSEG shareholders are being asked to approve the merger agreement and thereby approve the merger and to take action on the other proposals in the PSEG notice. If you do not submit your proxy by telephone or the Internet, or return your signed proxy card(s) by mail or vote in person at your annual meeting, it will be more difficult for Exelon and PSEG to obtain the necessary quorum to hold their respective annual meetings.

**Q:**

**How will my proxy be voted?**

A:

If you vote by telephone or by the Internet or by completing, signing, dating and returning your signed proxy card(s), your proxy will be voted in accordance with your instructions.

If you are an Exelon shareholder of record and submit your proxy but do not indicate how you want to vote, your shares will be voted **FOR** the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement, **FOR** the proposal to elect the directors named in the director proposal, **FOR** the proposal to approve the amendment to Exelon's Amended and Restated Articles of Incorporation to increase the number of authorized shares of Exelon common stock, **FOR** the proposal to ratify PricewaterhouseCoopers LLP as Exelon's independent accountants, **FOR** the proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan, **FOR** the proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries and **FOR** any proposal by the Exelon board of directors to adjourn or postpone the annual meeting, if necessary.

If you are a PSEG shareholder of record and submit your proxy but do not indicate how you want to vote, your shares will be voted **FOR** the proposal to approve the merger agreement, **FOR** the proposal to elect the directors named in the director proposal, **FOR** the proposal to ratify Deloitte & Touche LLP as PSEG's independent auditor, **FOR** any proposal by the PSEG board of directors to adjourn or postpone the annual meeting, if necessary, and **AGAINST** the shareholder proposal.

**Q:**

**May I vote in person?**

A:

Yes. If you are a shareholder of record of Exelon common stock as of May 2, 2005 or of PSEG common stock as of May 27, 2005, you may attend your annual meeting and vote your shares in person, instead of submitting your proxy by telephone or by the Internet or returning your signed proxy card(s).

**Q:**

**If my shares are held in "street name" by my broker, will my broker vote my shares for me?**

A:

If you are an Exelon shareholder whose shares are held in "street name" by your broker, you must provide your broker with instructions on how to vote your shares; otherwise, your broker will not vote your shares on the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement, the proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan or the proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries.

If you are a PSEG shareholder whose shares are held in "street name" by your broker, you must provide your broker with instructions on how to vote your shares; otherwise, your broker will not vote your shares on the proposal to approve the merger agreement or the shareholder proposal.

You should be sure to provide your broker with instructions on how to vote your shares. Please check the voting form used by your broker to see if it offers telephone or Internet submission of proxies.

**Q:**

**What if I fail to instruct my broker?**

A:

If you fail to instruct your broker to vote your shares and the broker submits an unvoted proxy, the resulting broker "non-vote" will, in the circumstances described under "Chapter Two  Information About the Annual Meetings and Voting," be counted toward a quorum at your annual meeting but will not be counted in determining the number of votes cast with respect to a proposal.

**Q:**

**Who will count the vote?**

A:

For the Exelon proposals, representatives of Equiserve Trust Company, N.A. and Exelon's Office of the Corporate Secretary will count the votes and serve as judges of election.

For the PSEG proposals, representatives of Corporate Election Services, Inc. will count the vote and serve as inspectors of election.

**Q:**

**What does it mean if I receive more than one set of materials?**

A:

This means you own shares of both Exelon and PSEG or you own shares of Exelon or PSEG that are registered under different names. For example, you may own some shares directly as a shareholder of record and other shares through a broker or you may own shares through more than one broker. In these situations, you will receive multiple sets of proxy materials. It is necessary for you to vote, sign and return all of the proxy cards or follow the instructions for any alternative voting procedure on each of the proxy cards you receive in order to vote all of the shares you own. Each proxy card you receive will come with its own prepaid return envelope; if you vote by mail, make sure you return each proxy card in the return envelope which accompanied that proxy card.

**Q:**

**Can I revoke my proxy and change my vote?**

A:

Yes. You have the right to revoke your proxy at any time prior to the time your shares are voted at your annual meeting. If you are a shareholder of record, your proxy can be revoked in several ways:

- by entering a new vote by telephone or the Internet;
- by delivering a written revocation to your company's secretary that is received prior to your annual meeting;
- by submitting another valid proxy bearing a later date that is received prior to your annual meeting; or
- by attending your annual meeting and voting your shares in person.

However, if your shares are held in "street name" through a bank, broker, custodian or other recordholder, you must check with your bank, broker, custodian or other recordholder to determine how to revoke your proxy.

**Q:**

**When and where are the annual meetings?**

A:

The Exelon annual meeting will take place on July 22, 2005, at 9:30 a.m., local time, at PECO Energy Headquarters, 2301 Market Street, Philadelphia, Pennsylvania.

The PSEG annual meeting will take place on July 19, 2005, at 2:00 p.m., local time, at The New Jersey Performing Arts Center, One Center Street, Newark, New Jersey.

**Q:**

**What must I bring to attend the annual meetings?**

A:

Admittance to the annual meetings is limited to shareholders of Exelon or PSEG, as the case may be, who are eligible to vote or their authorized representatives. If you wish to attend your meeting, bring the portion of your proxy which is marked as your "Admission Ticket" or your voting instruction form. Also, be sure to bring a photo ID. Seating is limited.

**Q:**

**Should I send in my stock certificates now?**

A:

No. After the merger is completed, Exelon will send PSEG shareholders written instructions for exchanging their PSEG stock certificates for Exelon stock certificates. Exelon shareholders will keep their existing stock certificates.

**Q:**

**Are there risks I, as an Exelon shareholder, should consider in deciding to vote on the issuance of shares of Exelon common stock as contemplated by the merger agreement or, as a PSEG shareholder, should consider in deciding to vote on the approval of the merger agreement?**

A:

Yes, in evaluating the issuance of shares of Exelon common stock as contemplated by the merger agreement, or the merger agreement and the merger, you should carefully read this joint proxy statement/prospectus, including the factors discussed in the section titled "Risk Factors" beginning on page 21 of this joint proxy statement/prospectus.

**Q:**

**Who can answer any questions I may have about the annual meetings or the merger?**

A:

Exelon shareholders may call Georgeson Shareholder Communications Inc. at (800) 561-4182.

PSEG shareholders may call Morrow & Co., Inc. at (800) 607-0088.

## SUMMARY

*This summary highlights selected information from this joint proxy statement/prospectus related to the merger and may not contain all of the information that is important to you. To understand the merger and for a more complete description of the legal terms of the merger agreement, you should carefully read this entire joint proxy statement/prospectus and the documents to which this joint proxy statement/prospectus refers you. A copy of the merger agreement is attached as Annex A to this joint proxy statement/prospectus and is incorporated by reference into this joint proxy statement/prospectus. See "Where You Can Find More Information" on page 243 of this joint proxy statement/prospectus.*

### The Companies Involved in the Merger (see page 37)

Exelon Corporation
10 South Dearborn Street 37th Floor
P.O. Box 805379
Chicago, Illinois 60680-5379
(312) 394-7398
Internet address: *www.exeloncorp.com*

Exelon Corporation, a registered public utility holding company under the Public Utility Holding Company Act of 1935, as amended, through its subsidiaries, operates in two business segments Energy Delivery and Generation as of January 1, 2005. Prior to January 1, 2005, Exelon operated in a third business segment, Enterprises. In addition to Exelon's two business segments, Exelon Business Services Company, a subsidiary of Exelon, provides Exelon and its subsidiaries with financial, human resource, legal, information technology, supply management and corporate governance services. Exelon was incorporated in Pennsylvania in February 1999.

Public Service Enterprise Group Incorporated
80 Park Plaza
P.O. Box 1171
Newark, New Jersey 07101-1171
(973) 430-7000
Internet address: *www.pseg.com*

Public Service Enterprise Group Incorporated is an exempt public utility holding company under PUHCA. PSEG has three principal direct wholly-owned subsidiaries engaged in the transmission and distribution of electric energy and gas in New Jersey; wholesale supply; and power production and distribution in selected domestic and international markets. In addition, PSEG Services provides management and administrative services to PSEG and its subsidiaries. PSEG was incorporated under the laws of the State of New Jersey in 1985.

### The Merger (see page 118)

Under the terms of the merger, PSEG will merge with and into Exelon with Exelon continuing as the surviving corporation. Upon completion of the merger, Exelon will change its name to Exelon Electric & Gas Corporation.

The merger agreement is attached as *Annex A* to this joint proxy statement/prospectus. We urge you to read the merger agreement carefully and fully to understand the rights and obligations of Exelon and PSEG under the merger agreement, as it is the legal document that governs the merger.

### PSEG Shareholders Will Receive 1.225 Shares of Exelon Common Stock for Each Share of PSEG Common Stock (see page 118)

Subject to the terms and conditions of the merger agreement, upon completion of the merger, PSEG shareholders will receive 1.225 shares of Exelon common stock for each share of PSEG common stock they hold. Exelon will not issue fractional shares pursuant to the merger. As a result, the total

number of shares of Exelon common stock that each PSEG shareholder would otherwise receive pursuant to the merger will be rounded down to the nearest whole number, and each PSEG shareholder will receive such whole number of shares of Exelon common stock and a cash payment for the remaining fraction of a share of Exelon common stock that such shareholder would otherwise receive, if any, based on the last reported sale price per share of Exelon common stock at the close of business on the closing date of the merger, rounded down to the nearest cent.

*Example: If you own 137 shares of PSEG common stock when the merger is completed, you will be entitled to receive 167 shares of Exelon common stock and a check for the market value of 0.83 shares of Exelon common stock at the close of business on the closing date of the merger.*

**Each Outstanding Option to Purchase PSEG Common Stock and Each PSEG Equity-Based Award Will be Substituted with an Option to Purchase Shares of Exelon Common Stock or an Exelon Equity-Based Award at the Exchange Ratio and All Restrictions on PSEG Equity-Based Awards Will Be Assigned to Exelon (see page 118)**

Upon completion of the merger, each outstanding option to purchase shares of PSEG common stock will be assumed by Exelon and substituted with an option to purchase shares of Exelon common stock, exercisable on generally the same terms and conditions that applied before the merger. The number of shares of Exelon common stock subject to the substitute Exelon stock option will equal the number of shares of PSEG common stock subject to the PSEG stock option immediately prior to completion of the merger, multiplied by the exchange ratio, rounded down to the nearest whole share. The per share exercise price of each substitute Exelon stock option will equal the exercise price of the PSEG stock option immediately prior to completion of the merger divided by the exchange ratio, rounded up to the nearest whole cent. In addition, upon completion of the merger, Exelon will assume all PSEG equity-based awards and substitute them with equity-based awards with respect to shares of Exelon common stock on generally the same terms and conditions that applied before completion of the merger. The number of shares of Exelon common stock issuable under those awards, and the exercise prices for those awards, will be adjusted to take into account the exchange ratio.

Upon completion of the merger, all restrictions on PSEG equity-based awards immediately prior to completion of the merger, including all repurchase and forfeiture rights, will be assigned to Exelon, and, subject to any acceleration, lapse or other vesting occurring by operation of the merger, those PSEG equity-based awards will continue to be unvested and subject to the same restrictions which applied immediately prior to completion of the merger.

**The Exchange Ratio is Fixed and Will Not Be Adjusted in Response to Changes in Our Stock Prices (see page 118)**

The exchange ratio is fixed in the merger agreement and neither Exelon nor PSEG has the right to terminate the merger agreement based solely on changes in either party's stock price. The market value of the Exelon common stock that PSEG shareholders receive in the merger may fluctuate significantly from its current value.

The table below shows the closing prices of Exelon and PSEG common stock, which are listed on the New York Stock Exchange under the trading symbols "EXC" and "PEG," respectively, and the pro forma "*equivalent stock price*" at the close of the regular trading session on:

December 15, 2004, the last full trading day prior to a significant increase in trading volume from the average trading volume of Exelon and PSEG common stock and inquiries from *The Wall Street Journal* regarding whether Exelon and PSEG were in advanced merger discussions;

December 16, 2004, the last full trading day prior to the publication of news articles reporting that Exelon and PSEG were in advanced merger discussions;

December 17, 2004, the last full trading day prior to our public announcement of the merger; and

May 31, 2005, the most recent trading day for which that information was available prior to the mailing of this joint proxy statement/prospectus.

The "equivalent stock price" of shares of PSEG common stock represents the closing price per share of Exelon common stock on the New York Stock Exchange as of the applicable date, multiplied by the exchange ratio of 1.225.

| | Exelon Common Stock Closing Price | PSEG Common Stock Closing Price | PSEG Equivalent Stock Price |
|---|---|---|---|
| December 15, 2004 | $ 43.38 | $ 44.58 | $ 53.14 |
| December 16, 2004 | $ 42.60 | $ 45.61 | $ 52.19 |
| December 17, 2004 | $ 41.86 | $ 47.27 | $ 51.28 |
| May 31, 2005 | $ 46.85 | $ 55.50 | $ 57.39 |

**The value of the consideration to be received by PSEG shareholders will fluctuate with changes in the price of Exelon common stock. You are urged to obtain current market quotations for shares of both companies.**

**Exelon and PSEG Expect to Continue Their Respective Stated Dividend Policies Until Completion of the Merger; Exelon has Agreed, Subject to Specified Limitations, to Increase its Dividend Following Completion of the Merger to Equal PSEG's Dividend on an Exchange Ratio Adjusted Basis**

The merger agreement permits each of us to continue to pay regular dividends to our respective shareholders in accordance with our previously announced dividend policies. Exelon has previously indicated it expects to maintain a dividend payout policy of 50% to 60% of earnings. On April 27, 2005, Exelon declared a second quarter dividend for 2005 of $0.40 per share. On January 18, 2005, PSEG increased its first quarter dividend for 2005 to $0.56 per share from $0.55 per share, for an indicated annual dividend increase of $0.04 per share for the year 2005. On April 19, 2005, PSEG declared a second quarter dividend for 2005 of $0.56 per share. For the year 2006, PSEG will continue to evaluate its dividend payment and consider modest increases.

We have agreed to coordinate dividend declarations and the related record dates and payment dates so that our shareholders will not receive two dividends, or fail to receive one dividend, for any single calendar quarter. Accordingly, prior to completion of the merger, we may coordinate and amend our record dates and payment dates in order to effect this policy.

In addition, the merger agreement provides that, subject to applicable law and the fiduciary duties of its board of directors, Exelon will increase its first quarterly dividend paid after completion of the merger to an amount equal, on an exchange ratio adjusted basis, to the dividend PSEG shareholders received in the quarter immediately prior to completion of the merger, up to a maximum of $0.47 per share of Exelon common stock. The lesser of $0.47 and the amount required to equal PSEG's dividend on an exchange ratio adjusted basis is referred to in this joint proxy statement/prospectus as the "threshold amount." If the first quarterly dividend to be paid by Exelon after completion of the merger will be less than the threshold amount, PSEG may make a one time special cash dividend to its shareholders equal to the amount of the difference between the dividend Exelon has informed PSEG it will pay and the threshold amount, on an exchange ratio adjusted basis.

**PSEG Shareholders Generally Will Not Recognize Any Gain or Loss for United States Federal Income Tax Purposes Upon the Exchange of Their Shares of PSEG Common Stock for Shares of Exelon Common Stock in the Merger, Except that Gain or Loss Will Be Recognized on the Receipt of Cash in Lieu of a Fractional Share of Exelon Common Stock (see page 109)**

A holder of shares of PSEG common stock generally will not recognize any gain or loss upon the exchange of the holder's shares of PSEG common stock for shares of Exelon common stock pursuant to the merger, except that gain or loss will be recognized on the receipt of cash in lieu of a fractional share of Exelon common stock. You should read carefully the discussion under the heading "The Merger Material United States Federal Income Tax Consequences of the Merger" beginning on page 109 of this joint proxy statement/prospectus.

**Holders of shares of PSEG common stock are urged to consult their tax advisors as to the specific tax consequences to them of the merger, including the applicability and effect of United States federal, state, local and foreign income and other tax laws in light of their particular circumstances.**

**Exelon's Financial Advisors Delivered their Opinions to the Exelon Board of Directors to the Effect that, as of December 20, 2004, the Exchange Ratio in the Merger Was Fair, from a Financial Point of View, to Exelon (see page 66)**

Each of Exelon's financial advisors, J.P. Morgan Securities Inc. and Lehman Brothers Inc., has delivered its opinion dated as of December 20, 2004 to the Exelon board of directors that, as of that date, based upon and subject to the assumptions, qualifications and limitations set forth in their respective opinions, the exchange ratio in the merger was fair, from a financial point of view, to Exelon. The full text of the opinions of JPMorgan and Lehman Brothers are attached as *Annex B* and *Annex C*, respectively, to this joint proxy statement/prospectus. Exelon urges its shareholders to read the opinions in their entirety. Each of JPMorgan and Lehman Brothers has provided its opinion for the information and assistance of the Exelon board of directors in connection with its consideration of the merger agreement, the issuance of shares of Exelon common stock as contemplated by the merger agreement and the merger, and the opinions do not constitute a recommendation as to how any holder of Exelon common stock should vote with respect to the issuance of shares of Exelon common stock as contemplated by the merger agreement.

The opinion of each of JPMorgan and Lehman Brothers will not reflect any developments that may occur or may have occurred after the date of the opinions and prior to completion of the merger.

Pursuant to an engagement letter dated October 26, 2004, Exelon has agreed to pay JPMorgan a fee of $15 million in consideration for its services as financial advisor, $5 million of which was paid following the public announcement of the execution of the merger agreement, $5 million of which is payable upon approval of the issuance of shares of Exelon common stock as contemplated by the merger agreement by Exelon shareholders and $5 million of which is payable upon completion of the merger. Pursuant to an engagement letter dated November 5, 2004, Exelon has agreed to pay Lehman Brothers a fee of $15 million in consideration for its services as financial advisor, $5 million of which was paid following the public announcement of the execution of the merger agreement, $5 million of which is payable upon approval of the issuance of shares of Exelon common stock as contemplated by the merger agreement by Exelon shareholders and $5 million of which is payable upon completion of the merger.

**PSEG's Financial Advisor Delivered its Opinion to the PSEG Board of Directors to the Effect that, as of December 20, 2004, the Exchange Ratio Under the Merger Agreement Was Fair, from a Financial Point of View, to the Holders of PSEG Common Stock (see page 82)**

PSEG's financial advisor, Morgan Stanley & Co. Incorporated, has delivered its opinion dated as of December 20, 2004 to the PSEG board of directors that, as of that date, based upon and subject to the assumptions, qualifications and limitations discussed in its opinion, the exchange ratio under the

merger agreement was fair, from a financial point of view, to the holders of PSEG common stock. The full text of Morgan Stanley's opinion is attached as *Annex D* to this joint proxy statement/prospectus. PSEG urges its shareholders to read that opinion in its entirety. Morgan Stanley provided its opinion for the information and assistance of the PSEG board of directors in connection with its consideration of the merger agreement and the merger, and the opinion does not constitute a recommendation as to how any holder of PSEG common stock should vote with respect to the merger agreement.

The opinion of Morgan Stanley will not reflect any developments that may occur or may have occurred after the date of its opinion and prior to completion of the merger.

Pursuant to an engagement letter dated November 8, 2004, PSEG has agreed to pay Morgan Stanley a fee of $20 million in consideration for its services as financial advisor, $5 million of which was paid following the public announcement of the execution of the merger agreement, $5 million of which is payable upon PSEG shareholder approval of the merger agreement and $10 million of which is payable upon completion of the merger.

**Both Exelon and PSEG Shareholder Approvals Will Be Required to Complete the Merger (see pages 40 and 45)**

***For Exelon Shareholders:***

Approval of the proposal to issue shares of Exelon common stock as contemplated by the merger agreement requires the affirmative vote of at least a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy and entitled to vote on the issuance of shares of Exelon common stock as contemplated by the merger agreement as long as a quorum, which is the presence of holders of shares of Exelon common stock outstanding and entitled to cast at least a majority of the votes that all shareholders are entitled to cast on the matter, is present in person or by proxy and the total votes cast on the proposal represents at least a majority of the shares of Exelon common stock entitled to vote. Approval of the proposal to issue shares of Exelon common stock as contemplated by the merger agreement is a condition to completion of the merger.

Because the holders of Exelon common stock immediately prior to completion of the merger will own a majority of the shares of Exelon common stock outstanding immediately following completion of the merger, a separate vote by the holders of Exelon common stock on the merger agreement or the merger itself is not required under Pennsylvania law.

On May 2, 2005, which is the record date for determining those Exelon shareholders who are entitled to vote at the Exelon annual meeting, directors and executive officers of Exelon and their affiliates beneficially owned and had the right to vote 4,955,493 shares of Exelon common stock, representing less than 1% of the shares of Exelon common stock outstanding on the record date. To Exelon's knowledge, directors and executive officers of Exelon and their affiliates intend to vote their shares of common stock in favor of the proposal to issue shares of Exelon common stock as contemplated by the merger agreement, although none of them has entered into any agreement requiring them to do so.

***For PSEG Shareholders:***

Approval of the merger agreement requires the affirmative vote of at least a majority of the votes cast by holders of shares of PSEG common stock present in person or by proxy and entitled to vote on the approval of the merger agreement as long as a quorum, which is a majority of the shares of PSEG common stock outstanding, is present in person or by proxy.

On May 27, 2005, which is the record date for determining those PSEG shareholders who are entitled to vote at the PSEG annual meeting, directors and executive officers of PSEG and their affiliates beneficially owned and had the right to vote 4,951,871 shares of PSEG common stock, representing approximately 1.8% of the outstanding shares of PSEG common stock outstanding on the

record date. To PSEG's knowledge, directors and executive officers of PSEG and their affiliates intend to vote their shares of common stock in favor of the approval of the merger agreement, although none of them has entered into any agreement requiring them to do so.

**Recommendations of Exelon and PSEG to Shareholders (see pages 57 and 62)**

***To Exelon Shareholders:***

The Exelon board of directors has reviewed and considered the terms of the merger and the merger agreement and has unanimously determined that the merger, including the issuance of shares of Exelon common stock as contemplated by the merger agreement, is advisable, fair to and in the best interests of Exelon and its shareholders and unanimously recommends that Exelon shareholders vote **FOR** the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement.

***To PSEG Shareholders:***

The PSEG board of directors has reviewed and considered the terms of the merger and the merger agreement and has unanimously determined that the merger is advisable, fair to and in the best interests of PSEG and its shareholders and unanimously recommends that PSEG shareholders vote **FOR** the proposal to approve the merger agreement and thereby approve the merger.

**Completion of the Merger is Subject to Regulatory Clearance (see page 111)**

To complete the merger, we must receive approval from and/or make filings with various federal and state regulatory authorities. At the federal level, these approvals include the approval of the Securities and Exchange Commission under PUHCA, the Federal Energy Regulatory Commission under the Federal Power Act and the Nuclear Regulatory Commission under the Atomic Energy Act. In addition, under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the merger cannot be completed until we have made required notifications and given certain information and materials to the Antitrust Division of the United States Department of Justice and until specified waiting period requirements have expired. At the state level, among other required approvals, the New Jersey Board of Public Utilities and the Pennsylvania Public Utility Commission must review and approve the merger and the New York Public Service Commission must approve the indirect transfer of the ownership interest of a subsidiary of PSEG Power that has generation assets located in the State of New York. The Illinois Commerce Commission has been notified of the merger and it has informed Exelon and PSEG that it does not have jurisdiction over the merger and thus its approval is not required. See "The Merger  Regulatory Matters Relating to the Merger" beginning on page 111 of this joint proxy statement/prospectus for a discussion of the status of the regulatory approval process.

**Exelon's Amended and Restated By-Laws Will Be Amended and Restated Following Completion of the Merger to, Among Other Things, Provide for Certain Governance Arrangements During a Transition Period Beginning Upon Completion of the Merger and Ending Three Years Following Completion of the Merger (see page 129)**

Exelon has agreed to amend and restate its Amended and Restated By-laws to, among other things, provide for certain arrangements relating to its board of directors and management during a transition period beginning upon completion of the merger and ending three years following completion of the merger, including the following:

- upon completion of the merger, the Exelon board of directors will consist of 18 members, 12 of whom will be continuing Exelon directors and six of whom will be former PSEG directors;

- Mr. E. James Ferland, the current Chairman, President and Chief Executive Officer of PSEG, will serve as non-executive Chairman of the Exelon board of directors until the earlier of (1) March 31, 2007, his announced date of retirement, and (2) the date on which Mr. Ferland

no longer serves as a director of Exelon, at which time the Chief Executive Officer of Exelon will be appointed as Chairman of the Exelon board of directors and continue in such role for the duration of the transition period and thereafter as determined by the Exelon board of directors; and

for at least the transition period, Mr. John W. Rowe, the current Chairman, President and Chief Executive Officer of Exelon, will continue to serve as the President and Chief Executive Officer of Exelon in charge of general supervision over the business and operations of Exelon.

A copy of the form of Amended and Restated By-laws of Exelon is attached as *Annex F* to this joint proxy statement/prospectus and is incorporated by reference into this joint proxy statement/prospectus.

**PSEG Executive Officers and Directors Have Interests in the Merger that May Be Different from, or in Addition to, the Interests of the PSEG shareholders (see page 99)**

When PSEG shareholders consider their board of directors' recommendation that they vote in favor of the approval of the merger agreement, PSEG shareholders should be aware that PSEG executive officers and directors may have interests in the merger that are different from, or in addition to, PSEG shareholders' interests. Those interests include, among other things, the accelerated vesting of PSEG equity-based awards, increased severance benefits under specified circumstances and the appointment of six of the PSEG directors to the Exelon board of directors.

As a result, the directors and officers of PSEG may be more likely to recommend the approval of the merger agreement than if they did not have these interests.

**Completion of the Merger is Subject to the Satisfaction of a Number of Conditions (see page 133)**

Completion of the merger depends upon the satisfaction of a number of conditions, including the following:

approval of the merger agreement by the PSEG shareholders and approval by the Exelon shareholders of the issuance of shares of Exelon common stock as contemplated by the merger agreement;

authorization for listing by the New York Stock Exchange of the shares of Exelon common stock issuable pursuant to the merger agreement, subject to official notice of issuance;

expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;

receipt of *"final orders"* for the *"required statutory approvals"* and the absence from such orders of any *"burdensome order,"* which term includes, among other things, any order requiring either party to divest any nuclear assets (see "The Merger Agreement Covenants" beginning on page 120 of this joint proxy statement/prospectus for a discussion of these terms);

receipt of all other required government and regulatory consents, registrations, approvals and permits and authorizations, except for those the failure of which to obtain would not, individually or in the aggregate, reasonably be expected to have a material adverse effect on PSEG or on Exelon (assuming the merger had taken place);

receipt of all required consents or approvals from third parties, except for those the failure of which to obtain would not, individually or in the aggregate, reasonably be expected to have a material adverse effect on PSEG or on Exelon (assuming the merger had taken place);

absence of any law, judgment, injunction or other order by a governmental authority prohibiting completion of the merger;

- compliance in all material respects by the parties with their respective obligations under the merger agreement;
- absence of material breaches of the representations and warranties in the merger agreement;
- receipt of opinions of counsel to Exelon and PSEG to the effect that the merger constitutes a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code; and
- absence of a material adverse effect having occurred to the other party since the date of the merger agreement.

Other than the conditions to obtain the regulatory approvals required by law and the shareholder approvals, each of Exelon and PSEG may waive any conditions relating to its obligations to complete the merger. However, the parties do not intend to waive the condition relating to the receipt of tax opinions referred to above. If it were determined that the merger would not qualify as a tax-free reorganization and Exelon and PSEG were to waive the condition relating to the receipt of the tax opinions described above, Exelon and PSEG would re-solicit their shareholders' vote on the issuance of the shares of Exelon common stock as contemplated by the merger agreement and approval of the merger agreement, respectively.

**How the Merger Agreement May Be Terminated by Exelon and PSEG (see page 134)**

Exelon and PSEG may mutually agree to terminate the merger agreement and abandon the merger at any time prior to completion of the merger, whether before or after the PSEG shareholders have approved the merger agreement and the Exelon shareholders have approved the issuance of shares of Exelon common stock as contemplated by the merger agreement.

In addition, either party could decide, without the consent of the other, to terminate the merger agreement in a number of situations, including:

- if the merger is not completed by June 20, 2006 (which date may be extended by six months by either party if all conditions to closing have been satisfied other than the receipt of approval by the FERC under Section 203 of the Federal Power Act, by the SEC under PUHCA or by any of the New Jersey, New York or Pennsylvania public utility commissions if Exelon and PSEG are reasonably satisfied such state commission is waiting for such FERC or SEC approval to be obtained prior to ruling and such ruling is required for completion of the merger);
- if the required approval of the Exelon or PSEG shareholders is not obtained at the respective shareholder meetings;
- if a nonappealable order has been entered prohibiting the merger or, in connection with the required statutory approvals, an order has been entered that is a burdensome order that is a nonappealable final order;
- if the board of directors of the other party withdraws, qualifies or modifies its declaration, approval or recommendation in a manner adverse to the other party; or
- if the other party breaches its representations, warranties or covenants in the merger agreement, which breach results in a failure of one of the conditions to completion of the merger being satisfied and is not curable or cured.

The merger agreement may be terminated by PSEG prior to completion of the merger if, prior to the PSEG annual meeting:

- the PSEG board of directors authorizes PSEG, subject to complying with the terms of the merger agreement, to enter into a definitive agreement with a third party concerning a transaction that constitutes a *"superior proposal"* (see "The Merger Agreement Covenants No Solicitation" beginning on page 120 of this joint proxy statement/prospectus for a discussion of this term) and PSEG notifies Exelon in writing that it intends to enter into the agreement;

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- Exelon does not make, within five business days of receipt of PSEG's written notification of its intention to enter into a definitive agreement for a superior proposal, an offer that the PSEG board of directors determines, in its reasonable good faith judgment after consultation with its financial advisors, is at least as favorable, from a financial point of view, to the shareholders of PSEG; and

- prior to or concurrently with the termination of the merger agreement, PSEG pays to Exelon a termination fee of $400 million and Exelon's out-of-pocket expenses up to a maximum of $40 million.

The merger agreement may also be terminated by PSEG prior to the PSEG annual meeting if Exelon enters into a definitive agreement with respect to a *"parent acquisition transaction"* (see "The Merger Agreement  Termination of Merger Agreement" beginning on page 134 of this joint proxy statement/prospectus for a discussion of this term) or consummates such a transaction and PSEG notifies Exelon in writing that it is terminating the merger agreement within 10 business days of the earlier to occur of such parent acquisition transaction and the public announcement of the entry into such definitive agreement. If the merger agreement is terminated under this provision, Exelon will be required to pay PSEG a termination fee of $400 million and up to $40 million of PSEG's out-of-pocket expenses.

The merger agreement may be terminated by Exelon prior to completion of the merger if:

- PSEG's board of directors or a committee thereof recommends to PSEG shareholders a takeover proposal other than the merger;

- a tender offer or exchange offer for 20% or more of the outstanding shares of PSEG capital stock is commenced and PSEG's board of directors fails to recommend against acceptance of such offer within 10 business days after such commencement;

- PSEG breaches in any material respect its obligations under the no-solicitation provisions of the merger agreement; or

- prior to Exelon's annual meeting, Exelon enters into a definitive agreement with respect to a parent acquisition transaction or consummates such a transaction and notifies PSEG in writing that it is terminating the merger agreement within 10 business days from the earlier to occur of such parent acquisition transaction and the public announcement of the entry into such definitive agreement.

**Termination Fees and Expenses May Be Payable Under Some Circumstances (see page 136)**

Generally, if the merger agreement is terminated by Exelon in specified circumstances where the PSEG board of directors has withdrawn, qualified or modified its declaration with respect to or its approval or recommendation of the merger agreement and the merger with Exelon in a manner adverse to Exelon, by either party in specified circumstances involving the acquisition of PSEG by another person, or by Exelon upon a material breach by PSEG of the no-solicitation provisions of the merger agreement, PSEG will be required to pay Exelon a termination fee of $400 million and up to $40 million of Exelon's out-of-pocket expenses.

Generally, if the merger agreement is terminated by PSEG where the Exelon board of directors has withdrawn, qualified or modified its declaration with respect to or its approval or recommendation of the merger agreement, the issuance of shares of Exelon common stock as contemplated by the merger agreement and the merger in a manner adverse to PSEG, Exelon will be required to pay up to $40 million of PSEG's out-of-pocket expenses. If the merger agreement is terminated by PSEG or Exelon where Exelon enters into a definitive agreement with respect to a parent acquisition transaction or consummates such a transaction, Exelon will be required to pay PSEG a termination fee of $400 million and up to $40 million of PSEG's out-of-pocket expenses.

**Neither Exelon nor PSEG Shareholders Will Have Appraisal Rights in Connection with the Merger (see page 116)**

Neither Exelon nor PSEG shareholders are entitled to dissenters' appraisal rights in connection with the merger.

**Exelon Common Stock Will Be Listed on the New York Stock Exchange (see page 117)**

The shares of Exelon common stock to be issued pursuant to the merger will be listed on the New York Stock Exchange. In addition, Exelon currently intends to list the shares of Exelon common stock issued in the merger on the Chicago Stock Exchange and the Philadelphia Stock Exchange.

**The Merger Will Be Accounted for Using the Purchase Method of Accounting (see page 109)**

Exelon will account for the merger under the purchase method of accounting for business combinations under accounting principles generally accepted in the United States. Under the purchase method of accounting, the assets and liabilities of PSEG will be recorded, as of completion of the merger, at their respective fair values and added to those of Exelon.

**PSEG Shareholders Will Hold Approximately 32% of the Outstanding Shares of Exelon Common Stock Following Completion of the Merger (see page 145)**

Upon completion of the merger, Exelon will issue up to approximately 313 million shares of Exelon common stock to PSEG shareholders as contemplated by the merger agreement. In addition, approximately 7.2 million shares of Exelon common stock will be issuable pursuant to PSEG stock options and PSEG equity-based awards to be assumed by Exelon, approximately 1.4 million of which will vest before or upon completion of the merger. Immediately following completion of the merger, it is expected that there will be approximately 991 million shares of Exelon common stock issued and outstanding on a fully diluted basis. The shares of Exelon common stock to be issued to PSEG shareholders will represent approximately 32% of the outstanding Exelon common stock after the merger on a fully diluted basis. This information is based on the number of Exelon and PSEG shares and PSEG equity-based awards and securities convertible into shares of PSEG common stock (PSEG's Participating Units) outstanding on April 30, 2005.

**Due to Variances Between the State Business Corporation Law of Pennsylvania and New Jersey and Between the Charters and Other Corporate Documents of Exelon and PSEG, Differences Exist Between the Rights of Exelon Shareholders and PSEG Shareholders (see page 158)**

The rights of Exelon and PSEG shareholders under the business corporation law of Pennsylvania and New Jersey, respectively, are different. There are additional differences in the rights of Exelon shareholders and PSEG shareholders as a result of the provisions of the charters, by-laws and other corporate documents of each company. See "Comparison of Exelon/PSEG Shareholder Rights" beginning on page 158 of this joint proxy statement/prospectus.

**The Merger and the Performance of the Combined Company are Subject to a Number of Risks (see page 21)**

There are a number of risks relating to the merger and to the businesses of Exelon, PSEG and the combined company following the merger. See "Risk Factors" beginning on page 21 of this joint proxy statement/prospectus for a discussion of these and other risks and see also the documents that we have filed with the SEC and which we have incorporated by reference into this joint proxy statement/prospectus.

**Selected Historical Financial Information**

The following selected historical financial information is being provided to assist you in your analysis of the financial aspects of the merger. The Exelon annual historical information is derived from the audited consolidated financial statements of Exelon as of and for each of the years in the five-year period ended December 31, 2004. The PSEG annual historical information is derived from the audited consolidated financial statements of PSEG as of and for each of the years in the five-year period ended December 31, 2004. The information as of and for the three months ended March 31, 2005 and 2004 has been derived from unaudited interim financial statements of Exelon and PSEG, respectively, and, in the opinion of such company's management, include all normal and recurring adjustments that are considered necessary for the fair presentation of the results for the interim period of such company. The information is only a summary and should be read in conjunction with each company's historical consolidated financial statements and related notes contained in the Exelon and PSEG annual reports on Form 10-K for the year ended December 31, 2004 and the quarterly reports on Form 10-Q for the period ended March 31, 2005 and the report on Form 8-K filed by Exelon on May 13, 2005, in which Items 6, 7 and 8 of Exelon's annual report on Form 10-K for the year ended December 31, 2004 were recast, which have been incorporated by reference into this joint proxy statement/prospectus, as well as other information that has been filed with the SEC. See "Where You Can Find More Information" beginning on page 243 of this joint proxy statement/prospectus for information on where you can obtain copies of this information. The historical results included below and elsewhere in this joint proxy statement/prospectus are not necessarily indicative of the future performance of Exelon, PSEG or the combined company.

**Exelon Selected Historical Financial Information**

| | As of and for the | | | | | | |
|---|---|---|---|---|---|---|---|
| | Three Months Ended March 31, | | Year Ended December 31, | | | | |
| | 2005 | 2004 | 2004 | 2003(2) | 2002 | 2001 | 2000(1) |
| | (unaudited) | | (in millions, except per share data) | | | | |
| **Statement of Operations Information:** | | | | | | | |
| Operating revenues | $ 3,561 | $ 3,635 | $ 14,133 | $ 15,148 | $ 14,060 | $ 13,978 | $ 7,060 |
| Operating income | 931 | 771 | 3,499 | 2,409 | 3,280 | 3,406 | 1,562 |
| Income from continuing operations | 507 | 397 | 1,870 | 892 | 1,690 | 1,448 | 606 |
| Income (loss) from discontinued operations | 14 | (17) | (29) | (99) | (20) | (32) | (44) |
| Income before cumulative effect of changes in accounting principles | 521 | 380 | 1,841 | 793 | 1,670 | 1,416 | 562 |
| Cumulative effect of changes in accounting principles (net of income taxes) | | 32 | 23 | 112 | (230) | 12 | 24 |
| Net income | 521 | 412 | 1,864 | 905 | 1,440 | 1,428 | 586 |
| Income from continuing operations per share of common stock:(4) | | | | | | | |
| Basic | $ 0.76 | $ 0.60 | $ 2.83 | $ 1.37 | $ 2.62 | $ 2.26 | $ 1.50 |
| Diluted | 0.75 | 0.59 | 2.79 | 1.36 | 2.60 | 2.24 | 1.49 |
| Discontinued operations:(4) | | | | | | | |
| Basic | $ 0.02 | $ (0.02) | $ (0.04) | $ (0.15) | $ (0.03) | $ (0.05) | $ (0.11) |
| Diluted | 0.02 | (0.02) | (0.04) | (0.15) | (0.03) | (0.05) | (0.11) |
| Income before cumulative effect of changes in accounting principles per share of common stock:(4) | | | | | | | |
| Basic | $ 0.78 | $ 0.58 | $ 2.79 | $ 1.22 | $ 2.59 | $ 2.21 | $ 1.40 |
| Diluted | 0.77 | 0.57 | 2.75 | 1.21 | 2.57 | 2.19 | 1.38 |
| Net income per share of common stock:(4) | | | | | | | |
| Basic | $ 0.78 | $ 0.63 | $ 2.82 | $ 1.39 | $ 2.23 | $ 2.23 | $ 1.46 |
| Diluted | 0.77 | 0.62 | 2.78 | 1.38 | 2.22 | 2.21 | 1.44 |
| Dividends per common share | 0.40 | 0.275 | 1.26 | 0.96 | 0.88 | 0.91 | 0.46 |
| **Balance Sheet Information:** | | | | | | | |
| Total assets | $ 42,408 | | $ 42,770 | $ 41,936 | $ 37,869 | $ 34,969 | $ 36,674 |
| Long-term debt | 10,997 | | 12,148 | 13,489 | 13,127 | 12,879 | 12,958 |
| Preferred securities of subsidiaries(3) | 87 | | 87 | 87 | 595 | 613 | 630 |
| Shareholders' equity | 9,713 | | 9,423 | 8,503 | 7,742 | 8,102 | 7,215 |

(1) Reflects the effects of the merger of Exelon, Unicom Corporation and PECO on October 20, 2000 (the "Unicom Merger"). The Unicom Merger was accounted for using the purchase method of accounting with PECO as the acquiring company. Accordingly, financial results for 2000 consist of PECO's results for 2000 and Unicom results after October 20, 2000.

(2) 2003 results include a pre-tax charge of $945 million ($573 million after-tax) related to the impairment of Exelon's investment in Boston Generating, LLC and a pre-tax charge of $255 million ($166 million after-tax) related to the impairment of Exelon's investment in Sithe Energies, Inc.

(3) Upon adoption of Financial Accounting Standards Board Interpretation ("FIN") No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN No. 46-R") in 2003, the mandatory redeemable preferred securities of ComEd and PECO were reclassified as long-term debt to financing trusts as of December 31, 2003.

(4)

Per share information for 2000 through 2004 has been adjusted to reflect the 2-for-1 stock split that was distributed to Exelon shareholders on May 5, 2004.

**PSEG Selected Historical Financial Information**

| | As of and for the | | | | | | |
|---|---|---|---|---|---|---|---|
| | Three Months Ended March 31, | | Year Ended December 31, | | | | |
| | 2005 | 2004 | 2004 | 2003 | 2002(1) | 2001 | 2000 |
| | (unaudited) | | (in millions, except per share data) | | | | |
| **Statement of Operations Information:** | | | | | | | |
| Operating revenues | $ 3,310 | $ 3,225 | $ 10,996 | $ 11,139 | $ 8,220 | $ 6,883 | $ 6,521 |
| Income from continuing operations | 285 | 271 | 721 | 852 | 405(1) | 766 | 782 |
| Net income | 285 | 271 | 726 | 1,160 | 235(1) | 764 | 770 |
| Income from continuing operations per share of common stock: | | | | | | | |
| Basic | $ 1.20 | $ 1.15 | $ 3.04 | $ 3.73 | $ 1.94(1) | $ 3.68 | $ 3.64 |
| Diluted | 1.18 | 1.14 | 3.03 | 3.72 | 1.94(1) | 3.68 | 3.64 |
| Net income per share of common stock: | | | | | | | |
| Basic | $ 1.20 | $ 1.15 | $ 3.06 | $ 5.08 | $ 1.13(1) | $ 3.67 | $ 3.58 |
| Diluted | 1.18 | 1.14 | 3.05 | 5.07 | 1.13(1) | 3.67 | 3.58 |
| Dividends per common share | 0.56 | 0.55 | 2.20 | 2.16 | 2.16 | 2.16 | 2.16 |
| **Balance Sheet Information:** | | | | | | | |
| Total assets | $ 28,885 | | $ 29,237 | $ 28,131 | $ 26,147 | $ 25,568 | $ 21,531 |
| Long-term debt obligations(2)(3) | 12,775 | | 12,975 | 12,995 | 12,291 | 10,814 | 5,869 |
| Preferred stock with mandatory redemption | | | | | | | 75 |
| Shareholders' equity | 5,736 | | 5,739 | 5,529 | 3,885 | 4,068 | 3,946 |

(1) 2002 results include after-tax charges of $368 million, or $1.76 per share, related to losses from PSEG Energy Holdings L.L.C.'s Argentine investments.

(2) Includes capital lease obligations. The increase between 2000 and 2001 is related to the $2.5 billion securitization transaction in 2001.

(3) Amounts include debt obligations between PSEG and PSE&G and their respective capital trusts due to the implementation of FIN No. 46-R which required the deconsolidation of such trusts. This implementation resulted in the removal of the preferred securities issued by the trusts from the PSEG consolidated financial statements and the addition of long-term debt between PSEG and PSE&G and their respective trusts equal to the amount of preferred securities issued by the trusts and the common equity investment contributed to the trusts.

**Selected Unaudited Pro Forma Condensed Combined Consolidated Financial Information**

The merger will be accounted for under the purchase method of accounting, which means the assets and liabilities of PSEG will be recorded, as of completion of the merger, at their respective fair values and added to those of Exelon. For a more detailed description of purchase accounting, see "The Merger Accounting Treatment" beginning on page 109 of this joint proxy statement/prospectus.

We have presented below selected unaudited pro forma condensed combined consolidated financial information that reflects the purchase method of accounting and gives effect to the merger, in the case of the statement of operations information, as though the merger had occurred as of January 1, 2004 and, in the case of the balance sheet information, as though the merger had occurred as of March 31, 2005.

The unaudited pro forma condensed combined consolidated financial information has been prepared giving effect to the issuance of 1.225 shares of Exelon common stock in exchange for each outstanding share of PSEG common stock.

The unaudited pro forma condensed combined consolidated financial information may have been different had the companies actually been combined as of January 1, 2004 or March 31, 2005. The selected unaudited pro forma condensed combined consolidated financial information does not reflect the effect of asset dispositions, if any, or synergies that may result from the merger. You should not rely on the selected unaudited pro forma condensed combined consolidated financial information as being indicative of the historical results that would have occurred had the companies been combined or the future results that may be achieved after completion of the merger. The following selected unaudited pro forma condensed combined consolidated financial information has been derived from, and should be read in conjunction with, the Exelon and PSEG Unaudited Pro Forma Condensed Combined Consolidated Financial Statements and related notes beginning on page 145 of this joint proxy statement/prospectus.

| | As of and for the | |
|---|---|---|
| **Unaudited Pro Forma Condensed Combined Consolidated** | **Three Months Ended March 31, 2005** | **Year Ended December 31, 2004** |
| | **(in millions, except per share data)** | |
| **Statement of Operations Information:** | | |
| Operating revenues | $ 6,984 | $ 25,544 |
| Operating income | 1,641 | 6,101 |
| Income from continuing operations | 820 | 2,867 |
| Earnings per share from continuing operations: | | |
| Basic | $ 0.86 | $ 3.01 |
| Diluted | 0.84 | 2.98 |
| Weighted average number of shares and share equivalents: | | |
| Basic | 958 | 952 |
| Diluted | 973 | 963 |
| **Balance Sheet Information (as of March 31, 2005):** | | |
| Cash and cash equivalents | $ 683 | |
| Total assets | 79,716 | |
| Long-term debt | 24,407 | |
| Total liabilities | 57,003 | |
| Shareholders' equity | 22,545 | |
| Shareholders' equity per share | 23.53 | |

**Comparative Historical and Unaudited Pro Forma Per Share Information**

The following table sets forth selected pro forma and historical per share information of Exelon and PSEG, respectively, and unaudited pro forma condensed combined consolidated per share information reflecting the merger between Exelon and PSEG, under the purchase method of accounting, and the issuance of 1.225 shares of Exelon common stock in exchange for each outstanding share of PSEG common stock. You should read this information in conjunction with the selected historical financial information, included elsewhere in this joint proxy statement/prospectus, the historical financial statements of Exelon and PSEG and related notes contained in the Exelon and PSEG annual reports on Form 10-K for the year ended December 31, 2004, the Exelon and PSEG quarterly reports on Form 10-Q for the period ended March 31, 2005 and the report on Form 8-K filed by Exelon on May 13, 2005, in which Items 6, 7 and 8 of Exelon's annual report on Form 10-K for the year ended December 31, 2004 were recast, which have been incorporated by reference into this joint proxy statement/prospectus and the Exelon Unaudited Pro Forma Condensed Consolidated Financial Statements beginning on page 145 of this joint proxy statement/prospectus. The unaudited pro forma condensed combined consolidated per share information is derived from, and should be read in conjunction with, the Exelon and PSEG Unaudited Pro Forma Condensed Combined Consolidated Financial Statements and related notes beginning on page 145 of this joint proxy statement/prospectus. The historical per share information is derived from the audited financial statements of Exelon, as adjusted for discontinued operations, and the audited financial statements of PSEG as of and for the year ended December 31, 2004 and the unaudited financial statements of Exelon and PSEG for the three months ended March 31, 2005. The unaudited pro forma PSEG per share equivalents are calculated by multiplying the unaudited Exelon pro forma combined per share amounts by the exchange ratio of 1.225.

The unaudited pro forma condensed combined consolidated per share information does not purport to represent what the actual results of operations of Exelon and PSEG would have been had

the companies been combined during the periods presented or to project Exelon's and PSEG's results of operations that may be achieved after completion of the merger.

| | As of and for the | |
|---|---|---|
| | **Three Months Ended March 31, 2005** | **Year Ended December 31, 2004** |
| **Unaudited Pro Forma Combined** | | |
| Income from continuing operations per share: | | |
| Basic | $ 0.86 | $ 3.01 |
| Diluted | 0.84 | 2.98 |
| Shareholders' equity per share | 23.53 | |
| **Exelon Historical (as adjusted for discontinued operations)** | | |
| Income from continuing operations per share: | | |
| Basic | $ 0.76 | $ 2.83 |
| Diluted | 0.75 | 2.79 |
| Dividends declared per common share | 0.40 | 1.26 |
| Shareholders' equity per share | 14.58 | 14.29 |
| **PSEG Historical** | | |
| Income from continuing operations per share: | | |
| Basic | $ 1.20 | $ 3.04 |
| Diluted | 1.18 | 3.03 |
| Dividends declared per common share | 0.56 | 2.20 |
| Shareholders' equity per share | 24.07 | 24.22 |
| **Unaudited Pro Forma PSEG Equivalents Combined** | | |
| Income from continuing operations per share: | | |
| Basic | $ 1.47 | $ 3.72 |
| Diluted | 1.45 | 3.71 |
| Shareholders' equity per share | 29.48 | |

**Comparative Per Share Market Price and Dividend Information**

Exelon common stock and PSEG common stock are each listed on the New York Stock Exchange. Exelon's and PSEG's trading symbols are "EXC" and "PEG," respectively. The following table shows, for the calendar quarters indicated, based on published financial sources: (1) the high and low sale prices of shares of Exelon and PSEG common stock as reported on the New York Stock Exchange Composite Transaction Tape and (2) the cash dividends paid per share of Exelon and PSEG common stock. The sales prices and dividends with respect to Exelon common stock noted below have been retroactively restated for all periods to reflect the 2 for 1 stock split that was distributed to the Exelon shareholders on May 5, 2004.

| | Exelon Common Stock | | | PSEG Common Stock | | |
|---|---|---|---|---|---|---|
| | **High** | **Low** | **Dividends** | **High** | **Low** | **Dividends** |
| **2003** | | | | | | |
| First Quarter | $ 27.60 | $ 23.04 | $ 0.23 | $ 37.25 | $ 32.09 | $ 0.54 |
| Second Quarter | 30.46 | 24.83 | 0.23 | 44.50 | 36.45 | 0.54 |
| Third Quarter | 31.98 | 27.09 | 0.25 | 43.78 | 39.77 | 0.54 |
| Fourth Quarter | 33.31 | 30.48 | 0.25 | 44.20 | 39.40 | 0.54 |
| **2004** | | | | | | |
| First Quarter | 34.44 | 32.18 | 0.275 | 47.71 | 42.85 | 0.55 |
| Second Quarter | 34.90 | 30.92 | 0.275 | 47.70 | 39.66 | 0.55 |
| Third Quarter | 37.90 | 32.69 | 0.305 | 42.60 | 38.10 | 0.55 |
| Fourth Quarter | 44.70 | 37.16 | 0.40 | 52.64 | 40.55 | 0.55 |
| **2005** | | | | | | |
| First Quarter | 47.18 | 41.77 | 0.40 | 56.09 | 49.67 | 0.56 |
| Second Quarter (through May 31, 2005) | 49.70 | 44.14 | 0.40 | 58.28 | 52.00 | 0.56 |

## RISK FACTORS

*Exelon and PSEG will operate as a combined company in a market environment that involves significant risks, many of which will be beyond the combined company's control. In addition to the other information contained in or incorporated by reference into this joint proxy statement/prospectus, you should carefully consider the risks described below before deciding how to vote your shares. This section does not describe risks that are generally applicable to participants in the utility and generation industries. We believe we have described all other material risks relating to the merger and the combined company; however, additional risks and uncertainties not presently known to Exelon and PSEG or that are not currently believed to be important to you, if they materialize, also may adversely affect the merger and Exelon and PSEG as a combined company.*

### Risks Relating to the Merger

***The value of Exelon shares to be received by PSEG shareholders will fluctuate.***

Upon completion of the merger, each outstanding share of PSEG common stock will be converted into the right to receive 1.225 shares of Exelon common stock. The number of shares of Exelon common stock to be issued pursuant to the merger for each share of PSEG common stock is fixed. The market price of Exelon common stock when the merger is completed may differ significantly from its market price at the date of this joint proxy statement/prospectus and at the date of the annual meetings of Exelon and PSEG. For example, during the 12-month period ended on May 31, 2005, the most recent practicable date prior to the mailing of this joint proxy statement/prospectus, Exelon common stock traded in a range from a low of $32.10 to a high of $49.70 and ended that period at $46.85. See "Summary Comparative Per Share Market Price and Dividend Information" beginning on page 20 of this joint proxy statement/prospectus for more detailed share price information.

Because of the number of regulatory approvals necessary to complete the merger, there may be a significant period of time between the date of the Exelon and PSEG annual meetings and the closing date of the merger, which under the merger agreement must occur no later than December 20, 2006 unless that date is extended by Exelon and PSEG. **At the time of their respective annual meetings, Exelon and PSEG shareholders will not know the exact market value of the Exelon common stock that will be issued in connection with the merger. The value of the merger consideration to be received by PSEG shareholders will fluctuate with changes in the price of Exelon's common stock. Shareholders of Exelon and PSEG are urged to obtain current market quotations for Exelon and PSEG common stock.**

***The anticipated benefits of combining PSEG and Exelon may not be realized.***

Exelon and PSEG entered into the merger agreement with the expectation that the merger would result in various benefits, including, among other things, synergies, cost savings and operating efficiencies. Although we expect to achieve the anticipated benefits of the merger, achieving them, including the synergies, is subject to a number of uncertainties, including:

- whether FERC, the NJBPU and the other regulatory authorities whose approval is required to complete the merger impose conditions on the merger that may have a material adverse effect on the combined company;
- the extent to which the NJBPU, PPUC and other state regulatory authorities whose approval is required to complete the merger require the combined company to share a portion of the expected synergies of the merger with customers; and
- general competitive factors in the market place.

Although the companies' plans for integration and operation of the combined company and its subsidiaries and divisions are focused on minimizing uncertainties in order to achieve these anticipated

benefits, no assurance can be given that these benefits will be achieved. Failure to achieve these anticipated benefits could result in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy and could have an adverse effect on the combined company's business, financial condition, operating results and prospects.

***Exelon and PSEG may be unable to successfully integrate their operations.***

The merger involves the integration of two companies that previously operated independently. The difficulties of combining each company's operations include:

- the necessity of coordinating geographically separated organizations, systems and facilities; and
- integrating personnel with diverse business backgrounds.

In addition, the integration of some of Exelon's and PSEG's operations will require regulatory approval.

Exelon and PSEG recognize that the process of integrating operations could cause an interruption of, or loss of momentum in, the activities of one or more of the combined company's businesses, and we intend to address these issues. The diversion of management's attention and any delays or difficulties encountered in connection with the merger and the integration of the two companies' operations could have an adverse effect on the business, financial condition, operating results and prospects of the combined company after the merger, and could impair the combined company's ability to realize the anticipated benefits of the merger.

***The application of the purchase method of accounting will result in approximately $8.1 billion of additional goodwill which could become impaired and adversely affect the market value of the combined company's common stock following completion of the merger.***

Under the purchase method of accounting, the total purchase price paid by Exelon in the merger will be allocated to PSEG's tangible assets and liabilities and identifiable intangible assets, if any are identified, based on their fair values as of the date of completion of the merger. The excess of the purchase price over those fair values will be recorded as goodwill. We expect that the merger will result in the creation of approximately $8.1 billion in goodwill based upon the application of purchase accounting. As a result, upon completion of the merger, the combined company will have approximately $13.4 billion in goodwill. To the extent the value of goodwill or intangibles becomes impaired, the combined company may be required to incur material charges relating to such impairment. Such a potential impairment charge could have a material impact on the combined company's operating results.

***The combined company may be unable to obtain permission from the NJBPU to recover PSE&G's pension and other post-retirement benefit expenses, which could have an adverse effect on its cash flow and results of operation.***

PSE&G is permitted by its current NJBPU rate order to recover through its rates the amortized portion of its pension expenses and other post-retirement benefit expenses associated with its pension and post-retirement obligations. As a result of the application of the purchase method of accounting to these costs, the recognition of certain unrecognized pension and OPEB expenses will be accelerated and, as a result, will no longer be reflected in the calculation of pension and OPEB expenses that PSE&G's current rate order permits it to recover. PSE&G estimates that it could have as much as $1.2 billion in unrecognized pension and OPEB expenses that PSE&G may be unable to recover following completion of the merger unless it obtains approval from the NJBPU to permit continued recovery of those expenses in the manner the current rate order permits. Exelon and PSEG have made it a condition to completion of the merger that PSE&G receive an order from the NJBPU permitting

PSE&G to continue to recover the pension expenses as it did prior to completion of the merger. The NJBPU has issued similar orders in other merger proceedings and such an order would not be expected to increase rates above current levels; however, Exelon and PSEG cannot assure you that PSE&G will receive such an order from the NJBPU or that if it does receive such an order, it will be permitted in future rate proceedings to continue to recover these expenses. Failure to obtain or maintain the right to recover the pension and OPEB expenses would have an adverse effect on the combined company's cash flow and results of operations.

***Exelon and PSEG will incur significant transaction and merger-related integration costs in connection with the merger.***

Exelon and PSEG expect to incur costs associated with consummating the merger and integrating the operations of the two companies, as well as approximately $41 million in transaction fees in the case of Exelon and $29 million in the case of PSEG. The estimated $41 million of transaction costs incurred by Exelon will be included as a component of the purchase price for purposes of purchase accounting. The amount of transaction fees expected to be incurred is a preliminary estimate and subject to change. Exelon currently estimates integration costs associated with the merger to be approximately $700 million over a period of four years, with approximately $450 million being incurred in the first full year of operations following completion of the merger. Exelon is in the early stages of assessing the magnitude of these costs and, therefore, these estimates may change, and additional unanticipated costs may be incurred in the integration of the businesses of Exelon and PSEG. Although Exelon and PSEG believe that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, will offset incremental transaction and merger-related costs over time, we cannot assure you that this net benefit will be achieved in the near term, or at all.

***Exelon and PSEG will be subject to business uncertainties and contractual restrictions while the merger is pending which could adversely affect their businesses.***

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on Exelon and PSEG and, consequently, on the combined company. Although Exelon and PSEG intend to take steps to reduce any adverse effects, these uncertainties may impair Exelon's and PSEG's ability to attract, retain and motivate key personnel until the merger is consummated and for a period of time thereafter, and could cause customers, suppliers and others that deal with Exelon and PSEG to seek to change existing business relationships with Exelon and PSEG. Employee retention may be particularly challenging during the pendency of the merger, as employees may experience uncertainty about their future roles with the combined company. If, despite Exelon's and PSEG's retention efforts, key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with the combined company, the combined company's business could be seriously harmed. In addition, the merger agreement restricts Exelon and PSEG from making certain acquisitions and taking other specified actions until the merger occurs or the merger agreement terminates. These restrictions may prevent Exelon and PSEG from pursuing otherwise attractive business opportunities and making other changes to their businesses that may arise prior to completion of the merger or termination of the merger agreement. Please see the section titled "The Merger Agreement  Covenants" beginning on page 120 of this joint proxy statement/prospectus for a description of the restrictive covenants applicable to PSEG and Exelon.

***The combined company may be subject to adverse regulatory conditions following completion of the merger.***

Before the merger may be completed, various approvals or consents must be obtained from FERC, the SEC, the NRC and various utility regulatory, antitrust and other authorities in the United States and in foreign jurisdictions. The governmental authorities from which these approvals are required may

impose conditions on completion of the merger or require changes to the terms of the merger. These conditions or changes could have the effect of delaying completion of the merger or imposing additional costs on or limiting the revenues of the combined company following the merger, any of which might have a material adverse effect on the combined company following completion of the merger.

Exelon and PSEG have filed or will file applications for the required statutory approvals with the governmental authorities described above, including a market concentration mitigation plan with FERC. The market concentration mitigation plan included with the companies' original filing with FERC contemplated (1) the divestiture of fossil fuel generating facilities with 2,900 MW of generating capacity and (2) the transfer of control of 2,600 MW of baseload nuclear capacity through either long-term firm baseload energy sales contracts or an annual auction. In response to certain objections and concerns raised by intervenors, the companies filed a supplement to the market concentration mitigation plan, which proposed the divestiture of at least 1,100 MW of additional fossil fuel generating capacity, for a total of 6,600 MW of capacity proposed for mitigation, if FERC approves the merger without an evidentiary hearing. Exelon and PSEG have not offered to divest any nuclear generating facilities and do not anticipate doing so. FERC could, however, condition its approval of the merger on the parties agreeing to divest or transfer control of a greater amount of capacity and/or to divest additional generation assets. If that were to occur, it could have the effects described in the previous paragraph. See "The Merger Regulatory Matters Relating to the Merger" beginning on page 111 of this joint proxy statement/prospectus for a discussion of the required statutory approvals and the filings by Exelon and PSEG.

***Some of the directors and executive officers of PSEG and Exelon have interests and arrangements that could have affected their decision to support or approve the merger.***

The interests of some of the directors and executive officers of PSEG in the merger are different from, and may be in addition to, those of PSEG shareholders generally and could have affected their decision to support or approve the merger. These interests include those described under "The Merger Interests of PSEG's Directors and Executive Officers in the Merger" beginning on page 99 of this joint proxy statement/prospectus. As a result, the directors and officers of PSEG may be more likely to recommend to PSEG's shareholders the approval of the merger agreement than if they did not have these interests.

The interests of some of the executive officers of Exelon in the merger are different from, and may be in addition to, those of Exelon shareholders generally and could have affected their decision to support the merger. The Amended and Restated By-laws of Exelon to be adopted upon completion of the merger provide that for at least the three-year transition period following completion of the merger, Mr. Rowe will be the Chief Executive Officer of Exelon and that when Mr. Ferland ceases to serve as the non-executive Chairman of the Exelon board of directors, the Chief Executive Officer of Exelon will be appointed Chairman of the Exelon board of directors. In addition, the merger agreement permits Exelon to amend its severance agreements and plans to treat the merger as a change in control under those agreements and plans. The Exelon compensation committee has recently considered changes to the senior management severance plan that would provide certain benefits to participating executives whose employment terminates in connection with the merger, including the accelerated vesting of outstanding stock options and restricted stock awards. No such changes have been formally adopted to date, but it is currently anticipated that such changes will be adopted on or before the closing of the merger. As a result, the officers of Exelon may be more likely to recommend to Exelon's shareholders the approval of the issuance of shares of Exelon common stock as contemplated by the merger agreement.

**Risks Relating to the Business of the Combined Company**

***Under the combined company's holding company structure, the payment of dividends to shareholders will be subject to the ability of its subsidiaries to pay dividends.***

Each of Exelon and PSEG is, and the combined company will be, a holding company with no material assets other than the stock of its subsidiaries. Accordingly, all of the combined company's operations will be conducted by its subsidiaries. The combined company's ability to pay dividends on its common stock will depend on the payment to it of dividends by its operating subsidiaries. These subsidiaries' payments of dividends to the combined company in turn will depend on their results of operations and cash flows and other other items impacting retained earnings. Under applicable federal law, Exelon, ComEd, PECO, and Exelon Generation can pay dividends only from retained, undistributed or current earnings. Following completion of the merger, PSE&G will be subject to the same restrictions. Following completion of the merger, a significant loss recorded at ComEd, PECO, PSE&G or Exelon Generation may limit the dividends that these companies can distribute to Exelon. Under Illinois law, ComEd may not pay any dividend on its stock unless, among other things, its earnings and earned surplus are sufficient to declare and pay a dividend after provision is made for reasonable and proper reserves, or unless ComEd has specific authorization from the Illinois Commerce Commission. As a condition to approval of other utility mergers, the NJBPU has imposed dividend restrictions. We can give no assurance that a similar restriction will not be imposed on PSE&G. In addition, PSEG Energy Holdings and its subsidiaries are parties to debt agreements that restrict their ability to pay dividends, make cash distributions or otherwise transfer funds to PSEG, or after completion of the merger, the combined company.

***Exelon's and PSEG's businesses are, and the combined company's business will be, subject to extensive regulation that will affect their operations and costs.***

Exelon and PSEG are, and the combined company will be, subject to regulation by the SEC under PUHCA, by FERC and the NRC, by federal, state and local authorities under environmental laws and by state public utility commissions under laws regulating Exelon's and PSEG's distribution businesses, among others. Regulation will affect almost every aspect of the combined company's businesses, from its fundamental business management actions to its ability to:

- determine the terms and rates of its transmission and distribution businesses' services;
- make acquisitions;
- issue equity or debt securities;
- engage in transactions between its utilities and other subsidiaries and affiliates; and
- pay dividends.

Changes in regulation can cause delays in or affect business planning and transactions and can increase the combined company's costs. As part of retail electric restructuring initiatives in Illinois and Pennsylvania and other regulatory proceedings, ComEd's and PECO's rates are currently subject to limitations, including:

- a freeze on ComEd's bundled rates through 2006;
- a limitation on ComEd's return on equity through 2006;
- a cap on PECO's electric transmission and distribution rates through 2006;
- a cap on PECO's generation rates through 2010; and

scheduled recovery of PECO's electric stranded costs that will increase amortization expenses through 2010.

These rate provisions limit the ability of ComEd and PECO to recover cost increases or the costs of new investments. As a result, ComEd and PECO must effectively manage their costs to maintain their current profitability.

In addition, the end of the transition periods in Illinois and Pennsylvania include uncertainties, including the source and pricing of generation services to be provided by PECO and methodology for wholesale supply procurement in Illinois and Pennsylvania and recovery of supply costs from retail customers. The end of the transition periods in Illinois and Pennsylvania also presents uncertainty for Exelon Generation, which sells a significant portion of its output to ComEd and PECO under long-term purchased power agreements. The agreement with ComEd, which expires at the end of 2006, may not be replaced with a similar arrangement. If the agreement is not replaced, Exelon Generation will need to sell more power at market-based prices, which may include an auction-based model, or enter into new contractual arrangements with third parties, which may have shorter durations and lower volume sales. Increased market sales and new contractual arrangements may adversely affect Exelon Generation's credit risk, due to an increase in the number of customers and the loss of a highly predictable revenue source, and may increase the variability of Exelon's earnings.

PSE&G's New Jersey base rates for electric and gas distribution are subject to regulation by the NJBPU and are effective until a new base rate case is filed and concluded. In addition, limited categories of costs are recovered through adjustment charges that are periodically reset to reflect current costs. Inability to recover material costs not included in base rates or adjustment clauses could have an adverse effect on cash flow and financial position of the combined company.

PSEG Global's electric and gas distribution facilities located in various foreign jurisdictions are rate-regulated enterprises. Governmental authorities establish rates charged to customers. While these rates are designed to cover all operating costs and provide a return, considerable fiscal and cash uncertainties in certain countries due to local regulation or economic, political and social crisis could have an adverse impact. In addition, future rates may not be adequate to provide cash flow to pay principal and interest on the debt of PSEG Global's subsidiaries and affiliates or to enable its subsidiaries and affiliates to comply with the terms of debt agreements.

***The combined company's financial performance will be affected by the amortization and eventual completion of stranded cost recovery for ComEd and PECO.***

ComEd's and PECO's current retail electric rates include charges to recover stranded costs that might not otherwise be recoverable in a fully competitive market. The amount of stranded cost recovery by ComEd varies annually depending on wholesale market prices and other factors, with stranded cost recovery ending at the end of 2006. Stranded cost recovery by PECO continues through 2010. Although the annual amount of stranded cost recovery is scheduled to increase during that period, annual increases in amortization of PECO's stranded cost recovery and the corresponding reductions in the return on the unamortized portion of stranded cost recovery will adversely affect PECO's results through 2010. Further, the termination of stranded cost recovery at the end of 2006 for ComEd and at the end of 2010 for PECO could significantly adversely affect their future results of operation.

***The combined company's energy delivery business will be obligated as the provider-of-last-resort to provide energy to all retail customers in its service territories, which makes it difficult to predict and plan for load requirements.***

PECO, ComEd and PSE&G serve as the provider-of-last-resort, referred to in this proxy statement/prospectus as a "POLR," for energy for all retail customers in their respective electric and gas service territories in Illinois, Pennsylvania, and New Jersey. As POLR suppliers, PECO, ComEd and PSE&G could be required to secure load requirements sufficient to serve all customers in their

respective service territories in the event that customers do not choose alternate suppliers or a third party supplier is unable to satisfy its obligations. As a result, planning has a higher level of uncertainty than that traditionally experienced due to weather and the economy, and it is more difficult to predict and plan for the number of customers and their associated energy demand.

***The combined company's energy generation business will have contractual obligations to certain energy delivery businesses to provide full requirements service to satisfy POLR requirements, which makes it difficult to predict and plan for load requirements and may result in increased operating costs to the business.***

The combined companies' generation business will have contractual obligations to certain energy delivery businesses to supply requirements service to such companies to satisfy all or a portion of such companies' POLR obligations. The uncertainty regarding the amount of load that the combined company's generation business must prepare for will likely increase the operating cost of the combined company's generation business. A significant under-estimation of load requirements could result in the combined company's generation business not having enough power to cover its load obligation, in which case it would be required to buy power from third parties at prevailing market prices. Those prices may not be as favorable or as manageable as the long-term supply costs of the combined company's generation business and thus could increase its operating costs. The divestiture of generation assets or capacity in order to obtain the required regulatory approvals to complete the merger, increases the likelihood of the combined company's generation business not having enough power to cover its load obligation.

***The combined company's generation business may incur substantial costs and liabilities due to its ownership and operation of nuclear generating facilities.***

Following completion of the merger, it is expected that, prior to giving effect to any divestitures required by governmental authorities to complete the merger and prior to implementing the combined company's anticipated strategy of divesting assets that do not meet the strategic objectives of the combined company, approximately 46% of the combined company's owned generation capacity will be nuclear and the combined company will own approximately 20% of the nuclear generation capacity in the United States. Accordingly, the combined company will have greater exposure to risks that adversely affect the nuclear generation industry compared to other companies in the utility industry.

The ownership and operation of nuclear generating facilities involve risks, including:

- mechanical or structural problems;
- inadequacy or lapses in maintenance protocols;
- impairment of reactor operation and safety systems due to human error;
- costs of storage, handling and disposal of nuclear materials, including the availability or unavailability of a permanent repository for spent nuclear fuel;
- limitations on the amounts and types of insurance coverage commercially available;
- uncertainties regarding both technological and financial aspects of decommissioning nuclear generating facilities; and
- environmental regulatory risks associated with regulatory change.

The material risks known or currently anticipated by Exelon and PSEG that could affect the ability of the combined company's nuclear generation business to achieve desired levels of profitability are:

*Capacity Factors.* The combined company's nuclear fleet must operate at consistently high capacity factors in order for it to produce efficient, low-cost energy and sustain the current profitability levels of Exelon and PSEG.

*NRC License Extensions.* Exelon Generation's nuclear generating facilities are currently operating under 40-year NRC licenses. Exelon Generation has received 20-year extensions for the operating licenses for Peach Bottom units 2 and 3, Dresden units 2 and 3 and Quad Cities nuclear generating facilities. In December 2004, the NRC issued an order that will permit Oyster Creek to operate beyond its license expiration in April 2009 if the NRC has not completed reviewing the application for extension. The application for Oyster Creek's license renewal is expected to be filed by August 2005 to comply with this agreement. Exelon Generation is currently evaluating other nuclear facilities for possible license extension. PSEG Power's nuclear generating facilities are currently operating under NRC licenses that expire in 2016, 2020 and 2026. The operating license extension process takes approximately four to five years from the commencement of the project until completion of NRC review. Exelon Generation and PSEG Power cannot be sure that they will receive the requested extensions or be able to operate the facilities for all or any portion of any extended license.

*Regulatory Risk.* The NRC may modify, suspend or revoke licenses, shut down a nuclear facility and impose civil penalties for failure to comply with the Atomic Energy Act, related regulations or the terms of the licenses for nuclear generating facilities. A change in the Atomic Energy Act or the applicable regulations or licenses may require a substantial increase in capital expenditures or may result in increased operating or decommissioning costs.

*Operational Risk.* Operations at any of the combined company's nuclear generation plants could degrade to the point where the combined company has to shut down the plant or operate at less than full capacity. If this were to happen, identifying and correcting the causes may require significant time and expense. The combined company may choose to close a plant rather than incur the expense of restarting it or returning it to full capacity. In either event, the combined company may lose revenue and incur increased fuel and purchased power expense to meet its supply commitments.

*Nuclear Accident Risk.* Accidents and other unforeseen problems have occurred both in the United States and elsewhere. The consequences of an accident can be severe and include loss of life and property damage. Any resulting financial impact from a nuclear accident may exceed the combined company's resources, including insurance coverages.

*Nuclear Fuel Quality May Affect Costs.* The quality of nuclear fuel utilized by the combined company's generation business can affect the efficiency and costs of its operations. Certain Exelon Generation nuclear generating facilities have recently identified a limited number of fuel performance issues. Remediation actions have resulted in increased costs due to accelerated fuel amortization and/or increased outage costs and could continue to do so. It is difficult to predict the total cost of these remediation procedures.

***The combined company's generation business may incur substantial costs and liabilities and be exposed to volatility as a result of its participation in the wholesale energy markets.***

The material risks associated with the wholesale energy markets known or currently anticipated by Exelon and PSEG that could adversely affect the combined company's operations are:

*Price Fluctuations.* Exelon Generation sells electricity in both the wholesale bilateral markets and spot markets. These sales expose it to the risks of rising and falling prices in those markets, and its cash flows may vary accordingly. To the extent it does not supply power to serve the needs of ComEd and PECO at fixed rates mandated by state regulatory commissions, its cash flows will largely be determined by wholesale prices of electricity and its ability to market successfully energy, capacity and ancillary services. At any given time, the wholesale spot-market price of electricity for each hour is generally determined by the cost of supplying the next unit of electricity to the market during that hour. In many cases, the next unit of electricity supplied would be supplied from generating stations fueled by fossil fuels, primarily coal and natural gas. Consequently, the open market wholesale price of

electricity may reflect the cost of coal and natural gas plus the cost to convert the fuel to electricity, commonly known as the spark spread. Therefore, changes in the supply and cost of coal and natural gas may impact the open market wholesale price of electricity.

PSEG Power expects to meet its supply obligations through a combination of generation and energy purchases managed by PSEG ER&T. PSEG Power also enters into trading positions related to its generation assets and supply obligations. To the extent PSEG Power does not hedge its costs, PSEG Power will be subject to the risk of price fluctuations that could affect its future results including variability in costs, such as changes in the expected price of energy and capacity that PSEG Power sells into the market, increases in the price of energy purchased to meet its supply obligations or the amount of excess energy sold into the market, the cost of fuel to generate electricity and the cost of emission credits and congestion credits that are used by PSEG Power to transmit electricity.

*Third Party Credit Risk.* In the bilateral markets, Exelon Generation and PSEG Power are exposed to the risk that counterparties that owe them money or energy as a result of market transactions will not perform their obligations. For example, energy supplied by third-party generators under long-term agreements represents a significant portion of Exelon Generation's overall capacity and may provide a significant portion of PSEG's NJBPU auction load requirements. These generators face operational risks, such as those that Exelon Generation and PSEG Power face, and their ability to perform depends on their financial condition. If the counterparties to these arrangements fail to perform, Exelon Generation and PSEG Power might be forced to honor the underlying commitment at then-current market prices and incur additional losses, to the extent of amounts, if any, already paid to the counterparties, and increased cost of energy or capacity to the extent the market price exceeds the contract price. In the spot markets, Exelon Generation and PSEG Power are exposed to the risks of whatever default mechanisms exist in that market, some of which attempt to spread the risk across all participants, which may not be an effective way of lessening the severity of the risk and the amounts at stake.

*Risk of Credit Downgrades.* Exelon Generation's and PSEG Power's trading businesses are, and the trading business of the combined company will be, required to meet credit quality standards. If either of Exelon Generation or PSEG Power, or the generation business of the combined company after the merger, were to lose its investment grade credit rating, it would be required under trading agreements to provide collateral in the form of letters of credit or cash, which may materially adversely affect the liquidity of Exelon or PSEG, or after completion of the merger, the combined company. If Exelon Generation had lost its investment grade credit rating as of March 31, 2005, it would have been required to provide approximately $920 million in collateral. If PSEG Power had lost its investment grade credit rating as of March 31, 2005, it would have been required to provide approximately $869 million in collateral.

***Impairment of ComEd's goodwill could adversely affect the combined company's results of operation and could restrict ComEd's ability to pay dividends to the combined company.***

At March 31, 2005, ComEd had recorded goodwill of approximately $4.7 billion. This goodwill was recognized and recorded in connection with the merger of Unicom Corporation and PECO. Under generally accepted accounting principles, the goodwill will remain at its recorded amount unless it is determined to be impaired, based upon an annual (or more often as circumstances dictate) analysis of ComEd's expected future cash flows. If an impairment of goodwill is determined at ComEd, the amount of the impaired goodwill will be written off and expensed at ComEd. ComEd's cash flows include competitive transition charges, which will cease at the end of 2006, unless there is a legislative or regulatory change, and collections from traditional bundled customers at tariffed rates. ComEd's cash flows will be affected by other factors, including the restructuring of the power purchase agreement, referred to in this joint proxy statement/prospectus as a "PPA," with Exelon Generation. Absent another source of revenues to replace the loss of competitive transition charge revenue or

changes in its cost structure, there is a reasonable possibility that goodwill will be impaired at ComEd, and possibly Exelon, in 2005 or later periods. Under current regulations, a significant goodwill impairment may restrict ComEd's ability to pay dividends to the combined company with the result that the combined company's dividends would depend upon the receipt of dividends from other subsidiaries. For a discussion of potential impairment charges in connection with accounting for the merger under the purchase method of accounting, see " Risks Relating to the Merger The application of the purchase method of accounting will result in approximately $8.1 billion of additional goodwill which could become impaired and adversely affect the market value of the combined company's common stock following completion of the merger" on page 22 of this joint proxy statement/prospectus.

***The Internal Revenue Service might successfully challenge certain leveraged lease transactions entered into by PSEG, which could have a material adverse impact on the combined company's operating results.***

In 1996 through 2002, PSEG, through its subsidiary PSEG Resources, entered into a number of leveraged leasing transactions in the ordinary course of PSEG Resources' business. The IRS is likely to argue that certain of those transactions are of a type that it has announced its intention to challenge, and PSEG and Exelon understand that similar transactions entered into by other companies have been the subject of review and challenge by the IRS. As of March 31, 2005, the total gross investment by PSEG Resources in such transactions was approximately $1.4 billion.

The IRS is presently reviewing the tax returns of PSEG and its subsidiaries for tax years 1997 through 2000, years when PSEG Resources entered into these transactions. The IRS is aware of these lease transactions and has requested information and documents associated with them. To date, the IRS has not proposed to disallow any deductions claimed relative to these transactions, but may propose such disallowances in the future. If the tax benefits associated with the lease transactions were successfully challenged by the IRS, PSEG or, following completion of the merger, the combined company would be assessed interest and possibly penalties in addition to any underpayments of tax. During the time period of 1997 through 2000, these transactions reduced current tax liabilities of PSEG by approximately $240 million and during the subsequent time period of 2001 though 2004, these and similar transactions reduced the current tax liabilities of PSEG by approximately $345 million. Interest that would be assessed on these potential deficiencies, if associated deductions were disallowed, would be approximately $140 million through March 31, 2005.

It is presently unclear the extent to which the IRS will seek to disallow deductions associated with lease transactions, if at all, and, if it were to do so, the extent to which any such challenge would be successful. If deductions associated with these transactions entered into by PSEG were successfully challenged by the IRS, it could have a material adverse impact on the combined company's operating results and could impact future returns on these transactions.

The Financial Accounting Standards Board, referred to in this joint proxy statement/prospectus as "FASB," is currently considering a modification to the Generally Accepted Accounting Principles, referred to in this joint proxy statement/prospectus as "GAAP," for leveraged leases. Under present GAAP, a tax settlement with the IRS that results merely in a change in the timing of tax liabilities would not require an accounting repricing of the lease investment. As such, income from the lease would continue to accrue at the original economic yield computed for the lease and there would be no writedown of the lease investment.

A modification currently being considered by the FASB could require a lease to be repriced if a change in the timing of tax liabilities has a significant impact on the economic yield of the lease and to be retested to determine if it qualifies for leveraged lease accounting. If this or a similar modification were to be adopted by the FASB, a successful challenge by the IRS to the tax treatment of the leases referred to above (or a settlement with the IRS), could trigger a lease repricing. If a repricing were to occur, there could be a material adverse impact on the combined company's operating results. Further,

such a successful challenge or settlement may cause the lease to fail to qualify for leveraged lease accounting. Failure to so qualify would require that the non-recourse debt associated with the lease be brought onto the balance sheet of the combined company, which also could have a material adverse impact on the combined company's operating results. It is presently unclear what modifications, if any, will be adopted by the FASB, the timing of any such modification and the effect of any such modification on the operating results of PSEG or the combined company.

***The IRS might successfully challenge certain tax positions taken by Exelon in connection with certain sale transactions, which could have a material adverse impact on the combined company's operating results.***

Exelon, through its ComEd subsidiary, has taken certain tax positions, which have been disclosed to the IRS, to defer the tax gain on a 1999 sale of its fossil generating assets. As of March 31, 2005, deferred tax liabilities related to the fossil plant sale are reflected in Exelon's consolidated balance sheets, with the majority allocated to the consolidated balance sheets of ComEd and the remainder to the consolidated balance sheets of Exelon Generation. The 1999 income tax liability deferred as a result of these transactions was approximately $1.1 billion. Exelon's ability to defer a portion of this liability depends on whether its characterization of a portion of the sales proceeds as having been received in connection with an "involuntary conversion" is proper. Exelon's ability to defer the remainder of this liability may depend in part on whether its tax characterization of a lease transaction it entered into in connection with the sale is proper. The IRS might argue that the lease transaction is of a type it has announced its intention to challenge, and Exelon understands that somewhat similar transactions entered into by other companies have been the subject of review and challenge by the IRS. Changes in IRS interpretations of existing primary tax authority or challenges to Exelon's tax positions could have the impact of accelerating future income tax payments and increasing interest expense related to the deferred tax gain that becomes current. Any required payments could be significant to the cash flows of Exelon. Exelon's management believes Exelon's reserve for interest, which has been established in the event that such positions are not sustained, has been appropriately recorded in accordance with SFAS No. 5, "Accounting for Contingencies." However, the ultimate outcome of such matters could result in additional unfavorable adjustments to the results of operations, and such adjustments could be material. Federal tax returns covering the period of the 1999 sale are currently under IRS audit. Final resolution of this matter is not anticipated for several years.

It is presently unclear the extent to which the IRS will seek to disallow the deferral of tax liability resulting from the 1999 sale of fossil generating assets, if at all, and if it were to do so, the extent to which any such challenge would be successful. If the deferral were successfully challenged by the IRS, it could have a material adverse impact on the combined company's operating results.

***Because a portion of the combined company's business will be conducted outside the United States, adverse international developments could negatively impact its business.***

Following completion of the merger and prior to implementing the combined company's anticipated strategy of divesting assets that do not meet the strategic objectives of the combined company, it is expected that approximately 5% of its assets will be outside the United States and 3% of its revenue will be generated from sources outside the United States, most of which will be held by and generated from PSEG Global.

The economic and political conditions in certain countries where PSEG Global has interests present risks that may be different from, or more extensive than, those found in the United States including:

- foreign currency fluctuations;
- risks of war;

- expropriation;
- nationalization;
- renegotiation or nullification of existing contracts; and
- changes in law or tax policy.

Changes in the legal environment in foreign countries in which PSEG Global has investments could make it more difficult to obtain non-recourse project refinancing on suitable terms and could impair PSEG Global's ability to enforce its rights under agreements relating to such projects. In addition, such changes could make it more difficult for the combined company to pursue an accelerated strategy of selling certain of PSEG Global's investments that no longer meet strategic objectives of the combined company.

Operations in foreign countries also present risks associated with currency exchange and convertibility, inflation and repatriation of earnings. In countries in which PSEG Global operates in the future, economic and monetary conditions and other factors could affect PSEG Global's ability to convert its cash distributions to United States dollars or other freely convertible currencies, or to move funds offshore from these countries. Furthermore, the central bank of any of these countries may have the authority to suspend, restrict or otherwise impose conditions on foreign exchange transactions or to approve distributions to foreign investors. Although PSEG Global generally seeks to structure power purchase contracts and other project revenue agreements to provide for payments to be made in, or indexed to, United States dollars or a currency freely convertible into United States dollars, its ability to do so in all cases may be limited.

***Market performance will affect the combined company's decommissioning trust funds and benefit plan asset values.***

The performance of the capital markets will affect the value of the assets that are held in trust to satisfy the combined company's future obligations under its pension and post-retirement benefit plans and to decommission nuclear generating plants. A decline in the market value of those assets, as was experienced from 2000 to 2002, may increase the combined company's funding requirements for these obligations.

***The combined company's results of operations and cash flows may be affected by its ability to divest unprofitable or under-performing businesses.***

The combined company will pursue opportunities to sell businesses and assets that either do not meet the strategic objectives of the combined company or are unprofitable. The combined company may incur significant expenses in divesting these businesses. The combined company also may be unable to implement successfully this strategy for a number of reasons, including an inability to locate appropriate buyers or to negotiate acceptable terms for the transactions. In addition, the amounts that the combined company may realize from a divestiture are subject to fluctuating market conditions that may contribute to pricing and other terms that are materially different than expected and could result in a loss on the sale. Timing of any divestitures may positively or negatively affect the combined company's results of operations and cash flows.

***War and acts and threats of terrorism may adversely affect the combined company's results of operations, the combined company's ability to raise capital and its future growth.***

Exelon and PSEG do not fully know the impact that any future terrorist attacks may have on the industry in general and on the combined company in particular. In addition, any retaliatory military strikes or sustained military campaign may affect the combined company's operations in unpredictable ways, such as changes in insurance markets and disruptions of fuel supplies and markets, particularly

oil. The possibility alone that infrastructure facilities, such as electric generation, electric and gas transmission and distribution facilities, would be direct targets of, or indirect casualties of, an act of terror may affect the combined company's operations. Additionally, the continuing military activity in Iraq and other wars may have an adverse effect on the economy in general. A lower level of economic activity might result in a decline in energy consumption, which may adversely affect the combined company's revenues or restrict its future growth. Instability in the financial markets as a result of terrorism or war may affect the combined company's stock price and its ability to raise capital.

***The combined company may incur substantial costs to fulfill its obligations related to environmental matters.***

Subsidiaries of Exelon and PSEG are subject to extensive environmental regulation by local, state and federal authorities. These laws and regulations affect the manner in which Exelon and PSEG and their subsidiaries conduct their operations and make capital expenditures. Further, such laws and regulations are subject to future changes that may result in increased compliance costs. For example, on March 10, 2005 the United States Environmental Protection Agency finalized more stringent nitrogen oxide ("NOx") and sulfur dioxide ("SO2") regulation for the eastern United States that will take effect in two phases, Phase I in 2010 and Phase II in 2015. Similarly, on March 15, 2005 the EPA also finalized "cap-and-trade" based mercury regulations that must be implemented in two phases on roughly the same timeline. Subsidiaries of Exelon and PSEG are subject to liability under environmental laws for the costs of remediating environmental contamination of property now or formerly owned by them and of property contaminated by hazardous substances they generated. Remediation activities associated with manufactured gas plant operations for subsidiaries of Exelon and PSEG will be one source of such costs. Also, subsidiaries of Exelon and PSEG are currently involved in a number of proceedings relating to sites where hazardous substances have been deposited and may be subject to additional proceedings in the future. In addition, most of PSEG's generating facilities are located in the State of New Jersey. In particular, New Jersey's environmental programs are generally considered to be more stringent in comparison to similar programs in other states. Therefore, there may be instances where the facilities located in New Jersey are subject to more stringent and, therefore, more costly pollution control requirements than competitive facilities in other states. The Salem nuclear generating facility has a permit from the New Jersey Department of Environment Protection allowing for the continued operation of the Salem facility with its existing cooling water system. That permit expires in July 2006. The NJDEP, in anticipation of PSEG's application to renew the permit for Salem, has advised PSEG that it strongly recommends that cooling water intake flow at the Salem facility be reduced commensurate with closed cycle cooling. The application of Federal Water Pollution Control Act Section 316(b) regulations published in 2004 could, as one option, require the installation of structures at the Salem facility to reduce cooling water intake commensurate with closed cycle cooling, which would result in material costs of compliance for the combined company. The regulations under Section 316(b) of the FWPCA could also result in material costs of compliance at other generating facilities of the combined company.

***Exelon and PSEG retain contingent liabilities in connection with asset sales.***

Exelon and PSEG have each divested assets or businesses for aggregate consideration (purchase price plus debt assumed) in the amount of approximately $2.6 billion and approximately $1.5 billion, respectively, over the last three years. We have entered into a number of agreements for the sale of assets that include provisions whereby we are required to:

- retain specified preexisting liabilities such as for taxes and pensions;
- indemnify the buyers against specified risks, including the inaccuracy of representations and warranties we made; and

require payments to the buyers depending on the outcome of post-closing adjustments, audits or other reviews.

Many of these contingent liabilities can remain open for extended periods of time after the sales are closed. Depending on the extent to which the buyers may ultimately seek to enforce their rights under these contractual provisions, and the resolution of any disputes we may have concerning them, these liabilities could have a material adverse effect on our financial condition, liquidity, cash flow and results of operations.

Each of Exelon and PSEG has established reserves with respect to the obligations under the agreements described above; however, we cannot assure you that such reserves would be sufficient to cover any payments required under the agreements described above.

**FORWARD-LOOKING STATEMENTS**

We have made forward-looking statements in this joint proxy statement/prospectus, including in the documents that are incorporated by reference into this joint proxy statement/prospectus, that are subject to risks and uncertainties. These statements are based on the current expectations of each company's management. Generally, forward-looking statements include information concerning possible or assumed future actions, events or results of operations of Exelon, PSEG and the combined company. Forward-looking statements include the information in this joint proxy statement/prospectus regarding:

- management forecasts, projections and estimates;
- liquidity and the ability to access the capital and credit markets;
- regulatory matters;
- efficiencies/cost avoidance;
- cost savings;
- income and margins;
- earnings per share;
- economies of scale;
- combined operations;
- the economy;
- future economic performance;
- conditions to, and the timetable for, completing the merger;
- future acquisitions and dispositions;
- litigation;
- potential and contingent liabilities;
- management's plans;
- business portfolios;

taxes; and

merger and integration-related expenses.

These statements may be preceded by, followed by or include the words "may," "will," "should," "could," "would," "potential," "possible," "believes," "expects," "anticipates," "intends," "plans," "estimates," "hopes" or similar expressions. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements.

Forward-looking statements are not guarantees of performance. You should understand that the following important factors, in addition to those discussed in "Risk Factors" above and elsewhere in this joint proxy statement/prospectus, and in the documents which are incorporated by reference into this joint proxy statement/prospectus, could affect the future results of Exelon and PSEG, and of the combined company after completion of the merger, and could cause those results or other outcomes to differ materially from those expressed or implied in our forward-looking statements:

Exelon and PSEG may be unable to obtain shareholder approvals required for completion of the merger;

Exelon and PSEG may be unable to obtain regulatory approvals required for completion of the merger, or required regulatory approvals may delay the merger or result in the imposition of conditions that could have a material adverse effect on the combined company or cause the companies to abandon the merger;

problems may arise in successfully integrating the businesses of the companies, which may result in the combined company not operating as effectively and efficiently as expected;

the combined company may be unable to achieve cost-cutting synergies or it may take longer than expected to achieve those synergies;

the merger may involve unexpected costs or unexpected liabilities, or the effects of purchase accounting may be different from Exelon's and PSEG's expectations;

the credit ratings of the combined company or its subsidiaries may be different from what Exelon and PSEG expect;

the businesses of Exelon and PSEG may suffer as a result of uncertainty surrounding the merger;

Exelon and PSEG may experience more difficulties than expected in achieving operating improvements at jointly owned nuclear generating facilities;

Exelon and PSEG may not realize the values expected to be obtained for properties expected or required to be divested;

the industry may be subject to future regulatory or legislative actions that could further limit revenues or cost recoveries or impose additional costs or otherwise adversely affect Exelon, PSEG or the combined company;

Exelon and PSEG may be adversely affected by other economic, business and competitive factors and volatility of energy and commodities markets;

changes in accounting policies, practices or their interpretations; and

the factors described in Exelon's and PSEG's reports filed with the SEC.

Because forward-looking statements are subject to assumptions and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Shareholders are cautioned not to place undue reliance on such statements, which speak only as of the date of this joint proxy statement/prospectus or the date of any document incorporated by reference.

All subsequent written and oral forward-looking statements concerning the merger or other matters addressed in this joint proxy statement/prospectus and attributable to Exelon or PSEG or any person acting on either company's behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except to the extent required by applicable law or regulation, neither Exelon nor PSEG undertakes any obligation to publicly release any revisions or updates to such forward-looking statements to reflect events or circumstances after the date of this joint proxy statement/prospectus or to reflect the occurrence of unanticipated events.

**THE COMPANIES**

**Exelon Corporation**
10 South Dearborn Street 37th Floor
P.O. Box 805379
Chicago, Illinois 60680-5379
(312) 394-7398
Internet address: *www.exeloncorp.com*

Exelon Corporation, a registered public utility holding company under the Public Utility Holding Company Act of 1935, as amended, through its subsidiaries, operates in two business segments Energy Delivery and Generation as of January 1, 2005 as described below. Prior to January 1, 2005, Exelon operated in a third business segment, Enterprises. In addition to Exelon's two business segments, Exelon Business Services Company, a subsidiary of Exelon, provides Exelon and its subsidiaries with financial, human resource, legal, information technology, supply management and corporate governance services. Exelon was incorporated in Pennsylvania in February 1999.

*Energy Delivery.* Exelon's energy delivery business consists of the purchase and sale of electricity and distribution and transmission services by Commonwealth Edison Company in northern Illinois and by PECO Energy Company in southeastern Pennsylvania and the purchase and sale of natural gas and distribution services by PECO in the Pennsylvania counties surrounding the City of Philadelphia. ComEd's retail service territory has an area of approximately 11,300 square miles and an estimated population of 8 million. The service territory includes the City of Chicago, an area of about 225 square miles with an estimated population of 3 million. ComEd has approximately 3.76 million customers. PECO's retail service territory has an area of approximately 2,100 square miles and an estimated population of 3.8 million. PECO provides electric delivery service in an area of approximately 2,000 square miles, with a population of approximately 3.7 million, including 1.5 million in the City of Philadelphia. Natural gas service is supplied in an area of approximately 1,900 square miles in southeastern Pennsylvania adjacent to the city of Philadelphia, with a population of approximately 2.3 million. PECO delivers electricity to approximately 1.5 million customers and natural gas to approximately 460,000 customers.

*Generation.* Exelon's generation business consists of the owned and contracted for electric generating facilities and energy marketing operations of Exelon Generation Company, a 49.5% interest in two power stations in Mexico and the competitive retail sales business of Exelon Energy Company.

*Generating Facilities.* At December 31, 2004, Exelon Generation owned generation assets in the Midwest, Mid-Atlantic, Southern and Northeast regions and the state of Texas with a net capacity of 26,756 MWs, including 16,751 MWs of nuclear capacity. Exelon Generation controls another 8,701 MWs of capacity in the Midwest, Southeast regions and South Central regions of the state of Texas through long-term contracts.

*Energy Marketing Operations.* Exelon Generation's wholesale marketing unit, Power Team, a major wholesale marketer of energy, uses Exelon Generation's energy generation portfolio, transmission rights and expertise to ensure delivery of energy to Exelon Generation's wholesale customers under long-term and short-term contracts, including the load requirements of ComEd and PECO. In addition, Power Team markets energy in the wholesale bilateral and spot markets.

*Retail Sale.* Exelon Energy Company became part of Exelon Generation effective as of January 1, 2004. Exelon Energy provides retail electric and gas services as an unregulated retail energy supplier in Illinois, Michigan, Ohio, Pennsylvania and Kentucky.

*Enterprises.* Exelon's enterprise business was comprised of infrastructure and electrical contracting services of Exelon Enterprises Company, LLC and other investments weighted towards the communications and energy services industries. During 2004 and 2003, Enterprises exited a significant number of businesses and investments. Exelon plans to divest or wind-down the remaining assets of Enterprises during 2005.

**Public Service Enterprise Group Incorporated**
80 Park Plaza
P.O. Box 1171
Newark, New Jersey 07101-1171
(973) 430-7000
Internet address: *www.pseg.com*

Public Service Enterprise Group Incorporated is an exempt public utility holding company under PUHCA. PSEG has four principal direct wholly-owned subsidiaries: Public Service Electric and Gas Company, PSEG Power LLC, PSEG Energy Holdings L.L.C. and PSEG Services Corporation. PSEG was incorporated under the laws of the State of New Jersey in 1985.

*PSE&G.* PSE&G is an operating public utility company engaged principally in the transmission and distribution of electric energy and gas service in New Jersey. PSE&G provides electric and gas service in areas of New Jersey in which approximately 5.5 million people, about 70% of the State's population, reside. PSE&G's electric and gas service area is a corridor of approximately 2,600 square miles running diagonally across New Jersey from Bergen County in the northeast to an area below the city of Camden in the southwest. The greater portion of this area is served with both electricity and gas, but some parts are served with electricity only and other parts with gas only. This heavily populated, commercialized and industrialized territory encompasses most of New Jersey's largest municipalities, including its six largest cities Newark, Jersey City, Paterson, Elizabeth, Trenton and Camden in addition to approximately 300 suburban and rural communities. This service territory contains a diversified mix of commerce and industry, including major facilities of many nationally prominent corporations. PSE&G's load requirements are almost evenly split among residential, commercial and industrial customers.

*PSEG Power.* PSEG Power is a multi-regional, wholesale energy supply company that integrates its generating asset operations with its wholesale energy, fuel supply, energy trading and marketing and risk management function through three principal direct wholly-owned subsidiaries: PSEG Nuclear LLC, PSEG Fossil LLC and PSEG Energy Resources & Trade LLC.

*PSEG Fossil.* PSEG Fossil has a direct ownership interest in twelve generating stations in New Jersey, two in Pennsylvania, one in New York, two in Connecticut, one in Ohio and one in Indiana. PSEG Fossil also has an ownership interest in one hydroelectric pumped storage facility in New Jersey. PSEG Fossil uses coal, natural gas and oil for electric generation. These fuels are purchased through various contracts and in the spot market and represent a significant portion of PSEG Power's working capital requirements. Changes in the prices of these fuel sources can impact PSEG Power's costs and working capital requirements. The majority of PSEG Power's fossil generating stations obtain their fuel supply from within the United States.

*PSEG Nuclear.* PSEG Nuclear has an ownership interest in five nuclear generating units and operates three of them: the Salem Nuclear Generating Station, Units 1 and 2, each owned 57.41% by Nuclear and 42.59% by Exelon Generation, and the Hope Creek Nuclear Generating Station, which is 100% owned by PSEG Nuclear. Exelon Generation operates the Peach Bottom Atomic Power Station Units 2 and 3, each of which is 50% owned by PSEG Nuclear.

*PSEG ER&T.* PSEG ER&T purchases virtually all of the capacity and energy produced by PSEG Fossil and PSEG Nuclear. In conjunction with these purchases, PSEG ER&T uses commodity and financial instruments designed to cover estimated commitments for the New Jersey Basic Generation Service auction and other bilateral contract agreements. PSEG ER&T also markets electricity, capacity, ancillary services and natural gas products on a wholesale basis. PSEG ER&T is a fully integrated wholesale energy marketing and trading organization that is active in the long-term and spot wholesale energy markets.

*PSEG Energy Holdings.* PSEG Energy Holdings is a New Jersey limited liability company and is the successor to PSEG Energy Holdings Inc., which was originally incorporated in 1989. PSEG Energy Holdings has two principal direct wholly-owned subsidiaries, PSEG Global L.L.C. and PSEG Resources L.L.C. PSEG Global has pursued investment opportunities in electric generation, transmission and distribution facilities and is engaged in power production and distribution in selected domestic and international markets. PSEG Resources invests in energy-related financial transactions and manages a diversified portfolio of assets. Upon completion of the merger, the combined company intends to pursue opportunities to sell certain of PSEG Global's investments that do not meet the strategic objectives of the combined company.

*PSEG Services.* PSEG Services provides management and administrative services to PSEG and its subsidiaries. These include accounting, legal, communications, human resources, information technology, treasury and financial, investor relations, shareholder services, real estate, insurance, risk management, tax, library and information services, security, corporate secretarial and certain planning, budgeting and forecasting services. PSEG Services charges PSEG and its subsidiaries for the cost of work performed and services provided pursuant to the terms and conditions of intercompany service agreements.

# CHAPTER TWO
# INFORMATION ABOUT THE ANNUAL MEETINGS AND VOTING

## THE EXELON ANNUAL MEETING

The Exelon board of directors is using this joint proxy statement/prospectus to solicit proxies from the holders of Exelon common stock for use at the annual meeting of Exelon's shareholders. Exelon is first mailing this joint proxy statement/prospectus and accompanying proxy card to Exelon shareholders on or about June 10, 2005.

### Date, Time and Place of Annual Meeting

The Exelon annual meeting of shareholders will be held on July 22, 2005 at 9:30 a.m., local time at PECO Energy Headquarters, 2301 Market Street, Philadelphia, Pennsylvania.

### Purpose of the Annual Meeting

The purpose of the annual meeting is to take action upon the following:

- a proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement;
- the election of five Class II directors: Edward A. Brennan, Bruce DeMars, Nelson A. Diaz, John W. Rowe and Ronald Rubin, each for a three year term;
- a proposal to approve the amendment to Exelon's Amended and Restated Articles of Incorporation to increase the number of authorized shares of Exelon common stock from 1,200,000,000 to 2,000,000,000;
- a proposal to ratify PricewaterhouseCoopers LLP as Exelon's independent accountants for the year 2005;
- a proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan;
- a proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries;
- any proposal of the Exelon board of directors to adjourn or postpone the Exelon annual meeting; and
- any other business that properly comes before the annual meeting and any adjournment or postponement thereof.

### Record Date for the Annual Meeting

The Exelon board of directors has fixed the close of business on May 2, 2005 as the record date for determination of shareholders entitled to notice of and to vote at the Exelon annual meeting.

### Outstanding Shares

As of May 2, 2005, the record date for the Exelon annual meeting, there were approximately 669,137,081 shares of Exelon common stock outstanding.

### Shares Entitled to Vote

Shares entitled to vote at the Exelon annual meeting are shares of Exelon common stock held as of the close of business on the record date, May 2, 2005. Each shareholder is entitled to one vote at the Exelon annual meeting for each share of Exelon common stock held by that

shareholder at the

close of business on the record date. Shares of Exelon common stock held by Exelon in its treasury are not voted.

**Quorum, Abstentions and Broker Non-Votes**

A quorum of Exelon shareholders is necessary to permit a particular matter to be considered and acted upon at the meeting. The presence in person or by proxy at the annual meeting of holders of issued and outstanding shares of Exelon common stock entitled to cast at least a majority of the votes that all shareholders are entitled to cast on a particular matter constitutes a quorum. Shares held by Exelon in its treasury do not count towards a quorum. Broker non-votes (so long as such shares are voted on the director proposal or proposal to ratify Exelon's independent accountants) and abstentions count as present for establishing a quorum. A broker non-vote occurs on an item when the broker is not permitted to vote on that item without instruction from the beneficial owner of the shares of Exelon common stock and the beneficial owner gives no instruction as to voting of the shares. Under New York Stock Exchange rules, your broker or bank does not have discretionary authority to vote your shares on the proposal to issue shares of Exelon common stock as contemplated by the merger agreement, the proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan or the proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries. Without your voting instructions on those items, a broker non-vote will occur.

**Vote Required**

The proposals require different percentages of votes in order to approve them:

- approval of the proposal to issue shares of Exelon common stock as contemplated by the merger agreement requires the affirmative vote of at least a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy and entitled to vote so long as the total vote cast on the proposal represents at least a majority of the shares of Exelon common stock entitled to vote on the proposal, assuming a quorum is present;

- directors are elected by a plurality vote, with the five nominees who receive the most votes elected, assuming a quorum is present;

- approval of the proposal to amend Exelon's Amended and Restated Articles of Incorporation to increase the number of authorized shares of Exelon common stock from 1,200,000,000 to 2,000,000,000 requires the affirmative vote of at least a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy and entitled to vote, assuming a quorum is present;

- approval of the proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan and the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries requires the affirmative vote of at least a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy and entitled to vote so long as the total vote cast on the proposal represents at least a majority of the shares of Exelon common stock entitled to vote on the proposal, assuming a quorum is present;

- approval of a proposal by the Exelon board of directors to adjourn or postpone the meeting requires the affirmative vote a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy at the meeting, whether or not a quorum is present; and

- approval of all other proposals requires the affirmative vote of a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy and entitled to vote, assuming a quorum is present.

Abstentions and broker non-votes are not counted as votes cast on a proposal.

**Shares Beneficially Owned by Exelon Directors and Officers**

Exelon directors and officers beneficially owned 4,955,493 shares of Exelon common stock on May 2, 2005 the record date for the Exelon annual meeting. These shares represent in total less than 1% of the total voting power of Exelon's voting securities outstanding and entitled to vote as of May 2, 2005. Exelon currently expects that Exelon's directors and officers will vote their shares in favor of the share issuance proposal, although none of them has entered into any agreements obligating them to do so.

**Voting at the Annual Meeting**

If you are a shareholder of record, you may vote in person by ballot at the Exelon annual meeting or by submitting a proxy. Exelon recommends you submit your proxy even if you plan to attend the annual meeting. If you attend the annual meeting, you may vote by ballot, thereby canceling any proxy previously submitted.

Voting instructions are included on your proxy card. If you properly give your proxy and submit it to Exelon in time to vote, one of the individuals named as your proxy will vote your shares as you have directed. You may vote for or against the proposals or abstain from voting.

**How to Vote by Proxy**

*By Telephone or Internet.* If you are a shareholder of record, you can submit your proxy by telephone by calling the toll-free telephone number on your proxy card (877) 779-8683 or by Internet by accessing the website identified on your proxy card *www.eproxyvote.com/exc*. Telephone and Internet voting are available 24 hours a day and will be accessible until 11:59 p.m. on July 21, 2005. Exelon's telephone and Internet voting procedures are designed to authenticate shareholders by using individual control numbers. **If you hold your shares through a bank, broker, custodian or other recordholder, please refer to your proxy card or the voting instruction form provided by your bank, broker, custodian or other recordholder for information on telephone or Internet voting. If you submit your proxy by telephone or Internet, please do not mail your proxy card. If you are located outside the United States, Canada and Puerto Rico, see your proxy card or other materials for additional instructions with respect to voting by telephone.**

*By Mail.* If you are a shareholder of record and choose to submit your proxy by mail, please complete each proxy card you receive, date and sign it, and return it in the prepaid envelope which accompanied that proxy card. If you hold your shares through a bank, broker, custodian or other recordholder, please refer to your proxy card or the voting instruction form provided to you by your bank, broker, custodian or other recordholder.

**Proxies without Instruction**

If you are a shareholder of record and submit your proxy but do not make specific choices, your proxy will follow the Exelon board of directors' recommendations and your shares will be voted:

- "FOR" the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement;
- "FOR" the proposal to elect the directors named in the director proposal;
- "FOR" the proposal to approve the amendment to Exelon's Amended and Restated Articles of Incorporation to increase the number of authorized shares of Exelon common stock;
- "FOR" the proposal to ratify PricewaterhouseCoopers LLP as Exelon's independent accountants for the year 2005;

"FOR" the proposal to approve the Exelon Corporation 2006 Long-Term Incentive Plan;

"FOR" the proposal to approve the Exelon Corporation Employee Stock Purchase Plan for Unincorporated Subsidiaries; and

"FOR" any proposal by the Exelon board of directors to adjourn or postpone the Exelon annual meeting.

If you hold your shares through a bank, broker, custodian or other recordholder, failure to instruct such recordholder how to vote your shares will have the effect described under "  Quorum, Abstentions and Broker Non-Votes."

**Revocation of Proxies**

You may revoke your proxy at any time prior to the time your shares are voted. If you are a shareholder of record, your proxy can be revoked in several ways:

by entering a new vote by telephone or the Internet;

by delivering a written revocation to Exelon's secretary that is received prior to the Exelon annual meeting;

by submitting another valid proxy bearing a later date that is received prior to the Exelon annual meeting; or

by attending the Exelon annual meeting and voting your shares in person.

However, if your shares are held in "street name" through a bank, broker, custodian or other recordholder, you must check with your bank, broker, custodian or other recordholder to determine how to revoke your proxy.

**Proxy Solicitation**

Exelon will pay the costs of soliciting proxies from Exelon shareholders. In addition to this mailing, proxies may be solicited by directors, officers or employees of Exelon in person or by telephone or electronic transmission. None of the directors, officers or employees will be directly compensated for such services. Exelon has retained Georgeson Shareholder Communications Inc. to assist in the distribution and solicitation of proxies. Exelon will pay Georgeson Shareholder Communications Inc. a fee of $16,500, plus reasonable expenses, for these services.

The extent to which these proxy soliciting efforts will be necessary depends entirely upon how promptly proxies are submitted. You should submit your proxy without delay by telephone, by the Internet or by mail. Exelon also reimburses brokers and other nominees for their expenses in sending these materials to you and getting your voting instructions.

**Other Business; Adjournments**

Exelon is not currently aware of any other business to be acted upon at the Exelon annual meeting. If, however, other matters are properly brought before the annual meeting, or any adjourned meeting, your proxies include discretionary authority on the part of the individuals appointed to vote your shares to act on those matters according to their best judgment.

Adjournments may be made for the purpose of, among other things, soliciting additional proxies. Any adjournment may be made from time to time by the affirmative vote of a majority of the votes cast by holders of shares of Exelon common stock present in person or by proxy at the Exelon annual meeting, whether or not a quorum is present, without further notice other than by an announcement at the meeting. Exelon does not currently intend to seek an adjournment of its annual meeting.

**Exelon Shareholder Account Maintenance**

Exelon's transfer agent is Equiserve Trust Company, N.A. All communications concerning accounts of Exelon shareholders of record, including address changes, name changes, inquiries as to requirements to transfer shares of common stock and similar issues can be handled by calling the Exelon Shareholder Services department at (312) 394-2345, or by calling Equiserve, toll-free at (800) 626-8792. For other information about Exelon, Exelon shareholders can visit Exelon's web site at *www.exeloncorp.com*.

## THE PSEG ANNUAL MEETING

The PSEG board of directors is using this joint proxy statement/prospectus to solicit proxies from the holders of PSEG common stock for use at the annual meeting of PSEG's shareholders. PSEG is first mailing this joint proxy statement/prospectus and accompanying proxy card to PSEG shareholders on or about June 10, 2005.

### Date, Time and Place of Annual Meeting

The PSEG annual meeting of shareholders will be held on July 19, 2005 at 2:00 p.m., local time at The New Jersey Performing Arts Center, One Center Street, Newark, New Jersey.

### Purpose of the Annual Meeting

The purpose of the PSEG annual meeting is to take action upon the following:

- a proposal to approve the merger agreement and thereby approve of the merger;
- the election of three Class III directors: Conrad K. Harper, Shirley Ann Jackson and Thomas A. Renyi, each for a three year term;
- a proposal to ratify Deloitte & Touche LLP as PSEG's independent auditor for the year 2005;
- any proposal of the PSEG board of directors to adjourn or postpone the PSEG annual meeting;
- a shareholder proposal related to executive compensation, if presented; and
- any other business that properly comes before the annual meeting and any adjournment or postponement thereof.

### Record Date for the Annual Meeting

The PSEG board of directors has fixed the close of business on May 27, 2005 as the record date for determination of shareholders entitled to notice of and to vote at the PSEG annual meeting.

### Outstanding Shares

As of May 27, 2005, the record date for the PSEG annual meeting, there were approximately 238,731,592 shares of PSEG common stock outstanding.

### Shares Entitled to Vote

Shares entitled to vote at the PSEG annual meeting are shares of PSEG common stock held as of the close of business on the record date, May 27, 2005. Each shareholder is entitled to one vote at the PSEG annual meeting for each share of PSEG common stock held by that shareholder at the close of business on the record date, except for the proposal relating to the election of directors, on which PSEG shareholders are entitled to cumulative voting. Shares of PSEG common stock held by PSEG in its treasury are not voted.

### Quorum, Abstentions and Broker Non-Votes

A quorum of PSEG shareholders is necessary to hold a valid meeting. The presence in person or by proxy at the annual meeting of holders of a majority of the issued and outstanding shares of PSEG common stock entitled to vote at the meeting is a quorum. Shares held by PSEG in its treasury do not count towards a quorum. Abstentions and broker non-votes count as present for establishing a quorum. A broker non-vote occurs on an item when the broker is not permitted to vote on that item without instruction from the beneficial owner of the shares of PSEG common stock and the beneficial owner

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gives no instruction as to voting of the shares. Under New York Stock Exchange rules, your broker or bank does not have discretionary authority to vote your shares on the proposal to approve the merger agreement or on the shareholder proposal. Without your voting instructions on those items, a broker non-vote will occur.

**Vote Required**

The proposals require different percentages of votes in order to approve them:

- approval of the merger agreement requires the affirmative vote of at least a majority of the votes cast by holders of shares of PSEG common stock present in person or by proxy and entitled to vote on the approval of the merger agreement, assuming a quorum is present;

- directors are elected by a plurality vote, assuming a quorum is present, with shareholders entitled to cast the number of votes equal to the number of shares held multiplied by the number of directors to be elected;

- approval of a proposal by the PSEG board of directors to adjourn or postpone the meeting requires the affirmative vote of a majority of the votes cast by holders of shares of PSEG common stock person or by proxy at the meeting, whether or not a quorum is present; and

- approval of all other proposals requires the affirmative vote of a majority of the votes cast by holders of shares of PSEG common stock present in person or by proxy and entitled to vote, assuming a quorum is present.

Abstentions and broker non-votes are not counted as votes cast on a proposal.

**Shares Beneficially Owned by PSEG Directors and Officers**

PSEG directors and officers beneficially owned 4,951,871 shares of PSEG common stock on May 27, 2005 the record date for the PSEG annual meeting. These shares represent in total 1.8% of the total voting power of PSEG's voting securities outstanding and entitled to vote as of May 27, 2005. PSEG currently expects that PSEG's directors and officers will vote their shares in favor of the share issuance proposal, although none of them has entered into any agreements obligating them to do so.

**Voting at the Annual Meeting**

If you are a shareholder of record, you may vote in person by ballot at the PSEG annual meeting or by submitting a proxy. PSEG recommends you submit your proxy even if you plan to attend the PSEG annual meeting. If you attend the annual meeting, you may vote by ballot, thereby canceling any proxy previously submitted.

Voting instructions are included on your proxy card. If you properly give your proxy and submit it to PSEG in time to vote, one of the individuals named as your proxy will vote your shares as you have directed. You may vote for or against the proposals or abstain from voting.

**How to Vote by Proxy**

*By Telephone or Internet.* If you are a shareholder of record, you can submit your proxy by telephone by calling the toll-free telephone number on your proxy card (866) 242-0618 or by Internet by accessing the website identified on your proxy card *www.proxyvotenow.com/pseg*. Telephone and Internet voting are available 24 hours a day and will be accessible until 11:59 p.m. on July 18, 2005. PSEG's telephone and Internet voting procedures are designed to authenticate shareholders by using individual control numbers. **If you hold your shares through a bank, broker, custodian or other recordholder, please refer to your proxy card or the voting instruction form provided by your bank, broker, custodian or other recordholder for information on telephone or Internet voting. If you submit**

**your proxy by telephone or Internet, please do not mail your proxy card. If you are located outside the United States, Canada and Puerto Rico, see your proxy card or other materials for additional instructions with respect to voting by telephone.**

*By Mail.* If you are a shareholder of record and choose to submit your proxy by mail, please complete each proxy card you receive, date and sign it, and return it in the prepaid envelope which accompanied that proxy card. If you hold your shares through a bank, broker, custodian or other recordholder, please refer to your proxy card or the voting instruction form provided to you by your bank, broker, custodian or other recordholder.

**Proxies without Instruction**

If you are a shareholder of record and submit your proxy but do not make specific choices, your proxy will follow the PSEG board of directors' recommendations and your shares will be voted:

- "FOR" the proposal to approve the merger agreement;
- "FOR" the proposal to elect the directors named in the director proposal;
- "FOR" the proposal to ratify Deloitte & Touche LLP as PSEG's independent auditor for the year 2005;
- "FOR" any proposal by the PSEG board of directors to adjourn or postpone the PSEG annual meeting; and
- "AGAINST" the shareholder proposal.

If you hold your shares through a bank, broker, custodian or other recordholder, failure to instruct such recordholder how to vote your shares will have the effect described under " Quorum, Abstensions and Broker Non-Votes."

**Revocation of Proxies**

You may revoke your proxy at any time prior to the time your shares are voted. If you are a shareholder of record, your proxy can be revoked in several ways:

- by entering a new vote by telephone or the Internet;
- by delivering a written revocation to PSEG's secretary that is received prior to the PSEG annual meeting;
- by submitting another valid proxy bearing a later date that is received prior to the PSEG annual meeting; or
- by attending the PSEG annual meeting and voting your shares in person.

However, if your shares are held in "street name" through a bank, broker, custodian or other recordholder, you must check with your bank, broker, custodian or other recordholder to determine how to revoke your proxy.

**Proxy Solicitation**

PSEG will pay the costs of soliciting proxies from PSEG shareholders. In addition to this mailing, proxies may be solicited by directors, officers or employees of PSEG in person or by telephone or electronic transmission. None of the directors, officers or employees will be directly compensated for such services. PSEG has retained Morrow & Co., Inc. to assist in the distribution and solicitation of proxies. PSEG will pay Morrow & Co., Inc. a fee of $25,000 plus reasonable expenses, for these services.

The extent to which these proxy soliciting efforts will be necessary depends entirely upon how promptly proxies are submitted. You should submit your proxy without delay by telephone, by the Internet or by mail. PSEG also reimburses brokers and other nominees for their expenses in sending these materials to you and getting your voting instructions.

**Other Business; Adjournments**

PSEG is not currently aware of any other business to be acted upon at the PSEG annual meeting. If, however, other matters are properly brought before either meeting, or any adjourned meeting, your proxies include discretionary authority on the part of the individuals appointed to vote your shares or act on those matters according to their best judgment.

Adjournments may be made for the purpose of, among other things, soliciting additional proxies. Any adjournment may be made from time to time by the affirmative vote of a majority of the votes cast by holders of shares of PSEG common stock present in person or by proxy at the meeting, whether or not a quorum is present, without further notice other than by an announcement made at the meeting. PSEG does not currently intend to seek an adjournment of its annual meeting.

**PSEG Shareholder Account Maintenance**

PSEG acts as its own transfer agent. All communications concerning accounts of PSEG shareholders of record, including address changes, name changes, inquiries as to requirements to transfer shares of common stock and similar issues can be handled by calling the PSEG Shareholder Services department, toll-free, at (800) 242-0813, or by visiting PSEG's web site at *www.pseg.com*.

**Do not send in any stock certificates with your proxy cards. The exchange agent will mail transmittal forms with instructions for the surrender of stock certificates for PSEG common stock to former PSEG shareholders as soon as practicable after completion of the merger.**

**Enterprise Direct (Dividend Reinvestment and Stock Purchase Plan) and Employee Stock Purchase Plan, PSEG Thrift and Tax-Deferred Savings Plan and PSEG Employee Savings Plan**

Participants in PSEG's Enterprise Direct Plan and Employee Stock Purchase Plan will receive one proxy card for all shares of PSEG common stock beneficially held in each such plan. Your proxy card will serve as voting instructions to the administrator of the plan. **If you fail to complete, sign and return your proxy card for the Enterprise Direct Plan, the administrator of the plan will vote your shares of PSEG common stock in accordance with the recommendation of the PSEG board of directors. If you fail to complete, sign and return your proxy card for the Employee Stock Purchase Plan, your shares will not be voted.**

Participants in the PSEG Thrift and Tax-Deferred Savings Plan or the PSEG Employee Savings Plan will receive a separate direction card from the respective plan's trustee for shares of PSEG common stock that have been allocated to their accounts under the PSEG Common Stock Fund and their ESOP Accounts. The trustee will vote the shares of PSEG common stock beneficially owned by the participant under the respective plan in accordance with such participant's instructions. **If you do not instruct the trustee how to vote your shares of PSEG common stock, your shares will not be voted.**

## CHAPTER THREE
## EXELON PROPOSAL 1 AND PSEG PROPOSAL 1: THE MERGER

**General**

The Exelon board of directors is using this joint proxy statement/prospectus to solicit proxies from the holders of Exelon common stock for use at the Exelon annual meeting. The PSEG board of directors also is using this joint proxy statement/prospectus to solicit proxies from the holders of PSEG common stock for use at the PSEG annual meeting.

**Exelon's Proposal**

At the Exelon annual meeting, holders of shares of Exelon common stock will be asked to vote on the issuance of shares of Exelon common stock as contemplated by the merger agreement.

**The merger will not be completed unless Exelon's shareholders approve the issuance of shares of Exelon common stock as contemplated by the merger agreement.**

Because the holders of Exelon common stock immediately prior to completion of the merger will own a majority of the shares of Exelon common stock outstanding immediately following completion of the merger, a separate vote by the holders of Exelon common stock on the merger agreement or the merger itself is not required under Pennsylvania law.

**PSEG's Proposal**

At the PSEG annual meeting, holders of shares of PSEG common stock will be asked to vote on the approval of the merger agreement and thereby approve the merger.

**The merger will not be completed unless PSEG's shareholders approve the merger agreement and thereby approve the merger.**

**Background of the Merger**

As participants in the energy industry, the management of Exelon and of PSEG are each generally familiar with the business and operations of the other company, and management personnel meet from time to time at industry conferences and similar events. John W. Rowe, Chairman, President and Chief Executive Officer of Exelon, and E. James Ferland, Chairman, President and Chief Executive Officer of PSEG, have each served as a chief executive officer in the electric utility industry for a period of approximately 20 years, and Messrs. Rowe and Ferland have met from time to time to discuss industry issues, personal experiences and philosophies relating to the management of utilities. In addition, as Exelon and PSEG have been joint owners of certain nuclear generating facilities for over 30 years, management of Exelon and PSEG meet from time to time to discuss operations at jointly owned facilities. Further, PSE&G and PECO have conducted utility operations in adjacent territories for over 75 years. As a consequence of these business relationships, Exelon and PSEG each is generally familiar with the other's business and operations.

On an ongoing basis, each of Exelon and PSEG evaluates options for achieving its long-term strategic goals and enhancing shareholder value. For several years, the Exelon board of directors and management have been engaged in a strategic planning process designed to position Exelon to take advantage of growth opportunities in its industry. As part of this process, Exelon periodically has evaluated a variety of possible business combinations in light of its evolving acquisition criteria and opportunities presented by various potential transactions. As part of its regular strategic planning process, management of PSEG periodically made presentations to the PSEG board of directors that included review of potential opportunities for business combinations or acquisitions within the utility industry.

On May 12, 2004, Mr. Robert S. Shapard, the then Executive Vice President and Chief Financial Officer of Exelon, telephoned Mr. Thomas M. O'Flynn, Executive Vice President and Chief Financial Officer of PSEG, in order to arrange a meeting to discuss the general business environment, the strategic direction of their companies and operations at jointly-owned nuclear generating facilities, including, among other options, the possibility of Exelon providing operations assistance to PSEG with respect to the Salem nuclear generating facility, one of the companies' jointly-owned nuclear generating facilities. Messrs. Shapard and O'Flynn met to discuss these matters and other strategic opportunities regarding the companies' generation businesses on May 20, 2004.

On May 25, 2004, at a regularly scheduled meeting of the Exelon board of directors and as part of Exelon's ongoing strategic planning process described above, members of Exelon management mentioned several potential candidates for an acquisition or business combination, including PSEG. The Exelon board of directors gave informal authorization to management to make contact with some of the companies discussed in order to assess the possibility of a business combination or other strategic transaction. Management of Exelon was engaged in an evaluation of the feasibility of transactions with several companies, including PSEG, and management had begun working on financial models as part of these feasibility studies.

On June 11, 2004, Randall E. Mehrberg, Executive Vice President, Corporate Strategy, Mergers & Acquisitions, and General Counsel of Exelon, and Mr. O'Flynn attended the annual meeting of Nuclear Electric Insurance Limited, or "NEIL," in Bermuda. Messrs. Mehrberg and O'Flynn, both NEIL board members, met briefly at that time to discuss further the matters that Mr. O'Flynn had previously discussed with Mr. Shapard at their May 20, 2004 meeting.

On June 14, 2004, Mr. Rowe contacted Mr. Ferland and scheduled a meeting to discuss strategic alternatives for Exelon and PSEG, in particular with respect to Exelon's and PSEG's jointly-owned nuclear generating facilities.

On June 15, 2004, the PSEG board of directors held a regularly scheduled meeting at which the conversations between Messrs. Mehrberg, Shapard and O'Flynn and the proposed meeting between Mr. Ferland and Mr. Rowe were discussed.

On June 23, 2004, Mr. Rowe met with Mr. Ferland in Boston, Massachusetts. Mr. Rowe and Mr. Ferland discussed possible arrangements for improving operations at jointly-owned nuclear generating facilities, including the suggestion made by Exelon that Exelon provide operational assistance with respect to the Salem nuclear generating facility jointly-owned by Exelon and PSEG and operated by PSEG. They also discussed other alternatives, including a possible exchange of ownership of jointly-owned nuclear generating facilities. Messrs. Rowe and Ferland also discussed general considerations relating to a possible business combination between Exelon and PSEG.

Exelon held a previously scheduled strategy retreat of its board of directors on June 27 through June 29, 2004. At the retreat and as part of the ongoing strategic planning process, management presented to the Exelon board of directors an analysis of the mergers and acquisition strategy of Exelon and an evaluation of a number of possible transactions, including a possible business combination with PSEG or one of several other companies.

On July 1, 2004, Mr. Mehrberg and Mr. O'Flynn attended a meeting of the strategic planning committee of the board of NEIL held at PSEG's offices in Newark, New Jersey. After the NEIL meeting, Messrs. Mehrberg and O'Flynn met to discuss further strategic options relating to nuclear generating facilities and to discuss strategic alternatives for their companies, including a possible business combination.

On July 16, 2004, Mr. Mehrberg phoned Mr. O'Flynn to discuss the possibility of exploring a business combination to be structured as a stock-for-stock merger with a fixed exchange ratio representing a pricing premium in the range of 10-20%, subject to, among other things, the results of

due diligence, the input of financial advisors and the outcome of further discussions. Mr. Mehrberg also expressed Exelon's interest in putting in place an operating services contract with respect to PSEG's and Exelon's jointly-owned nuclear generation facilities. Mr. Mehrberg indicated that Mr. Rowe would contact Mr. Ferland to discuss the matter further.

Mr. Rowe and Mr. Ferland had a telephone discussion on July 19, 2004. Mr. Rowe and Mr. Ferland discussed the possibility of an operating services contract for PSEG's and Exelon's jointly-owned nuclear generating facilities. They also discussed the possibility of exploring a business combination to be structured as a stock-for-stock merger with a pricing premium in the range of 10 to 20%, subject to a number of different factors, including results of due diligence, input of financial advisors, satisfactory regulatory assessments, governance issues, the outcome of further discussions and approval of each company's board of directors.

On July 20, 2004, the PSEG board of directors held a regularly scheduled board meeting at which Mr. Ferland reviewed with the directors his discussions with Mr. Rowe. The PSEG board of directors directed Mr. O'Flynn to request certain information from Exelon, including information about Exelon's operating experience with respect to its nuclear generating facilities. Mr. O'Flynn phoned Mr. Mehrberg that day to request that information.

On July 21, 2004, Mr. Mehrberg and Mr. Shapard participated in a conference call with Mr. O'Flynn and R. Edwin Selover, Senior Vice President and General Counsel of PSEG. They discussed the possibility of further discussions with respect to a possible business combination and the provision by Exelon of nuclear operating services. They concluded that, given the early stage of the discussions, they would not retain investment banking firms at that time to act as financial advisors in connection with a possible business combination. That same day, Mr. Selover provided a form of mutual confidentiality agreement to Mr. Mehrberg.

On July 26, 2004, Mr. Mehrberg and Mr. Shapard participated in a call with Mr. O'Flynn to discuss PSEG's interest in continuing discussions concerning a possible business combination. During this conversation, Messers Mehrberg, Shapard and O'Flynn confirmed the mutual interest of Exelon and PSEG in continuing discussions about a possible nuclear operating services contract and a possible business combination structured as a stock-for-stock merger.

On July 27, 2004, Exelon held a regularly scheduled meeting of its board of directors, at which Exelon management discussed contacts made with companies in the industry with respect to the possibility of a business combination and the results of management's further analysis of potential transactions with two of those companies. At this meeting, Exelon management reported on the status of the preliminary investigation of potential business combination transactions, including a potential transaction with PSEG. The results of the preliminary investigation presented to the Exelon board of directors included analysis of various factors that would affect the value of potential transactions to Exelon, including, but not limited to, earnings per share accretion/dilution, synergies and scalability, consistency of state regulatory models, regional diversity, opportunities for diversification, opportunities to serve markets with generation fleet, social issues, international and non-core assets, size of transaction, and credit considerations. The Exelon board of directors also discussed the continuing conversations with PSEG with respect to the general terms of a possible business combination and the terms of the proposed operating services contract. After considering the factors relevant to the evaluation of alternatives, the feasibility of the alternatives and the nature of discussions with PSEG, the Exelon board of directors accepted management's recommendation that Exelon pursue a possible business combination with PSEG. The Exelon board of directors instructed management to proceed with discussions with PSEG on the basis of the conversations held to date and to begin due diligence efforts.

On July 29, 2004, Mr. Mehrberg and Mr. Shapard spoke again with Mr. O'Flynn regarding Exelon's perspective with respect to a possible business combination. They also identified various financial advisors that each company might consider retaining.

Considering the size, complexity and geographic diversity of the proposed merger with PSEG, Exelon determined to retain two internationally recognized financial advisors with complementary strengths and substantial experience in similar transactions involving complex financial analysis, international operations and nuclear electric generation. On August 5, 2004, Mr. Rowe met with representatives of J.P. Morgan Securities Inc. to discuss the retention of JPMorgan as a financial advisor with respect to a possible business combination with PSEG. Exelon retained JPMorgan on August 9, 2004. On August 7, 2004, Messrs. Mehrberg and Shapard contacted representatives of Lehman Brothers Inc. to discuss the potential retention of Lehman Brothers as a financial advisor with respect to a possible transaction. Exelon retained Lehman Brothers as one of its financial advisors shortly thereafter.

On August 9, 2004, Mr. O'Flynn contacted representatives of Morgan Stanley & Co. Incorporated to discuss the possible retention of Morgan Stanley by PSEG as its financial advisor with respect to PSEG's strategic discussions with Exelon, including the fact that Morgan Stanley was then acting as Exelon's financial advisor with respect to its possible disposition of Sithe Energies, Inc.

On August 12, 2004, Exelon and PSEG entered into the mutual confidentiality agreement and a joint defense and common interest agreement. Mr. Mehrberg and Mr. O'Flynn attended a meeting of the strategic planning committee of the board of NEIL held at Exelon's offices in Philadelphia, Pennsylvania. That day Mr. Mehrberg and Mr. O'Flynn spoke again about the possibility of a strategic combination of Exelon and PSEG and the possible terms of such a transaction, as well as the due diligence and other steps that would be necessary to determine whether an agreement could be reached. During the course of later discussions on August 12, Messrs. Mehrberg, Shapard and O'Flynn talked generally about a possible business combination with an exchange ratio representing a pricing premium in the range of 13 to 17%, subject to, among other things, the results of due diligence, the input of financial advisors, satisfactory regulatory assessments, the outcome of further discussions and approval of each company's board of directors. Later that evening, Messrs. Mehrberg, Shapard, O'Flynn and Selover and Mr. Frank Cassidy, President and Chief Operating Officer of PSEG Power, met in Washington, D.C., to discuss various aspects of the possible strategic combination, including financial matters and nuclear operations.

On August 13, 2004, representatives of Exelon and PSEG, including Messrs. Mehrberg, Shapard, O'Flynn, Selover and Cassidy and Ms. Elizabeth A. Moler, Executive Vice President, Governmental & Environmental Affairs and Policy of Exelon, along with representatives of Skadden, Arps, Slate, Meagher & Flom LLP, Exelon's federal regulatory counsel, and representatives of Steptoe & Johnson LLP, PSEG's federal regulatory counsel, and representatives of other advisors of Exelon and PSEG, met in Washington, DC to discuss the federal regulatory aspects relating to a possible business combination and arrangements relating to the operation of PSEG's nuclear generating facilities.

On August 18, 2004, Mr. Mehrberg and Mr. Shapard discussed with Mr. O'Flynn PSEG's possible retention of Morgan Stanley as its financial advisor with respect to a possible business combination. The parties discussed the scope of Morgan Stanley's proposed engagement and the fact that Morgan Stanley was then acting as Exelon's financial advisor with respect to its possible disposition of Sithe. The parties confirmed that Morgan Stanley's work on this assignment would not pose an impediment to PSEG's engagement of Morgan Stanley as its financial advisor. Management of PSEG continued to discuss internally its selection of a financial advisor.

On August 24, 2004, PSEG retained Morgan Stanley as its financial advisor. On that day, Mr. O'Flynn and other representatives of PSEG met with representatives of Morgan Stanley in order to discuss PSEG's strategic alternatives, including a possible business combination with Exelon.

On August 30, 2004, at the request of the PSEG board of directors, Mr. Rowe met with members of the PSEG board of directors in Short Hills, New Jersey in order to discuss his strategic rationale for a possible business combination and his long-range plans for a combined company.

On September 2, 2004, the PSEG board of directors held a previously scheduled strategy conference. Members of PSEG management, including Mr. O'Flynn and Mr. Selover, also participated in the conference. At the conference, the PSEG board of directors discussed industry trends and strategic issues and alternatives for PSEG, including a possible business combination with Exelon.

Also on September 2, 2004 senior officers of Exelon, including Mr. Mehrberg and Mr. Shapard, representatives of Sidley Austin Brown & Wood LLP, Exelon's mergers and acquisitions counsel, Skadden, JPMorgan and Lehman Brothers and other advisors held an organizational meeting in Chicago, Illinois, at the offices of Sidley Austin Brown & Wood LLP in order to formally begin due diligence efforts with respect to a possible business combination with PSEG.

During the period of September to mid-November 2004, PSEG consulted regularly with Pillsbury Winthrop LLP (now Pillsbury Winthrop Shaw Pittman LLP), outside counsel to PSEG, and Morgan Stanley concerning legal and financial issues that would arise in the course of consideration of a potential business combination with Exelon.

During the period of September 9 through November 17, 2004, the parties and certain of their financial, legal, accounting and other advisors held numerous and extensive meetings by telephone or in person to exchange information in the course of the due diligence process, to consider possible synergies and other opportunities presented by a business combination and to discuss regulatory requirements and strategies. Additional document due diligence was conducted during this same period. During this time Exelon and PSEG reviewed a broad range of business, financial, accounting, legal and operational issues, with a particular emphasis on financial and related accounting matters and on Exelon's understanding of the business of PSEG Energy Holdings. The parties were also in regular contact, as appropriate, concerning the outcome of meetings of their respective boards of directors at which the possible business combination was discussed. In addition, representatives of Exelon and PSEG met during this period to discuss an operating services contract in order to improve operations at PSEG's nuclear generating facilities.

On September 21, 2004, the PSEG board of directors held a regularly scheduled meeting during which regulatory considerations relating to a possible business combination with Exelon were discussed.

On October 1, 2004, Messrs. Mehrberg, Shapard, O'Flynn and Selover, together with other representatives of Exelon and PSEG, JPMorgan, Lehman Brothers and Morgan Stanley, met at Lehman Brothers' offices in New York City in order to discuss the status of due diligence and related matters.

On October 4, 2004, representatives of Exelon and PSEG, including Messrs. Mehrberg, Shapard, O'Flynn and Selover spoke regarding alternatives for a nuclear operating services contract.

On October 18, 2004, Mr. Mehrberg and Mr. O'Flynn spoke by telephone with respect to the status of the due diligence efforts of the parties and the progress of discussions with respect to the terms of possible business combination. The discussion covered various subjects that the parties had been evaluating as part of the due diligence effort and how those subjects might become relevant to the possible terms of a business combination.

On October 19, 2004, the PSEG board of directors held a previously scheduled regular meeting at which the directors discussed the status of the evaluation of a possible business combination with Exelon and Exelon's performance with respect to nuclear generation.

On October 26, 2004, the Exelon board of directors held a previously scheduled regular meeting at which representatives of Sidley Austin, JPMorgan and Lehman Brothers were present and at which

management provided an update to the Exelon board of directors as to the ongoing discussions with PSEG and the progress to date with respect to due diligence and Exelon's preliminary financial analysis of PSEG. The update also included a discussion of the general terms of an operating services contract relating to PSEG's nuclear generating facilities. At this meeting, representatives of Sidley Austin reviewed with the directors their fiduciary duties in connection with considering a possible business combination.

On October 29, 2004, Messrs. Mehrberg, Shapard, O'Flynn and Selover spoke with respect to the status of due diligence and the progress of discussions with respect to the possible business combination, as well as the status and scope of the proposed operating services contract.

On the evening of November 7 and morning of November 8, 2004, Mr. Mehrberg and Mr. Shapard met with Mr. Selover and Mr. O'Flynn in Chicago, Illinois, to discuss in more detail the terms of a possible business combination. Exelon proposed, subject to the results of due diligence and approval by the Exelon board of directors, a stock-for-stock merger with a fixed exchange ratio representing a pricing premium of approximately 15%. In addition, there was a discussion of regulatory, nuclear, governance, headquarters and related issues.

On November 10, 2004, Mr. John Young, Executive Vice President of Exelon and President of Exelon Generation, and Mr. Christopher M. Crane, Senior Vice President of Exelon, President & Chief Nuclear Officer of Exelon Nuclear and President and Chief Executive Officer of Amergen, met with Mr. Ferland and Mr. Cassidy in order to discuss Exelon's management process with respect to the operation of nuclear generating facilities.

Also on November 10, 2004, Messrs. Mehrberg, Shapard, O'Flynn and Selover spoke with respect to the regulatory aspects of a possible business combination.

On November 11, 2004, Messrs. Mehrberg, Shapard, O'Flynn and Selover met in Elizabeth, New Jersey, in order to discuss in more detail the terms of a possible business combination, including possible exchange ratios. Messrs. Mehrberg and Shapard initially proposed a fixed exchange ratio of 1.20 shares of Exelon stock for each share of PSEG common stock. Mr. O'Flynn proposed a premium of 17%, which was roughly equivalent to a 1.25 exchange ratio based on then current prices. The parties did not reach any agreement on the exchange ratio for a possible business combination during the course of these discussions. The parties also discussed the proposed agreement for nuclear operating services, issues associated with regulatory approvals for a business combination, governance issues, the location of headquarters of business units and related matters.

On November 12, 2004, Messrs. Mehrberg, Shapard, O'Flynn and Selover spoke again with respect to the terms of a possible business combination and, in particular, the exchange ratio for such a transaction. In these discussions, the parties had further discussion about a possible exchange ratio in the range of between 1.22 and 1.24 shares of Exelon common stock for each share of PSEG common stock. That same day Mr. Rowe and Mr. Ferland met in Washington, DC to discuss the proposed terms of a possible business combination. Mr. Rowe proposed, subject to approval by the Exelon board of directors, the completion of due diligence and both companies near-term stock performance, a business combination with a fixed exchange ratio of 1.225 shares of Exelon common stock for each share of PSEG common stock. They also discussed a proposed commitment by Exelon to raise its dividend over time after the execution of a merger agreement such that the first dividend received by PSEG shareholders after completion of the merger would match the dividend received by them prior to completion of the merger on an exchange ratio adjusted basis.

On November 13, 2004, Messrs. Rowe and Ferland had a telephone conference in which Mr. Ferland indicated that he would present the proposed terms to the PSEG board of directors, including the 1.225 fixed exchange ratio proposed by Mr. Rowe, and recommend proceeding with full due diligence and negotiation of the terms of a merger agreement.

On November 15, 2004, the Exelon board of directors met in person, along with representatives of Sidley Austin, JPMorgan and Lehman Brothers, in order to discuss the results of Exelon's due diligence efforts to date, including the proposed regulatory strategy and preliminary analysis of the financial prospects of PSEG and a combined company, and the proposed terms of the business combination. In addition, the Exelon board of directors reviewed the terms of the proposed operating services contract and the general terms of a proposed business combination, including the general terms of a draft merger agreement. After a discussion, the Exelon board of directors authorized management to go forward with further due diligence and to present a draft of a proposed merger agreement to PSEG. Later the same day Mr. Rowe spoke with Mr. Ferland by phone to report the decision of the Exelon board of directors.

On November 16, 2004, the PSEG board of directors held a regularly scheduled meeting, also attended by representatives of Pillsbury Winthrop and Morgan Stanley, in order to discuss the status of the possible business combination, including the proposed terms thereof. Pillsbury Winthrop reviewed with the PSEG board of directors the legal and fiduciary responsibilities of directors when contemplating potential business combination transactions. After a discussion, the PSEG board of directors authorized management to go forward with further due diligence, including the formation of an expanded internal and external due diligence team, and to begin negotiation of a merger agreement. Later that day Mr. Ferland phoned Mr. Rowe in order to discuss the outcome of the meeting and to discuss a time schedule for conducting further due diligence and negotiations regarding a possible business combination. Mr. Ferland also requested that Mr. Crane and Mr. Young meet with the nuclear committee of the PSEG board of directors to discuss Exelon's management process with respect to the operation of nuclear generating facilities.

During the period from November 17, 2004 through December 19, 2004, the parties conducted further due diligence with respect to each other, including document review and in person and telephonic meetings among the parties and their legal, financial, accounting and other advisors. This review included an examination of business and financial outlooks, litigation, environmental, accounting, financial reporting, tax, treasury, power trading, human resources, employee benefits, executive compensation, information technology and general legal matters.

On November 18, 2004, Sidley Austin delivered a draft of the merger agreement to PSEG and Pillsbury Winthrop. On November 30, 2004, Pillsbury Winthrop delivered PSEG's comments to the draft merger agreement.

On November 30, December 1 and December 3, 2004, the generation oversight, energy delivery oversight and enterprises oversight committees of the Exelon board of directors, respectively, met to discuss with members of management certain aspects of Exelon's due diligence efforts. In addition, on November 30, 2004, Exelon and PSEG made a joint presentation to each of Standard and Poor's and Moody's in order to inform the rating agencies of a possible merger of PSEG with Exelon and present the financial outlook for the combined company.

On December 6, 2004, Messrs. Mehrberg and Shapard and other representatives of Exelon, along with representatives of Sidley Austin and Lehman Brothers, met with Messrs. O'Flynn and Selover, along with representatives of Pillsbury Winthrop and Morgan Stanley, in Chicago, Illinois, to discuss the draft merger agreement and related transaction issues. On December 7, 2004, Sidley Austin delivered a revised draft of the merger agreement to PSEG and Pillsbury Winthrop.

On December 7, 2004, the Exelon board of directors held a previously scheduled regular meeting, which meeting was attended by representatives of Sidley Austin, JPMorgan and Lehman Brothers. The Exelon board of directors discussed the status of due diligence and the financial analysis of PSEG, the course of negotiations to date and various other matters relating to the proposed business combination. Exelon management reviewed with the Exelon board of directors the proposed terms of the operating

services contract. That same day Messrs. Mehrberg, Shapard, O'Flynn and Selover spoke regarding the outcome of the meeting of the Exelon board of directors and the course of negotiations.

On December 8, 2004, the parties reached substantial agreement in principle on the terms of the operating services contract, subject to board approval and satisfactory resolution of related regulatory matters.

On December 10, 2004, Mr. Shapard and other representatives of Exelon, along with representatives of Sidley Austin and Lehman Brothers, met in New York, New York, at the offices of Sidley Austin with Messrs. O'Flynn and Selover, along with representatives of Pillsbury Winthrop and Morgan Stanley, to discuss the revised draft of the merger agreement. On December 11, 2004, Sidley Austin sent a revised draft of the merger agreement to PSEG and Pillsbury Winthrop.

On December 11, 2004, Mr. Rowe met over dinner with directors of PSEG in Bernardsville, New Jersey to discuss his strategic vision for a combined company.

On December 12, 2004, the nuclear committee of the PSEG board of directors, and certain other PSEG directors, met with Messrs. Rowe, Young and Crane and with representatives of PSEG to review Exelon's management process with respect to the operation of nuclear generating facilities. Also on December 12, the PSEG board of directors held a special meeting, also attended by representatives of Pillsbury Winthrop, Steptoe & Johnson, Morgan Stanley and other advisors, to discuss the results of PSEG's due diligence and the discussions to date with respect to the merger agreement. Pillsbury Winthrop led the PSEG board of directors through a discussion of the terms of the draft merger agreement and discussed the PSEG board of directors' duties in the context of considering the proposed business combination. Morgan Stanley reviewed the status of certain preliminary financial analyses of the proposed business combination with the PSEG board of directors. That evening, Mr. O'Flynn spoke to Mr. Mehrberg with respect to various matters raised by the PSEG board of directors on the merger agreement and related items.

On December 13, 2004, Messrs. Mehrberg and Shapard and other representatives of Exelon, along with representatives of Sidley Austin and Lehman Brothers, met with Messrs. O'Flynn and Selover and representatives of Pillsbury Winthrop and Morgan Stanley by teleconference to discuss the revised draft of the merger agreement. On December 14, 2004, Sidley Austin distributed a revised draft of the merger agreement to PSEG and Pillsbury Winthrop.

On December 15, 2004, Messrs. Mehrberg and Shapard and other representatives of Exelon, along with representatives of Sidley Austin and Lehman Brothers, and Messrs. O'Flynn and Selover, along with representatives of Pillsbury Winthrop and Morgan Stanley, met by teleconference to discuss the revised draft of the merger agreement. Later that day, Sidley Austin distributed a revised draft of the merger agreement to PSEG and Pillsbury Winthrop and to the Exelon board of directors. On December 16, 2004, PSEG distributed the revised draft of the merger agreement to the PSEG board of directors.

On December 17, 2004, at a special meeting, the Exelon board of directors met in person and by video conference in Chicago, Illinois and Philadelphia, Pennsylvania, to discuss the merger agreement and the proposed terms and conditions of the merger. The Exelon board of directors also reviewed the business, regulatory, financial and operational aspects of the proposed merger. At the meeting, representatives of Sidley Austin led the Exelon board of directors through a detailed review of the merger agreement. Representatives of Sidley Austin also reviewed with the members of the Exelon board of directors their fiduciary duties in connection with considering a business combination. The Exelon board of directors also reviewed the due diligence findings and management's financial analysis of the transaction. In addition, representatives of JPMorgan and Lehman Brothers presented their analysis of the transaction and each stated that they were prepared to render an opinion to the Exelon board of directors that, based upon and subject to the assumptions, qualifications and limitations

described by them and to be set forth in their written opinions, the proposed 1.225 exchange ratio in the merger was fair, from a financial point of view, to Exelon.

On December 17, 2004, Sidley Austin distributed a revised draft of the merger agreement to PSEG and Pillsbury Winthrop in response to comments on the previous draft communicated by representatives of Pillsbury Winthrop. On December 18, 2004, representatives of Sidley Austin held further discussions with representatives of Pillsbury Winthrop with respect to the draft merger agreement. On December 18, 2004, Sidley Austin distributed a revised draft of the merger agreement to PSEG and Pillsbury Winthrop and to the Exelon board of directors. PSEG distributed this revised draft of the merger agreement to its board of directors that same day.

On December 19, 2004, the organization and compensation committee of the PSEG board of directors held a special meeting in person and by telephone attended, for a portion of the meeting, by Hewitt Associates LLC and by Messrs. Ferland and Selover, to consider the proposed severance and retention plans, an amendment to Mr. Ferland's employment agreement, to avoid triggering the severance benefit that would otherwise result from the merger and the change in his responsibilities, and certain employment agreements. The committee approved the proposed arrangements and resolved to recommend their adoption to the PSEG board of directors.

On the morning of December 20, 2004, the PSEG board of directors held a special meeting, in person and by teleconference, with representatives of PSEG, Pillsbury Winthrop, Steptoe & Johnson and Morgan Stanley to discuss the merger agreement and the proposed terms and conditions of the transaction, the operating services agreement, severance and retention plans, the amendment to Mr. Ferland's employment agreement and other employment agreements. Pillsbury Winthrop reviewed the merger agreement with the PSEG board of directors. Morgan Stanley delivered its oral opinion (subsequently confirmed in writing) that, as of December 20, 2004 and based upon and subject to the considerations, assumptions and limitations discussed in the opinion, the exchange ratio under the merger agreement was fair, from a financial point of view, to the holders of PSEG common stock.

The PSEG board of directors, by unanimous vote, approved the merger agreement and the merger and the operating services contract.

The Exelon board of directors held a special meeting by telephone on the morning of December 20, 2004. At this meeting the Exelon board of directors reviewed the final merger agreement and the factors that it considered in connection with the proposed merger, and representatives of each of JPMorgan and Lehman Brothers delivered their firm's respective written opinions that, based upon and subject to the assumptions, qualifications and limitations described in such opinion, the 1.225 exchange ratio in the merger was fair, from a financial point of view, to Exelon.

Also on the morning of December 20, 2004, the Exelon board of directors, by unanimous vote, approved the merger agreement and the merger, including the issuance of shares of Exelon common stock as contemplated by the merger agreement, and the operating services contract. Thereafter Exelon and PSEG executed the merger agreement and the operating services contract and issued a joint press release announcing execution of the merger agreement.

**Recommendation of Exelon Board; Exelon's Reasons for the Merger**

**The Exelon board of directors has unanimously approved the merger agreement, has unanimously determined that the merger, including the issuance of shares of Exelon common stock as contemplated by the merger agreement, is advisable, fair to and in the best interests of Exelon and its shareholders and unanimously recommends a vote FOR the proposal to approve the issuance of shares of Exelon common stock as contemplated by the merger agreement.**

In reaching its decision to recommend the issuance of shares of Exelon common stock as contemplated by the merger agreement, the Exelon board of directors consulted with Exelon

management, as well as J.P. Morgan Securities Inc. and Lehman Brothers Inc., Exelon's financial advisors, Sidley Austin Brown & Wood LLP, Exelon's outside mergers and acquisitions counsel, and, with respect to federal regulatory matters, Skadden, Arps, Slate, Meagher & Flom LLP, Exelon's outside federal regulatory counsel, and considered various material factors, which are described below. The following discussion of the information and factors considered by the Exelon board of directors is not exhaustive, but includes all material factors considered by the Exelon board of directors. In view of the wide variety of factors considered by the Exelon board of directors in connection with its evaluation of the merger, the Exelon board of directors did not consider it practical to, nor did it attempt to, quantify, rank or otherwise assign relative weights to the specific factors that it considered in reaching its decision. In considering the factors described below, individual members of the Exelon board of directors may have given different weight to different factors. The Exelon board of directors considered this information as a whole, and overall considered the information and factors to be favorable to, and in support of, its determinations and recommendations. Among the material information and factors considered by the Exelon board of directors were the following:

*Strategic Considerations.* The Exelon board of directors considered a number of factors pertaining to the strategic rationale for the merger, including the following:

Increased Scale and Scope; Diversification. The merger will create a combined company with increased scale and scope in both energy delivery and generation. In addition, the combined company will have greater diversification and balance in its energy delivery business and generation portfolio. This increased scale, scope and diversification should allow for improved service and reliability with greater earnings predictability. In the energy delivery business, the combined company will have three urban utility-based franchises with service areas encompassing more than 18 million people. The combined company will also have a large gas distribution portfolio to complement its electric distribution business. In the generation business, the combined company is expected to have approximately 52,000 megawatts of domestic capacity in multiple states prior to giving effect to any divestitures or other measures that may be required by governmental authorities, including approximately 20,000 megawatts of low-cost nuclear generation. This generation portfolio diversification should create a more balanced portfolio in terms of geography, fuel mix, dispatch and load-servicing capacity.

Anticipated Financial Strength and Flexibility. The increased scale and scope is ultimately expected to strengthen the balance sheet of the combined company. In addition, the diversification of the energy delivery and generation portfolios of the combined company should result in a more stable cash flow, with approximately half of the combined company's earnings and cash flow coming from the three utilities and approximately half coming from the generation and other non-utility businesses.

Expanded and Improved Nuclear Operations. The combined company will have expanded nuclear operations and should be able to capitalize on Exelon's nuclear operating and cost structure improvements, as well as the sharing of best practices across organizations.

Combined Expertise in Competitive Markets. The Exelon board of directors believes the merger will combine companies with complementary areas of expertise: Exelon's expertise in generation operations and PSEG's expertise in transmission and distribution operations. In addition, PSEG's knowledge of the New Jersey auction process for procurement of power for utility customers will be valuable for ComEd as Illinois transitions to a competitive market with an expected similar auction process. The combined company is expected to be able to draw upon the intellectual capital, technical expertise and experience of a deeper and more diverse workforce. The combined company should also be better able to invest in and deploy new technologies to improve service.

Common Regulatory Framework. New Jersey, Pennsylvania and Illinois have all passed legislation bringing competition to the electric industry, and are in varying phases of the transition to full competition.

*Synergies.* The Exelon board of directors considered that, although no assurance can be given that any particular level of cost savings and other synergies will be achieved, Exelon management had identified estimated synergies of approximately $400 million in the first full year of operations following completion of the merger and approximately $500 million in the second full year of operations following completion of the merger, prior to out-of-pocket expenses and transaction costs. The Exelon board of directors also considered the probability that the net present value of the estimated synergies over a ten-year period, plus terminal value, would exceed the premium to be paid in the merger under a range of assumptions. The Exelon board of directors took note of the fact that the synergy numbers were estimates, that they may change and that achieving the synergies is subject to a number of uncertainties. See "Risk Factors Risks Relating to the Merger The anticipated benefits of combining PSEG and Exelon may not be realized."

*Comparable Business Approach.* The Exelon board of directors considered the comparable corporate cultures of the two companies, including their shared commitment to supporting and participating in competitive energy markets and the competitive strategies of the companies.

*Impact of the Merger on Customers, Employees, Suppliers.* The Exelon board of directors evaluated the expected impact of the merger on Exelon's customers, employees and suppliers. Specifically, the merger should benefit customers by enhancing operations and strengthening reliability and provide more opportunities for employees in a larger, more competitive company.

*Impact of the Merger on Communities.* The Exelon board of directors evaluated the expected impact of the merger on the communities in which Exelon and PSEG are located and which they serve. In particular, the Exelon board of directors believes the merger will benefit the municipalities served by the combined company by creating a strong combined company able to provide more reliable service with operating headquarters in Newark, New Jersey, Chicago, Illinois, and Philadelphia, Pennsylvania. In addition, the companies expect to maintain their substantial presence in the cities and communities they serve, including significant charitable contributions.

*Benefits of Operating Services Contract.* The Exelon board of directors evaluated the expected benefits to Exelon and the expected increase in the value of PSEG resulting from the nuclear operating services contract entered into by Exelon Generation and PSEG Nuclear. See "The Merger Certain Relationships Between Exelon and PSEG; Operating Services Contract" for a description of the contract.

*Share Prices.* The Exelon board of directors took note of the historic stock prices of Exelon and PSEG, including that the exchange ratio represented a 14.6% premium over the closing price of PSEG's common stock on December 16, 2004 and a 18.7% premium over the 30-day average closing price of PSEG's common stock as of December 16, 2004.

*Financial Considerations.* The Exelon board of directors considered the expected financial impact of the merger on Exelon in light of Exelon's acquisition criteria, including that the merger is expected to be accretive to shareholders of both companies. In particular, the Exelon board of directors considered the quantitative analysis of the merger on the combined company's earnings per share and the financial prospects of Exelon and PSEG, including the financial projections and extensions thereof prepared by the management of Exelon and the financial projections prepared by the management of PSEG, as adjusted by the management of Exelon. The Exelon board of directors also considered the historic financial condition, operating results and businesses of Exelon and PSEG, including information with respect to their respective earnings history.

*Opinions of Financial Advisors.* The Exelon board of directors considered the opinions of each of JPMorgan and Lehman Brothers to the Exelon board of directors that, as of December 20, 2004 and subject to and based upon the assumptions, qualifications and limitations discussed in each opinion, the exchange ratio in the merger was fair, from a financial point of view, to Exelon. See "The Merger Opinions of Financial Advisors Opinions of Exelon's Financial Advisors."

*Strategic Alternatives.* The Exelon board of directors considered the trends and competitive developments in the industry and the range of strategic alternatives available to Exelon, including the possibility of business combinations with other participants in the industry or continuing to operate as a stand-alone entity.

*Recommendation of Management.* The Exelon board of directors took into account management's recommendation in favor of the merger.

*Terms of the Merger Agreement.* The Exelon board of directors reviewed the terms of the merger agreement, including that the exchange ratio is fixed, the restrictions on Exelon's interim operations, the covenant for Exelon, subject to the Exelon board of directors' fiduciary duties and applicable laws, to increase its dividend to equal PSEG's on an exchange ratio adjusted basis, the ability of PSEG in specified circumstances to issue up to $350 million in equity or equity equivalents prior to completion of the merger, the conditions to each party's obligation to complete the merger, the instances in which each party is permitted to terminate the merger agreement and the related termination fees payable by each party in the event of termination of the merger agreement under specified circumstances. See "The Merger Agreement" for a detailed discussion of the terms and conditions of the merger agreement. The Exelon board of directors also considered the course of negotiations of the merger agreement.

*Severance and Retention Arrangements.* The Exelon board of directors considered the severance and retention arrangements of PSEG in place prior to the execution of the merger agreement and those adopted in contemplation of execution of the merger agreement and the impact of such arrangements on the retention of key management of PSEG.

*Due Diligence.* The Exelon board of directors considered the scope of the due diligence investigation conducted by management and Exelon's outside advisors, including due diligence with respect to PSEG's international operations and evaluated the results thereof, including the information contained in PSEG's disclosure letter relating to the merger agreement. The Exelon board of directors also took note of the reports of the committees of the Exelon board of directors evaluating the results of the due diligence investigations and the coverage of identified risk areas in the representations and warranties in the merger agreement.

*Likelihood of Completion of the Merger.* The Exelon board of directors considered the likelihood that the merger will be completed on a timely basis, including the likelihood that the merger will receive all necessary regulatory approvals without unacceptable conditions. The Exelon board of directors took note of the closing condition in the merger agreement that neither Exelon nor PSEG is required to complete the merger if any governmental authority has entered a "*burdensome order*" in connection with the required statutory approvals. (See "The Merger Agreement Covenants" for a description of this term). The Exelon board of directors also took note of Exelon's history of completing on a timely basis a transaction with similar regulatory approval requirements.

The Exelon board of directors also considered the potential risks of the merger, including the following:

*Regulatory Approvals.* The Exelon board of directors considered the extensive regulatory approvals required to complete the merger and the risk that the governmental authorities and third parties may seek to impose unfavorable terms or conditions on the required approvals or that such approvals would

not be obtained at all. The Exelon board of directors also considered the potential length of the regulatory approval process and that the merger agreement provides that it may not be terminated until June 20, 2006, which may be extended to December 20, 2006 under specified circumstances.

*Restrictions on Interim Operations.* The Exelon board of directors considered the provisions of the merger agreement placing restrictions on Exelon's operations until completion of the merger.

*Diversion of Management.* The Exelon board of directors considered the possible diversion of management resulting from the substantial time and effort necessary to complete the merger and integrate the operations of Exelon and PSEG following completion of the merger.

*Integration.* The Exelon board of directors evaluated the challenges inherent in the combination of two business enterprises of the size and scope of Exelon and PSEG, including the possibility of not achieving the anticipated synergies and other benefits sought from the merger.

*Impact on Credit Rating.* The Exelon board of directors considered the likelihood that the merger could result in a lower investment grade credit rating for the combined company and certain of its subsidiaries for a period of time from that of Exelon and its subsidiaries prior to the merger and the implications of such lower credit rating.

*Increased Regulation.* The Exelon board of directors considered the additional regulation to which the combined company would be subject.

*PSEG Nuclear Generating Facilities.* The Exelon board of directors considered the state of the nuclear generating facilities operated by PSEG and the impact on the combined company if the shutdown of the Hope Creek generating facility that was then in effect was extended beyond its expected timeframe or one or more of the nuclear generating facilities were unexpectedly shut down by the NRC or otherwise for an extended period of time. The Exelon board of directors took note of the ameliorative efforts of Exelon and PSEG on this matter, including under the operating services contract.

*Rate Recovery.* The Exelon board of directors considered the fact that as a result of purchase method accounting, certain of PSE&G's pension expenses currently recoverable under its current rate order from the NJBPU would be accelerated and may no longer be recoverable under that rate order. The Exelon board of directors took note of the fact that it is a condition to completion of the merger that PSE&G obtain an order from the NJBPU that permits PSE&G to recover such costs.

The Exelon board of directors also considered the corporate governance provisions of the merger agreement and the Amended and Restated By-laws to be adopted upon completion of the merger, including that, upon completion of the merger, the Exelon board of directors will be comprised of twelve legacy Exelon directors and six legacy PSEG directors and that following completion of the merger until March 31, 2007, Mr. E. James Ferland, the current Chairman, President and Chief Executive Officer of PSEG, will serve as the non-executive Chairman of the Exelon board of directors.

The Exelon board of directors realized that there can be no assurance about future results, including results considered or expected as described in the factors listed above, such as assumptions regarding potential synergies. It should be noted that this explanation of the Exelon board of directors' reasoning and all other information presented in this section are forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading "Forward-Looking Statements."

**Recommendation of PSEG Board; PSEG's Reasons for the Merger**

**The PSEG board of directors has unanimously approved the merger agreement, has unanimously determined that the merger agreement and the merger are advisable, fair to and in the best interests of PSEG and the holders of PSEG common stock, and unanimously recommends that PSEG shareholders vote FOR the proposal to approve the merger agreement and thereby approve the merger.**

In reaching its determination to recommend the approval of the merger agreement and the merger, the PSEG board of directors consulted with management, as well as Morgan Stanley & Co. Incorporated, PSEG's financial advisor, Pillsbury Winthrop Shaw Pittman LLP, PSEG's outside legal counsel, and, with respect to federal regulatory matters, Steptoe & Johnson LLP, PSEG's outside federal regulatory counsel, and considered various material factors, which are discussed below. The following discussion of the information and factors considered by the PSEG board of directors is not intended to be exhaustive. In view of the wide variety of factors considered in connection with the merger, the PSEG board of directors did not consider it practicable to, nor did it attempt to, quantify or otherwise assign relative weights to the specific material factors it considered in reaching its decision. In addition, individual members of the PSEG board of directors may have given different weight to different factors. The PSEG board of directors considered this information and these factors as a whole, and overall considered the relevant information and factors to be favorable to, and in support of, its determinations and recommendations. Among the material information and factors considered by the PSEG board of directors were the following:

*Strategic Considerations.* The PSEG board of directors considered a number of factors pertaining to the strategic rationale for the merger, including the following:

- Common View of the Future of the Utility Industry. The PSEG board of directors considered that the two companies share a common outlook on the preferred business model in the evolving utility industry and the characteristics necessary to assure long-term success in the industry, including supporting and participating in competitive energy markets.

- Increased Scale and Scope, Diversification of Risk. The PSEG board of directors considered that the merger will create a combined company with increased scale and scope in both energy delivery and electricity generation. The combined company will have greater diversification of markets and regulatory regimes. After merging, the combined company will maintain its proportion of business in regulated operations while reducing the proportion in international operations. By extending its operations across several states, the merger will diversify PSEG's regulatory risk by subjecting the combined company's utility operations to the jurisdictions of multiple state regulators rather than solely New Jersey. The generation portfolio will have a greater balance in terms of geography, dispatch, and load-servicing capabilities.

- Anticipated Financial Strength and Flexibility. The PSEG board of directors considered that the increased scale and diversification of the generation portfolio and utility operations are expected to provide improved earnings and cash flows, hence financial stability, for the combined company. The PSEG board of directors considered the anticipated improved credit rating of the combined company and certain of its subsidiaries. Additionally, the PSEG board of directors considered that certain of the combined company's assets, including international investments, would represent a smaller proportion of the combined company, and that opportunities to monetize selected assets would increase.

- Improved Nuclear Operations. The PSEG board of directors considered that the merger will give PSEG the opportunity to accelerate and sustain improvements at the Salem and Hope Creek nuclear generating facilities through access to Exelon's management model for nuclear operations, as well as Exelon's management employees, creating the ability to share best practices and improve both operating and cost performance. Additionally, the combined

company will have 20 nuclear generating facilities at 12 sites, reducing PSEG's operating risk at any one unit.

Combined Expertise. The PSEG board of directors considered that the merger will combine complementary areas of expertise: PSEG's expertise in electric and gas transmission and distribution operations and Exelon's expertise in nuclear generation operations. The combined company is expected to be able to draw upon the intellectual capital, technical expertise, and experience of a deeper, more diverse workforce.

Common Regulatory Framework. The PSEG board of directors considered that Illinois, New Jersey, and Pennsylvania have all passed legislation bringing competition to the electric industry, and are in the varying phases of transition to full competition, with New Jersey being the most advanced. Both PSEG and Exelon have experience operating within the complexities of markets which have both regulated and unregulated aspects.

*Cost Savings and Synergies.* The PSEG board of directors considered that, although no assurance can be given that any particular level of cost synergies will be achieved, management had identified estimated annual pre-tax cost savings and synergies of $300 million in the first full year following completion of the merger increasing to approximately $400 million by the third year (without deduction for out-of-pocket expenses and transaction costs). These cost savings and synergies would occur in general and administrative operations, trading operations, fossil and nuclear operations and other operations, as well as opportunities to improve its meter reading and customer service efficiency, but did not include expected improvements in the operating performance of nuclear generating units to the extent those improvements were already reflected in PSEG's forward-looking financial information for 2005-2009. The PSEG board of directors believes that particular synergy opportunities exist in the areas of corporate staffing, operations and support staffing, corporate programs, information technology, the supply chain and plant optimization. The PSEG board of directors took note of the fact that the cost synergy numbers were estimates, that they may change and that achieving the cost synergies is subject to a number of uncertainties. See "Risk Factors Risks Relating to the Merger The anticipated benefits of combining PSEG and Exelon may not be realized."

*Impact of the Merger on Communities.* The PSEG board of directors evaluated the expected impact of the merger on the communities in which PSEG is located and which it serves. The PSEG board of directors believes the merger will benefit the municipalities served by the combined company by creating a strong combined company with operating headquarters in Newark, New Jersey, Chicago, Illinois and Philadelphia, Pennsylvania. The PSEG board of directors considered that, although the corporate headquarters of the combined company will be located in Chicago, Illinois, Exelon has agreed that it will maintain the combined company's generation headquarters in Newark, New Jersey. In addition, the companies expect to maintain their substantial presence in the cities and communities they serve, including through ongoing and significant charitable contributions. In particular, the PSEG board of directors considered the provision of the merger agreement to the effect that, during the four-year period immediately following the merger, the combined company will provide charitable contributions and traditional local community support within the service areas of PSEG and its subsidiary utilities at levels substantially comparable to and no less than the levels of charitable contributions and community support provided within their service areas within the two-year period immediately prior to completion of the merger.

*Benefits of Nuclear Operating Services Contract.* The PSEG board of directors considered the expected benefits to PSEG resulting from the nuclear operating services contract entered into by PSEG Nuclear and Exelon Generation. See "The Merger Certain Relationships Between Exelon and PSEG; Operating Services Contract" for a description of the contract.

*Share Prices and Tax-Free Exchange.* The PSEG board of directors took note of the historic stock prices of PSEG and Exelon, including that the exchange ratio represented a 19.2% premium over the closing price of PSEG's common stock on December 15, 2004 and a 17.2% premium over the 30 day average closing price of PSEG's common stock as of December 15, 2004. The PSEG board of directors considered the potential for appreciation in value of Exelon's common stock and the opportunity for PSEG shareholders receiving Exelon shares in the merger to participate in this appreciation. The PSEG board of directors also took into account the fact that the merger is designed to be tax-free to the holders of PSEG common stock.

*Financial Considerations.* The PSEG board of directors considered the expected financial impact of the merger on PSEG, including that the merger is expected to be accretive to PSEG shareholders in the estimated amount of 13% in the first year following the merger. In particular, the PSEG board of directors considered the quantitative analysis of the merger on the combined company's earnings per share and the financial prospects of PSEG and Exelon. The PSEG board of directors also considered the historic financial condition, operating results and businesses of PSEG and Exelon, including information with respect to their respective earnings history.

*Opinion of Financial Advisor.* The PSEG board of directors considered the opinion of Morgan Stanley delivered to it that, as of December 20, 2004 and subject to and based on the considerations, assumptions and limitations discussed in that opinion, the exchange ratio under the merger agreement was fair, from a financial point of view, to the holders of PSEG's common stock. See "The Merger Opinions of Financial Advisors Opinion of PSEG's Financial Advisor."

*Recommendation of Management.* The PSEG board of directors considered management's recommendation in support of the merger.

*Stand-Alone Strategy.* The PSEG board of directors considered the prospects inherent in PSEG's stand-alone business plan, including among other strategies the potential monetization of certain of its assets and the plans for improvement in its nuclear operations. The PSEG board of directors considered that the benefits of the merger are likely to be achieved on a more accelerated basis and with less uncertainty of execution than the stand-alone business plan.

*Terms of the Merger Agreement.* The PSEG board of directors reviewed the terms of the merger agreement, including Exelon's undertaking, subject to the Exelon board of directors' fiduciary duties and applicable law, to increase its dividend to equal PSEG's on an exchange ratio adjusted basis, the degree of mutuality and symmetry of representations, obligations and rights of the parties under the merger agreement, the conditions to each party's obligation to complete the merger, the instances in which each party is permitted to terminate the merger agreement and the related termination fees payable by each party in the event of termination of the merger agreement under specified circumstances. See "The Merger Agreement" for a detailed discussion of the terms and conditions of the merger agreement.

*Due Diligence.* The PSEG board of directors considered the scope of the due diligence investigation conducted by management and PSEG's outside advisors and evaluated the results thereof, including the information contained in Exelon's disclosure letter relating to the merger agreement.

*Likelihood of Completion of the Merger.* The PSEG board of directors considered the likelihood that the merger will be completed on a timely basis, including the likelihood that the merger will receive all necessary regulatory approvals without unacceptable conditions. The PSEG board of directors took note of the closing condition in the merger agreement that neither PSEG nor Exelon is required to complete the merger if any governmental authority has entered a *"burdensome order"* in connection with the required statutory approvals. (See "The Merger Agreement Covenants" for a description of this term.)

*Employee Matters.* The PSEG board of directors considered that Exelon has agreed that the combined company will give fair and equitable consideration to workforce reductions and job opportunities in the combined company. Exelon also has agreed in the merger agreement that the combined company will honor and perform PSEG's collective bargaining agreements and benefit plans, including continuing to provide benefits which, in the aggregate, are no less favorable than those provided to employees of Exelon in comparable positions and providing benefit plan credit for pre-merger service under PSEG's benefit plans.

The PSEG board of directors also considered the potential risks of the merger, including the following:

*Regulatory Uncertainty in Illinois and Pennsylvania.* The PSEG board of directors considered the uncertainty surrounding the completion of electric restructuring initiatives in both Illinois and Pennsylvania. While New Jersey completed its transition period in August 2003, the Illinois transition period concludes at the end of 2006 and the Pennsylvania transition period concludes in 2010. In both states, the full details of the transition to fully competitive markets remain to be decided. The PSEG board of directors considered the effects of the completion of restructuring of the Illinois power markets in 2006, including the uncertainties and effects of a new and developing competitive generation market and the need for ComEd to file a rate case for its distribution business and place new rates in effect by January 1, 2006.

*Regulatory Approvals.* The PSEG board of directors considered the extensive regulatory approvals required to complete the merger and the risk that the governmental authorities and third parties may seek to impose unfavorable terms or conditions on the required approvals or that such approvals would not be obtained at all. The PSEG board of directors also considered the potential length of the regulatory approval process and that the merger agreement provides that it may not be terminated until June 20, 2006, which may be extended to December 20, 2006 under specified circumstances.

*Concentration in Nuclear Generation.* The PSEG board of directors considered the combined company's predominant focus on nuclear generation and attendant risks. The PSEG board of directors considered the fact that the combined entity will be the largest owner and operator of nuclear generation in the country with 20 reactors.

*Fixed Exchange Ratio.* The PSEG board of directors considered that the exchange ratio is fixed and there is a possibility that the value of the Exelon common stock could be more or less at closing than at the time of announcement of the merger.

*Goodwill.* The PSEG board of directors considered the fact that Exelon had $4.7 billion of goodwill on its balance sheet related to the PECO/Unicom merger in 2000, and that some or all of that goodwill may be impaired at some time in the future.

*Restrictions on Interim Operations.* The PSEG board of directors considered the provisions of the merger agreement placing restrictions on PSEG's operations until completion of the merger, and the extent of those restrictions as negotiated between the parties.

*Integration.* The PSEG board of directors evaluated the challenges inherent in the combination of two business enterprises of the size and scope of PSEG and Exelon, including the possibility of not achieving the anticipated synergies and other benefits sought to be obtained from the merger.

*Shareholders.* The PSEG board of directors considered the fact that PSEG shareholders will hold approximately 32% of the common stock of the combined company after completion of the merger and will therefore not control the combined company.

*Personnel.* The PSEG board of directors considered the adverse impact that business uncertainty pending completion of the merger could have on the ability to attract, retain and motivate key personnel until the merger is completed. The PSEG board of directors also considered the level and impact of job reductions as a result of merger related synergies. Further, the PSEG board of directors considered the increased complexity of industrial relations resulting from the merger.

The PSEG board of directors also considered the corporate governance provisions of the merger agreement and the Amended and Restated By-laws to be adopted by Exelon upon completion of the merger, including that upon completion of the merger and for a fixed period of time thereafter, the Exelon board of directors will be comprised of six legacy PSEG directors and twelve legacy Exelon directors.

The PSEG board of directors believed that, overall, the potential benefits of the merger to PSEG and PSEG's shareholders outweighed the risks which are mentioned above.

The PSEG board of directors realized that there can be no assurance about future results, including results considered or expected as described in the factors listed above. It should be noted that this explanation of the PSEG board of directors' reasoning and all other information presented in this section are forward-looking in nature and, therefore, should be read in light of the factors discussed under the heading "Forward-Looking Statements."

**Opinions of Financial Advisors**

***Opinions of Exelon's Financial Advisors***

At the meeting of the Exelon board of directors on December 17, 2004, JPMorgan and Lehman Brothers jointly presented materials combining both firms' respective analyses of the exchange ratio in the merger. JPMorgan and Lehman Brothers informed the Exelon board of directors that each firm had independently performed its analysis, and had applied different methodologies to the underlying data. The jointly presented materials reflected the full range of analyses of both advisors.

As described below, on December 20, 2004 at the Exelon board of directors meeting each of JPMorgan and Lehman Brothers delivered its opinion to the Exelon board of directors that, based upon and subject to the assumptions, qualifications and limitations set forth therein, the exchange ratio in the merger was fair, from a financial point of view, to Exelon.

**Opinion of JPMorgan**

**The full text of the opinion of JPMorgan dated December 20, 2004, which sets forth, among other things, the assumptions made, the procedures followed, matters considered, and qualifications and limitations of the review undertaken by JPMorgan in rendering its opinion is attached as *Annex B* to this joint proxy statement/prospectus and is incorporated into this joint proxy statement/prospectus by reference. The summary of the JPMorgan fairness opinion set forth in this joint proxy statement/prospectus is qualified in its entirety by reference to the full text of the opinion. Exelon shareholders should read the opinion carefully and in its entirety. JPMorgan provided its opinion for the information and assistance of the Exelon board of directors in connection with its consideration of the proposed merger. The JPMorgan opinion is not a recommendation to any Exelon shareholder as to how any shareholder should vote with respect to the issuance of shares of Exelon common stock as contemplated by the merger agreement or any other matter and should not be relied upon by any Exelon shareholder as such.**

In arriving at its opinion, JPMorgan, among other things:

- reviewed the terms of the merger agreement;

reviewed certain publicly available business and financial information concerning Exelon and PSEG and the industries in which they operate;

compared the proposed financial terms of the merger with the publicly available financial terms of certain transactions involving companies JPMorgan deemed relevant and the consideration received for such companies;

compared the financial and operating performance of Exelon and PSEG with publicly available information concerning certain other companies JPMorgan deemed relevant and reviewed the then current and historical market prices of the PSEG common stock and Exelon common stock and certain publicly traded securities of such other companies;

reviewed certain internal financial analyses, projections and, in the case of Exelon, extensions of those projections, in each case prepared by the managements of PSEG and Exelon relating to their respective businesses, as well as the estimated amount and timing of the cost savings and related expenses, synergies and other strategic benefits expected to result from the merger; and

performed such other financial studies and analyses and considered such other information as JPMorgan deemed appropriate for the purposes of its opinion.

In addition, JPMorgan held discussions with certain members of the management of PSEG and Exelon with respect to certain aspects of the merger, and the past and current business operations of PSEG and Exelon, the financial condition and future prospects and operations of PSEG and Exelon, the effects of the merger, including the estimated cost savings and related expenses, synergies and other strategic benefits expected to result from the merger, on the financial condition and future prospects of Exelon, and certain other matters JPMorgan believed necessary or appropriate to its inquiry.

JPMorgan relied upon and assumed, without independent verification, the accuracy and completeness of all information that was publicly available or was furnished to JPMorgan by Exelon and PSEG or otherwise reviewed by JPMorgan, and JPMorgan did not assume any responsibility or liability therefor. JPMorgan did not conduct any valuation or appraisal of any assets or liabilities, nor were any such valuations or appraisals provided to JPMorgan. In relying on financial analyses and projections (and extensions thereof) provided to JPMorgan, including the estimated cost savings and related expenses, synergies and other strategic benefits expected to result from the merger, JPMorgan assumed that they were reasonably prepared based on assumptions reflecting the best then currently available estimates and judgments by management as to the expected future results of operations and financial condition of PSEG and Exelon to which such analyses or projections relate. JPMorgan also assumed that the merger will qualify as a tax-free reorganization for United States federal income tax purposes and that the transactions contemplated by the merger agreement will be consummated as described in the merger agreement, without material waiver, modification or amendment. JPMorgan relied as to all legal matters relevant to rendering its opinion upon the advice of its counsel. JPMorgan further assumed that all material governmental, regulatory or other consents and approvals necessary for the consummation of the merger will be obtained within the constraints contemplated by the merger agreement and without any material adverse effect on the contemplated benefits of the merger, and that all other conditions to the merger will be satisfied in all material respects.

JPMorgan's opinion is necessarily based on economic, market and other conditions as in effect on, and the information made available to JPMorgan as of, the date of the opinion. It should be understood that subsequent developments may affect the opinion and that JPMorgan does not have any obligation to update, revise, or reaffirm its opinion. JPMorgan's opinion is limited to the fairness, from a financial point of view, to Exelon of the exchange ratio in the proposed merger and JPMorgan expresses no opinion as to the underlying decision by Exelon to engage in the merger. JPMorgan is expressing no opinion as to the price at which Exelon common stock or PSEG common stock will trade at any future time.

In connection with rendering its opinion to the Exelon board of directors, JPMorgan performed a variety of financial and comparative analyses, including those described below. The preparation of a fairness opinion is a complex process and involves various judgments and determinations as to the most appropriate and relevant assumptions and financial analyses and the application of these methods to the particular circumstances involved. Fairness opinions are therefore not necessarily susceptible to partial analysis or summary description.

Accordingly, JPMorgan believes that the analyses it performed and the summary set forth below must be considered as a whole and that selecting portions of its analyses and factors, or focusing on information in tabular format, without considering all analyses and factors or the narrative description of the analyses, could create a misleading or incomplete view of the processes underlying the analyses performed by JPMorgan in connection with its opinion. In arriving at its opinion, JPMorgan did not attribute any particular weight to any analyses or factors considered by it and did not form an opinion as to whether any individual analysis or factor (positive or negative), considered in isolation, supported or failed to support its opinion. Rather, JPMorgan arrived at its ultimate opinion based on the results of all analyses undertaken by it and assessed as a whole, and believes that the totality of the factors considered and analyses it performed in connection with its opinion operated collectively to support its determination as to the fairness to Exelon of the exchange ratio in the proposed merger from a financial point of view.

In performing its analysis, JPMorgan considered industry performance, general business and economic conditions and other matters, many of which are beyond the control of Exelon and PSEG. The analyses performed by JPMorgan are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by the analyses. The analyses were prepared solely as part of JPMorgan's analysis of the fairness of the exchange ratio in the proposed merger, from a financial point of view, to Exelon. Additionally, the analyses performed by JPMorgan relating to the values of businesses do not purport to be appraisals or to reflect the prices at which businesses actually may be acquired or sold.

JPMorgan's opinion and financial analyses were only one of many factors considered by the Exelon board of directors in its evaluation of the merger and should not be viewed as determinative of the views of the Exelon board of directors or management with respect to the merger or the exchange ratio.

The following is a summary of the material financial analyses performed by JPMorgan in connection with providing its opinion to the Exelon board of directors on December 20, 2004. Some of the summaries of the financial analyses include information presented in tabular format. To fully understand the financial analyses, the tables should be read together with the text of each summary. Considering the data set forth in the tables without considering the narrative description of the financial analyses, including the methodologies and assumptions underlying the analyses, could create a misleading or incomplete view of the financial analyses.

***Comparable Publicly Traded Companies Analysis***

Using publicly available information, JPMorgan compared selected financial data of Exelon and PSEG with similar data for selected publicly traded companies engaged in businesses that JPMorgan judged to be reasonably comparable to Exelon and PSEG, based upon its experience with companies in the power and utility industry and their relative similarity in size and business mix to that of Exelon and PSEG, in order to assess how the public market values shares of similar publicly traded companies and to provide an implied range of relative values for shares of Exelon and PSEG common stock by reference to these companies, which could then be used to determine implied exchange ratio ranges. In evaluating companies identified by JPMorgan as reasonably comparable to Exelon and PSEG, JPMorgan made judgments and assumptions with regard to industry performance, general business,

economic, market and financial conditions and other matters, many of which are beyond the control of Exelon or PSEG.

JPMorgan reviewed the trading and operating statistics of the following selected publicly traded companies in the power and utility industry:

- American Electric Power Company, Inc.
- Constellation Energy Group, Inc.
- Cinergy Corp.
- Dominion Resources, Inc.
- Entergy Corporation
- FPL Group, Inc.
- PPL Corporation

Based on the above companies' closing stock prices on December 16, 2004, JPMorgan calculated the ratio of firm value (calculated as equity value, plus debt, less cash and cash equivalents) to 2005 estimated earnings before interest, taxes, depreciation and amortization, referred to in this joint proxy statement/prospectus as "EBITDA," and the ratio of stock price to 2005 estimated earnings per share, referred to in this joint proxy statement/prospectus as "EPS." Estimated financial performance for the comparable companies, for Exelon and for PSEG were based on publicly available information, financial projections for Exelon provided by Exelon's management and financial projections for PSEG prepared by PSEG's management, as adjusted by Exelon's management and provided to JPMorgan by Exelon's management, respectively. This analysis indicated the following firm value and share price multiples:

| **Company** | **Firm value as a multiple of 2005 Estimated EBITDA** | **Price as a multiple of 2005 Estimated EPS** |
|---|---|---|
| American Electric Power | 6.9x | 14.5x |
| Constellation Energy | 7.6x | 12.6x |
| Cinergy | 8.7x | 14.5x |
| Dominion Resources | 7.9x | 13.4x |
| Entergy | 7.5x | 14.1x |
| FPL Group | 7.6x | 14.5x |
| PPL Corp. | 7.6x | 12.9x |
| Median | 7.6x | 14.1x |
| Mean | 7.7x | 13.8x |
| Exelon | 8.6x | 14.1x |
| PSEG | 8.8x | 15.2x |

Based on the current trading multiples of the comparable companies, JPMorgan applied a range of multiples of estimated 2005 EBITDA and 2005 earnings to the corresponding financial data regarding Exelon and PSEG provided to JPMorgan by Exelon's management as discussed above, without giving effect to potential transaction-related synergies, to derive an implied range of values for shares of Exelon and PSEG common stock. Based on these value ranges, JPMorgan determined implied exchange ratio ranges of 0.747 to 1.238 and 0.863 to 1.149 Exelon shares of common stock per PSEG share of common stock based on EBITDA multiples and price to earnings multiples, respectively, as

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compared to the proposed merger exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock in the proposed merger. Accordingly, JPMorgan determined that the proposed merger exchange ratio fell within or reasonably close to these calculated values.

JPMorgan noted that none of the selected comparable companies is either identical or directly comparable to Exelon or PSEG and that any analysis of selected companies necessarily involves complex considerations and judgments concerning financial and operating characteristics and other factors that could affect the public trading of the selected companies.

**Discounted Cash Flow Analysis**

JPMorgan performed discounted cash flow analyses of PSEG and Exelon for the purpose of determining the implied fully diluted equity value for each share of the companies' respective common stocks, based on the expected future cash flows to be generated by each company, as described below. Utilizing these implied values, JPMorgan then calculated implied exchange ratio ranges.

*Exelon:* JPMorgan conducted a discounted cash flow analysis to determine a range of estimated equity values per diluted share for Exelon common stock. JPMorgan calculated the present value of the Exelon cash flow streams from 2005 through 2009, assuming it continued to operate as a stand-alone entity, based on financial projections for 2005 through 2007 and extensions of those projections from 2008 through 2009 (also referred to in this joint proxy statement/prospectus as Exelon forward-looking financial information for 2005 through 2007 and extensions of that forward-looking financial information for 2008 through 2009), in each case provided by Exelon's management. JPMorgan also calculated an implied range of terminal values for Exelon at the end of 2009 by applying a range of multiples of 8.0x to 9.0x to Exelon's 2009 EBITDA assumption. The cash flow streams and the range of terminal values were then discounted to present values using a range of discount rates from 5.25% to 5.75%, which was based on Exelon's estimated weighted average cost of capital, to determine a discounted cash flow value range. The value of Exelon's common stock was derived from the discounted cash flow value range by subtracting Exelon's debt and adding Exelon's cash and cash equivalents outstanding as of December 31, 2004, in each case based on Exelon's management estimates.

*PSEG:* JPMorgan conducted a discounted cash flow analysis to determine a range of estimated equity values per diluted share for PSEG common stock. JPMorgan calculated the present value of the PSEG cash flow streams from 2005 through 2009, with and without giving effect to potential transaction-related synergies, based on financial projections prepared by PSEG's management (also referred to in this joint proxy statement/prospectus as PSEG forward-looking financial information), as adjusted by Exelon's management and provided to JPMorgan by Exelon's management. JPMorgan also calculated an implied range of terminal values for PSEG at the end of 2009 by applying a range of multiples of 8.0x to 9.0x to PSEG's 2009 estimated EBITDA. The cash flow streams and the range of terminal values were then discounted to present values using a range of discount rates from 5.25% to 5.75%, which was based on PSEG's weighted average cost of capital, to determine a discounted cash flow value range. The value of PSEG's common stock was derived from the discounted cash flow value range by subtracting PSEG's debt and adding PSEG's cash and cash equivalents outstanding as of December 31, 2004, in each case based on estimates provided by PSEG's management.

Using the range of implied equity values for Exelon and PSEG described above, JPMorgan then calculated a range of implied exchange ratios. The high and the low implied exchange ratio were calculated by dividing the highest per share value for PSEG with the lowest per share value for Exelon and the lowest per share value for PSEG with the highest per share value for Exelon, respectively. This analysis indicated the following implied exchange ratio reference ranges both with and without synergies attributed to PSEG, as compared to the proposed merger exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock in the proposed merger. As set forth in the

table below, JPMorgan determined that the proposed merger exchange ratio fell within or reasonably close to these calculated values.

| Implied Exchange Ratio with Synergies | Implied Exchange Ratio without Synergies |
|---|---|
| 1.263x - 1.862x | 1.021x - 1.506x |

***Historical Exchange Ratio Analysis***

JPMorgan reviewed the historical average exchange ratio between PSEG and Exelon common stocks as of December 16, 2004 and for the four-week, three-month, six-month, one-year and two-year periods ending December 16, 2004. These historical exchange ratios were reviewed in order to provide background information and perspective with respect to the relative historical share prices of Exelon and PSEG common stock. The historical average exchange ratios were calculated by dividing the daily closing price per share of PSEG common stock by the daily closing price per share of Exelon common stock for each day in the indicated periods and then calculating the average for such period. JPMorgan also reviewed the high and the low historical exchange ratio for the two-year period ending December 16, 2004. This review indicated implied exchange ratios set out in the table below, as compared to the proposed merger exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock in the proposed merger. As set forth in the table below, JPMorgan determined that the proposed merger exchange ratio fell within the values calculated for the exchange ratio range as part of the historical exchange ratio analysis.

| Period Ended December 16, 2004 | Exchange Ratio |
|---|---|
| One-day | 1.071x |
| Four-week average | 1.044x |
| Three-month average | 1.084x |
| Six-month average | 1.117x |
| One-year average | 1.219x |
| Two-year average | 1.291x |

***Premium Paid Analysis***

In order to assess the premium to be paid by Exelon to PSEG shareholders, JPMorgan reviewed the premiums paid to one-day, one-week and four-weeks prior closing target stock prices in transactions involving United States publicly traded target companies for transactions valued at greater than $1 billion announced between January 1, 1998 and November 30, 2004. Additionally, JPMorgan also reviewed the premiums paid to one-day, one-week and four-weeks prior closing target stock prices in seven precedent transactions in the power and utility sector, including the proposed acquisition of UniSource Energy Corporation by Saguaro Acquisition Corp., a corporation whose indirect owners include investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P., J.P. Morgan Partners, LLC and Wachovia Capital Partners; Energy East Corporation's acquisition of RGS Energy Group, Inc.; Potomac Electric Power Company's acquisition of Conectiv; FirstEnergy Corp.'s acquisition of GPU, Inc.; PECO Energy Company's merger with Unicom Corporation; Northern States Power Company's acquisition of New Century Energies, Inc.; and American Electric Power's acquisition of Central and South West Corporation.

JPMorgan compared the premiums implied in the above group of transactions with the premiums in the proposed merger based on the merger consideration implied by the exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock and Exelon's closing stock price on December 16, 2004, and the closing price for PSEG stock on December 16, 2004, one-week prior to December 16, 2004, and four-weeks prior to December 16, 2004. This analysis indicated the

following implied premiums for the selected transactions, as compared to the premiums implied in the proposed merger:

| | One-Day | One-Week | Four-Weeks |
|---|---|---|---|
| All deals | 29.7% | 34.4% | 39.3% |
| Comparable power and utility deals | 18.1% | 22.1% | 25.4% |
| Implied premium in the merger | 14.4% | 21.1% | 18.4% |

As set forth in the table above, JPMorgan determined that the premiums implied in the proposed merger for the one-day, one-week and four-week periods described above were in each case below the average premiums paid in similar precedent transactions.

JPMorgan noted that none of these transactions is either identical or directly comparable to the merger and that any analysis of selected transactions necessarily involves complex considerations and judgments concerning financial and operating characteristics and other factors that could affect the premiums paid in transactions.

***Relative Contribution Analysis***

JPMorgan reviewed selected Exelon forward-looking financial information and extensions of that forward-looking financial information provided by Exelon's management and selected PSEG forward-looking financial information prepared by PSEG's management, as adjusted by Exelon's management and provided to JPMorgan by Exelon's management, to determine the companies' relative contribution to the combined business, which is one measure of whether shareholders of Exelon and PSEG, respectively, are receiving an appropriate portion of the equity ownership of the combined company. JPMorgan analyzed Exelon's and PSEG's relative contributions to EBITDA and net income for the year 2005, making an adjustment for PSEG's financial leverage.

Based on the relative contributions of Exelon and PSEG, prior to consideration of the impact of any potential transaction-related synergies, JPMorgan determined a range of implied exchange ratios from 0.996 to 1.051 shares of Exelon common stock per share of PSEG common stock as compared to the proposed merger exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock.

| Financial Contribution Measure | Implied Exchange Ratio |
|---|---|
| 2005E EBITDA | 1.051x |
| 2005E Net income | 0.996x |

***Analysis of Merger Impact on Earnings***

JPMorgan analyzed the expected impact of the proposed merger on Exelon's estimated earnings per common share for years 2006 and 2007, after giving effect for potential transaction-related synergies. Based on the terms of the proposed merger and using Exelon forward-looking financial information for 2005 through 2007 provided by Exelon's management, PSEG forward-looking financial information prepared by PSEG's management, as adjusted by Exelon's management and provided to JPMorgan by Exelon's management, and estimates of potential synergies provided by Exelon's management, JPMorgan's analysis indicated that the proposed merger can be expected to be accretive to Exelon's earnings per share in each year analyzed. JPMorgan noted that actual results may vary from projected results and the variations may be material.

***Miscellaneous***

JPMorgan has acted as financial advisor to Exelon with respect to the proposed merger, and will receive a fee of $15 million from Exelon for its services, which is payable in three equal installments. The first installment was paid following announcement of the execution of the merger agreement, the second one will be due upon Exelon's shareholder approval of the issuance of shares of Exelon common stock as contemplated by the merger agreement, and the third installment will be due upon consummation of the proposed merger. JPMorgan and its affiliates have performed in the past, and may perform in the future, a variety of investment banking and commercial banking services for each of Exelon and the PSEG. Specifically, JPMorgan's commercial bank affiliate is an agent bank and lender under credit facilities of each of Exelon and PSEG. During the past two years, JPMorgan and its affiliates have received fees of approximately $6.2 million from Exelon and its affiliates for advisory, underwriting, loan syndication, and other investment banking assignments, exclusive of any fees received in connection with the merger, and approximately $8.7 million from PSEG and its affiliates. In the ordinary course of business, JPMorgan and its affiliates may participate in loans and actively trade the debt and equity securities of Exelon or PSEG for their own accounts or for the accounts of customers and, accordingly, JPMorgan may at any time hold long or short positions in such securities.

**Opinion of Lehman Brothers**

**The full text of Lehman Brothers' written opinion, dated as of December 20, 2004 is attached as *Annex C* to this joint proxy statement/prospectus and is incorporated into this joint proxy statement/prospectus by reference. You are urged to read Lehman Brothers' opinion carefully in its entirety for a description of the assumptions made, procedures followed, factors considered and limitations upon the review undertaken by Lehman Brothers in rendering its opinion. The following is a summary of Lehman Brothers' opinion and the methodology that Lehman Brothers used to render its opinion. This summary is qualified in its entirety by reference to the full text of the opinion.**

Lehman Brothers' advisory services and opinion were provided for the information and assistance of the Exelon board of directors in connection with its consideration of the merger. Lehman Brothers' opinion is not intended to be and does not constitute a recommendation to any Exelon shareholders as to how such shareholder should vote in connection with the merger. Lehman Brothers was not requested to opine as to, and Lehman Brothers' opinion does not address, Exelon's underlying business decision to proceed with or effect the merger.

In arriving at its opinion, Lehman Brothers reviewed and analyzed, among other things:

- the merger agreement and the specific terms of the merger;
- publicly available information concerning Exelon and PSEG that Lehman Brothers believed to be relevant to its analysis, including each of their respective latest Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and other relevant filings with the SEC;
- financial and operating information with respect to the business, operations and prospects of Exelon furnished to Lehman Brothers by Exelon, including financial projections of Exelon and extensions of such financial projections, in each case, prepared by Exelon's management;
- financial and operating information with respect to the business, operations and prospects of PSEG furnished to Lehman Brothers by PSEG, including financial projections of PSEG prepared by PSEG's management, as adjusted by the management of Exelon;
- trading histories of Exelon common stock for the last two years and of PSEG common stock for the last two years, and a comparison of each of their trading histories with each other and with those of other companies that Lehman Brothers deemed relevant;

- a comparison of the historical financial results and then present financial condition of Exelon and PSEG with each other and with those of other companies that Lehman Brothers deemed relevant;

- a comparison of the financial terms of the merger with the financial terms of certain other recent transactions that Lehman Brothers deemed relevant;

- estimates prepared by the management of Exelon of the cost savings and operating synergies expected to result from the combination of the businesses of Exelon and PSEG;

- the pro forma contribution of earnings before interest, taxes, depreciation and amortization, net income and cash flow from operations that each company would contribute to the combined company following the consummation of the merger; and

- the pro forma impact of the merger on the future financial performance of Exelon, PSEG and the combined company.

In addition, Lehman Brothers had discussions with the managements of Exelon and PSEG concerning their respective businesses, operations, assets, liabilities, financial conditions and prospects, and the strategic benefits of the merger, and undertook such other studies, analyses and investigations as Lehman Brothers deemed appropriate.

In arriving at its opinion, Lehman Brothers assumed and relied upon the accuracy and completeness of the financial and other information provided to Lehman Brothers without assuming any responsibility for independent verification of such information and further relied upon the assurances of the managements of Exelon and PSEG that they were not aware of any facts or circumstances that would make such information inaccurate or misleading. With respect to the financial projections of Exelon and PSEG, including the associated cost savings and operating synergies estimated to result from the merger, upon advice of Exelon, Lehman Brothers assumed that such projections were reasonably prepared on a basis reflecting the best then currently available estimates and judgments of the management of Exelon as to the respective future financial performance of Exelon and PSEG and that Exelon and PSEG would perform substantially in accordance with such projections. With respect to the extensions of Exelon's financial projections for any periods after December 31, 2007, upon advice of Exelon, in arriving at its opinion, Lehman Brothers used and relied on extensions of the financial projections of Exelon for the calendar years ended December 31, 2008 and 2009 which were prepared by the management of Exelon using similar assumptions as those used by the management of Exelon in preparing its financial projections for the periods up to December 31, 2007 and such projection extensions were reviewed and determined to be reasonable by Exelon's management. In arriving at its opinion, Lehman Brothers did not conduct a physical inspection of the properties and facilities of Exelon or PSEG and did not make or obtain any evaluations or appraisals of the assets or liabilities of Exelon or PSEG. Upon the advice of Exelon and its legal and accounting advisors, Lehman Brothers assumed that (1) the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, and therefore as a tax-free transaction to the shareholders of Exelon and (2) the merger will be treated as a purchase of interests for accounting purposes and that certain purchase accounting adjustments provided to Lehman Brothers by Exelon's management represented Exelon's management's best estimates of the likely accounting for the merger. Lehman Brothers further assumed, upon advice of Exelon, that all material governmental, regulatory or other consents or approvals necessary for the consummation of the merger will be obtained within the constraints contemplated by the merger agreement. Lehman Brothers' opinion necessarily was based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date Lehman Brothers' rendered its opinion to the Exelon board of directors.

In addition, Lehman Brothers expressed no opinion as to the prices at which shares of Exelon common stock would trade at any time following the announcement of the merger or the consummation of the merger.

In connection with rendering its opinion, Lehman Brothers performed certain financial, comparative and other analyses described below. Lehman Brothers also relied on these analyses in preparing the joint presentation with JPMorgan made to the Exelon board of directors. In arriving at its opinion, Lehman Brothers did not ascribe a specific range of value to Exelon or PSEG but rather made its determination as to the fairness, from a financial point of view, to Exelon of the exchange ratio to be paid by Exelon in the merger, on the basis of financial and comparative analyses. The preparation of a fairness opinion involves various determinations as to the most appropriate and relevant methods of financial and comparative analysis and the application of those methods to the particular circumstances, and therefore, such an opinion is not readily susceptible to summary description. In arriving at its opinion, Lehman Brothers did not attribute any particular weight to any analysis or factor considered by it but rather made qualitative judgments as to the significance and relevance of each analysis and factor. Accordingly, Lehman Brothers believes that its analysis must be considered as a whole and that considering any portion of such analyses and factors, without considering all analyses and factors as a whole, could create a misleading or incomplete view of the process underlying its opinion. In its analyses, Lehman Brothers made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of Exelon and PSEG. Any estimates contained in Lehman Brothers' analyses were not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than those suggested by its analyses. In addition, analyses relating to the value of the businesses do not purport to be appraisals or to reflect the prices at which businesses actually may be sold.

The following is a summary of the material financial analyses used by Lehman Brothers in connection with providing its opinion to the Exelon board of directors. The financial analyses summarized below include information presented in tabular format. In order to fully understand the financial analyses used by Lehman Brothers, the tables must be read together with the text of each summary.

***Comparable Public Companies Analysis***

In order to assess how the public market values shares of similar publicly traded companies and to provide a range of relative implied equity values per share of Exelon and PSEG common stock by reference to these companies, which could then be used to calculate implied exchange ratio ranges, Lehman Brothers reviewed and compared certain financial information, ratios and public market multiples relating to Exelon and PSEG to corresponding financial data for comparable publicly traded power and utility companies. Lehman Brothers selected these companies based upon its views as to the comparability of the financial and operating characteristics of these companies to Exelon and PSEG.

The companies included in the comparable companies analysis for both Exelon and PSEG were:

American Electric Power Company, Inc.

Constellation Energy Group, Inc.

Cinergy Corp.

Dominion Resources, Inc.

Entergy Corporation

FPL Group, Inc.

PPL Corporation

Lehman Brothers then reviewed publicly available research analysts' estimates to compare financial information and multiples of market value of these companies to Exelon's and PSEG's:

stock price to 2004 estimated EPS;

stock price to 2005 estimated EPS;

firm value to 2004 estimated EBITDA, where firm value means market equity value as of December 16, 2004 plus the following balance sheet items as of September 30, 2004: debt, minority interest, nonconvertible preferred stock and all out-of-money convertible securities less cash; and

firm value to 2005 estimated EBITDA.

Multiples were based on closing stock prices on December 16, 2004. The following table reflects the results of the analysis, as compared to the multiples for Exelon and PSEG:

| | **Firm Value to EBITDA** | | **Stock Price to EPS** | |
|---|---|---|---|---|
| | **2004E** | **2005E** | **2004E** | **2005E** |
| Comparable Companies: Selected | | | | |
| Range | 7.7x - 8.7x | 7.2x - 8.2x | 14.2x - 16.2x | 12.8x - 14.8x |
| Exelon | 8.7x | 8.3x | 15.6x | 14.5x |
| PSEG | 8.8x | 8.7x | 14.8x | 15.2x |

Applying a range of multiples derived from the comparable public companies analysis to corresponding financial data on Exelon and PSEG provided to Lehman Brothers by Exelon and PSEG as discussed below, including attributing 100% of the expected transaction synergies from the merger (net of any estimated costs to achieve such synergies) to PSEG's estimated earnings and EBITDA, Lehman Brothers calculated a range of implied equity values per share of Exelon and PSEG common stock which were then used to calculate a range of implied exchange ratios, with and without transaction synergies. The following table reflects the results of this analysis:

| | **Firm Value to EBITDA** | **Stock Price to EPS** |
|---|---|---|
| Implied Exchange Ratio: No Synergies | 0.721x - 1.206x | 0.934x - 1.231x |
| Implied Exchange Ratio: With Synergies | 0.979x - 1.559x | 1.225x - 1.614x |

As illustrated by the table above, Lehman Brothers noted that the transaction's proposed exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock was in line with the exchange ratio ranges resulting from the comparable public companies analysis.

No company utilized in the comparable public companies analysis was identical to Exelon or PSEG. Accordingly, an analysis of the results of the foregoing necessarily involves complex considerations and judgments concerning differences in financial and operating characteristics of Exelon and PSEG and other factors that could affect the public trading value of the companies to which they are being compared. In evaluating the comparable companies, Lehman Brothers made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of Exelon or PSEG, such as the impact of competition on Exelon or PSEG and the industry generally, industry growth and the absence of any material adverse change in the financial conditions and prospects of Exelon or PSEG or the industry or in the financial markets in general.

***Discounted Cash Flow Analysis***

In order to estimate the respective present values for Exelon common stock and PSEG common stock, a measure designed to provide insight into the value of a company based upon its expected future cash flows, Lehman Brothers performed discounted cash flow analyses on Exelon and PSEG using financial projections for Exelon provided by Exelon's management for the period from January 1, 2005 through December 31, 2007, extensions of the projections of Exelon provided by Exelon's management for the period from January 1, 2008 through December 31, 2009 (also referred to in this

joint proxy statement/prospectus as Exelon forward-looking financial information for 2005 through 2007 and extensions of that forward-looking financial information for 2008 through 2009) and financial projections for PSEG prepared by the management of PSEG (also referred to in this joint proxy statement/prospectus as PSEG forward-looking financial information), as adjusted by the management of Exelon and provided to Lehman Brothers by Exelon's management, for the period from January 1, 2005 through December 31, 2009.

For the Exelon discounted cash flow analysis, Lehman Brothers calculated terminal values by applying a range of terminal multiples to assumed 2009 EBITDA of 7.72x to 8.72x. This range was based on the firm value to 2004 estimated EBITDA multiple range derived in the comparable companies analysis. The cash flow streams and terminal values were discounted to present values using a range of discount rates of 5.43% to 6.43%. From this analysis, Lehman Brothers calculated a range of implied equity values per share of Exelon common stock.

For the PSEG discounted cash flow analysis, Lehman Brothers performed separate analyses assuming (1) no transaction synergies and (2) that 100% of the transaction synergies (net of any estimated costs to achieve such synergies) would be attributed to PSEG. In both cases, Lehman Brothers calculated terminal values by applying the same range of terminal multiples of 7.72x to 8.72x as applied in the discounted cash flow analysis of Exelon to PSEG's 2009 estimated EBITDA. The cash flow streams and terminal values were discounted to present values using the same range of discount rates of 5.43% to 6.43% as applied to the discounted cash flow analysis of Exelon. From these analyses, Lehman Brothers calculated a range of implied equity values per share of PSEG common stock.

Based on the range of values calculated in the Exelon and PSEG discounted cash flow analyses with and without transaction synergies (net of any estimated costs to achieve such synergies) attributed to PSEG, Lehman Brothers calculated a range of implied exchange ratios for PSEG common stock to Exelon common stock. The following table reflects the results of this analysis:

| | Discounted Cash Flow Analysis |
|---|---|
| Implied Exchange Ratio: No Synergies | 0.979x - 1.558x |
| Implied Exchange Ratio: With Synergies | 1.211x - 1.872x |

Lehman Brothers noted that the transaction's proposed exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock fell within the exchange ratio ranges resulting from the discounted cash flow analysis as summarized above.

***Historical Trading Analysis***

Lehman Brothers reviewed the ratio of daily closing share prices of PSEG common stock to Exelon common stock for the two-year, one-year, six-month, three-month and four-week periods ended December 16, 2004. This historical trading data was reviewed to provide background information and perspective with respect to the relative historical share prices of PSEG and Exelon common stock. The following table reflects the results of the analysis:

| Historical Period | Daily Average Trading Ratios |
|---|---|
| Two-year historical period | 1.291x |
| One-year historical period | 1.219x |
| Six-month historical period | 1.117x |
| Three-month historical period | 1.084x |
| Four-week historical period | 1.044x |
| December 16, 2004 | 1.071x |

Lehman Brothers noted that the transaction's proposed exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock fell within the exchange ratio range resulting from the selected historical trading analysis as illustrated above.

***Premiums Paid Analysis***

To assess the premium to be paid by Exelon to PSEG shareholders, Lehman Brothers reviewed selected historical transactions for the premiums paid to shareholders in such transactions. Lehman Brothers selected transactions with an equity value greater than $1 billion for (1) all industries announced from 1998 to December 16, 2004 (507 transactions in total), and (2) comparable transactions in the power and utility sector. The selected comparable historical transactions in the power and utility sector were the following:

Proposed acquisition of UniSource Energy Corporation by Saguaro Acquisition Corp., a corporation whose indirect owners include investment funds affiliated with J.P. Morgan Partners, LLC, Kohlberg, Kravis, Roberts & Co., L.P., and Wachovia Capital Partners (announced November 2003)

Energy East Corporation's acquisition of RGS Energy Group, Inc. (announced February 2001)

Potomac Electric Power Company's merger with Conectiv (announced February 2001)

FirstEnergy Corp.'s acquisition of GPU, Inc. (announced August 2000)

PECO Energy Company's merger with Unicom Corporation (announced September 1999)

Northern States Power Company's merger with New Century Energies, Inc. (announced March 1999)

American Electric Power Company, Inc.'s merger with Central and South West Corporation (announced December 1997)

The premiums were calculated over the share price one-day prior, one-week prior and four-weeks prior to the selected historical transactions' respective announcement date. These premiums were then compared to the implied premium to be paid to PSEG shareholders over the price one-day prior to, one-week prior to, and for the four-weeks prior to December 16, 2004. The following table reflects the results of the analysis:

| | **Premium to Price Prior to Announcement** | | |
|---|---|---|---|
| | **1 Day** | **1 Week** | **4 Weeks** |
| Selected Historical Transactions: All Industries | 29.7% | 34.4% | 39.3% |
| Selected Historical Transactions: Power and Utility Sector | 18.1% | 22.1% | 25.4% |
| Implied Premium to PSEG Shareholders (as of December 16, 2004) | 14.4% | 21.1% | 18.4% |

The implied premium paid to PSEG shareholders over the share price one-day prior, one-week prior and four-weeks prior to the transaction's announcement were derived from the transaction's proposed exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock. As illustrated by the table above, Lehman Brothers noted that the implied premium to be paid to PSEG shareholders over the share price one-day prior, one-week prior and four-weeks prior to the transaction's announcement was below the average premiums paid in similar historical transactions.

***Contribution Analysis***

Lehman Brothers reviewed selected historical and estimated future financial information for Exelon and PSEG to determine Exelon's and PSEG's relative contribution to the combined company after the merger, which is one measure of whether the shareholders of Exelon and PSEG, respectively,

are receiving an appropriate portion of the equity ownership of the combined company. Lehman Brothers analyzed Exelon's and PSEG's relative contribution to estimated EBITDA, net income and cash flow from operations for the years 2004 and 2005. Lehman Brothers analyzed estimated EBITDA and net income and cash flow from operations based on:

- Exelon forward-looking financial information provided by Exelon's management;
- PSEG forward-looking financial information prepared by PSEG's management, as adjusted by the management of Exelon and provided to Lehman Brothers by Exelon's management; and
- PSEG forward-looking financial information adjusted to include the benefits of estimated transaction synergies.

Based on the relative contributions of Exelon and PSEG to the combined company calculated in the contribution analysis, Lehman Brothers determined a range of implied exchange ratios for PSEG common stock to Exelon common stock.

The following table reflects the results of the analysis:

| | **Implied Exchange Ratio Based on Contributions to the Combined Company** | |
|---|---|---|
| | **No Synergies** | **With Synergies** |
| 2004E EBITDA | 1.002x | 1.312x |
| 2005E EBITDA | 0.890x | 1.185x |
| 2004E Net Income | 1.135x | 1.484x |
| 2005E Net Income | 1.020x | 1.342x |
| 2004E Cash Flow from Operations | 1.347x | 1.564x |
| 2005E Cash Flow from Operations | 1.308x | 1.511x |
| **High** | **1.347x** | **1.564x** |
| **Low** | **0.890x** | **1.185x** |

Lehman Brothers noted that the transaction's proposed exchange ratio of 1.225 shares of Exelon common stock per share of PSEG common stock fell within the exchange ratio range resulting from the contribution analysis as summarized in the table above.

***Purchase Price Multiples Analysis***

In order to assess how the public market values comparable publicly traded companies and companies that have been involved in comparable transactions and to provide a basis for comparing these companies to Exelon and PSEG, Lehman Brothers performed a purchase price multiples analysis of the merger. This analysis compared the market multiples of selected comparable companies and the multiples of selected announced comparable historical transactions in the power and utility sector to the following multiples of the transaction:

- stock price to 2004 estimated EPS;
- stock price to 2005 estimated EPS;
- firm value to 2004 estimated EBITDA; and
- firm value to 2005 estimated EBITDA.

For this analysis, Lehman Brothers used the publicly available financial and market information of the following announced comparable historical transactions in the power and utility sector:

PNM Resources, Inc.'s acquisition of TNP Enterprises, Inc. (announced July 2004)

Ameren Corporation's acquisition of Illinois Power Company (announced February 2004)

Proposed acquisition of UniSource Energy Corporation by Saguaro Acquisition Corp., a corporation whose indirect owners include investment funds affiliated with J.P. Morgan Partners, LLC, Kohlberg, Kravis, Roberts & Co., L.P., and Wachovia Capital Partners (announced November 2003)

Texas Pacific Group's proposed acquisition of Portland General Electric Company (announced November 2003)

Energy East Corporation's acquisition of RGS Energy Group, Inc. (announced February 2001)

Potomac Electric Power Company's merger with Conectiv (announced February 2001)

FirstEnergy Corp.'s acquisition of GPU, Inc. (announced August 2000)

PECO Energy Company's merger with Unicom Corporation (announced September 1999)

Northern States Power Company's merger with New Century Energies, Inc. (announced March 1999)

American Electric Power Company, Inc.'s merger with Central and South West Corporation (announced December 1997)

Ameren Corporation's acquisition of CILCORP, Inc. (announced April 2002)

From these selected announced comparable historical transactions, Lehman Brothers employed the following ratios in the purchase price multiples analysis:

price paid to projected EPS for the first fiscal year after announcement;

price paid to the last twelve months EPS before announcement;

aggregate value paid to projected EBITDA for the first fiscal year after announcement; and

aggregate value paid to last twelve months EBITDA before announcement.

As part of the purchase price multiples analysis, Lehman Brothers also reviewed and compared certain financial information, ratios and public market multiples relating to Exelon and PSEG to corresponding financial data for comparable publicly traded power and utility companies and calculated various financial multiples as set forth above under the comparable public companies analysis. To reflect a merger premium paid, Lehman Brothers increased the comparable companies market equity value by a 15% premium and calculated the same financial multiples as it did under the comparable public companies analysis.

The following table reflects the results of the purchase price multiples analysis:

| | **Firm Value to EBITDA** | | **Stock Price to EPS** | |
|---|---|---|---|---|
| | **2004E** | **2005E** | **2004E** | **2005E** |
| Comparable Announced Transactions (Last Twelve Months and 1 Year Forward) | 7.5x | 7.0x | 16.3x | 15.8x |

| | Firm Value to EBITDA | | Stock Price to EPS | |
|---|---|---|---|---|
| Comparable Companies | 8.2x | 7.7x | 15.2x | 13.8x |
| Comparable Companies Adjusted for 15% Premium | 9.5x | 8.9x | 17.5x | 15.9x |
| Exelon and PSEG Merger | 9.4x | 9.2x | 16.9x | 17.4x |

Lehman Brothers noted that the purchase price multiples resulting from the proposed transaction were in line with the multiples from the comparable companies when adjusted for a merger premium.

***Accretion/Dilution Analysis***

Lehman Brothers analyzed and considered the impact of the merger on the estimated EPS and dividends per share of Exelon for the years 2006, 2007, 2008 and 2009, assuming the merger is completed at the exchange ratio of 1.225x, using the Exelon forward-looking financial information for 2005 through 2007 and extensions of that forward-looking financial information for 2008 through 2009 provided by Exelon's management and PSEG forward-looking financial information prepared by the management of PSEG, as adjusted by the management of Exelon and provided to Lehman Brothers by Exelon's management and including estimates of transaction synergies, for the period from January 1, 2006 through December 31, 2009.

Lehman Brothers assumed that, among other things:

- Exelon would be the acquirer for purchase accounting purposes;
- the estimated transaction synergies applicable to the combined company's businesses would be as provided by management of Exelon;
- the combined company's pro forma dividend would be such that PSEG shareholders would have the same projected dividend taking into account of the proposed exchange ratio;
- the merger would be tax-free to both Exelon and PSEG shareholders except to the extent of any additional cash received by PSEG shareholders for fractional shares or for any increase in projected dividends; and
- the merger would close on January 1, 2006.

Based on this analysis, the proposed transaction is expected to result in an increase in EPS when compared to Exelon's EPS on a stand-alone basis in the years 2006, 2007, 2008 and 2009. In addition, based on this analysis, the proposed transaction is also expected to result in an increase in dividends per share paid to Exelon shareholders of common stock, when compared to the dividends per share paid to Exelon shareholders of common stock on a stand-alone basis, in the years 2006, 2007, 2008 and 2009.

Lehman Brothers also analyzed and considered the impact of the merger on the estimated EPS of Exelon for the years 2006 and 2007, assuming the merger is completed at the exchange ratio of 1.225x. Estimated EPS for Exelon and PSEG for 2006 were based on consensus EPS of the Institutional Brokers Estimate System, referred to in this joint proxy statement prospectus as "I/B/E/S," and for 2007 were based on I/B/E/S consensus EPS for 2006 grown at the I/B/E/S long-term earnings per share growth estimates. The analysis took into account estimates of transaction synergies provided to Lehman Brothers by the management of Exelon. Based on this analysis, the proposed merger is expected to result in an increase in EPS when compared to Exelon's EPS on a stand-alone basis in the years 2006 and 2007.

Lehman Brothers is an internationally recognized investment banking firm and, as part of its investment banking activities, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive bids, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes. The Exelon board of directors selected Lehman Brothers because of its expertise, reputation and familiarity with Exelon, PSEG and the utility industry generally and because its investment banking professionals have substantial expertise in transactions comparable to the merger.

As compensation for its services in connection with the merger, Exelon has agreed to pay Lehman Brothers a transaction fee of $15 million, which is payable in three equal installments. The first installment was paid following the announcement of the execution of the merger agreement, the second one will be due upon Exelon's shareholder approval of the issuance of shares of Exelon common stock

as contemplated by the merger agreement, and the third installment will be due upon completion of the merger. Exelon has also agreed to reimburse Lehman Brothers for certain expenses incurred by Lehman Brothers, including fees of outside legal counsel, and to indemnify Lehman Brothers and related parties against liabilities arising out of Lehman Brothers' engagement and the rendering of its opinion. Lehman Brothers in the past has rendered investment banking services to Exelon, PSEG and their affiliates and received customary fees for such services. During the past two years, Lehman Brothers and its affiliates have received fees of approximately $3.4 million from Exelon and its affiliates for advisory, underwriting and other investment banking assignments exclusive of any fees received in connection with the merger, and approximately $7.8 million from PSEG and its affiliates.

In the ordinary course of its business, Lehman Brothers may participate in loans and actively trade in the debt or equity securities of Exelon and PSEG for its own account and for the accounts of its customers and, accordingly, may at any time hold a long or short position in those securities.

***Opinion of PSEG's Financial Advisor***

Pursuant to a letter agreement dated November 8, 2004, PSEG formally retained Morgan Stanley to provide it with certain financial advisory services in connection with the merger. At the meeting of the PSEG board of directors on December 20, 2004, Morgan Stanley rendered its oral opinion, subsequently confirmed in writing, that as of December 20, 2004, and based upon and subject to the assumptions, qualifications and limitations discussed in its opinion, the exchange ratio under the merger agreement was fair, from a financial point of view, to holders of PSEG common stock.

**The full text of Morgan Stanley's opinion, dated December 20, 2004, which sets forth, among other things, the assumptions made, procedures followed, matters considered and qualifications and limitations of the reviews undertaken in rendering its opinion is attached as *Annex D* to this joint proxy statement/prospectus and is incorporated by reference into this joint proxy statement/prospectus. The summary of Morgan Stanley's fairness opinion set forth in this joint proxy statement/prospectus is qualified in its entirety by reference to the full text of the opinion. Shareholders should read this opinion carefully and in its entirety. Morgan Stanley's opinion is directed to the board of directors of PSEG, addresses only the fairness from a financial point of the merger consideration to be received by holders of PSEG common stock pursuant to the merger agreement, and does not address any other aspect of the merger. Morgan Stanley's opinion does not constitute a recommendation to any shareholder of PSEG as to how such shareholder should vote with respect to the merger agreement.**

In connection with rendering its opinion, Morgan Stanley, among other things:

- reviewed certain publicly-available financial statements and other information of PSEG and Exelon;
- reviewed certain internal financial statements and other financial and operating data concerning PSEG and Exelon, prepared by the managements of PSEG and Exelon, respectively;
- reviewed certain financial projections of PSEG and Exelon and, in the case of Exelon, extensions thereof, prepared by the managements of PSEG and Exelon, respectively;
- discussed the past and then current operations and financial condition and the prospects of PSEG and Exelon with senior executives of PSEG and Exelon, respectively;
- reviewed the pro forma impact of the merger on various Exelon financial metrics;
- reviewed information relating to certain strategic, financial and operational benefits anticipated from the merger prepared by the managements of PSEG and Exelon with senior executives of PSEG and Exelon, respectively;
- discussed the strategic rationale for the merger with senior executives of PSEG and Exelon;

reviewed the reported prices and trading activity for the PSEG common stock and the Exelon common stock;

compared the financial performance of PSEG and Exelon and the prices and trading activity of the PSEG common stock and the Exelon common stock with that of certain other comparable publicly-traded companies and their securities;

reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;

participated in discussions and negotiations among representatives of PSEG and Exelon and their financial and legal advisors;

reviewed the merger agreement, the operating services contract between Exelon Generation Company, LLC and PSEG Nuclear, LLC and certain related documents; and

considered such other factors and performed such other analyses as it deemed appropriate.

In arriving at its opinion, Morgan Stanley assumed and relied upon without independent verification the accuracy and completeness of the information reviewed by it for the purposes of its opinion. With respect to the financial projections and extensions thereof, including information relating to certain strategic, financial and operational benefits anticipated from the merger, Morgan Stanley assumed that they had been reasonably prepared on bases reflecting the best then currently available estimates and judgments of the future financial performance of PSEG and Exelon. Morgan Stanley also relied on the assessments of senior management of PSEG and Exelon of the strategic rationale for the merger. In addition, Morgan Stanley assumed that the merger and the other transactions contemplated in the merger agreement would be consummated in accordance with the terms set forth in the merger agreement, including, among other things, that the merger would be treated as a tax-free reorganization, pursuant to the Internal Revenue Code of 1986, as amended. Morgan Stanley assumed that in connection with the receipt of all necessary regulatory approvals for the proposed merger, no restrictions would be imposed that would have a material adverse effect on the contemplated benefits expected to be derived in the proposed merger. Morgan Stanley did not make any independent valuation or appraisal of the assets or liabilities of PSEG or of Exelon, nor was Morgan Stanley furnished with any such appraisals. Morgan Stanley is not a legal, regulatory or tax expert and relied on the assessments made by advisors to PSEG with respect to such issues. Morgan Stanley's opinion was necessarily based on financial, economic, market and other conditions as in effect on, and the information made available to Morgan Stanley as of December 20, 2004.

In arriving at its opinion, Morgan Stanley was not authorized to solicit, and did not solicit, interest from any party with respect to the acquisition of PSEG or any of its assets.

The following is a summary of the financial analyses performed by Morgan Stanley in connection with its oral opinion and the preparation of its written opinion, dated December 20, 2004. Some of these summaries include information in tabular format. In order to understand fully the financial analyses used by Morgan Stanley, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the analyses.

In connection with its analysis, Morgan Stanley calculated the implied consideration to be paid for each share of PSEG common stock by multiplying the merger exchange ratio of 1.225 times the closing price of a share of Exelon common stock of $43.38 as of December 15, 2004 for a per share implied consideration of $53.14.

***Historical Trading and Exchange Ratio Analysis.*** Morgan Stanley reviewed the historical trading ranges of PSEG and Exelon for various periods ending on December 15, 2004 and the resulting implied exchange ratios to provide it with background and perspective for how each company's stock has historically traded on a standalone basis and relative to each other.

Morgan Stanley noted that for the 52-week period ending December 15, 2004, the range of closing prices for PSEG common shares was $38.10 to $47.72. Morgan Stanley also noted that for the 52-week period ending December 15, 2004, the range of closing prices for Exelon common shares was $30.92 to $43.40. Morgan Stanley also observed the following:

| Period Ending December 15, 2004 | Average PSEG Price Per Share | Average Exelon Price Per Share | Historical Trading Ratio | Implied Premium at Merger Exchange Ratio |
|---|---|---|---|---|
| 5 Trading Days Prior | $ 43.82 | $ 42.56 | 1.03x | 19.0% |
| 10 Trading Days Prior | $ 43.57 | $ 42.14 | 1.03x | 18.5% |
| One Month Prior | $ 43.96 | $ 42.06 | 1.05x | 17.2% |
| Two Months Prior | $ 43.44 | $ 40.99 | 1.06x | 15.6% |

Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was greater than the average prices per share for PSEG common stock listed above.

***Comparable Public Companies Analysis.*** Morgan Stanley performed a comparable company analysis on PSEG and Exelon, which attempted to provide an implied value for PSEG and Exelon by comparing them to similar companies. For purposes of its analysis, Morgan Stanley reviewed and compared certain public and internal PSEG and Exelon financial information, ratios and available public market multiples relating to PSEG and Exelon to corresponding financial data for selected publicly-traded utility companies. Morgan Stanley selected these companies for its comparable company analysis of PSEG and Exelon based on its experience with companies in the utility industry and their relative similarity in size and business mix to that of PSEG and Exelon, respectively.

***PSEG.*** The companies included in the PSEG comparable companies analysis were:

- Constellation Energy Group, Inc.
- Entergy Corporation
- Exelon Corporation
- FirstEnergy
- PPL Corporation

Morgan Stanley then reviewed both public and internal PSEG financial information to compare financial metrics of these companies to the following PSEG metrics:

- stock price to 2005 estimated EPS;
- stock price to 2006 estimated EPS; and
- Aggregate Value (defined as equity value plus estimated non-convertible debt, minority interest, capital lease obligations and preferred stock less cash and cash equivalents as of December 31, 2004) to the estimated 2006 EBITDA.

The following table reflects the results of the analysis and the corresponding multiples for PSEG based on representative ranges of median earnings and EBITDA estimates for these companies

obtained from I/B/E/S, a data service that monitors and publishes a compilation of earnings estimates produced by selected research analysts on companies of interest to investors:

| | Price to EPS | | Aggregate Value to EBITDA |
|---|---|---|---|
| | 2005E | 2006E | 2006E |
| Range derived from PSEG comparables | 12.5x - 13.5x | 11.5x - 12.5x | 6.75x - 7.25x |
| PSEG multiples | 13.5x | 12.2x | 7.6x |

Applying a representative range of multiples derived from the comparable public companies analysis, Morgan Stanley calculated a range of implied equity values per share of PSEG with respect to PSEG's:

- stock price to 2005 estimated EPS;
- stock price to 2006 estimated EPS; and
- Aggregate Value to 2006 estimated EBITDA.

Based on this analysis, Morgan Stanley derived a range of implied equity values per share of PSEG common stock of $40.00 to $48.68. Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was greater than the range implied by the analysis.

***Exelon.*** The companies included in the Exelon comparable companies analysis were:

- Constellation Energy Group, Inc.
- Entergy Corporation
- FirstEnergy
- PPL Corporation
- Public Service Enterprise Group Incorporated

Morgan Stanley then reviewed public financial information to compare financial metrics of market value of these companies to Exelon's public and internal financial metrics:

- stock price to 2005 estimated EPS;
- stock price to 2006 estimated EPS;
- Aggregate Value to 2005 estimated EBITDA; and
- Aggregate Value to 2006 estimated EBITDA.

The following table reflects the results of the analysis and the corresponding multiples for Exelon based on representative ranges of median I/B/E/S earnings and EBITDA forecasts:

| | Price to EPS | | Aggregate Value to EBITDA | |
|---|---|---|---|---|
| | **2005E** | **2006E** | **2005E** | **2006E** |
| Ranges derived from Exelon comparables | 13.0x - 14.0x | 12.0x - 13.0x | 7.5x - 8.0x | 7.25x - 7.75x |
| Exelon multiples | 14.5x | 13.4x | 8.0x | 7.7x |

Applying a range of multiples derived from the comparable public companies analysis, Morgan Stanley calculated a range of implied equity values per share of Exelon with respect to Exelon's and based on public and internal Exelon financial information:

stock price to 2005 estimated EPS;

stock price to 2006 estimated EPS;

Aggregate Value to 2005 estimated EBITDA; and

Aggregate Value to 2006 estimated EBITDA.

Based on this analysis, Morgan Stanley derived a range of implied equity values per share of Exelon common stock of $38.48 to $45.51. Morgan Stanley noted that the closing price of Exelon common stock on December 15, 2004 was $43.38, which was within the range implied by this analysis.

No company utilized in the comparable public companies analysis is identical to PSEG or Exelon. Accordingly, an analysis of the results of the foregoing necessarily involves complex considerations and judgments concerning differences in financial and operating characteristics of PSEG and Exelon and other factors that could affect the public trading value of the companies to which they are being compared. In evaluating the comparable companies, Morgan Stanley made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond the control of PSEG or Exelon, such as the impact of competition on PSEG or Exelon and the industry generally, industry growth and the absence of any adverse material change in the financial conditions and prospects of PSEG or Exelon or the industry or in the financial markets in general. Mathematical analysis, such as determining the mean, median or average, is not in itself a meaningful method of using comparable company data.

***Sum-of-the-Parts Discounted Cash Flow Analyses.*** Given the different nature of businesses in which PSEG and Exelon participate, Morgan Stanley also analyzed each company as the sum of its constituent businesses, or as the "sum of its parts" and performed a discounted cash flow analysis on each of its constituent businesses. A discounted cash flow analysis is designed to provide insight into the value of a company as a function of its future cash flows and terminal value. Morgan Stanley's discounted cash flow analysis was based on:

subsidiary and consolidated financial projections provided by management of PSEG for the period from January 1, 2005 through December 31, 2009 (also referred to in this joint proxy statement/prospectus as the PSEG forward-looking financial information);

subsidiary consolidated financial projections provided by management of Exelon for the period from January 1, 2005 through December 31, 2007 (also referred to in this joint proxy statement/prospectus as the Exelon forward-looking financial information for 2005 through 2007); and

extensions of the projections of Exelon provided by Exelon's management for the period from January 1, 2008 through December 31, 2009 (also referred to in this joint proxy statement/prospectus as extensions of the Exelon forward-looking financial information for 2008 through 2009).

Unlevered free cash flows were calculated as net income available to common shareholders plus the aggregate of preferred stock dividends, depreciation and amortization, deferred taxes, and other noncash expenses and after-tax net interest expense less the sum of capital expenditures and investment in noncash working capital for each operating subsidiary. The free cash flows and range of terminal values were then discounted to present values using a range of discount rates which were chosen by Morgan Stanley based upon an analysis of market discount rates applicable to comparable companies in the electric utility sector.

*PSEG.* For the PSEG discounted cash flow analysis, Morgan Stanley performed discounted cash flow analysis on the following business units with the noted assumptions and considerations.

PSE&G: For PSEG's regulated utility subsidiary, Morgan Stanley calculated a range of terminal values at the end of the projection period by applying a multiple to PSE&G's projected 2009 earnings and then adding back the projected debt and preferred stock amounts in 2009. The

price to earnings multiple range used was 14.0x to 15.0x and the weighted average cost of capital was 5.5% to 6.0%.

PSEG Power: Morgan Stanley calculated a range of terminal values at the end of the projection period by applying an Aggregate Value/EBITDA multiple to PSEG Power's projected 2009 EBITDA. The Aggregate Value to EBITDA multiple range used was 7.5x to 8.5x and the weighted average cost of capital range was 8.0% to 8.5%.

PSEG Global: Morgan Stanley discounted the cash flows to equity holders by the equity cost of capital for each business owned by PSEG Global based on the risk profiles. Morgan Stanley determined the terminal value applicable for each business based on the valuation metrics associated with that business and the business's standalone prospects.

PSEG Resources: Morgan Stanley performed a discounted cash flow analysis covering the entire period during which PSEG Resources' assets were projected to provide cash flow, with a terminal value based on the residual asset value at the end of the period. Morgan Stanley used a cost of capital for each lease owned by PSEG Resources based on the risk profile of each lease.

From this analysis, Morgan Stanley calculated a range of equity value per share of PSEG common stock of $40.53 to $45.49. Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was greater than the range implied by this analysis.

*Exelon.* For the Exelon discounted cash flow analysis, Morgan Stanley performed discounted cash flow analysis on the following business units with the noted assumptions and considerations.

ComEd and PECO: For Exelon's utility subsidiaries, Morgan Stanley calculated a range of terminal values at the end of the projection and extension period by applying a price to earnings multiple to ComEd's and PECO's estimated ongoing 2009 earnings based on the extensions of the Exelon forward-looking financial information for 2008 through 2009 provided by Exelon's management. The price to earnings multiple range used was 14.0x to 15.0x for ComEd and PECO and the weighted average cost of capital was 5.5% to 6.0%.

Exelon Generation: Morgan Stanley calculated a range of aggregate terminal values at the end of the projection and extension period by applying an Aggregate Value to EBITDA multiple to Exelon Generation's 2009 estimated EBITDA based on the extensions of the Exelon forward-looking financial information for 2008 through 2009 provided by Exelon's management. The 2009 estimated EBITDA Morgan Stanley used to calculate the terminal Aggregate Value of Exelon Generation was increased based upon an estimate made with respect to the potential increase in EBITDA Exelon Generation would receive for its generation output currently used to satisfy its Provider of Last Resort, referred to in this joint proxy statement/prospectus as a "POLR," service obligations to PECO; this estimate was based on an assessment of the potential amount by which market prices for POLR service in the PECO service territory would have exceeded the current POLR pricing charged by Exelon Generation to PECO through the period covered under Exelon Generation's POLR service agreement with PECO, which runs through December 31, 2010. The Aggregate Value to EBITDA multiple range used was 8.0x to 9.0x and the weighted average cost of capital was 7.5% to 8.0% for cash flows through the period ended December 31, 2009 and 7.75% to 8.25% for the terminal value.

Synthetic fuel assets: Morgan Stanley conducted a discounted cash flow analysis covering the entire period during which Exelon's synthetic fuel assets were projected to provide cash flow; therefore, a terminal value approach was not used for this business. The cost of equity range used in the discounting of Exelon Generation's synthetic fuel assets' cash flow to equity holders was 6.5% to 7.5%.

From this analysis, Morgan Stanley calculated a range of equity value per share of Exelon common stock of $40.32 to $44.45. Morgan Stanley noted that the closing price of Exelon common stock on December 15, 2004 was $43.38, which was within the range implied by this analysis.

The sum-of-the-parts discounted cash flow analyses does not imply the value at which the individual PSEG or Exelon businesses could be sold. Morgan Stanley did not consider the effect of transaction costs, including taxes that could be payable, associated with a disposition of any of the PSEG or Exelon businesses.

***Sum-of-Parts Comparable Public Companies Analysis.*** Morgan Stanley also used a comparable companies analysis as described earlier to analyze each of PSEG's and Exelon's constituent businesses. Using management estimates, Morgan Stanley compared certain financial measures of selected comparable companies to those of the relevant businesses within PSEG and Exelon. Morgan Stanley selected these comparable companies based upon its views as to the comparability of the financial and operating characteristics of these companies to the relevant PSEG and Exelon businesses. Morgan Stanley calculated reference value ranges for the PSEG and Exelon businesses by applying various multiples derived from these comparable companies to selected financial measures of the relevant PSEG and Exelon businesses based on information provided by each company's management. Based on this analysis, Morgan Stanley calculated per share values for PSEG common stock ranging from $38.66 to $41.51. Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was greater than the range implied by this analysis. In addition, based on this analysis, Morgan Stanley calculated per share value for Exelon common stock ranging from $41.16 to $45.97 and noted that the closing price of Exelon common stock on December 15, 2004 was $43.38, which was within the range implied by this analysis.

***Dividend Discount Analysis.*** Morgan Stanley also analyzed the implied values of PSEG and Exelon as a function of the present value of their respective dividend payments. Morgan Stanley performed these analyses of PSEG and Exelon based on the following information:

- PSEG forward-looking financial information for 2005 through 2009 provided by management of PSEG;
- Exelon forward-looking financial information for 2005 through 2007 provided by management of Exelon; and
- extensions of the Exelon forward-looking financial information for 2008 through 2009 provided by Exelon's management.

Morgan Stanley calculated terminal values by applying a range of multiples to the estimated EPS in fiscal year 2009 and the dividend streams and terminal values were then discounted to the present using a range of discount rates representing an estimated range of the cost of equity for each of PSEG and Exelon. Based on this analysis, Morgan Stanley calculated per share values for PSEG ranging from $42.75 to $47.10. Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was greater than the range implied by this analysis. In addition, based on this analysis, Morgan Stanley calculated per share values for Exelon ranging from $38.15 to $42.01 and noted that the closing price of Exelon common stock on December 15, 2004 was $43.38, which was greater than the range implied by this analysis.

***Analysis of Selected Precedent Transactions.*** Morgan Stanley also performed an analysis of selected precedent transactions, which attempted to provide an implied value for PSEG by comparing it to other companies involved in business combinations. Using publicly available information, Morgan Stanley considered three sets of announced or completed transactions:

- United States mergers (excluding transactions in the technology sector), referred to in this joint proxy statement/prospectus as "Large United States All-Stock Mergers," announced since

January 2001 involving 100% stock-for-stock exchanges, in which the smaller company involved had an equity market capitalization of at least $5 billion;

Utility sector merger-of-equal transactions, referred to in this joint proxy statement/prospectus as "Utility MOEs," since January 1998; and

Utility sector corporate acquisition transactions since January 1999, referred to in this joint proxy statement/prospectus as "Utility Acquisitions."

Morgan Stanley compared certain financial and market statistics of the three sets of selected precedent transactions. Based on an assessment of the Large United States All-Stock Mergers, Morgan Stanley applied a premium to unaffected market price ranging from 10% to 20%. Based on the analysis of Large United States All-Stock Mergers, Morgan Stanley calculated per share values for PSEG common stock ranging from $49.04 to $53.50.

Based on an assessment of the Utility MOEs, Morgan Stanley applied a premium to unaffected market price ranging from 0% to 10% and the 1-year forward I/B/E/S price to earnings multiple ranging from 12.0x to 14.0x. Based on the analysis of Utility MOEs, Morgan Stanley calculated per share values for PSEG common stock ranging from $38.40 to $49.04.

Based on an assessment of the Utility Acquisitions, Morgan Stanley applied a premium to unaffected market price ranging from 20% to 40%. Based on the analysis of Utility Acquisitions, Morgan Stanley calculated per share values for PSEG common stock ranging from $53.50 to $62.41.

Morgan Stanley noted that the implied consideration to be paid for each share of PSEG common stock was $53.14 as of December 15, 2004, which was within the range implied by the large United States All-Stock Mergers, greater than the range implied by the Utility MOEs, and less than the range implied by the Utility Acquisitions. Morgan Stanley also noted that the Utility Acquisitions involved much smaller transactions in terms of the size (of the target), and very few of these transactions occurred in 2003 or 2004. Of the 24 transactions comprising the Utility Acquisitions group, the target company median size was $2 billion, and only four of these transactions were announced since the end of 2002. Morgan Stanley further noted that no Utility MOEs have been announced since 2000.

No transaction utilized as a comparison in the analysis of selected precedent transactions is identical to the merger in both business mix, timing and size. Accordingly, an analysis of the results of the foregoing necessarily involves complex considerations and judgments concerning differences in financial and operating characteristics of PSEG and other factors that would affect the value of the companies to which it is being compared. In evaluating the precedent transactions, Morgan Stanley made judgments and assumptions with regard to industry performance, global business, economic, market and financial conditions and other matters, many of which are beyond the control of PSEG, such as the impact of competition on PSEG and the industry generally, industry growth and the absence of any adverse material change in the financial conditions and prospects of PSEG or the industry or the financial markets in general. Mathematical analysis (such as determining the mean or median) is not, in itself, a meaningful method of using precedent transactions data.

***Pro Forma Transaction Analysis.*** Using financial projections provided by PSEG's and Exelon's managements and publicly available I/B/E/S earnings estimates and taking into account certain management estimates of synergies provided to Morgan Stanley by PSEG management, Morgan Stanley reviewed the pro forma impact of the merger on PSEG's and Exelon's estimated EPS for the years 2006-2009. For purposes of this analysis, Morgan Stanley assumed the transaction closed on January 1, 2006.

The pro forma impact on Recurring Earnings Per Share (defined as earnings based on all projected merger-related adjustments to EPS except for impacts relating to costs to achieve synergies and certain short-term purchase accounting adjustments) was found to be accretive to earnings from 2006 to 2009 to both PSEG and Exelon using each company's forward-looking financial information, and extension thereof in the case of Exelon, as the basis of comparison for both companies. The pro forma impact on Reported Earnings Per Share (defined as earnings per share taking into account all projected merger-related adjustments and any extraordinary items) was found to be accretive to earnings from 2006 to 2009 to PSEG and accretive to earnings from 2007 to 2009 to Exelon using each company's forward-looking financial information and, extension thereof in the case of Exelon, as the basis of comparison for both companies. Assuming no merger-related adjustments to earnings per share and based on I/B/E/S earnings estimates, the pro forma impact on EPS was found to be accretive to earnings from 2006 to 2009 to both PSEG and Exelon using I/B/E/S projections as the basis for comparison for both companies.

***Contribution Analysis.*** Morgan Stanley also performed a contribution analysis which reviewed the pro forma contribution of each of PSEG and Exelon to the combined entity and implied contributions based on other financial metrics. Morgan Stanley reviewed the pro forma effect of the merger and computed the implied equity contribution of PSEG and Exelon for the years ended December 31, 2004, December 31, 2005 and December 31, 2006. Such financial results included EBITDA and net income. The computation showed, among other things, that PSEG's implied equity contribution based on 2004, 2005 and 2006 projected EBITDA was 27%, 28% and 30%, respectively; based on 2004, 2005 and 2006 projected net income, PSEG's implied equity contribution was 28%, 28% and 30%, respectively. In addition, Morgan Stanley calculated the implied equity contribution of PSEG and Exelon based on the results of the Sum-of-Parts Discounted Cash Flow, Sum-of-Parts Comparable Public Companies, and Dividend Discount analyses; the computation showed, among other things, that PSEG's implied equity contribution based on these three analyses was 27%, 25% and 29%, respectively. Morgan Stanley noted that the 1.225x exchange ratio of Exelon common shares to PSEG common shares would result in pro forma ownership of the combined company for holders of PSEG common stock equal to approximately 31%.

In connection with the review of the transaction with the PSEG board of directors, Morgan Stanley performed a variety of financial and comparable analyses for purposes of rendering its opinion. The preparation of a fairness opinion is a complex process and is not susceptible to partial analysis or summary description. In arriving at its opinion, Morgan Stanley considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor considered. Furthermore, Morgan Stanley believes that the summary provided and the analyses described above must be considered as a whole and that selecting any portion of the analyses, without considering all of them, would create an incomplete view of the process underlying Morgan Stanley's analyses and opinion. As a result, the ranges of valuations resulting from any particular analysis or combination of analyses described above should not be taken to be the view of Morgan Stanley with respect to the actual value of PSEG or Exelon common stock.

In performing its analyses, Morgan Stanley made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of PSEG or Exelon. Any estimates contained in Morgan Stanley's analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by the estimates. The analyses performed were performed solely as part of Morgan Stanley's analysis of the fairness from a financial point of view of the exchange ratio pursuant to the merger agreement to the holders of PSEG common stock and were conducted in connection with the delivery of Morgan Stanley's opinion to the PSEG board of directors. The analyses do not purport to be appraisals or to reflect the prices at which PSEG common stock or Exelon common stock might actually trade. The exchange ratio applicable to each share of PSEG common stock under the merger agreement and other terms of the merger agreement were determined through

arm's length negotiations between PSEG and Exelon and approved by the PSEG board of directors. The written opinion of Morgan Stanley dated December 20, 2004, was one of a number of factors taken into consideration by PSEG's board of directors in making its decision to approve the merger agreement and the transactions contemplated by the merger agreement. Consequently, Morgan Stanley's analyses described above should not be viewed as determinative of the opinion of the PSEG board of directors with respect to the value of PSEG or Exelon. See " Recommendation of PSEG Board; PSEG's Reasons for the Merger."

Morgan Stanley, as part of its investment banking businesses, is continually engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for estate, corporate and other purposes. PSEG selected Morgan Stanley as its financial advisor based upon the firm's qualifications, experience and expertise and because it is an internationally recognized investment banking firm with substantial experience in transactions similar to the merger. In the ordinary course of its trading and brokerage activities, Morgan Stanley and its affiliates may at any time hold long or short positions, trade or otherwise effect transactions, for their own accounts or for the accounts of customers, in the equity or debt securities or senior loans of PSEG or Exelon.

Pursuant to the terms of its engagement, PSEG agreed to pay Morgan Stanley a transaction fee of $20 million. The fee is payable as follows: $5 million of which was due upon the public announcement of the execution of the merger agreement, $5 million of which is payable upon PSEG's shareholder approval and $10 million of which is payable upon completion of the merger. PSEG has also agreed to reimburse Morgan Stanley for its fees and expenses incurred in performing its services. In addition, PSEG has agreed to indemnify Morgan Stanley and its affiliates, their respective directors, officers, agents and employees and each person, if any, controlling Morgan Stanley or any of its affiliates against certain liabilities and expenses, including certain liabilities under the federal securities laws, related to or arising out of Morgan Stanley's engagement and any related transactions. During the past two years, Morgan Stanley and its affiliates have provided financial advisory, underwriting, loan syndication and other investment banking services for PSEG and Exelon and have received fees of approximately $4 million, exclusive of any fees for the merger, and $3 million, respectively, for the rendering of these services. The fees received from Exelon relate primarily to financial advice Morgan Stanley provided to Exelon in connection with the sale of the outstanding common stock of ExRes SHC Inc., the parent company of Sithe Energies and Sithe Independent L.P., to Dynegy, Inc. Exelon Generation enters into various energy related derivative transactions for hedging and speculative purposes with Morgan Stanley. These transactions, include, but are not limited to, power forwards, power swaps, natural gas swaps, natural gas options, oil swaps and oil options. Morgan Stanley also may or may in the future seek to provide financial advice or financing services to PSEG and Exelon and may receive fees for such services.

**Forward-Looking Financial Information**

***Exelon Forward-Looking Financial Information***

Exelon does not as a matter of course publicly disclose detailed forecasts or internal projections as to future revenues, earnings or financial condition. However, in the course of its discussions with PSEG leading up to the execution of the merger agreement, Exelon provided PSEG with some business and financial information which Exelon and PSEG believe was not publicly available. The information provided to PSEG included forward-looking financial information for years 2005 through 2007 based upon projections developed by Exelon through a regular internal planning and forecasting process that included input from Exelon's business units and a corporate level review. As described below, those projections were adjusted to reflect market price assumptions that Exelon and PSEG agreed to use for the purpose of providing to each other comparable information. The following table is a summary of the forward-looking financial information Exelon provided to PSEG for years 2005 through 2007.

**Exelon Corporation**
**Forward-Looking Income and Cash Flow Statement Data**
**(in millions, except per share data)**

| | For the Year Ending December 31, | | |
|---|---|---|---|
| | **2005** | **2006** | **2007** |
| Net Income Available for Common Shareholders(1) | $ 2,080 | $ 2,210 | $ 2,303 |
| Exelon Earnings Per Share(2) | $ 3.11 | $ 3.30 | $ 3.44 |
| Total Common Dividends(3) | $ (1,135) | $ (1,204) | $ (1,245) |

(1) Net income amounts include $64, $64 and $65 for 2005, 2006 and 2007, respectively, reflecting the impact of investments in synthetic fuel.

(2) Earnings per share amounts include $0.10, $0.10 and $0.10 per share for 2005, 2006 and 2007, respectively, reflecting the impact of investments in synthetic fuel.

(3) Reflects cash disbursement for common dividends.

PSEG also requested forward-looking financial information for years 2008 and 2009. In response to PSEG's request, Exelon created forward-looking financial information for years 2008 and 2009 through a process of extension of the forward-looking financial information for years 2005 through 2007 described above, but only with a corporate level review not involving the same planning processes, analysis and input from Exelon's business units that were used in the preparation of Exelon's projections for years 2005 through 2007. The following table is a summary of the extended forward-looking financial information Exelon provided to PSEG for years 2008 and 2009.

**Exelon Corporation**
**Extension of Forward-Looking Income and Cash Flow Statement Data**
**(in millions, except per share data)**

| | For the Year Ending December 31, | |
|---|---|---|
| | **2008** | **2009** |
| Net Income Available for Common Shareholders(1) | $ 2,302 | $ 2,349 |
| Exelon Earnings Per Share(2) | $ 3.43 | $ 3.49 |
| Total Common Dividends(3) | $ (1,281) | $ (1,315) |

(1) Net income amounts include $16 and $0 for 2008 and 2009, respectively, reflecting the impact of investments in synthetic fuel.

(2) Earnings per share amounts include $0.02 and $0.00 for 2008 and 2009, respectively, reflecting the impact of investments in synthetic fuel.

(3) Reflects cash disbursement for common dividends.

The Exelon forward-looking financial information was based upon various assumptions, including the following principal assumptions:

In order to provide each other with comparable information, Exelon and PSEG developed common assumptions about energy and gas prices through 2009, based in large part on market data that was extended through the forecast period. The common assumptions were similar to, but not necessarily the same as, Exelon's forecasts of energy and gas prices for internal planning purposes. Based on this data, the forward-looking financial information that Exelon provided to PSEG assumed that ComEd around-the-clock ("ATC") energy prices would decline slightly but

remain relatively flat over the forecast period and that PJM ATC prices would decrease from approximately $47.50 per MWh in 2005 to approximately $41.00 per MWh in 2009 due to a forecast of declining gas prices.

Market data for capacity is relatively limited. Exelon assumed the capacity markets would tighten over time, thereby resulting in higher capacity prices. For purposes of the forward-looking financial information provided to PSEG, Exelon assumed that ComEd region capacity prices would increase by approximately 23% per year over the period from 2005 through 2009 and that prices in the PJM region would be approximately $11.00 per kW per year in 2005 and increase by approximately 29% per year through 2009. These assumptions were similar to, but not necessarily the same as, Exelon's forecasts of capacity prices for internal planning purposes.

Exelon assumed the Exelon nuclear fleet and the PSEG nuclear fleet co-owned with Exelon would perform at levels consistent with its recent historical performance.

Exelon assumed that ComEd's rates would be reset in 2007 based on full cost recovery for the Exelon energy delivery business with a pass through of energy rates based on a descending clock energy auction process similar to the process used in New Jersey. Exelon assumed that PECO's rates would remain consistent with current scheduled rates through 2009.

The estimated operating and maintenance expense and capital expenditures for years 2005 through 2007 were based upon Exelon's internal forecast and assessment of expenditures required to meet reliability goals. For the forward-looking financial information for years 2008 and 2009, Exelon assumed total operating and maintenance expense and capital expenditures would grow at a rate of 1% per year.

The estimates and assumptions underlying the forward-looking financial information involved judgments with respect to, among other things, future economic, competitive, regulatory and financial market conditions and future business decisions which may not be realized and are inherently subject to significant business, economic, competitive and regulatory uncertainties, all of which are difficult to predict and many of which are beyond the control of Exelon and PSEG. Accordingly, there can be no assurance that the prospective results thereof would be realized or that actual results would not differ materially from those presented in the forward-looking financial information.

See cautionary statements regarding forward-looking information under "Forward-Looking Statements."

Although all of the forward-looking financial information Exelon provided to PSEG was prepared in good faith by Exelon management, the information provided for years 2008 and 2009 was not prepared with the same degree of analysis as the information provided for years 2005 through 2007. In addition, no assurance can be made regarding future events. As a result, prospective financial information such as that provided for years 2005 through 2009 above cannot be considered a reliable predictor of future operating results, and this information should not be relied on as such. The information provided to PSEG and summarized above was not prepared with a view toward public disclosure or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, published guidelines of the SEC regarding forward-looking statements, or United States generally accepted accounting principles. In the view of Exelon management, the information was prepared on a reasonable basis and reflects reasonable estimates and judgments. However, this information should not be relied upon as being necessarily indicative of future results, and readers of this joint proxy statement/prospectus are cautioned not to place reliance on this information.

The forward-looking financial information included in the previous two tables was prepared by, and is the responsibility of, Exelon management. Neither PricewaterhouseCoopers LLP nor Deloitte & Touche LLP has examined or compiled the accompanying prospective financial information and, accordingly, neither PricewaterhouseCoopers LLP nor Deloitte & Touche LLP expresses an opinion or

any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP reports included in this joint proxy statement/prospectus relate to Exelon's historical financial information. They do not extend to the prospective financial information and should not be read to do so.

The Exelon forward-looking financial information for years 2005 through 2007 and the extensions of that forward-looking financial information for years 2008 through 2009 were prepared for Exelon on a stand-alone basis and the PSEG forward-looking financial information was prepared for PSEG on a stand-alone basis. The combination of the Exelon and PSEG forward-looking financial information does not represent the results the combined company will achieve if the merger is completed nor does it represent forward-looking financial information for the combined company.

The information concerning forward-looking financial information provided by Exelon is not included in this joint proxy statement/prospectus in order to induce any shareholder to vote in favor of the merger agreement or to acquire securities of Exelon.

Exelon does not intend to update or otherwise revise the forward-looking financial information to reflect circumstances existing since its preparation or to reflect the occurrence of unanticipated events, even in the event that any or all of the underlying assumptions are shown to be in error. Furthermore, Exelon does not intend to update or revise the forward-looking financial information to reflect changes in general economic or industry conditions.

***PSEG Forward-Looking Financial Information***

PSEG does not as a matter of course make public projections as to future sales, earnings, or other financial results. However, in the course of its discussions with Exelon leading up to the execution of the merger agreement, the management of PSEG provided to Exelon certain prospective financial information which PSEG and Exelon believe is not publicly available. The accompanying prospective financial information was not prepared with a view toward public disclosure or with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, but, in the view of PSEG management, was prepared on a reasonable basis and reflects reasonable estimates and judgments. However, this information should not be relied upon as being necessarily indicative of future results, and readers of this joint proxy statement/prospectus are cautioned not to place reliance on the prospective financial information.

Neither PSEG's independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the prospective financial information.

The following table is a summary of the forward-looking financial information PSEG provided to Exelon for years 2005 through 2009.

**PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED**
**Forward-Looking Income and Cash Flow Statement Data**
**(in millions, except per share data)**

| | For the Year Ending December 31, | | | | |
|---|---|---|---|---|---|
| | **2005** | **2006** | **2007(1)** | **2008** | **2009** |
| Net Income Available for Common Shareholders | $ 771 | $ 910 | $ 1,002 | $ 1,068 | $ 1,067 |
| Adjusted PSEG Earnings Per Share | $ 3.20 | $ 3.58 | $ 3.82 | $ 4.11 | $ 4.22 |
| Total Common Dividends(2) | $ (543) | $ (583) | $ (608) | $ (619) | $ (630) |

(1) Reflects exclusion of after-tax loss on a forecasted sale of a plant.

(2) Reflects cash disbursement for common dividends.

The PSEG forward-looking financial information was based upon various assumptions, including the following principal assumptions:

- In order to provide comparable information, PSEG and Exelon developed common assumptions about electric energy and natural gas prices though 2009, based largely on market data that was extended through the forecast period. The common assumptions were similar to, but not necessarily the same as, PSEG's forecasts of electric energy and natural gas prices used for internal planning purposes. Based on this data, the forward-looking financial information that PSEG provided to Exelon assumed that PJM ATC energy prices would decrease from approximately $47.50 per MWh in 2005 to approximately $41.00 per MWh in 2009 due to declining natural gas price prices and moderating coal prices.

- Market data for capacity pricing is limited. PSEG assumed that continuing demand growth in the region would create conditions resulting in higher capacity prices over the planning period. For the forward-looking financial information provided to Exelon, PSEG assumed that capacity prices in the PJM region would be approximately $11.00 per kW-year in 2005 and increase by approximately 29% per year through 2009. These capacity price assumptions were similar to, but not necessarily the same as, those used for PSEG's internal planning purposes.

- PSEG assumed that the performance of the nuclear units that it operates will return to levels consistent with the period prior to 2004. PSEG also assumed that the nuclear fleet co-owned with and operated by Exelon would continue to operate at levels consistent with recent historical performance.

- PSEG assumed that its New Jersey-based electric and gas utility, PSE&G, would continue to receive fair rate treatment and reasonable allowed returns on equity from the NJBPU. PSEG further assumed that the NJBPU would continue to employ a competitive auction process to procure energy for customers of the State's Basic Generation Service.

- Consistent with PSEG's publicly stated strategy, PSEG's forward-looking financial information reflects no new investment in PSEG Energy Holdings.

- PSEG estimated its operating and maintenance expense and capital expenditures for the period from 2005 to 2009 based on both historical practice, and in the case of capital, known project investments. The forward-looking financial information reflects growth in total operating and maintenance expenditures of approximately 2% per year.

The estimates and assumptions on which the forward-looking financial information is based involved judgments with respect to, among other things, future economic, competitive, regulatory and financial market conditions and future business decisions which may not be realized and are inherently subject to significant business, economic, competitive and regulatory uncertainties, all of which are difficult to predict and many of which are beyond the control of PSEG and Exelon. Accordingly, there can be no assurance that the prospective results thereof would be realized or that actual results would not differ materially from those presented in the forward-looking financial information.

See cautionary statements regarding forward-looking information under "Forward-Looking Statements."

The PSEG forward-looking financial information for years 2005 through 2009 was prepared for PSEG on a stand-alone basis and the Exelon forward-looking financial information for years 2005 through 2007 and the extensions of that forward-looking financial information for 2008 through 2009 were prepared for Exelon on a stand-alone basis. The combination of the PSEG and Exelon forward-looking financial information does not represent the results the combined company will achieve if the merger is completed nor does it represent forward-looking financial information for the combined company.

The information concerning forward-looking financial information provided by PSEG is not included in this joint proxy statement/prospectus in order to induce any shareholder to vote in favor of the merger agreement or to acquire securities of PSEG.

PSEG does not intend to update or otherwise revise the forward-looking financial information to reflect circumstances existing since its preparation or to reflect the occurrence of unanticipated events, even in the event that any or all of the underlying assumptions are shown to be in error. Furthermore, PSEG does not intend to update or revise the forward-looking financial information to reflect changes in general economic or industry conditions.

***Estimated Potential Synergies Attributable to the Merger***

The companies have estimated potential reductions and avoidances in costs and other synergies, collectively referred to as synergies, that may be attributable to the merger. Recognition has also been given to those out-of-pocket costs that are expected to be incurred to successfully complete the merger and to integrate operations. These estimated potential cost savings are directly attributable to the merger and do not include estimated potential savings from other initiatives that were already underway or planned by either company independent of the merger or that could be achieved in the absence of the merger.

Total potential cost savings and other synergies identified by the management of Exelon have been estimated at approximately $400 million in the first full year of operations following completion of the merger and approximately $500 million in the second full year of operations following completion of the merger. The management of PSEG estimated similar levels of synergies, giving effect to all expected improvements in the operating performance of nuclear generating units, including improvements reflected in PSEG's forward-looking financial information for 2005-2009. Related costs-to-achieve these synergies are currently estimated at approximately $450 million in the first full year of operations following completion of the merger and approximately $700 million over a period of four years following the merger. Identified plans for stand-alone cost reduction initiatives have also been recognized and deducted from the estimated potential cost savings in the amount of $5 million in the first full year of operations and $9 million in the second full year of operations. The impact of these planned initiatives will continue into the future and reduce identified merger synergies each year.

The principal components of the anticipated synergies identified by the companies are set forth below.

*Staffing*: The combined company should be able to integrate certain overlapping or duplicative functions for the corporate, shared services, utility and, generation business units. These functions relate to business unit management and back-office support functions for each business unit and to reduced plant staffing in nuclear operations. Such estimated cost savings amount to approximately 43% of the total estimated level of synergies in the second full year of operations. The identified reductions will not affect field related functions and should not create any adverse impacts on service quality, reliability or safety.

*Corporate and Administrative Programs*: In addition to the staffing costs related to the functions referred to above, non-labor costs in support of these functions will be reduced through the combination of the companies. Of the total estimated synergies in the second full year of operations, approximately 15% are attributable to this category. These estimated cost reductions will relate to expenditures in the areas of miscellaneous administrative and general expense, benefits administration, facilities, insurance, professional services and, shareholder services, among others. These reductions relate to redundant costs that can be avoided and to economies of scale that can be achieved with respect to sourcing of certain of these expenditures.

*Information Technology*: Estimated cost savings in the information technology area are approximately 9% of total estimated synergies in the second full year of operations. It is

expected the combined company will integrate the stand-alone information technology functions including data centers, network operations, workstation support, applications and, telecommunications, where applicable. In addition, certain projects planned on a stand-alone basis by each company can be avoided with the integration of the respective system architectures and underlying operating systems.

*Supply*: The merger is expected to enable the consolidation of supply chain management and operations. The common management of this function should enable the integrated sourcing of both materials and supplies and contract services and is expected to produce economies of scale and lower unit costs of acquisition. Estimated cost savings in the supply area are approximately 16% of total estimated synergies in the second full year of operations.

*Nuclear Production Improvements*: In the nuclear business unit, additional revenues are expected to be available from improvement in the generating plan operating performance of PSEG's nuclear fleet. These opportunities are expected to arise from higher capacity factors as a result of the implementation of the Exelon Nuclear Management Model and the potential for increased market sales of this additional output and amount to approximately 14% of total estimated synergies in the second full year of operations.

*Nuclear Outage Costs*: Improvements in the execution of plant outages are also expected with durations for the PSEG plants to be reduced to a length consistent with that existing within the Exelon nuclear fleet. These estimated savings amount to approximately 3% of the total estimated synergies level in the second full year of operations.

Potential synergies were analyzed across an extended time period and continued into perpetuity in order to determine the net present value of estimated synergies. This calculation reflects the ongoing nature of the estimated synergies and was used to develop a basis for determining the present value of the future stream of estimated synergies.

These estimated synergies were grown at an escalation rate over time with a terminal value used to value the stream of estimated synergies in future years. A conservative synergies sharing assumption was made to reflect the net retainable level of total synergies. This total stream of synergies was converted to an after-tax value and discounted back to the present at a 6% discount rate.

This analysis indicated that the identified level of estimated annual synergies over a 10 year period, plus a terminal value at the end of that period for the estimated synergies in subsequent years, would result in approximately $8 to 9 billion of estimated retained synergies on a net present value basis.

The Exelon analysis of estimated expected and growing synergies under a conservative synergies retention assumption indicated that the merger is expected to be accretive to earnings of the combined company in the second full year of operations by approximately 3 to 4%.

The estimates and assumptions underlying the identification of potential synergies and estimated accretion involve judgments with respect to, among other things, the extent to which the regulatory authorities require the combined company to share synergies with its customers, future economic, competitive, regulatory and market conditions and future business decisions which may not be realized and are inherently subject to uncertainties. For this reason, synergies are difficult to predict and there can be no assurance that the estimated synergies referred to in the preceding paragraphs will be achieved and in the amounts and time periods estimated by the managements of the companies. See "Risk Factors Risks Relating to the Merger The anticipated benefits of combining PSEG and Exelon may not be realized."

**Board of Directors and Management Following Completion of the Merger**

Exelon has agreed to amend and restate its Amended and Restated By-laws upon completion of the merger to provide for certain arrangements relating to the Exelon board of directors and

management during a transition period lasting for three years following completion of the merger. Generally, these new provisions of the Amended and Restated By-laws to be adopted will not be able to be changed by the board of directors without the approval of at least 80% of the whole Exelon board of directors. These provisions and the provisions of the merger agreement related to the governance of Exelon following completion of the merger are described below.

***Board of Directors***

Pursuant to the merger agreement and the Amended and Restated By-laws, upon completion of the merger, Exelon will increase the number of directors on its board of directors to 18 and appoint six former PSEG directors designated by the Chief Executive Officer of PSEG to fill six directors seats, subject to applicable laws and regulations. Such former PSEG directors will be allocated evenly among Classes I, II and III of the Exelon board of directors.

Pursuant to Exelon's Amended and Restated By-laws to be adopted upon completion of the merger, with respect to the first and second elections of directors during the transition period, the Exelon board of directors is required, subject to its fiduciary duties and applicable laws and regulations, to nominate for election the legacy PSEG directors (or their successors) whose class is standing for election and to nominate the legacy Exelon directors (or their successors) whose class is standing for election. In addition, during the transition period, the Exelon board of directors is required to, subject to its fiduciary duties and applicable laws and regulations, take any action necessary to ensure that any vacancy of a position on the Exelon board of directors previously held by a legacy PSEG director will be filled by a person nominated by the Exelon board of directors and approved by a majority of the legacy PSEG directors remaining on the Exelon board of directors, and that any vacancy of a position on the Exelon board of directors previously held by a legacy Exelon director will be filled by a person nominated by the Exelon board of directors and approved by a majority of the legacy Exelon directors remaining on the Exelon board of directors.

In addition, pursuant to Exelon's Amended and Restated By-laws to be adopted upon completion of the merger, during the transition period, a legacy PSEG director will be the chairman of at least one committee of the board of directors as determined by the Exelon corporate governance committee.

To help assure continuity before and for a period of time following completion of the merger, the Exelon board of directors has deferred, until after completion of the merger, the retirement of three directors who otherwise would have retired at the end of 2004. In addition, the Exelon board of directors suspended its director retirement policy so that directors who reach the retirement age of 72 within three years following completion of the merger will not be required to retire until the end of that three-year period.

***Chairman of the Board; Chief Executive Officer; President***

Pursuant to Exelon's Amended and Restated By-laws to be adopted, upon completion of the merger, Mr. Ferland will become the non-executive Chairman of the Exelon board of directors. Mr. Ferland will serve as non-executive Chairman of the Exelon board of directors until the earlier of (1) March 31, 2007, his announced date of retirement, and (2) the date on which Mr. Ferland no longer serves as a member of the Exelon board of directors. At such time, the Chief Executive Officer of Exelon will be appointed as Chairman of the Exelon board of directors and continue in such role for the duration of the transition period and thereafter as determined by the Exelon board of directors.

As the non-executive Chairman, Mr. Ferland will preside at all meetings of the Exelon board of directors and will, in consultation with the Chief Executive Officer of Exelon, establish the agenda for meetings of the Exelon board of directors. Mr. Ferland will have such other duties as non-executive Chairman of the Exelon board of directors as may from time to time be requested by the Chief Executive Officer of Exelon.

For at least the transition period, Mr. Rowe will continue to serve as the President and Chief Executive Officer of Exelon in charge of general supervision over the business and operations of Exelon.

***Senior Officers***

The merger agreement provides that the officers of Exelon following the merger will continue as the officers of Exelon with such substitutions, additions and deletions as shall be determined by Mr. Rowe in consultation with the Chief Executive Officer of PSEG and approved by the Exelon board of directors.

***Corporate Offices***

Pursuant to the Amended and Restated By-laws to be adopted upon completion of the merger, the corporate headquarters of Exelon will continue to be in Chicago, Illinois. The headquarters of Exelon's power trading business will be in southeastern Pennsylvania and the headquarters of Exelon's generation business will be in Newark, New Jersey, with headquarters of Exelon's nuclear generating business in southeastern Pennsylvania. ComEd will maintain its headquarters in Chicago, Illinois, PECO will maintain its headquarters in southeastern Pennsylvania and PSE&G will maintain its headquarters in Newark, New Jersey. Following completion of the merger, the Exelon board of directors may amend the provisions of the Amended and Restated By-laws setting Chicago, Illinois, as the corporate headquarters by the approval of at least 80% of the whole Exelon board of directors. Following completion of the merger, the Exelon board of directors may amend the provisions of the Amended and Restated By-laws setting the headquarters of the subsidiaries and divisions of the combined company by the approval of a majority of the directors present and voting at a meeting, so long as a quorum is present.

The proposed arrangement described above relating to the headquarters of subsidiaries and divisions of the combined company could be changed by agreement of Exelon and PSEG prior to the completion of the merger, if approved by the companies' boards of directors. However, the headquarters of PSE&G, PECO and ComEd will remain, respectively, in Newark, Philadelphia and Chicago. In addition, the parties expect that the headquarters of another significant business unit of the combined company will be located in Newark and the headquarters of another significant business unit will be located in southeastern Pennsylvania.

**Interests of PSEG's Directors and Executive Officers in the Merger**

***Appointment of Directors and Executive Officers***

When the merger is completed, six current members of the PSEG board of directors as designated by the Chief Executive Officer of PSEG, including Mr. Ferland, will be appointed to the Exelon board of directors. The Exelon board of directors will have the authority to fix the compensation of the directors for their services as such and a director may be a salaried officer of Exelon.

Pursuant to the second amendment to his employment agreement and Exelon's Amended and Restated By-laws to be adopted upon completion of the merger, Mr. Ferland will serve as the Chairman of the Exelon board of directors until the earlier of March 31, 2007 and the date on which he ceases to be a director of Exelon. After the merger becomes effective, pursuant to the second amendment to his employment agreement, which amendment does not change the compensation provisions of his employment agreement, Mr. Ferland will continue to receive:

- an annual base salary no less than the annual base salary he received prior to completion of the merger which may, after completion of the merger, be increased but may not be subsequently decreased; as of April 30, 2005, Mr. Ferland's annual base salary was $1,080,000;

a target annual incentive bonus under the Management Incentive Compensation Plan equal to no less than 100% of his annual base salary (the target award for which Mr. Ferland was eligible immediately prior to completion of the merger); and

a target long-term incentive bonus under the long-term incentive plans equal to no less than 300% of his annual base salary (the target award for which Mr. Ferland was eligible immediately prior to completion of the merger).

Under the second amendment, Mr. Ferland agreed to waive his right to resign for "good reason" and to be paid any severance as a result of the merger and the change in his responsibilities and agreed that the change in his responsibilities following completion of the merger will not constitute "good reason" or the termination of his employment without "cause." The second amendment further provides that Mr. Ferland will voluntarily retire as an employee of Exelon and as a member of the Exelon board of directors no later than March 31, 2007.

In addition, the merger agreement provides that the officers of Exelon immediately prior to completion of the merger will continue as the officers of Exelon following completion of the merger with such substitutions, additions and deletions as will be determined by the Chief Executive Officer of Exelon, in consultation with the Chief Executive Officer of PSEG, and approved by the Exelon board of directors.

***PSEG Director and Executive Officer Stock Options and Equity-Based Awards***

*Substitution of Current PSEG Stock Options and Equity-Based Awards*

Upon completion of the merger, each PSEG stock option which is outstanding pursuant to the PSEG 1989, 2001 and 2004 Long-Term Incentive Plans will be assumed by Exelon and substituted with an option to purchase the number of shares of Exelon common stock determined by multiplying (1) the number of shares of PSEG common stock subject to such PSEG stock option immediately prior to completion of the merger by (2) the exchange ratio of 1.225, at an exercise price per share of Exelon common stock equal to the exercise price per share of PSEG common stock under such PSEG stock option immediately prior to completion of the merger divided by the exchange ratio. Thereafter, except as provided in this paragraph and the accelerated vesting of certain stock options as described below, each substituted Exelon stock option will be exercisable on the same terms and conditions that applied before the merger.

Upon completion of the merger, all PSEG equity-based awards will be assumed by Exelon and substituted with a right or award with respect to shares of Exelon common stock on the same terms and conditions as were applicable under the PSEG equity-based award, including all repurchase and forfeiture rights held by PSEG. The number of shares of Exelon common stock issuable under those equity-based awards will be adjusted to take into account the exchange ratio.

The table below shows the number of PSEG stock options and equity-based awards held by the directors and executive officers of PSEG as of April 30, 2005 and the total number of substitute Exelon stock options and substitute Exelon equity-based awards the directors and executive officers of PSEG

will receive in substitution for such PSEG stock options and equity-based awards upon completion of the merger.

**SUBSTITUTE STOCK OPTIONS AND SUBSTITUTE EQUITY-BASED AWARDS**

| | PSEG Stock Options Pre-Merger | Exelon Stock Options Post-Merger | PSEG Restricted Shares Pre-Merger | Exelon Restricted Shares Post-Merger |
|---|---|---|---|---|
| **Executive Officer** | | | | |
| E. James Ferland | 1,566,000 | 1,918,350 | 109,800(1) | 134,505 |
| Thomas M. O'Flynn | 506,333 | 620,257 | 17,167 | 21,029 |
| Ralph Izzo | 354,667 | 434,467 | 19,667 | 24,092 |
| Frank Cassidy | 693,000 | 848,925 | 17,167 | 21,029 |
| Robert J. Dougherty | 618,000 | 757,050 | 17,167 | 21,029 |
| R. Edwin Selover | 227,000 | 278,075 | 11,300 | 13,842 |
| Patricia A. Rado | 64,266 | 78,725 | 3,933 | 4,817 |
| Robert E. Busch | 365,000 | 447,125 | 9,500 | 11,637 |
| **Total:** | 4,394,266 | 5,382,974 | 205,701 | 251,980 |

(1) Includes 30,000 shares of restricted stock awarded to Mr. Ferland under Mr. Ferland's employment agreement.

As of April 30, 2005, there were 5,796,645 shares of PSEG common stock subject to PSEG stock options with a weighted average exercise price of $40.48, of which options with respect to 4,147,512 shares of PSEG common stock were vested as of that date. Of the remaining 1,649,133 unvested PSEG stock options, options with respect to 901,596 shares of PSEG common stock, with a weighted average exercise price of $36.55, are scheduled to vest in accordance with their terms prior to December 31, 2005. Of the 747,537 balance of unvested PSEG stock options, options with respect to 435,429 shares of PSEG common stock, with a weighted average exercise price of $42.79, will vest as a result of the approval by PSEG shareholders of the merger agreement or the completion of the merger.

*Lapse of Restrictions on Director Restricted Shares*

If following consummation of the merger, any member of the PSEG board of directors (other than Mr. Ferland) ceases to be a director of PSEG, or Exelon as its successor, all restrictions on such member's restricted shares will immediately lapse and be of no effect. As of January 1, 2005, the members of the PSEG board of directors (other than Mr. Ferland) collectively held 28,800 shares of restricted PSEG common stock.

*Acceleration of Executive Officer PSEG Stock Options Granted Pursuant to Employment Agreements*

Employment agreements with certain executive officers of PSEG, other than Mr. Ferland, provide for accelerated vesting of their PSEG stock options granted pursuant to the employment agreements in certain circumstances. If, during the term of the employment agreement, there occurs a change in control of PSEG or the PSEG shareholders approve an agreement to effect a change in control of PSEG, the executive officer's right to his PSEG stock options granted pursuant to the agreement will vest and become exercisable as of the date of such change in control or approval. Accordingly if the PSEG shareholders approve the merger agreement, whether or not the merger is completed, the outstanding PSEG stock options subject to these employment agreements (other than Mr. Ferland's whose options will vest as described elsewhere in this section and Mr. Izzo's whose options will vest upon completion of the merger) will vest.

As of April 30, 2005, PSEG executive officers with employment agreements held options with accelerated vesting provisions to acquire an aggregate of 450,000 shares of PSEG common stock at a weighted average exercise price of $43.237. The following chart sets forth as of April 30, 2005 the aggregate number of stock options granted pursuant to these employment agreements held by executive officers of PSEG that will become exercisable upon approval of the merger agreement by PSEG shareholders (or in the case of Mr. Izzo, upon completion of the merger) and the weighted average exercise price of those stock options. Each executive officer may hold additional PSEG stock options that are already exercisable or which were not granted pursuant to his employment agreement and with respect to which vesting will not accelerate upon approval of the merger by PSEG shareholders. Such PSEG stock options are not reflected in this chart.

**STOCK OPTIONS SUBJECT TO ACCELERATION UNDER EMPLOYMENT AGREEMENTS**

| Executive Officer | Number of Stock Options to Become Exercisable | Weighted Average Exercise Price |
|---|---|---|
| Thomas M. O'Flynn | 100,000 | $ 45.85 |
| Ralph Izzo | 200,000 | $ 40.77 |
| Frank Cassidy | 50,000 | $ 44.0625 |
| Robert J. Dougherty | 50,000 | $ 44.0625 |
| Robert E. Busch | 50,000 | $ 46.23 |
| **Total:** | 450,000 | $ 43.237 |

***Acceleration of PSEG Stock Options and Equity-Based Awards Under Long-Term Incentive Plans***

Certain executive officers of PSEG have received grants of PSEG stock options, dividend equivalents and performance units under PSEG's 2001 Long-Term Incentive Plan and 2004 Long-Term Incentive Plan, the vesting of which may accelerate following completion of the merger under the circumstances described below.

*2001 and 2004 Long-Term Incentive Plans.* Under the terms of the 2001 LTIP, if after a change in control occurs, the officer's employment is terminated, all outstanding options, dividend equivalents and performance shares granted thereunder will immediately vest and become fully exercisable. Under the terms of the 2004 LTIP, if an officer is terminated within 18 months following a change in control, other than a termination for "cause," his or her equity-based awards (other than stock options, stock appreciation rights and performance units, the treatment of which is described below) will vest. The merger constitutes a change in control under the LTIPs. Accordingly, if following completion of the merger any officer of PSEG is terminated at any time, in the case of the 2001 LTIP, or within 18 months after completion of the merger, in the case of the 2004 LTIP (and only if not for cause), his or her options, dividend equivalents and performance units under the 2001 LTIP will vest and his or her other equity-based awards under the 2004 LTIP will vest. The following chart sets forth as of

April 30, 2005, the number of stock options granted to executive officers of PSEG under the 2001 LTIP, the vesting of which will accelerate if such executive is terminated as described above.

**2001 LTIP STOCK OPTIONS**
**SUBJECT TO ACCELERATION UPON TERMINATION**

| Executive Officer | PSEG Stock Options |
|---|---|
| E. James Ferland | 116,667 |
| Thomas M. O'Flynn | 43,333 |
| Ralph Izzo | 11,667 |
| Frank Cassidy | 93,333 |
| Robert J. Dougherty | 43,333 |
| R. Edwin Selover | 26,667 |
| Patricia A. Rado | 8,333 |
| Robert E. Busch | 21,667 |
| **Total:** | 365,000 |

The 2004 LTIP also provides for the granting of other equity-based awards as described above. As of April 30, 2005, however, no such awards have been granted other than performance units, the treatment of which is described below under " 2004 Long-Term Incentive Plan Performance Units."

*2004 Long-Term Incentive Plan Stock Options and Stock Appreciation Rights.* Under the terms of the 2004 LTIP, upon a change in control, all outstanding PSEG stock options and stock appreciation rights granted under the 2004 LTIP will immediately vest and become fully exercisable. The merger constitutes a change in control under the 2004 LTIP. The following chart sets forth as of April 30, 2005, the number of PSEG stock options granted to executive officers of PSEG under the 2004 LTIP, the vesting of which will accelerate upon completion of the merger. As of April 30, 2005, no SARs have been granted.

**2004 LTIP STOCK OPTIONS SUBJECT TO ACCELERATION**

| Executive Officer | PSEG Stock Options |
|---|---|
| E. James Ferland | 90,000 |
| Thomas M. O'Flynn | 22,000 |
| Ralph Izzo | 22,000 |
| Frank Cassidy | 22,000 |
| Robert J. Dougherty | 22,000 |
| R. Edwin Selover | 14,667 |
| Patricia A. Rado | 5,067 |
| Robert E. Busch | 13,333 |
| **Total:** | 211,067 |

*2004 Long-Term Incentive Plan Performance Units.* Under the terms of the 2004 LTIP, if a change in control occurs after performance units have been granted but before completion of the performance period, a pro rata portion of such performance award will become payable as of the date of the change in control to the extent otherwise earned on the basis of achievement of the pro rata portion of the performance goals relating to the portion of the performance period completed as of the date of the change in control. As of April 30, 2005, all performance units granted under the 2004 LTIP are subject to a three-year performance period that expires December 31, 2006. Based upon the assumptions described in the following paragraph, PSEG currently estimates that the aggregate value of the payments to executive officers of PSEG following completion of the merger in connection with the

acceleration of vesting of outstanding performance shares under the 2004 LTIP will be approximately $2.9 million.

The following chart sets forth the amounts of the estimated value of the payments to be made to each executive officer of PSEG following completion of the merger in connection with the acceleration of vesting of outstanding performance units, assuming that the merger is completed at the beginning of the second quarter of 2006 and assuming that each PSEG performance unit has a value of $51.28 when the merger is completed (based on the $41.86 per share closing price of Exelon common stock on the last trading day preceding the announcement of the merger multiplied by the exchange ratio). If the merger is completed after such time, the value of the payments may be greater since the calculation under the plan factors in the length of time in the performance period that has elapsed prior to completion of the merger. The value may also be higher or lower than these estimates depending upon the market value of Exelon common stock when the merger is completed.

**2004 LTIP PERFORMANCE UNITS**

| Executive Officer | Estimated Value of Aggregate Payment(1) |
|---|---|
| E. James Ferland | $ 1,245,878 |
| Thomas M. O'Flynn | 308,664 |
| Ralph Izzo | 308,664 |
| Frank Cassidy | 308,664 |
| Robert J. Dougherty | 308,664 |
| R. Edwin Selover | 185,198 |
| Patricia A. Rado | 70,151 |
| Robert E. Busch | 168,362 |
| **Total:** | $ 2,904,245 |

(1) Assumes performance is at 100% of goal.

***Severance Agreements with Executive Officers***

Pursuant to the second amendment to his employment agreement with PSEG, if Mr. Ferland retires at the expiration of his employment period, March 31, 2007, he will be paid the following in a lump sum of cash within 30 days of the date of such retirement:

- his annual base salary through the date of retirement;
- a pro rata portion of his target annual bonus; and
- any accrued vacation pay.

In addition, all outstanding stock options and equity-based awards (including stock options and equity-based awards granted following completion of the merger) will immediately vest and become fully exercisable.

The employment agreements of Messrs. Ferland, O'Flynn, Cassidy, Dougherty, Izzo and Busch and the PSEG Key Executive Severance Plan, which covers 30 officers including Ms. Patricia A. Rado, and one executive officer, Mr. R. Edwin Selover, who do not currently have individual employment agreements, provide severance benefits for a termination by PSEG without "cause" or by the executive officer for "good reason" that occurs at any time after a change in control (or in the case of Mr. Izzo's employment agreement and the severance plan, within two years after a change in control). The merger will constitute a change in control under the agreements and the severance plan.

Specifically, if a covered executive officer's employment were terminated following completion of the merger without cause or the executive resigned for good reason, the executive officer would be entitled to:

- three times the sum of his or her annual salary and target bonus;

- continuation of welfare benefits for the longer of three years or the duration provided by the terms of the applicable plan, unless sooner reemployed;

- a lump sum payment equal to the difference of the actuarial equivalent of the officer's benefits under all of PSEG's defined benefit retirement plans in which the officer participates calculated as though the officer remained employed for three years beyond the date his or her employment terminates over the actuarial equivalent of such benefits on the date his or her employment terminates; and

- a gross-up for excise taxes on any termination payments due under the Internal Revenue Code.

In addition, under the severance plan, the executive officer would be entitled to a pro rata portion of his or her annual salary and target bonus, accelerated vesting of his or her PSEG stock options and other equity-based awards, vesting of any compensation previously deferred and a year of outplacement services. These benefits are also provided for under the employment agreements upon a termination without cause or the resignation of the executive officer for good reason; however, under the employment agreements they are available whether or not a change in control has occurred.

The other officers covered under the severance plan, including Ms. Rado, will receive the same benefits described above except the amounts under the three bullets will be two times and two years rather than three times and three years and they are not entitled to the excise tax gross-up.

The following chart sets forth, as of April 30, 2005, the estimated termination payments that would be payable to each executive if, following completion of the merger, the executive's employment were terminated without cause or the executive resigned for good reason within the applicable time frames. The salary, bonus and incentive awards for an executive may be increased from time to time subsequent to March 15, 2005 (including following completion of the merger), which would in turn increase the aggregate termination payments.

**SEVERANCE PAYMENTS UPON TERMINATION FOLLOWING THE MERGER**

| Executive Officer | 3 X (Base Salary + Target Bonus) | Lump Sum Retirement Plan Payment | Aggregate Termination Payments |
|---|---|---|---|
| E. James Ferland(1) | $ 6,480,000 | $ 0 | $ 6,480,000 |
| Thomas M. O'Flynn(2) | 2,568,000 | 1,848,000 | 4,416,000 |
| Ralph Izzo | 2,400,000 | 242,000 | 2,642,000 |
| Frank Cassidy | 2,520,000 | 0 | 2,520,000 |
| Robert J. Dougherty | 2,808,000 | 0 | 2,808,000 |
| R. Edwin Selover | 2,070,000 | 0 | 2,070,000 |
| Patricia A. Rado(3) | 742,500 | 0 | 742,500 |
| Robert E. Busch | 1,777,500 | 33,000 | 1,810,500 |

(1) Under the second amendment to his employment agreement, Mr. Ferland agreed to waive his right to resign for "good reason" and to be paid any severance as a result of the merger and the change in his responsibilities and agreed that the change in his responsibilities following completion of the merger will not constitute "good reason" or the termination of his employment without "cause."

(2) Mr. O'Flynn's employment agreement provides that, upon completion of five years of service with PSEG (July 1, 2006), Mr. O'Flynn will be granted 15 years of pension credit in respect of his prior service.

(3) Ms. Rado's severance payments are 2x (Base Salary + Target Bonus).

Under the second amendment to Mr. Ferland's employment agreement, "cause" is defined as any of the following:

- the willful and continued failure by Mr. Ferland to substantially perform his duties under the agreement;
- the willful engaging by Mr. Ferland in gross misconduct which is materially and demonstrably injurious to PSEG; or
- the conviction of Mr. Ferland of a felony,

and following a change in control, "good reason" is defined as any of the following:

- any reduction in his annual base salary, target annual bonus, target long-term incentive, or retirement benefit;
- the failure of the PSEG board of directors (or Exelon board of directors following completion of the merger) to nominate Mr. Ferland for reelection to the PSEG board of directors (or the Exelon board of directors following completion of the merger) at any annual meeting during the term of his employment agreement at which his term is scheduled to expire, and if elected a director, to elect Mr. Ferland as Chairman of the PSEG board of directors (or the Exelon board of directors following completion of the merger);
- any requirement that Mr. Ferland's service be rendered primarily at a location or locations other than in New Jersey;
- any purported termination of Mr. Ferland's employment for a reason or in a manner not expressly permitted by his employment agreement;
- any failure by PSEG to require a successor to expressly assume and agree to perform under the employment agreement; or
- any other material breach of the employment agreement by PSEG that either is not taken in good faith or, even if taken in good faith, is not remedied by PSEG promptly after receipt of notice thereof from Mr. Ferland.

Under Mr. O'Flynn's employment agreement, "cause" is defined as any of the following:

- the willful and continued failure by Mr. O'Flynn to substantially perform his duties under the agreement;
- the willful engaging by Mr. O'Flynn in gross misconduct which is materially and demonstrably injurious to PSEG; or
- the conviction of Mr. O'Flynn of a felony,

and "good reason" is defined as any of the following:

- any reduction in his annual base salary, target annual incentive, target long-term incentive, or retirement benefit;
- any adverse change in his title, authority, duties, responsibilities and reporting lines or the assignment to him of any duties or responsibilities inconsistent in any respect with those customarily associated with the position of the chief financial officer;
- any requirement that he move his principal place of employment more than 50 miles from Newark, New Jersey;

termination of his employment agreement at the expiration of its term as a result of PSEG not renewing the employment agreement;

- any purported termination of his employment by PSEG for a reason or in a manner not expressly permitted by his employment agreement;

- any failure by PSEG to require a successor to expressly assume and agree to perform under the employment agreement; or

- any other material breach of the employment agreement by PSEG that either is not taken in good faith or, even if taken in good faith, is not remedied by PSEG promptly after receipt of notice thereof from him.

"Cause" under the other employment agreements and under the severance plan is defined as:

- the willful and continued failure by the executive officer to substantially perform his duties under the agreement;

- the willful engaging by the executive officer in gross misconduct which is materially and demonstrably injurious to PSEG; or

- the conviction of the executive officer of a felony.

In addition, under Mr. Izzo's employment agreement and the severance plan, "cause" further includes the willful conduct by the executive officer in violation of PSEG's Standards of Integrity.

"Good reason" under the other employment agreements and the severance plan is defined as:

- any reduction in the executive officer's annual base salary, target annual incentive, target long-term incentive below the market norm, or retirement benefit (except, in the case of Mr. Izzo, any reduction in the target annual incentive or target long-term incentive that applies to all similarly situated executives);

- any adverse change in the executive officer's title, authority, duties, responsibilities and reporting lines or the assignment to him or her of any duties or responsibilities inconsistent with those customarily associated with the position of such officer;

- any failure by PSEG to require a successor to expressly assume and agree to perform under the employment agreement or the plan; or

- any other material breach of the employment agreement or the plan by PSEG that either is not taken in good faith or, even if taken in good faith, is not remedied by PSEG promptly after receipt of notice thereof from the executive officer.

In addition under the employment agreements, "good reason" includes any purported termination of the executive officer's employment by PSEG for a reason or in a manner not expressly permitted by his employment agreement.

***Retention Program***

In connection with the execution of the merger agreement, PSEG adopted a Retention Program for Key Employees of Public Service Enterprise Group Incorporated. The program provides for payments to be made to certain officers and key employees of PSEG who remain employed from the date of the merger agreement through the date that is 90 days after completion of the merger, subject to an aggregate limit of $10 million. Under the program, the organization and compensation committee of the PSEG board of directors will select any officers that may receive retention payments under the program. The committee will determine the amount of each officer's retention payment. The amount of an officer's retention payment may not be less than 40% or more than 150% of his or her annual base salary. PSEG currently does not intend to grant awards to any officers under the program.

***Directors and Executive Officers Indemnification and Insurance***

*Indemnification and Insurance.* Subject to applicable laws, Exelon has agreed that after completion of the merger:

- all rights of current or former directors, officers, employees, agents or fiduciaries under benefit plans currently indemnified by PSEG or its subsidiaries will survive;
- any such person who becomes a director, officer, employee or fiduciary under a benefit plan of Exelon will be entitled to the indemnity rights and protections afforded to Exelon's directors, officers, employees and fiduciaries under benefit plans;
- it will advance expenses so long as such person has provided an undertaking to repay such advances if it is ultimately determined that such expenses cannot be reimbursed; and
- for a period of six years following consummation of the merger, it will maintain officers' and directors' liability insurance at least as favorable as PSEG's existing insurance so long as the annual premium for the insurance does not exceed 200% of the last annual premium that PSEG paid prior to the date of the merger agreement. If the annual premium of PSEG's existing insurance policy exceeds the 200% limitation, Exelon will maintain the maximum amount of coverage under a policy having the same deductible as is available for such 200% of PSEG's current annual premium.

**Certain Relationships Between Exelon and PSEG; Operating Services Contract**

PSEG Nuclear and Exelon Generation jointly own the Salem and Peach Bottom nuclear generation stations. Under the Salem co-owners agreement dated November 24, 1971, as amended, Exelon Generation owns 42.59% and PSEG Nuclear owns 57.41% of Salem Units 1, 2 and 3. PSEG Nuclear is responsible for operation of the Salem Units. Exelon Generation and PSEG Nuclear each own 50% of the Peach Bottom Units. Exelon Generation is responsible for operation of the Peach Bottom Units.

Concurrently with the execution of the merger agreement by Exelon and PSEG, Exelon Generation and PSEG Nuclear entered into an operating services contract relating to the provision of operating services by Exelon Generation in respect of PSEG Nuclear's Salem and Hope Creek nuclear generating facilities. The operating services contract provides that Exelon Generation will provide a chief nuclear officer and other key personnel to oversee daily plant operations at the Hope Creek and Salem nuclear generating facilities and to implement the Exelon Nuclear Management Model, which defines practices that Exelon has used to manage its own nuclear performance improvement program. Until completion of the merger, PSEG Nuclear will continue as the license holder with exclusive legal authority to operate and maintain the facilities, will retain responsibility for management oversight and will have full authority with respect to the marketing of its share of the output from the nuclear generating facilities. Exelon Generation will be entitled to receive reimbursement of its costs in discharging its obligations, an annual operating services fee and incentive fees based on attainment of goals relating to safety, capacity factors of the plants and operation and maintenance expenses. The operating services contract has a term of two years, subject to earlier termination in certain events upon prior notice, including any termination of the merger agreement. In the event of termination, Exelon Generation will continue to provide services under the operating services contract for a transition period of at least 180 days and up to two years at the election of PSEG Nuclear. This period may be further extended by PSEG Nuclear for up to an additional 12 months if PSEG Nuclear determines that additional time is necessary to complete required activities during the transition period.

The foregoing description of the operating services contract is qualified in its entirety by reference to the full text of the operating services contract which is filed as an exhibit to Exelon's Current Report on Form 8-K filed with the SEC on December 21, 2004.

**Accounting Treatment**

The merger will be accounted for as a purchase by Exelon under accounting principles generally accepted in the United States. Under the purchase method of accounting, the assets and liabilities of PSEG will be recorded, as of completion of the merger, at their respective fair values and added to those of Exelon. The reported financial condition and results of operations of Exelon issued after completion of the merger will reflect PSEG's balances and results after completion of the merger, but will not be restated retroactively to reflect the historical financial position or results of operations of PSEG. Following completion of the merger, the earnings of the combined company will reflect purchase accounting adjustments, including increased amortization and depreciation expense for acquired assets.

**Material United States Federal Income Tax Consequences of the Merger**

*General.* The following discussion addresses the material United States federal income tax consequences of the exchange of shares of PSEG common stock for shares of Exelon common stock pursuant to the merger. This discussion, insofar as it relates to United States federal income tax law and legal conclusions with respect thereto, represents the opinion of each of Sidley Austin Brown & Wood LLP, legal counsel to Exelon, and Pillsbury Winthrop Shaw Pittman LLP, legal counsel to PSEG. The opinions of counsel are based, in part, upon customary written factual representations received from Exelon and PSEG, which factual representations counsel has assumed to be true and correct.

The following discussion is not binding on the IRS. It is based on the Internal Revenue Code, applicable United States Treasury regulations, administrative interpretations and court decisions, each as in effect as of the date of this joint proxy statement/prospectus and all of which are subject to change, possibly with retroactive effect. The tax consequences under foreign laws, United States state and local laws and United States federal laws other than United States federal income tax laws are not addressed.

This discussion addresses only those holders of shares of PSEG common stock that hold their shares as capital assets and does not address all aspects of United States federal income taxation that might be relevant to a holder of shares of PSEG common stock in light of that shareholder's particular circumstances or to a shareholder subject to special rules, such as:

- a shareholder that is not a citizen or resident of the United States for United States federal income tax purposes and otherwise not a "United States person" for United States federal income tax purposes;
- a financial institution or insurance company;
- a mutual fund;
- a tax-exempt organization;
- a broker or dealer in securities or foreign currencies;
- a trader in securities that elects to apply a mark-to-market method of accounting;
- a shareholder that holds its PSEG common stock as part of a hedge, appreciated financial position, straddle or conversion transaction; or
- a shareholder that acquired its PSEG common stock pursuant to the exercise of options or otherwise as compensation.

If a partnership holds shares of PSEG common stock, the United States federal income tax treatment of a partner generally will depend on the status of the partner and the activities of the

partnership. Partners of a partnership that holds shares of PSEG common stock should consult their tax advisors.

Holders of shares of PSEG common stock are urged to consult their tax advisors as to the specific tax consequences to them of the merger, including the applicability and effect of federal, state, local and foreign income and other tax laws in light of their particular circumstances.

*United States Federal Income Tax Consequences of the Merger.* Each of Sidley Austin Brown & Wood LLP, legal counsel to Exelon, and Pillsbury Winthrop Shaw Pittman LLP, legal counsel to PSEG, has delivered its opinion which provides that the merger will be treated for United States federal income tax purposes as a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code and that each of Exelon and PSEG will be a party to the reorganization within the meaning of Section 368(b) of the Internal Revenue Code. Assuming that the foregoing opinions are correct, the following are the material United States federal income tax consequences of the exchange of shares of PSEG common stock pursuant to the merger:

- a holder of shares of PSEG common stock will not recognize any gain or loss upon the exchange of the holder's shares of PSEG common stock for shares of Exelon common stock pursuant to the merger, except that gain or loss will be recognized on the receipt of cash in lieu of a fractional share of Exelon common stock;

- a holder of shares of PSEG common stock will have a tax basis in the shares of Exelon common stock received pursuant to the merger equal to the tax basis of the shares of PSEG common stock surrendered by the shareholder pursuant to the merger, reduced by any tax basis of the shares of PSEG common stock surrendered pursuant to the merger that is allocable to a fractional share of Exelon common stock for which cash is received;

- the holding period for shares of Exelon common stock received in exchange for shares of PSEG common stock pursuant to the merger will include the holding period for the shares of PSEG common stock surrendered in exchange for shares of Exelon common stock; and

- to the extent that a holder of shares of PSEG common stock receives cash in lieu of a fractional share of Exelon common stock, the shareholder will be required to recognize gain or loss equal to the difference between (1) the amount of cash received and (2) the tax basis of the shares of PSEG common stock surrendered pursuant to the merger that is allocable to the fractional share of Exelon common stock for which cash is received. This gain or loss will be capital gain or loss and will be long-term capital gain or loss if the holding period for the PSEG common stock exchanged for the fractional share of Exelon common stock is more than one year at the completion of the merger.

It is a condition to the obligation of each of Exelon and PSEG to complete the merger that, at the closing of the merger, it receive a separate opinion of Sidley Austin Brown & Wood LLP, legal counsel to Exelon, and Pillsbury Winthrop Shaw Pittman LLP, legal counsel to PSEG, respectively (or, in either case, another law firm of national standing), substantially to the same effect as the opinions described above. Neither Exelon nor PSEG intends to waive this condition.

Each of the opinions described above is or will be based, in part, on customary assumptions and representations that have been or will be received from Exelon and PSEG, including those contained in the merger agreement and in certificates of officers of Exelon and PSEG, each of which must be accurate as of the effective time of the merger. If any of those assumptions or representations is inaccurate as of the effective time of the merger, the tax consequences of the merger could differ materially from those described in this joint proxy statement/prospectus.

Opinions of counsel neither bind the IRS or any court, nor preclude the IRS from adopting a contrary position. No ruling has been or will be sought from the IRS on the tax consequences of the

merger, and no assurance can be given that the IRS will not take, or that a court will not sustain, a position contrary to any of the tax consequences set forth above.

This discussion does not address tax consequences that may vary with, or are contingent on, individual circumstances. In addition, it does not address any non-income tax or any foreign, state or local tax consequences of the merger. **Accordingly, we urge each holder of shares of PSEG common stock to consult the holder's tax advisor to determine the particular federal, state, local or foreign income or other tax consequences of the merger to that shareholder.**

**Regulatory Matters Relating to the Merger**

***General***

To complete the merger, we need to obtain approvals or consents from, or make filings with a number of United States federal and state public utility, antitrust and other regulatory authorities as well as authorities in various foreign jurisdictions. The material United States federal and state approvals, consents and filings are described below. Additional approvals, including the approval of various foreign governmental authorities which may be required in connection with the indirect transfer of PSEG Global, may be required to complete the merger. We have also made it a condition to each party's obligation to complete the merger that certain orders or approvals not required by law are obtained. These approvals are collectively referred to in this joint proxy statement/prospectus as the "required statutory approvals."

It is a condition to consummation of the merger that "*final orders*" are obtained for these approvals and that such orders do not constitute "*burdensome orders*" (see "The Merger Agreement  Covenants" for a description of these terms). The merger agreement provides for a regulatory approval team to formulate the approach with respect to obtaining these approvals. The composition and authority of the regulatory approval team is described in greater detail under "The Merger Agreement  Covenants."

While we believe that we will receive the required statutory approvals and other clearances for the merger, there can be no assurance as to the timing of these approvals and clearances or our ability to obtain these approvals and clearances on satisfactory terms or otherwise. There can be no assurance that any of these approvals will be obtained or, if obtained, will not contain terms or conditions that could reasonably be expected to have a material adverse effect on the combined company following completion of the merger. Based on the current status of the regulatory approval process, the parties expect that, assuming all other conditions to completion of the merger are satisfied, the merger should be completed in the first quarter of 2006 if the regulatory proceedings before the New Jersey Board of Public Utilities and the Pennsylvania Public Utility Commission are settled and approved before the dates on which those state authorities are expected to rule on the merger in the absence of settlement, as discussed below. If early settlements are not reached and approved, then the parties expect that, assuming all other conditions are satisfied, the merger should be completed in the second quarter of 2006. If FERC were to hold a hearing on the application relating to the merger, the anticipated closing would be extended into mid-2006 or perhaps later.

***State Approvals***

*New Jersey Board of Public Utilities.* As a utility in the State of New Jersey, PSE&G is subject to the jurisdiction of the New Jersey Board of Public Utilities. Under Section 48:2-51.1 of New Jersey's public utility law, the NJBPU's approval is required in connection with the indirect transfer of the capital stock of PSE&G resulting from the merger. In considering the merger, the NJBPU is required to evaluate the impact of the merger in four areas:

- competition;

the rates of ratepayers affected by the merger;

the employees of the affected public utility; and

the provision of safe and adequate utility service at just and reasonable rates.

On February 4, 2005, Exelon and PSE&G made the initial filing of their joint application with the NJBPU for approval of the indirect transfer of the capital stock of PSE&G resulting from the merger. On April 5, 2005, the administrative law judge in the proceeding before the NJBPU issued a prehearing order establishing a timetable for the regulatory approval process in New Jersey. The order provides for the administrative law judge to issue an initial decision by February 26, 2006. Thereafter, pursuant to the provision of the New Jersey Administrative Procedure Act, a decision of the full NJBPU can be expected by approximately March 23, 2006. The procedural schedule resulted from an agreement among Exelon, PSEG, the NJBPU staff, and the New Jersey Ratepayer Advocate pertaining to the procedural schedule to be followed during the course of the administrative process before the NJBPU.

In addition, while not required by law to complete the merger, Exelon and PSEG have made it a condition to the merger that PSE&G receive an order from the NJBPU allowing PSE&G to defer certain pension and other post-retirement benefit expenses that will be recognized in connection with the purchase accounting treatment of the merger, and that provides that PSE&G's rate recovery of pension and other post-retirement benefits will be calculated consistently with recovery of such amounts in the absence of the merger. For a description of this matter, see "Risk Factors Risks Relating to the Merger The combined company may be unable to obtain permission from the NJBPU to recover PSE&G's pension and other post-retirement benefit expenses, which could have an adverse effect on its cash flow and results of operations." On February 4, 2005, Exelon and PSE&G made the initial filing of their joint application with the NJBPU to obtain the order. The schedule for receiving this order is the same as that for the NJBPU's ruling on the merger.

*New Jersey Department of Environmental Protection.* Subsidiaries of PSEG own properties in New Jersey that may be subject to the New Jersey Industrial Site Recovery Act. The indirect transfer of those properties in connection with the merger may require approval by the NJDEP under ISRA. It is a condition to the completion of the merger that it be determined ISRA does not apply to the transfers or that the parties otherwise comply with the requirements of ISRA. The parties filed their application for a letter of non-applicability on March 31, 2005.

*New York Public Service Commission.* As an owner of generation facilities in the State of New York, a subsidiary of PSEG Power is subject to the jurisdiction of the New York Public Service Commission. Under Section 70 of the New York Public Service Law, the NYPSC's written consent is required in connection with the indirect transfer of ownership interests in such subsidiary of PSEG Power in connection with the merger. Under Section 70 of the New York Public Service Law, the NYPSC must determine whether the merger is in the public interest. The parties filed their application for approval with the NYPSC on March 16, 2005.

*Pennsylvania Public Utility Commission.* PECO and PSE&G are subject to the jurisdiction of the Pennsylvania Public Utility Commission. The issuance to each of PECO and PSE&G of a certificate of public convenience and necessity by the PPUC may be required as a result of the indirect transfer of the capital stock of PSE&G in connection with the merger under Chapters 11, 22 and 28 of the Public Utility Code of Pennsylvania. The standard for approval is whether the transaction is necessary and proper for the service, accommodation, convenience or safety of the public. This standard has been applied by the PPUC to require that applicants demonstrate that the transaction will affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way. In

addition, under provisions enacted as part of Pennsylvania's electric and natural gas restructuring legislation, the PPUC must consider:

- whether a proposed transaction is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which would prevent retail electric or natural gas customers in Pennsylvania from obtaining the benefits of a properly functioning and workable competitive retail electric or natural gas market; and

- the effect of the proposed transaction on the natural gas distribution company employees and any authorized collective bargaining agent.

On February 4, 2005, PECO and PSE&G made the initial filing of their joint application for approval by the PPUC under the Public Utility Code of Pennsylvania or a determination that Chapters 11, 22 and 28 are not applicable to the merger. On March 30, 2005, the administrative law judge in the proceeding before the PPUC issued a prehearing order establishing a timetable for the regulatory approval process in Pennsylvania, which provides for the administrative law judge to issue an initial decision on November 7, 2005. Thereafter, a decision of the full PPUC can be expected in December 2005 or January 2006. The procedural schedule resulted from an agreement among Exelon, PSEG, and numerous parties in the case, including the PPUC Office of Trial Staff and the Pennsylvania Office of Consumer Advocate.

*Illinois Commerce Commission.* ComEd has filed a notice with respect to the merger with the Illinois Commerce Commission. On February 23, 2005, at a meeting of its Electricity Policy Committee, the ICC's General Counsel confirmed that it does not have jurisdiction over the matter and its approval is not required for the merger.

*Connecticut.* As the owner of generation stations in the State of Connecticut, PSEG Power Connecticut LLC, an indirect subsidiary of PSEG Power, is subject to the jurisdiction of the Connecticut Siting Council under Connecticut public utility laws and the Connecticut Department of Environmental Protection under Connecticut environmental law. The indirect transfer of the ownership interests in these entities may require the approval of the Connecticut Department of Environmental Protection under Connecticut environmental law and will require the approval of the Connecticut Siting Council under Connecticut public utility laws. The parties received approval on March 16, 2005 from the CSC.

***Public Utility Holding Company Act***

Exelon is a registered holding company under PUHCA subject to the jurisdiction of the SEC thereunder. Exelon's acquisition of 100% of the common stock of PSEG will require approval by the SEC under Sections 9 and 10 of PUHCA.

Under the applicable standards of PUHCA, the SEC is directed to approve the merger unless it finds that:

- the merger would tend towards interlocking relations or a concentration of control detrimental to the public interest or the interest of investors or consumers;

- the consideration to be paid in connection with the merger is not reasonable; or

- the merger would unduly complicate the capital structure of Exelon's holding company system or would be detrimental to the public interest, the interest of investors or consumers or the proper functioning of Exelon's holding company system.

To approve the merger, the SEC must also find that the merger complies with state law, tends towards the economic and efficient development of an integrated public utility system and otherwise

conforms to PUHCA's integration and corporate simplification standards. The parties filed their application with the SEC on March 16, 2005.

In addition, SEC approval may be required under PUHCA in order for Exelon to own certain assets of PSEG Energy Holdings following completion of the merger.

***Nuclear Regulatory Commission***

PSEG Power holds a NRC operating license for its Salem and Hope Creek nuclear generating facilities. This license authorizes PSEG Power to own and/or operate its nuclear generating facilities. The Atomic Energy Act provides that a license may not be transferred or, in any manner disposed of, directly or indirectly, through transfer of control of any license unless the NRC finds that the transfer complies with the Atomic Energy Act and consents to the transfer. Therefore, the consent of the NRC is required for the transfer of control pursuant to the merger of the license held by PSEG Power. The NRC will consent to the transfer if it determines that:

- the proposed transferee is qualified to be the holder of the license; and
- the transfer of the license is otherwise consistent with applicable provisions of laws, regulations and orders of the NRC.

The parties filed their application with the NRC on March 8, 2005.

***Federal Energy Regulatory Commission***

Each of Exelon and PSEG has public utility subsidiaries subject to the jurisdictions of FERC under the Federal Power Act. Section 203 of the Federal Power Act provides that no public utility may sell or otherwise dispose of its jurisdictional facilities, directly or indirectly merge or consolidate its facilities with those of any other person, or acquire any security of any other public utility, without first having obtained authorization from FERC.

FERC has stated in its 1996 utility merger policy statement that, in analyzing a merger under Section 203, it will evaluate the following criteria:

- the effect of the merger on competition in wholesale electric power markets, utilizing an initial screening approach derived from the Department of Justice/Federal Trade Commission-Initial Merger Guidelines to determine if a merger will result in an increase in an applicant's market power;
- the effect of the merger on the applicants' FERC jurisdictional ratepayers; and
- the effect of the merger on state and federal regulation of the applicants.

On February 4, 2005 Exelon and PSEG made the initial filing of their application for approval with FERC. Included in the filing was the parties' market concentration mitigation plan. The market concentration mitigation plan submitted on February 4 contemplated (1) the divestiture of fossil fuel generating facilities with 2,900 MW of generating capacity and (2) the transfer of control of 2,600 MW of baseload nuclear capacity through either long-term firm baseload energy sales contracts or an annual auction referred to in this joint proxy statement/prospectus as a virtual divestiture. Approximately 50 intervenors, including governmental, consumer, industry and policy groups, intervened in the proceedings before FERC, approximately 20 of the intervenors filed protests, and several of those parties requested that FERC hold hearings on the proposed merger. On May 9, 2005, Exelon and PSEG filed a supplement to their February 4 filing with FERC, responding to objections and concerns raised by the intervenors. In the supplementary filing on May 9, Exelon and PSEG proposed that if FERC approved the merger without an evidentiary hearing, Exelon and PSEG would divest at least 1,100 MW of additional fossil fuel generation capacity. Exelon and PSEG also proposed to invest

approximately $25 million in new transmission projects over five years if the merger is approved by FERC without a hearing. Exelon and PSEG also proposed to eliminate restrictions on which entities may purchase divested generation and reduce the proposed period of time allowed for divestiture following the closing of the merger, and proposed an independent market monitor for the virtual divestitures. The divestitures of generation proposed in the May 9 filing with FERC, in combination with the 2,900 MW of fossil capacity divestiture and the 2,600 MW of baseload nuclear capacity virtual divestiture proposed in the February 4 filing, results in a total of 6,600 MW of capacity proposed for mitigation. Exelon and PSEG have not offered to divest any nuclear generating facilities and do not anticipate doing so.

Exelon and PSEG currently expect that the FERC schedule relating to approval under Section 203 will not impact the anticipated timing of closing of the merger. However, as indicated above, several intervenors in the FERC proceeding, including the NJBPU, have requested that FERC hold hearings on the application relating to the merger. If FERC were to hold hearings with respect to the merger the approval process would extend the anticipated closing into mid-2006 or perhaps later.

In addition, while not required by the Federal Power Act, Exelon and PSEG have made it a condition to completion of the merger that FERC approve under Section 205 of the Federal Power Act the sale by the public utility subsidiaries of the combined company of wholesale power and related services at market-based rates.

***Antitrust***

Under the provisions of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the merger cannot be completed until both Exelon and PSEG file a notification of the proposed transaction with the Antitrust Division of the United States Department of Justice and the Federal Trade Commission and the specified waiting periods have expired or been terminated. The parties filed the required notification on March 4, 2005. The parties have been informed that the Antitrust Division of the DOJ will review the case and FTC will not. On March 23, Exelon and PSEG received a letter from the Antitrust Division of the DOJ requesting additional information pertaining to the merger. Exelon and PSEG are in the process of responding to the request for additional information. The formal request for additional, specific information supplements information already provided in the original HSR filing. The DOJ request extends the waiting period under HSR, and the period of DOJ review of the proposed merger, for a period of 30 days after Exelon and PSEG provide the information requested by DOJ. The extension of the HSR waiting period is not expected to impact the anticipated closing date of the merger.

At any time before the merger is completed, either the Antitrust Division, or the FTC could challenge or seek to block the merger under the antitrust laws, as it deems necessary or desirable in the public interest. Other competition promoting agencies with jurisdiction over the merger could also initiate action to challenge or block the merger. In addition, in some jurisdictions, a competitor, customer or other third party could initiate a private action under the antitrust laws challenging or seeking to enjoin the merger, before or after it is completed. Based upon an examination of information available relating to the businesses in which the companies are engaged, Exelon and PSEG believe, with the market concentration mitigation plan they have proposed, that completion of the merger will not violate United States or applicable foreign antitrust laws. However, Exelon and PSEG cannot be sure that a challenge to the merger will not be made or that, if a challenge is made, Exelon and PSEG will prevail.

The merger may also be subject to review by the governmental authorities of various other jurisdictions under the antitrust laws of those jurisdictions.

There can be no assurance that the reviewing authorities will permit the applicable statutory waiting periods to expire or that the reviewing authorities will terminate the applicable statutory waiting

periods at all or without restrictions or conditions that would have a material adverse effect on the combined company if the merger were completed. These restrictions and conditions could include mandatory licenses, sales or other dispositions of assets, divestitures, or the holding separate of assets, businesses or PSEG capital stock.

***IRS Private Letter Ruling Regarding Nuclear Decommissioning Trust Funds***

United States Treasury regulations generally provide for the nonrecognition of gain or loss for United States federal income tax purposes with respect to the transfer of certain decommissioning trust funds maintained by nuclear power plant owners in connection with the transfer of an interest in a nuclear power plant. The precise application of these Treasury Regulations in the context of the merger, however, is not free from doubt. Therefore, Exelon and PSEG have agreed to seek a ruling from the IRS confirming that no gain or loss will be recognized for United States federal income tax purposes with respect to the transfer of PSEG's decommissioning trust funds as a result of the merger.

**Corporate Restructuring**

Subject to receipt of necessary regulatory approvals, Exelon and PSEG intend to pursue a restructuring of their corporate organizations after completion of the merger. In general, this restructuring will involve:

PSE&G becoming a diront-weight: bold"> ***(Dollars in thousands)*** Amount Rate Amount Rate Federal funds purchased $— 2.19% $— 1.82%Securities sold under agreements to repurchase 13,150 0.48% 22,844 0.41%Federal Discount Window — 2.19% — 1.71%Federal Home Loan
Bank 99,862 1.93% 3,452 1.16% $113,012 1.59% $26,296 0.97%

**Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”)**

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets.

As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability on the Corporation’s Consolidated Balance Sheets, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is not offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). The collateral is held by a correspondent bank in the counterparty’s custodial account. The counterparty has the right to sell or repledge the investment securities.

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The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreements as of June 30, 2018 and December 31, 2017.

| ***(Dollars in thousands)*** | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheet | Net Amounts of Liabilities Presented in the Consolidated Balance Sheet | Financial Instruments | Cash Collateral Pledge | Net Amount |
|---|---|---|---|---|---|---|
| June 30, 2018 | | | | | | |
| Repurchase agreements (a) | $ 13,150 | $ — | $ 13,150 | $ (13,150 ) | $ — | $ — |
| December 31, 2017 | | | | | | |
| Repurchase agreements (a) | $ 22,844 | $ — | $ 22,844 | $ (22,844 ) | $ — | $ — |

(a) As of June 30, 2018 and December 31, 2017, the fair value of securities pledged in connection with repurchase agreements was $21,741,000 and $26,023,000, respectively.

The following table presents the remaining contractual maturity of the master netting arrangement or repurchase agreements as of June 30, 2018:

| | Remaining Contractual Maturity of the Agreements | | | | |
|---|---|---|---|---|---|
| *(Dollars in thousands)* | Overnight and Continuous | Up to 30 days | 30 -90 Days | Greater than 90 Days | Total |
| June 30, 2018: | | | | | |
| Repurchase agreements and repurchase-to-maturity transactions: | | | | | |
| U.S. Treasury and/or agency securities | $ 13,150 | $ — | $ — | $ — | $ 13,150 |
| Total | $ 13,150 | $ — | $ — | $ — | $ 13,150 |

**Long-Term Borrowings**

Long-term borrowings are comprised of advances from FHLB. Under terms of a blanket agreement, collateral for the FHLB loans is certain qualifying assets of the Corporation’s banking subsidiary. The principal assets are real estate mortgages and certain investment securities.

## NOTE 6 — COMMITMENTS AND CONTINGENCIES

In the normal course of business, there are various pending legal actions and proceedings that are not reflected in the consolidated financial statements. Management does not believe the outcome of these actions and proceedings will have a material effect on the consolidated financial position or results of operations of the Corporation.

## NOTE 7 — FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

### Financial Instruments with Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation does not engage in trading activities with respect to any of its financial instruments with off-balance sheet risk.

The Corporation's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments.

The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Corporation may require collateral or other security to support financial instruments with off-balance sheet credit risk.

The contract or notional amounts at June 30, 2018 and December 31, 2017, were as follows:

| (Dollars in thousands) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit | $ 112,507 | $ 90,373 |
| Financial standby letters of credit | $ 430 | $ 450 |
| Performance standby letters of credit | $ 3,060 | $ 2,901 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses that may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, owner-occupied income-producing commercial properties, and residential real estate.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee payment to a third party when a customer either fails to repay an obligation or fails to perform some non-financial obligation. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation may hold collateral (similar to the items held as collateral for commitments to extend credit) to support standby letters of credit for which collateral is deemed necessary.

**Financial Instruments with Concentrations of Credit Risk**

The Corporation originates primarily commercial and residential real estate loans to customers in northeastern Pennsylvania. The ability of the majority of the Corporation's customers to honor their contractual loan obligations is dependent on the economy and real estate market in this area. At June 30, 2018, the Corporation had $478,546,000 in loans secured by real estate, which represented 81.8% of total loans. The real estate loan portfolio is largely secured by lessors of residential buildings and dwellings, lessors of non-residential buildings, and lessors of hotels/motels. As of June 30, 2018 and December 31, 2017, management is of the opinion that there were no concentrations exceeding 10% of total loans with regard to loans to borrowers who were engaged in similar activities that were similarly impacted by economic or other conditions.

As all financial instruments are subject to some level of credit risk, the Corporation requires collateral and/or guarantees for all loans. Collateral may include, but is not limited to property, plant, and equipment, commercial and/or residential real estate property, land, and pledge of securities. In the event of a borrower's default, the collateral supporting the loan may be seized in order to recoup losses associated with the loan. The Corporation also establishes an allowance for loan losses that constitutes the amount available to absorb losses within the loan portfolio that may exist due to deficiencies in collateral values.

**NOTE 8 — FAIR VALUE MEASUREMENTS**

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance provides additional information on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes information on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with the fair value measurement and disclosure guidance.

This guidance clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

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. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Inputs: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 Inputs: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth as follows.

**Financial Assets Measured at Fair Value on a Recurring Basis**

At June 30, 2018 and December 31, 2017, securities measured at fair value on a recurring basis and the valuation methods used are as follows:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| June 30, 2018 | | | | |
| Debt Securities Available-for-Sale: | | | | |
| U.S. Treasury securities | $— | $2,813 | $ — | $2,813 |
| Obligations of U.S. Government Corporations and Agencies: | | | | |
| Mortgage-backed | — | 77,659 | — | 77,659 |
| Other | — | 20,140 | — | 20,140 |
| Obligations of state and political subdivisions | — | 200,381 | — | 200,381 |
| Asset backed securities | — | 9,921 | — | 9,921 |
| Corporate debt securities | — | 27,656 | — | 27,656 |
| Total debt securities available-for-sale | — | 338,570 | — | 338,570 |
| Marketable equity securities | 1,653 | — | — | 1,653 |
| Total recurring fair value measurements | $1,653 | $338,570 | $ — | $340,223 |

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Debt Securities Available-for-Sale: | | | | |
| U.S. Treasury securities | $— | $— | $ — | $— |
| Obligations of U.S. Government Corporations and Agencies: | | | | |
| Mortgaged-backed | — | 81,860 | — | 81,860 |
| Other | — | 22,233 | — | 22,233 |
| Obligations of state and political subdivisions | — | 215,522 | — | 215,522 |
| Asset backed securities | — | — | — | — |
| Corporate debt securities | — | 28,971 | — | 28,971 |
| Total debt securities available-for-sale | — | 348,586 | — | 348,586 |
| Marketable equity securities | 1,632 | — | — | 1,632 |
| Total recurring fair value measurements | $ 1,632 | $ 348,586 | $ — | $ 350,218 |

The estimated fair values of equity securities classified as Level 1 are derived from quoted market prices in active markets; these assets consist mainly of stocks held in other banks. The estimated fair values of all debt securities classified as Level 2 are obtained from nationally-recognized third-party pricing agencies. The estimated fair values are derived primarily from cash flow models, which include assumptions for interest rates, credit losses, and prepayment speeds. The significant inputs utilized in the cash flow models are based on market data obtained from sources independent of the Corporation (observable inputs), and are therefore classified as Level 2 within the fair value hierarchy. The Corporation does not have any Level 3 inputs for securities. There were no transfers between Level 1 and Level 2 during 2018 or 2017.

**Financial Assets Measured at Fair Value on a Nonrecurring Basis**

At June 30, 2018 and December 31, 2017, impaired loans measured at fair value on a nonrecurring basis and the valuation methods used are as follows:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets at June 30, 2018 | | | | |
| Impaired loans: | | | | |
| Commercial Real Estate | $ — | $ — | $ 5,229 | $ 5,229 |
| Residential Real Estate | — | — | 191 | 191 |
| Total impaired loans | $ — | $ — | $ 5,420 | $ 5,420 |

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets at December 31, 2017 | | | | |
| Impaired loans: | | | | |
| Commercial Real Estate | $ — | $ — | $ 5,498 | $ 5,498 |
| Residential Real Estate | — | — | 254 | 254 |
| Total impaired loans | $ — | $ — | $ 5,752 | $ 5,752 |

The Bank's impaired loan valuation procedure for any loans greater than $250,000 requires an appraisal to be obtained and reviewed annually at year end. A quarterly collateral evaluation is performed which may include a site visit, property pictures and discussions with realtors and other similar business professionals to ascertain current values. For impaired loans less than $250,000 upon classification and annually at year end, the Bank completes a Certificate of Inspection, which includes an onsite inspection, insured values, tax assessed values, recent sales comparisons and a review of the previous evaluations. These assets are included as Level 3 fair values, based upon the lowest level that is significant to the fair value measurements. The fair value consists of the impaired loan balances less the valuation allowance and/or charge-offs. There were no transfers between valuation levels in 2018 and 2017.

**Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis**

At June 30, 2018 and December 31, 2017, foreclosed assets held for resale measured at fair value on a nonrecurring basis and the valuation methods used are as follows:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets at June 30, 2018 | | | | |
| Foreclosed assets held for resale: | | | | |
| Commercial Real Estate | $ — | $ — | $ 856 | $856 |
| Residential Real Estate | — | — | 129 | 129 |
| Total foreclosed assets held for resale | $ — | $ — | $ 985 | $985 |

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets at December 31, 2017 | | | | |
| Foreclosed assets held for resale: | | | | |
| Commercial Real Estate | $ — | $ — | $ 81 | $ 81 |
| Residential Real Estate | — | — | 13 | 13 |
| Total foreclosed assets held for resale | $ — | $ — | $ 94 | $ 94 |

The Bank's foreclosed asset valuation procedure requires an appraisal, which considers the sales prices of similar properties in the proximate vicinity, to be completed periodically with the exception of those cases which the Bank has obtained a sales agreement. These assets are included as Level 3 fair values, based upon the lowest level that is significant to the fair value measurements. There were no transfers between valuation levels in 2018 and 2017.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Bank has utilized Level 3 inputs to determine the fair value:

| (Dollars in thousands) | Quantitative Information about Level 3 Fair Value Measurements | | | | |
|---|---|---|---|---|---|
| | Fair Value Estimate | Valuation Technique | Unobservable Input | Range | Weighted Average |
| June 30, 2018 | | | | | |
| Impaired loans | $ 2,255 | Appraisal of collateral[1,3] | Appraisal adjustments[2] | (15%) – (71%) | (17 %) |
| Impaired loans | $ 3,165 | Discounted cash flow | Discount rate | (6%) – (7%) | (7 %) |
| Foreclosed assets held for resale | $ 985 | Appraisal of collateral[1,3] | Appraisal adjustments[2] | (2%) – (35%) | (6 %) |
| December 31, 2017 | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Impaired loans | $ 2,495 | Appraisal of collateral[1,3] | Appraisal adjustments[2] | (7%) – (65%) | (15 | %) |
| Impaired loans | $ 3,257 | Discounted cash flow | Discount rate | (7%) – (8%) | (7 | %) |
| Foreclosed assets held for sale | $ 94 | Appraisal of collateral[1,3] | Appraisal adjustments[2] | (35%) – (37%) | (36 | %) |

[1]Fair value is generally determined through independent appraisals of the underlying collateral, as defined by Bank regulators.

[2]Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The typical range of appraisal adjustments are presented as a percent of the appraisal value.

[3]Includes qualitative adjustments by management and estimated liquidation expenses.

**Fair Value of Financial Instruments**

| (Dollars in thousands) | Carrying | Fair Value Measurements at June 30, 2018 | | | |
|---|---|---|---|---|---|
| | Amount | Level 1 | Level 2 | Level 3 | Total |
| FINANCIAL ASSETS: | | | | | |
| Cash and due from banks | $9,032 | $9,032 | $— | $— | $9,032 |
| Interest-bearing deposits in other banks | 805 | — | 805 | — | 805 |
| Time deposits with other banks | 1,482 | — | 1,468 | — | 1,468 |
| Debt securities available-for-sale | 338,570 | — | 338,570 | — | 338,570 |
| Marketable equity securities | 1,653 | 1,653 | — | — | 1,653 |
| Restricted investment in bank stocks | 6,579 | — | 6,579 | — | 6,579 |
| Net loans | 577,878 | — | — | 572,041 | 572,041 |
| Mortgage servicing rights | 337 | — | — | 337 | 337 |
| Accrued interest receivable | 4,179 | — | 4,179 | — | 4,179 |
| FINANCIAL LIABILITIES: | | | | | |
| Core deposits | 497,631 | — | 497,631 | — | 497,631 |
| Time deposits | 227,403 | — | 224,325 | — | 224,325 |
| Short-term borrowings | 113,012 | — | 113,023 | — | 113,023 |
| Long-term borrowings | 55,000 | — | 54,764 | — | 54,764 |
| Accrued interest payable | 680 | — | 680 | — | 680 |
| OFF-BALANCE SHEET FINANCIAL INSTRUMENTS | — | — | — | — | — |

| (Dollars in thousands) | Carrying | Fair Value Measurements at December 31, 2017 | | | |
|---|---|---|---|---|---|
| | Amount | Level 1 | Level 2 | Level 3 | Total |
| FINANCIAL ASSETS: | | | | | |
| Cash and due from banks | $7,913 | $ 7,913 | $— | $— | $ 7,913 |
| Interest-bearing deposits in other banks | 826 | — | 826 | — | 826 |
| Time deposits with other banks | 1,482 | — | 1,482 | — | 1,482 |
| Debt securities available-for-sale | 348,586 | — | 348,586 | — | 348,586 |
| Marketable equity securities | 1,632 | 1,632 | — | — | 1,632 |
| Restricted investment in bank stocks | 4,058 | — | 4,058 | — | 4,058 |
| Net loans | 551,910 | — | — | 550,696 | 550,696 |
| Mortgage servicing rights | 379 | — | — | 379 | 379 |
| Accrued interest receivable | 4,237 | — | 4,237 | — | 4,237 |
| FINANCIAL LIABILITIES: | | | | | |
| Core deposits | 570,518 | — | 570,518 | — | 570,518 |
| Time deposits | 207,628 | — | 206,299 | — | 206,299 |
| Short-term borrowings | 26,296 | — | 26,296 | — | 26,296 |
| Long-term borrowings | 65,000 | — | 65,336 | — | 65,336 |
| Accrued interest payable | 490 | — | 490 | — | 490 |
| OFF-BALANCE SHEET FINANCIAL INSTRUMENTS | — | — | — | — | — |

**NOTE 9 — REVENUE RECOGNITION**

As disclosed in Note 2, as of January 1, 2018, the Corporation adopted ASU 2014-09 *Revenue from Contracts with Customers - Topic 606* and all subsequent ASUs that modified ASC 606. The Corporation has elected to apply the ASU and all related ASUs using the modified retrospective implementation method. The implementation of the guidance had no material impact on the measurement or recognition of revenue of prior periods, however, additional disclosures have been added in accordance with the ASU.

The main types of revenue contracts included in non-interest income within the consolidated statements of income are as follows:

**Deposits related fees and service charges**

Service charges and fees on deposits, which are included as liabilities in the consolidated balance sheets, consist of fees related to monthly fees for various retail and business checking accounts, automated teller machine ("ATM") fees (charged for withdrawals by our deposit customers from other bank ATMs) and insufficient funds fees ("NSF") (which are charged when customers overdraw their accounts beyond available funds). All deposit liabilities are considered to have one-day terms and therefore related fees are recognized in income at the time when the services are provided to the customers. The Corporation elected to adopt practical expedient related to incremental costs of obtaining deposit contracts. As such, any costs associated with acquiring the deposits, except for certificate of deposits ("CDs") with maturities in excess of one year, are recognized as an expense within the non-interest expense in the consolidated statements of income when incurred as the amortization period of the deposit liabilities that otherwise would have been recognized is one year or less.

**Wealth/Asset/Trust Management Fees**

Wealth management services are delivered to individuals, corporations and retirement funds located primarily within our geographic markets. The Trust Department of the Corporation conducts the wealth management operations, which provides a broad range of personal and corporate fiduciary services, including the administration of estates.

Assets held in a fiduciary capacity by the Trust Department are not assets of the Corporation and, therefore, are not included in our Consolidated Financial Statements. Wealth management fees, which are contractually agreed with each customer, are earned each month and recognized on a cash basis based on average fair value of the trust assets under management. The services provided under such a contract are considered a single performance obligation under ASC 606 because they embody a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Wealth management fees charged by the Trust Department follow a tiered structure based on the type and size of the assets under management. Wealth management fees are included within non-interest income in the consolidated statements of income. As of June 30 2018 and December 31, 2017, the fair value of trust assets under management was $115,850,000 and $111,130,000 respectively. The costs of acquiring asset management customers are incremental and recognized within the non-interest expense of the consolidated statements of income.

**Interchange Fees and Surcharges**

Interchange fees are related to the acceptance and settlement of debit card transactions, both point-of-sale and ATM, to cover operating costs and risks associated with the approval and settlement of the transactions. Interchange fees vary by type of transaction and each merchant sector. Net income recognized from interchange fees is included in non-interest income on the consolidated statements of income. A surcharge is assessed for use of the Corporation’s ATMs by non-customers. All interchange fees and surcharges are recognized as received on a daily basis for the prior business day’s transactions. All expenses related to the settlement of debit card transactions (both point-of-sale and ATM) are recognized on a monthly basis and included in non-interest expense on the consolidated statements of income.

**NOTE 10 — EARNINGS PER SHARE**

Basic earnings per share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Corporation. Potential common shares that may be issued by the Corporation relate solely to outstanding stock options and are determined using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share.

| (In thousands, except earnings per share) | Three Months Ended June 30, | |
|---|---|---|
| | 2018 | 2017 |
| Net income | $ 2,476 | $ 1,919 |
| Weighted-average common shares outstanding | 5,732 | 5,683 |
| Basic earnings per share | $ 0.43 | $ 0.34 |
| | | |
| Weighted-average common shares outstanding | 5,732 | 5,683 |
| Common stock equivalents due to effect of stock options | — | 2 |
| Total weighted-average common shares and equivalents | 5,732 | 5,685 |
| Diluted earnings per share | $ 0.43 | $ 0.34 |

| (In thousands, except earnings per share) | Six Months Ended June 30, | |
|---|---|---|
| | 2018 | 2017 |
| Net income | $ 4,253 | $ 4,205 |
| Weighted-average common shares outstanding | 5,726 | 5,678 |
| Basic earnings per share | $ 0.74 | $ 0.74 |
| | | |
| Weighted-average common shares outstanding | 5,726 | 5,678 |
| Common stock equivalents due to effect of stock options | — | 2 |
| Total weighted-average common shares and equivalents | 5,726 | 5,680 |
| Diluted earnings per share | $ 0.74 | $ 0.74 |

Item 2. First Keystone Corporation Management's Discussion and Analysis of Financial Condition and Results of Operation

This quarterly report contains certain forward-looking statements, which are included pursuant to the "safeharbor" provisions of the Private Securities Litigation Reform Act of 1995, and reflect management's beliefs and expectations based on information currently available. These forward-looking statements are inherently subject to significant risks and uncertainties, including changes in general economic and financial market conditions, the Corporation's ability to effectively carry out its business plans and changes in regulatory or legislative requirements. Other factors that could cause or contribute to such differences are changes in competitive conditions, and pending or threatened litigation. Although management believes the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially.

## CRITICAL ACCOUNTING ESTIMATES

The Corporation has chosen accounting policies that it believes are appropriate to accurately and fairly report its operating results and financial position, and the Corporation applies those accounting policies in a consistent manner. The Significant Accounting Policies are summarized in Note 1 to the consolidated financial statements included in the 2017 Annual Report on Form 10-K. There have been no changes to the Critical Accounting Estimates since the Corporation filed its Annual Report on Form 10-K for the year ended December 31, 2017.

## RESULTS OF OPERATIONS

***Quarter ended June 30, 2018 compared to quarter ended June 30, 2017***

First Keystone Corporation realized earnings for the second quarter of 2018 of $2,476,000, an increase of $557,000, or 29.0% from the second quarter of 2017. The increase in net income for the three months ended June 30, 2018 was primarily due to an increase in service charges and fees as well as an increase in interest income and fees on loans compared to the three months ended June 30, 2017.

On a per share basis, for the three months ended June 30, 2018, net income was $0.43 versus $0.34 for the same three month period of 2017. Cash dividends amounted to $0.27 per share for the three months ended June 30, 2018 and 2017.

## NET INTEREST INCOME

The major source of operating income for the Corporation is net interest income, defined as interest income less interest expense. For the three months ended June 30, 2018, interest income amounted to $8,737,000, an increase of $727,000 or 9.1% from the three months ended June 30, 2017, while interest expense amounted to $1,984,000 in the three months ended June 30, 2018, an increase of $357,000, or 21.9% from the three months ended June 30, 2017. As a result, net interest income increased $370,000 or 5.8% to $6,753,000 from $6,383,000 for the same period in 2017.

The Corporation's net interest margin for the three months ended June 30, 2018 was 3.20% compared to 3.07% for same period in 2017. The increase in net interest margin was a result of an increase in yield on the loan portfolio.

## PROVISION FOR LOAN LOSSES

There was no provision for loan losses recorded for the three months ended June 30, 2018 or June 30, 2017. The Corporation's analysis of the current portfolio during the three months ended June 30, 2018 and June 30, 2017, including historic losses, past-due trends, current economic conditions and other relevant factors, concluded that no additional provision for loan losses was necessary for the respective periods. Charge-off and recovery activity in the allowance for loan losses resulted in net charge-offs of $434,000 and $108,000 for the three months ended June 30, 2018 and 2017, respectively. See Allowance for Loan Losses on page 41 for further discussion.

NON-INTEREST INCOME

Total non-interest income was $1,470,000 for the three months ended June 30, 2018, as compared to $1,495,000 for the same period in 2017, a decrease of $25,000, or 1.7%. The decrease was mainly the result of a decrease in net investment securities gains. ATM fees and debit card income increased $43,000 or 12.1% to $399,000 for the three months ended June 30, 2018. Gains on sales of mortgage loans decreased $50,000 or 56.8% due to a decrease in loans originated with intent to sell. Net securities gains decreased $118,000 to $54,000 for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

NON-INTEREST EXPENSE

Total non-interest expense was $5,676,000 for the three months ended June 30, 2018, as compared to $5,666,000 for the three months ended June 30, 2017. Non-interest expense increased $10,000 or 0.2%.

Expenses associated with employees (salaries and employee benefits) continue to be the largest category of non-interest expense. Salaries and benefits amounted to $2,957,000 or 52.1% of total non-interest expense for the three months ended June 30, 2018, as compared to $3,031,000 or 53.5% for the same three months of 2017. The decrease was primarily due to the reversal of a retirement benefit as the result of the resignation of an executive officer of the Bank and lower overall health care costs during the three months ended June 30, 2018.

Net occupancy, furniture and equipment, and computer expense amounted to $819,000 for the three months ended June 30, 2018, a decrease of $15,000 or 1.8%. Professional services increased $114,000 or 58.5% to $309,000 in the three months ended June 30, 2018. This increase was due to a combination of higher engagement fees relating to income generation consulting and higher legal fees relating to the resignation of an executive officer of the Bank. Pennsylvania shares tax expense amounted to $200,000 for the three months ended June 30, 2018, a decrease of $5,000 or 2.4% as compared to the same three months in 2017.

FDIC insurance expense decreased $5,000 or 6.3% for the three months ended June 30, 2018. FDIC insurance expense varies with changes in net asset size, risk ratings, and FDIC derived assessment rates. ATM and debit card fees expense amounted to $192,000 for the three months ended June 30, 2018, an increase of $4,000 or 2.1% as compared to the same three months of 2017. Data processing

expenses increased $3,000 or 1.1% to $266,000 for the three months ended June 30, 2018 as compared to the same three months of 2017. Foreclosed assets held for resale expense decreased $73,000 in the second quarter of 2018 as the result of one OREO property sold at a gain and less general expense on owned properties during the three months ended June 30, 2018 as compared to the same three months of 2017. Advertising expense decreased $55,000 or 29.9% during the three months ended June 30, 2018. This decrease was mainly due to less media advertising during the period.

Other non-interest expense amounted to $722,000 for the three months ended June 30, 2018, an increase of $116,000 or 19.1% as compared to the three months ended June 30, 2017. The increase was due to an increase in amortization costs on one of the Corporation's low income housing investment properties and an increase the provision for unfunded commitments due to an increase in commercial real estate loans in process.

INCOME TAXES

Income tax expense amounted to $71,000 for the three months ended June 30, 2018, as compared to $293,000 for the three months ended June 30, 2017, a decrease of $222,000. The effective total income tax rate was 2.8% for the second quarter of 2018 as compared to 13.2% for the second quarter of 2017. The decrease in the effective tax rate was due to major tax reform legislation signed into law in December 2017 which reduced the Corporation's tax rate from 34% to 21% effective January 1, 2018. The Corporation recognized $101,000 of tax credits from low-income housing partnerships in the second quarter of 2018.

***Six months ended June 30, 2018 compared to six months ended June 30, 2017***

First Keystone Corporation realized earnings for the first six months of 2018 of $4,253,000, a increase of $48,000, or 1.1% from the same period in 2017. The increase in net income for the six months ended June 30, 2018 was primarily due to an increase in interest income and fees on loans, a decrease in interest expense on long-term borrowings, and a decrease in income tax expense compared to the six months ended June 30, 2017.

On a per share basis, net income was $0.74 for the six months ended June 30, 2018 and 2017. Cash dividends amounted to $0.54 per share for the six months ended June 30, 2018 and 2017.

NET INTEREST INCOME

The major source of operating income for the Corporation is net interest income, defined as interest income less interest expense. For the six months ended June 30, 2018, interest income amounted to $17,008,000, an increase of $1,101,000 or 6.9% from the six months ended June 30, 2017, while interest expense amounted to $3,765,000 for the six months ended June 30, 2018, an increase of $719,000, or 23.6% from the six months ended June 30, 2017. As a result, net interest income increased $382,000 or 3.0% to $13,243,000 from $12,861,000 for the same period in 2017.

The Corporation's net interest margin for the six months ended June 30, 2018 was 3.16% compared to 3.08% for same period in 2017. The increase in net interest margin was a result of an increase in yield on the loan portfolio.

PROVISION FOR LOAN LOSSES

The provision for loan losses for the six months ended June 30, 2018 and June 30, 2017 was $50,000 and $83,000, respectively. The decrease in the provision for loan losses resulted from the Corporation's analysis of the current loan portfolio, including historic losses, past-due trends, current economic conditions and other relevant factors. Charge-off and recovery activity in the allowance for loan losses resulted in net charge-offs of $591,000 and $87,000 for the six months ended June 30, 2018 and 2017, respectively. See Allowance for Loan Losses on page 41 for further discussion.

NON-INTEREST INCOME

Total non-interest income was $2,729,000 for the six months ended June 30, 2018, as compared to $3,033,000 for the same period in 2017, a decrease of $304,000, or 10.0%. The decrease was mainly the result of a decrease in net investment securities gains. ATM fees and debit card income increased $73,000 or 10.7% to $756,000 for the six months ended June 30, 2018. Gains on sales of mortgage loans decreased $57,000 or 46.0% due to a decrease in loans originated with the intent to sell. Net securities gains decreased $435,000 to $37,000 for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

NON-INTEREST EXPENSE

Total non-interest expense was $11,571,000 for the six months ended June 30, 2018, as compared to $10,929,000 for the six months ended June 30, 2017. Non-interest expense increased $642,000 or 5.9%.

Expenses associated with employees (salaries and employee benefits) continue to be the largest category of non-interest expense. Salaries and benefits amounted to $5,993,000 or 51.8% of total non-interest expense for the six months ended June 30, 2018, as compared to $5,773,000 or 52.8% for the same six months of 2017. The increase was primarily due to the addition of new sales positions in the commercial and residential mortgage lending areas plus additional staff, as well as increased costs associated with employee healthcare.

Net occupancy, furniture and equipment, and computer expense amounted to $1,684,000 for the six months ended June 30, 2018, a decrease of $22,000 or 1.3%. Professional services increased $99,000 or 22.9% to $532,000 as of June 30, 2018. This increase was the result of additional accounting fees for 2017 out of scope audit work and, an additional engagement for 2017 state taxes. There were also higher engagement fees related to income generation consulting and higher legal fees relating to the resignation of an executive officer of the Bank. Pennsylvania shares tax expense amounted to $399,000 for the six months ended June 30, 2018, a decrease of $12,000 or 2.9% as compared to the same six months in 2017.

FDIC insurance expense decreased $4,000 or 2.5% for the six months ended June 30, 2018. FDIC insurance expense varies with changes in net asset size, risk ratings, and FDIC derived assessment rates. ATM and debit card fees expense amounted to $367,000 for the six months ended June 30, 2018, an increase of $42,000 or 12.9% as compared to the same six months of 2017. The increase was due to higher electronic funds transfer fees. Data processing expenses increased $47,000 or 9.7% to $533,000 for the six months ended June 30, 2018 as compared to the same six months of 2017. The increase was a result of pricing increases and new products from our main third party data processor. Foreclosed assets held for resale expense decreased $31,000 in the first half of 2018 as the result of one OREO property sold at a gain, additional rental income from one OREO property and, less general expense on owned properties in 2018. Advertising expense decreased $52,000 or 19.8% during the six months ended June 30, 2018. The decrease was mainly due to less media advertising in 2018.

Other non-interest expense amounted to $1,622,000 for the six months ended June 30, 2018, an increase of $355,000 or 28.0% as compared to the six months ended June 30, 2017. The increase was due to an increase in amortization costs on one of the Corporation’s low income housing investment properties and an increase in the provision for unfunded commitments due to an increase in outstanding officer commitments and commercial real estate loans in process.

INCOME TAXES

Income tax expense amounted to $98,000 for the six months ended June 30, 2018, as compared to $677,000 for the six months ended June 30, 2017, a decrease of $579,000. The effective total income tax rate was 2.3% for the first half of 2018 as compared to 13.9% for the first half of 2017. The decrease in the effective tax rate was due to major tax reform legislation signed into law in December 2017 which reduced the Corporation’s tax rate from 34% to 21%, effective January 1, 2018. The Corporation recognized $202,000 of tax credits from low-income housing partnerships in the first half of 2018.

**FINANCIAL CONDITION**

SUMMARY

Total assets increased to $1,010,597,000 as of June 30, 2018, an increase of $20,476,000 from year-end 2017. Total assets as of December 31, 2017 amounted to $990,121,000.

Total debt securities decreased $10,016,000 or 2.9% to $338,570,000 as of June 30, 2018 from December 31, 2017.

Total loans increased $25,427,000 or 4.5% to $584,824,000 as of June 30, 2018 from December 31, 2017. Loan demand grew in the six months ended June 30, 2018 as the Bank has seen an increase in loan originations, primarily in the commercial real estate portfolio.

Total deposits decreased $53,112,000 or 6.8% to $725,034,000 as of June 30, 2018 from December 31, 2017.

The Corporation continues to maintain and manage its asset growth. The Corporation’s strong equity capital position provides an opportunity to further leverage its asset growth. Total borrowings increased in the first six months of 2018 by $76,716,000 to $168,012,000 from $91,296,000 as of December 31, 2017. Borrowings increased mainly due to decreased deposit balances and the need to fund growth in the loan portfolio.

Total stockholders’ equity decreased to $113,311,000 at June 30, 2018, a decrease of $3,408,000 or 2.9% from December 31, 2017 due to a decrease in Accumulated Other Comprehensive Income.

SEGMENT REPORTING

Currently, management measures the performance and allocates the resources of the Corporation as a single segment.

EARNING ASSETS

Earning assets are defined as those assets that produce interest income. By maintaining a healthy asset utilization rate, i.e., the volume of earning assets as a percentage of total assets, the Corporation maximizes income. The earning asset ratio (average interest earning assets divided by average total assets) equaled 92.5% at June 30, 2018 and June 30, 2017. This indicates that the management of earning assets is a priority and non-earning assets, primarily cash and due from banks, fixed assets and other assets, are maintained at minimal levels. The primary earning assets are loans and investment securities.

Our primary earning asset, total loans, increased to $584,824,000 as of June 30, 2018, up $25,427,000, or 4.5% since year-end 2017. The loan portfolio continues to be well diversified. Non-performing assets decreased since year-end 2017, and overall asset quality has remained consistent. Total non-performing assets were $5,666,000 as of June 30, 2018, a decrease of $565,000, or 9.1% from $6,231,000 reported in non-performing assets as of December 31, 2017. Total allowance for loan losses to total non-performing assets was 122.6% as of June 30, 2018 and 120.2% at December 31, 2017.

In addition to loans, another primary earning asset is our overall investment portfolio, which decreased in size from December 31, 2017 to June 30, 2018. Available-for-sale debt securities amounted to $338,570,000 as of June 30, 2018, a decrease of $10,016,000 from year-end 2017.

Interest-bearing deposits in other banks decreased as of June 30, 2018, to $805,000 from $826,000 at year-end 2017. Time deposits with other banks were $1,482,000 at June 30, 2018 and December 31, 2017.

LOANS

Total loans increased to $584,824,000 as of June 30, 2018 as compared to $559,397,000 as of December 31, 2017. The table on page 19 provides data relating to the composition of the Corporation’s loan portfolio on the dates indicated. Total loans increased by $25,427,000 or 4.6%.

Steady demand for borrowing by businesses accounted for the 4.6% increase in the loan portfolio from December 31, 2017 to June 30, 2018. The Commercial and Industrial portfolio increased $1,132,000 to $100,469,000 as of June 30, 2018, as compared to $99,337,000 at December 31, 2017. The increase in the Commercial and Industrial portfolio (which includes tax-free Commercial and Industrial loans) was attributed to new loan originations totaling $10,880,000 and a $6,878,000 increase in utilization of existing Commercial and Industrial lines of credit offset by loan payoffs of $11,146,000, as well as regular principal payments and other typical fluctuations and activity in the Commercial and Industrial portfolio. The Commercial Real Estate portfolio (which includes tax-free Commercial Real Estate loans) increased $25,096,000 to $316,066,000 at June 30, 2018, as compared to $290,970,000 at December 31, 2017. The increase was mainly the result of $46,104,000 in new loan originations, offset by 13,924,000 in loan payoffs in addition to regular principal payments and other typical amortizations in the Commercial Real Estate portfolio. Residential Real Estate loans decreased $445,000 to $162,480,000 at June 30, 2018, as compared to $162,925,000 at December 31, 2017. The decrease was the result of $10,206,000 in new loan originations offset by loan payoffs of $8,613,000, net loans sold of $565,000, and regular principal payments. Net loans sold in the

Residential Real Estate portfolio for the six months ended June 30, 2018 consisted of total loans sold during the six months ended June 30, 2018 of $3,656,000, offset with loans opened and sold in the same quarter during the first two quarters of 2018 which amounted to $3,091,000. The Corporation continues to originate and sell certain long-term fixed rate residential mortgage loans which conform to secondary market requirements. The Corporation derives ongoing income from the servicing of mortgages sold in the secondary market. The Corporation continues its efforts to lend to creditworthy borrowers despite the continued slow economic conditions.

Management believes that the loan portfolio is well diversified. The total commercial portfolio was $416,535,000 at June 30, 2018. Of total loans, $316,066,000 or 54.0% were secured by commercial real estate, primarily lessors of residential buildings and dwellings and lessors of non-residential buildings. The Corporation continues to monitor these portfolios.

The largest relationship is comprised of various real estate entities with a mutual owner who is a related party of the bank and began real estate investment and development activities in 1989. The relationship had outstanding loan balances and unused commitments of $12,633,000 at June 30, 2018. The individual owns a diverse mix of real estate entities which specialize in construction/development projects (which include VA clinics), leasing of commercial office space, and rental of multi-tenant residential units. This relationship is comprised of $11,433,000 in term debt and two lines of credit totaling $1,200,000. The relationship is well secured by first lien mortgages on income producing commercial and residential real estate, plus assignment of governmental leases and collateral pledge of cash accounts and marketable securities.

The second largest relationship is comprised of multiple first and second lien mortgages relating to the purchase and improvements of several existing hotels. The principal and related owners/guarantors have extensive experience in the hotel industry, owning and operating hotels in various states for over twenty-five years. At June 30, 2018, the relationship had outstanding loan balances and unused commitments of $9,853,000. The debt is comprised of $9,723,000 in term debt and three lines of credit totaling $130,000. The loans are secured by commercial real estate, the assignment of rents and leases, and business assets.

The third largest relationship consists of a large, suburban/rural public school district that provides educational services to over 5,000 students and employs approximately 750 individuals as administrative, professional, and support staff. At June 30, 2018, the relationship had outstanding balances totaling $9,640,000 which consisted entirely of tax-free commercial term debt. The relationship is secured by business assets and the full faith, credit, and taxing power of the district.

The fourth largest relationship consists of a distributor and marketer of energy products and services including natural gas, propane, butane, and electricity. During 2017, the company undertook to partner with local banks to finance its capital needs while promoting regional economic development. At June 30, 2018, the relationship had outstanding balances of $8,775,000 which consisted entirely of unsecured term debt. The debt will be utilized for general corporate needs, including upgrades to the company's utility distribution system that will enhance its ability to continue providing safe and reliable natural as service.

The fifth largest relationship consists of a real estate development/holding company that was established in 2006 to construct a multi-tenant medical complex, as well as the medical-related entities that operate out of the complex. The relationship had outstanding loan balances and unused commitments of $8,396,000 at June 30, 2018. The debt is comprised of $7,646,000 in term debt and $750,000 in lines of credit. The relationship is secured by commercial real estate, as well as the assignment of leases and collateral pledge of cash accounts and marketable securities.

Each of the five relationships is headquartered in Corporation's market area.

All of the above mentioned loans are performing as agreed and all are graded pass. The property securing each of the loans was appraised at the time the loan was originated. Appraisals are ordered independently of the loan approval process from appraisers on an approved list. All appraisals are reviewed internally for conformity with accepted standards of the Bank.

Overall, the portfolio risk profile as measured by loan grade is considered low risk, as $560,633,000 or 96.0% of gross loans are graded Pass; $9,635,000 or 1.7% are graded Special Mention; $13,713,000 or 2.3% are graded Substandard; and $0 are graded Doubtful. The rating is intended to represent the best assessment of risk available at a given point in time, based upon a review of the borrower's financial statements, credit analysis, payment history with the Bank, credit history and lender knowledge of the borrower. See Note 4 — Loans and Allowance for Loan Losses for risk grading tables.

Overall, non-pass grades increased to $23,348,000 at June 30, 2018, as compared to $16,712,000 at December 31, 2017. Commercial and Industrial non-pass grades decreased to $1,217,000 as of June 30, 2018 as compared to $1,344,000 as of December 31, 2017. Commercial Real Estate non-pass grades increased to $20,715,000 as of June 30, 2018 as compared to $13,724,000 as of December 31, 2017. The Residential Real Estate and Consumer loan non-pass grades decreased to $1,416,000 as of June 30, 2018 as compared to $1,644,000 as of December 31, 2017.

The increase in the Commercial Real Estate non-pass grade portfolio during the six months ended June 30, 2018 was mainly attributable to four loans to a hotel management company in the amount of $8,332,000 that were downgraded to Special Mention due to a warning letter that was issued by the hotel franchisor regarding unfavorable guest satisfaction survey and brand audit results. This large downgrade to non-pass grade status was offset by several large fluctuations during the six months ended June 30, 2018, including charge-offs, large payments/paydowns, and loans that were returned to pass-grade status due to the borrowers' improving financial conditions, combined with other regular principal payments and typical fluctuations that reduced the balance of the Commercial Real Estate non-pass grade portfolio. A charge-off in the amount of $342,000 on a non-accrual loan to a student housing holding company was completed during the three months ended June 30, 2018 to charge the loan balance down to the net realizable value of the collateral less costs to sell. The property securing a non-accrual purchased participation loan in the amount of $112,000 to a retailer of recreational vehicles was moved to foreclosed assets held for resale during the first quarter of 2018. Regular payments and paydowns totaling $330,000 were made during the six months ended June 30, 2018 on a large performing Substandard loan to the owner of a recreation facility. A real-estate secured working capital line of credit to a commercial real estate developer that carried a balance of $148,000 at December 31, 2017 was upgraded from Special Mention to pass-grade status during the first quarter of 2018 in order to bring the risk rating of the credit facility into alignment with the risk ratings assigned to loans to a related entity and also as the result of good payment history and an acceptable loan-to-value ratio associated with the specific credit facility. Two loans to a home improvement retailer and commercial property owner that carried a combined balance of $271,000 at December 31, 2017 were upgraded from Special Mention to pass-grade status during the three months ended June 30, 2018 as the result of the borrower's improved payment performance, as well as improvement in the adequacy of collateral coverage.

The Corporation continues to internally underwrite each of its loans to comply with prescribed policies and approval levels established by its Board of Directors.

**Total Loans**

| (Dollars in thousands) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Commercial and Industrial | $100,469 | $ 99,337 |
| Commercial Real Estate | 316,066 | 290,970 |
| Residential Real Estate | 162,480 | 162,925 |
| Consumer | 5,809 | 6,165 |
| Total loans | $584,824 | $ 559,397 |

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses constitutes the amount available to absorb losses within the loan portfolio. As of June 30, 2018, the allowance for loan losses was $6,946,000 as compared to $7,487,000 as of December 31, 2017. The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for possible loan losses when management believes that the collectability of the principal is unlikely. The risk characteristics of the loan portfolio are managed through various control processes, including credit evaluations of individual borrowers, periodic reviews, and diversification by industry. Risk is further mitigated through the application of lending procedures such as the holding of adequate collateral and the establishment of contractual guarantees.

Management performs a quarterly analysis to determine the adequacy of the allowance for loan losses. The methodology in determining adequacy incorporates specific and general allocations together with a risk/loss analysis on various segments of the portfolio according to an internal loan review process. This assessment results in an allocated allowance. Management maintains its loan review and loan classification standards consistent with those of its regulatory supervisory authority.

Management considers, based upon its methodology, that the allowance for loan losses is adequate to cover foreseeable future losses. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future.

The Analysis of Allowance for Loan Losses table contains an analysis of the allowance for loan losses indicating charge-offs and recoveries for the six month periods ended June 30, 2018 and 2017. For the six month periods ended June 30, 2018 and 2017, net charge-offs as a percentage of average loans was 0.10% and 0.02%, respectively. Net charge-offs amounted to $591,000 for the first six months of 2018 as compared to $87,000 for the first six months of 2017. The significant increase in net charge-offs during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 is mainly due to a charge-off in the amount of $342,000 that was completed during the three months ended June 30, 2018 on a loan to a student housing holding company to charge the loan balance down to the net realizable value of collateral less costs to sell, as the underlying value of the collateral was determined to be insufficient to cover the loan balance.

For the first six months of 2018, the provision for loan losses was $50,000 as compared to $83,000 for the first six months of 2017. The provision, net of charge-offs and recoveries, resulted in the quarter end Allowance for Loan Losses of $6,946,000 of which 13.1% was attributed to the Commercial and Industrial component; 57.3% attributed to the Commercial Real Estate component; 24.3% attributed to the Residential Real Estate component (primarily residential mortgages); 1.5% attributed to the Consumer component; and 3.8% being the unallocated component (refer to the activity in Note 4 – Loans and Allowance for Loan Losses on page 14). The Corporation determined that the provision for loan losses made during the current quarter was sufficient to maintain the allowance for loan losses at a level necessary for the probable losses inherent in the loan portfolio as of June 30, 2018.

**Analysis of Allowance for Loan Losses**

| (Dollars in thousands) | June 30, 2018 | June 30, 2017 |
|---|---|---|
| Balance at beginning of the six month period | $ 7,487 | $ 7,357 |
| Charge-offs: | | |
| Commercial and Industrial | 8 | — |
| Commercial Real Estate | 460 | 97 |
| Residential Real Estate | 106 | 61 |
| Consumer | 21 | 34 |
| | 595 | 192 |
| Recoveries: | | |
| Commercial and Industrial | 1 | 73 |
| Commercial Real Estate | — | 27 |
| Residential Real Estate | — | — |
| Consumer | 3 | 5 |
| | 4 | 105 |
| Net charge-offs (recoveries) | 591 | 87 |
| Additions charged to operations | 50 | 83 |
| Balance at end of the six month period | $ 6,946 | $ 7,353 |
| Ratio of net charge-offs (recoveries) during the period to average loans outstanding during the period | 0.10 % | (0.02 )% |
| Allowance for loan losses to average loans outstanding during the period | 1.21 % | 1.40 % |

It is the policy of management and the Corporation's Board of Directors to make a provision for both identified and unidentified losses inherent in its loan portfolio. A provision for loan losses is charged to operations based upon an evaluation of the potential losses in the loan portfolio. This evaluation takes into account such factors as portfolio concentrations, delinquency trends, trends of non-accrual and classified loans, economic conditions, and other relevant factors.

The loan review process, which is conducted quarterly, is an integral part of the Bank's evaluation of the loan portfolio. A detailed quarterly analysis to determine the adequacy of the Corporation's allowance for loan losses is reviewed by the Board of Directors.

With the Bank's manageable level of net charge-offs and the additions to the reserve from the provision out of operations, the allowance for loan losses as a percentage of average loans amounted to 1.21% at June 30, 2018 and 1.40% at June 30, 2017.

NON-PERFORMING ASSETS

The table on page 45 details the Corporation's non-performing assets and impaired loans as of the dates indicated. Generally, a loan is classified as non-accrual and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan currently is performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against current period income. A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession that the Corporation would not otherwise consider. Modifications to loans classified as TDRs generally include reductions in contractual interest rates, principal deferments and extensions of maturity dates at a stated interest rate lower than the current market for a new loan with similar risk characteristics. While unusual, there may be instances of loan principal forgiveness. Foreclosed assets held for resale represent property acquired through foreclosure, or considered to be an in-substance foreclosure.

Total non-performing assets amounted to $5,666,000 as of June 30, 2018 as compared to $6,231,000 as of December 31, 2017. The economy, in particular, high unemployment/labor underutilization rate, weak job markets, unsettled fuel prices and energy costs, and the continued slowness in the housing industry in our market areas had a direct effect on the Corporation’s non-performing assets. The Corporation is closely monitoring its Commercial Real Estate portfolio because of the current economic environment. In particular, vacancy rates are rising, while property values in some markets have fallen. Non-accrual loans totaled $4,466,000 as of June 30, 2018 as compared to $5,090,000 as of December 31, 2017. Foreclosed assets held for resale amounted to $1,076,000 at June 30, 2018 as compared to $1,071,000 at December 31, 2017. Loans past-due 90 days or more and still accruing interest amounted to $124,000 as of June 30, 2018 as compared to $70,000 as of December 31, 2017. At June 30, 2018, loans past-due 90 days or more and still accruing interest consisted of two Commercial Real Estate loans and one Residential Real Estate loan which were all well secured and in the process of collection as of June 30, 2018.

Non-performing assets to total loans was 1.0% at June 30, 2018 and 1.1% at December 31, 2017. Non-performing assets to total assets was 0.6% at June 30, 2018 and December 31, 2017. The allowance for loan losses to total non-performing assets was 122.6% as of June 30, 2018 as compared to 120.2% as of December 31, 2017. Additional detail can be found on page 45 in the Non-Performing Assets and Impaired Loans table and page 25 in the Non-Performing Assets table. Asset quality is a priority and the Corporation retains a full-time loan review officer to closely track and monitor overall loan quality, along with a full-time workout specialist to manage collection and liquidation efforts.

Potential problem loans are defined as performing substandard loans which are not deemed to be impaired. These loans have characteristics that cause management to have doubts regarding the ability of the borrower to perform under present loan repayment terms and which may result in reporting these loans as non-performing loans in the future. Potential problem loans amounted to $4,438,000 at June 30, 2018, compared to $5,043,000 at December 31, 2017.

Impaired loans were $13,329,000 at June 30, 2018 and $13,926,000 at December 31, 2017. The largest impaired loan relationship at June 30, 2018 consisted of one performing loan to a student housing holding company in the amount of $3,083,000, which was secured by commercial real estate. The loan was downgraded to substandard status and modified as a TDR during the first quarter of 2015 due to the borrower’s failure to achieve stabilization and meet projected occupancy rates that was attributed to the overall economic decline in students’ disposable income and an increase in enrollment in online courses. The loan experienced a secondary modification during the third quarter of 2016 to extend the repayment term and modify the interest rate. The discounted cash flow evaluation at June 30, 2018 resulted in a specific allocation of $0. The second largest impaired loan relationship at June 30, 2018 consisted of a non-performing participation loan to a student housing holding company which was secured by commercial real estate. The Corporation’s share of the loan at June 30, 2018 was $1,976,000. The loan was downgraded to substandard and placed on non-accrual status during

the third quarter of 2015 due to the borrower's inability to reach a break-even rental income, related to the borrower's failure to meet projected occupancy rates. One participant's share in the amount of $1,350,000 was repurchased during the third quarter of 2017. The collateral evaluation of the total participation at June 30, 2018 carried a value of $3,187,000, after considering estimated appraisal adjustments and cost to sell of 15%, resulted in the Bank's specific allocation of $0. The third largest impaired loan relationship at June 30, 2018 consisted of a substandard performing loan to a developer of a residential sub-division in the amount of $1,632,000, which was secured by commercial real estate. The contract was extended and the loan was modified as a TDR during the fourth quarter of 2015 because the weak real estate market has hindered the process of the development plans and expected sales of building lots have not materialized. The loan experienced a subsequent modification during the fourth quarter of 2017 to extend the maturity date to October 2020, reset the interest rate from a floating rate to a fixed rate, commence regular principal and interest payments, and take additional real estate collateral. The discounted cash flow evaluation at June 30, 2018 resulted in a specific allocation of $0.

The Bank estimates impairment based on its analysis of the cash flows or collateral estimated at fair value less cost to sell. For collateral dependent loans, the estimated appraisal adjustments and cost to sell percentages are determined based on the market area in which the real estate securing the loan is located, among other factors, and therefore, can differ from one loan to another. Of the $13,329,000 in impaired loans at June 30, 2018, none were located outside of the Corporation's primary market area.

The outstanding recorded investment of loans categorized as TDRs was $9,767,000 as of June 30, 2018 as compared to $9,109,000 as of December 31, 2017. The increase in TDRs at June 30, 2018 as compared to December 31, 2017 is attributable to several modifications completed during the six months ended June 30, 2018, combined with payments and pay-offs on existing TDRs and the Bank's proactive monitoring of the loan portfolio. Modifications were completed to resume principal and interest payments on non-accrual loans due to a slight improvement in the outlook surrounding the respective borrower's financial position although the borrower continues to experience financial difficulties. Additional modifications were completed to allow a temporary period of interest only payments due to the deterioration in the respective borrowers' financial positions. Of the thirty-nine restructured loans at June 30, 2018, nine loans are classified in the Commercial and Industrial portfolio, twenty-nine loans are classified in the Commercial Real Estate portfolio and one loan is classified in the Residential Real Estate portfolio. At June 30, 2018, eight Commercial Real Estate loans classified as TDRs with a combined recorded investment of $570,000, were not in compliance with the terms of their restructure, compared to June 30, 2017 when seven Commercial Real Estate loans classified as TDRs with a combined recorded investment of $454,000 and one Commercial and Industrial loan classified as a TDR with a recorded investment of $13,000 were not in compliance with the terms of their restructure. Troubled debt restructurings at June 30, 2018 consisted of sixteen term modifications beyond the original stated term, five interest rate modifications, and seventeen payment modifications. At June 30, 2018, there was also one troubled debt restructuring that experienced all three types of modifications – payment, rate, and term. TDRs are separately identified for impairment disclosures, and if necessary, a specific allocation is established. As of June 30, 2018 and December 31, 2017, there were $3,000 and $2,000, respectively in specific allocations attributable to the TDRs. There were no unused commitments attributable to TDRs at June 30, 2018 and December 31, 2017.

During the three months ended June 30, 2018, two Commercial Real Estate loans with a combined outstanding recorded investment of $47,000 that were modified as TDRs during the preceding twelve months had experienced payment defaults, compared to the three months ended June 30, 2017 when no loans that were modified as TDRs during the preceding twelve months had experienced payment defaults. During the six months ended June 30, 2018, two Commercial Real Estate loans with a combined outstanding recorded investment of $47,000 that were modified as TDRs during the preceding twelve months had experienced payment defaults, compared to the six months ended June 30, 2017 when no loans that were modified as TDRs during the preceding twelve months had experienced payment defaults.

The Corporation’s non-accrual loan valuation procedure for any loans greater than $250,000 requires an appraisal to be obtained and reviewed annually at year end. A quarterly collateral evaluation is performed which may include a site visit, property pictures and discussions with realtors and other similar business professionals to ascertain current values.

For non-accrual loans less than $250,000 upon classification and typically at year end, the Corporation completes a Certificate of Inspection, which includes the results of an onsite inspection, insured values, tax assessed values, recent sales comparisons and a review of the previous evaluations.

Improving loan quality is a priority. The Corporation actively works with borrowers to resolve credit problems and will continue its close monitoring efforts in 2018. Excluding the assets disclosed in the Non-Performing Assets and Impaired Loans tables on page 45 and the Troubled Debt Restructurings section in Note 4 — Loans and Allowance for Loan Losses, management is not aware of any information about borrowers’ possible credit problems which cause serious doubt as to their ability to comply with present loan repayment terms.

Should the economic climate no longer continue to be stable or deteriorate further, borrowers may experience difficulty, and the level of impaired loans and non-performing assets, charge-offs and delinquencies could rise and possibly require additional increases in the Corporation’s allowance for loan losses.

In addition, regulatory authorities, as an integral part of their examinations, periodically review the allowance for possible loan losses. They may require additions to allowances based upon their judgments about information available to them at the time of examination.

A concentration of credit exists when the total amount of loans to borrowers, who are engaged in similar activities that are similarly impacted by economic or other conditions, exceed 10% of total loans. As of June 30, 2018 and December 31, 2017, management is of the opinion that there were no loan concentrations exceeding 10% of total loans.

| (Dollars in thousands) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Non-Performing Assets | | |
| Non-accrual loans | $4,466 | $ 5,090 |
| Foreclosed assets held for resale | 1,076 | 1,071 |
| Loans past-due 90 days or more and still accruing interest | 124 | 70 |
| Total non-performing assets | $5,666 | $ 6,231 |
| | | |
| Impaired Loans | | |
| Non-accrual loans | $4,466 | $ 5,090 |
| Accruing TDRs | 8,863 | 8,836 |
| Total impaired loans | 13,329 | 13,926 |
| Allocated allowance for loan losses | (23 ) | (327 ) |
| Net investment in impaired loans | $13,306 | $ 13,599 |
| | | |
| Impaired loans with a valuation allowance | $279 | $ 2,646 |
| Impaired loans without a valuation allowance | 13,050 | 11,280 |
| Total impaired loans | $13,329 | $ 13,926 |
| | | |
| Allocated valuation allowance as a percent of impaired loans | 0.2 % | 2.3 % |
| Impaired loans to total loans | 2.3 % | 2.5 % |
| Non-performing assets to total loans | 1.0 % | 1.1 % |
| Non-performing assets to total assets | 0.6 % | 0.6 % |
| Allowance for loan losses to impaired loans | 52.1 % | 53.8 % |
| Allowance for loan losses to total non-performing assets | 122.6 % | 120.2 % |

Real estate mortgages comprise 81.8% of the loan portfolio as of June 30, 2018, as compared to 81.1% as of December 31, 2017. Real estate mortgages consist of both residential and commercial real estate loans. The real estate loan portfolio is well diversified in terms of borrowers, collateral, interest rates, and maturities. Also, the residential real estate loan portfolio is largely comprised of fixed rate mortgages. The real estate loans are concentrated primarily in the Corporation’s market area and are subject to risks associated with the local economy. The commercial real estate loans typically reprice approximately every three to five years and are also concentrated in the Corporation’s market area. The Corporation’s loss exposure on its impaired loans continues to be mitigated by collateral positions on these loans. The allocated allowance for loan losses associated with impaired loans is generally computed based upon the related collateral value of the loans. The collateral values are determined by recent appraisals, but are generally discounted by management based on historical dispositions, changes in market conditions since the last valuation and management’s expertise and knowledge of the borrower and the borrower’s business.

DEPOSITS AND OTHER BORROWED FUNDS

Consumer and commercial retail deposits are attracted primarily by the Bank's eighteen full service office locations, one loan production office and through its internet banking presence. The Bank offers a broad selection of deposit products and continually evaluates its interest rates and fees on deposit products. The Bank regularly reviews competing financial institutions' interest rates, especially when establishing interest rates on certificates of deposit.

Total deposits decreased $53,112,000 to $725,034,000 as of June 30, 2018 as non-interest bearing deposits increased by $4,278,000 and interest bearing deposits decreased by $57,390,000 from year-end 2017. Total deposits decreased due to the withdrawal of funds by municipal depositors through normal, seasonal fluctuations. Demand deposits, savings accounts and certificates of deposit increased from year-end 2017. Total short-term and long-term borrowings increased to $168,012,000 as of June 30, 2018, from $91,296,000 at year-end 2017, an increase of $76,716,000, or 84.0%. Total borrowings increased due to decreased deposit balances and an increase in the balance of the loan portfolio.

CAPITAL STRENGTH

Normal increases in capital are generated by net income, less dividends paid out. During the first six months of the year, net income less dividends paid increased capital by $1,162,000. Accumulated other comprehensive income (loss) derived from net unrealized gains on debt securities available-for-sale also impacts capital. At December 31, 2017 accumulated other comprehensive income was $1,826,000. Accumulated other comprehensive loss stood at $(3,627,000) at June 30, 2018, a decrease of $5,453,000. Fluctuations in interest rates have regularly impacted the gain/loss position in the Bank’s investment portfolio, as well as its decision to sell securities at a gain or loss. In order to protect the Bank from market risk in the event of further interest rate increases, the Bank chose to sell a portion of its securities during the first six months of 2018 at an overall net gain of $16,000. These fluctuations from net unrealized gains on debt securities available-for-sale do not affect regulatory capital, as the Bank elected to opt-out of this item with the filing of the March 31, 2015 Call Report.

The Corporation held 231,612 shares of common stock as treasury stock at June 30, 2018 and December 31, 2017. This had an effect of reducing our total stockholders’ equity by $5,709,000 as of June 30, 2018 and December 31, 2017.

Total stockholders’ equity was $113,311,000 as of June 30, 2018, and $116,719,000 as of December 31, 2017.

At June 30, 2018 the Bank met the definition of a “well-capitalized” institution under the regulatory framework for prompt corrective action and the minimum capital requirements under Basel III. The following table presents the Bank’s capital ratios as of June 30, 2018 and December 31, 2017:

| | June 30, 2018 | | December 31, 2017 | | To Be Well Capitalized Under Prompt Corrective Action Regulations | |
|---|---|---|---|---|---|---|
| Tier 1 leverage ratio (to average assets) | 8.82 | % | 8.84 | % | 5.00 | % |
| Common Equity Tier 1 capital ratio (to risk-weighted assets) | 12.78 | % | 13.06 | % | 6.50 | % |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 12.78 | % | 13.06 | % | 8.00 | % |
| Total risk-based capital ratio | 13.83 | % | 14.21 | % | 10.00 | % |

Under the final capital rules that became effective on January 1, 2015, there was a requirement for a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement is being phased in over three years beginning in 2016. The capital buffer requirement effectively raises the minimum required common equity Tier 1 capital ratio to 7.0%, the Tier 1 capital ratio to 8.5%, and the total capital ratio to 10.5% on a fully phased-in basis on January 1, 2019. Management believes that, as of June 30, 2018, the Corporation would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if all such requirements were currently in effect.

The Corporation’s capital ratios are not materially different than those of the Bank.

LIQUIDITY

The Corporation's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity is needed to provide the funding requirements of depositors' withdrawals, loan growth, and other operational needs.

Sources of liquidity are as follows:

- Growth in the core deposit base;
- Proceeds from sales or maturities of investment securities;
- Payments received on loans and mortgage-backed securities;
- Overnight correspondent bank borrowings on various credit lines;
- Borrowing capacity available from correspondent banks: FHLB, Atlantic Community Bankers Bank ("ACBB"), and Federal Reserve Bank;
- Securities sold under agreements to repurchase; and
- Brokered CDs.

At June 30, 2018, the Corporation had $301,724,000 in available borrowing capacity at FHLB (which takes into account FHLB long-term notes and FHLB short-term borrowings); the maximum borrowing capacity at ACBB was $15,000,000 and the maximum borrowing capacity of the Federal Discount Window was $4,974,000.

The Corporation enters into "Repurchase Agreements" in which it agrees to sell securities subject to an obligation to repurchase the same or similar securities. Because the agreement both entitles and obligates the Corporation to repurchase the assets, the Corporation may transfer legal control of the securities while still retaining effective control. As a result, the repurchase agreements are accounted for as collateralized financing agreements (secured borrowings) and act as an additional source of liquidity. Securities sold under agreements to repurchase were $13,150,000 at June 30, 2018.

Asset liquidity is provided by investment securities maturing in one year or less, other short-term investments, federal funds sold, and cash and due from banks. The liquidity is augmented by repayment of loans and cash flows from mortgage-backed securities. Liability liquidity is accomplished by maintaining a core deposit base, acquired by attracting new deposits and retaining maturing deposits. Also, short-term borrowings provide funds to meet liquidity needs.

Net cash flows provided by operating activities were $5,907,000 and $5,549,000 during the six months ended June 30, 2018 and 2017, respectively. Net income amounted to $4,253,000 for the six months ended June 30, 2018 and $4,205,000 for the six months ended June 30, 2017. During the six months ended June 30, 2018 and 2017, net premium amortization on investment securities amounted to $1,742,000 and $2,417,000, respectively. Net cash utilized for originations of mortgage loans originated for resale exceeded cash proceeds (including gains) from sales of mortgage loans originated for resale by $993,000 and $330,000 for the six months ended June 30, 2018 and 2017, respectively. Net securities gains were $37,000 during the six months ended June 30, 2018 and $472,000 during the six months ended June 30, 2017. Other assets increased $95,000 and $38,000 during the six months ended June 30, 2018 and 2017, respectively. Other liabilities increased $89,000 during the six months ended June 30, 2018 and decreased $166,000 during the six months ended June 30, 2017.

Investing activities used cash of $25,931,000 and $16,517,000 during the six months ended June 30, 2018 and 2017, respectively. Net activity in the available-for-sale securities portfolio (including proceeds from sales, maturities, and redemptions net against purchases) provided cash of $1,734,000 during the six months ended June 30, 2018 and used cash of $9,362,000 during the six months ended June 30, 2017. Net cash used to originate loans amounted to $25,058,000 during the six months ended June 30, 2018 and $5,189,000 during the six months ended June 30, 2017.

Financing activities provided cash of $21,122,000 and $11,951,000 during the six months ended June 30, 2018 and 2017, respectively. Net deposits used cash of $53,112,000 during the six months ended June 30, 2018 and $34,978,000 during the six months ended June 30, 2017. Short-term borrowings increased by $86,716,000 and $59,440,000 during the six months ended June 30, 2018 and 2017, respectively. Repayment of long-term borrowings used cash of $10,000,000 and $10,062,000 during the six months ended June 30, 2018 and 2017, respectively. Dividends paid amounted to $3,091,000 and $3,066,000 for the six months ended June 30, 2018 and 2017, respectively.

Managing liquidity remains an important segment of asset/liability management. The overall liquidity position of the Corporation is maintained by an active asset/liability management committee. The Corporation believes that its core deposit base is stable even in periods of changing interest rates. Liquidity and funds management are governed by policies and are measured on a monthly basis. These measurements indicate that liquidity generally remains stable and exceeds the Corporation's minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. The Corporation's market risk is composed primarily of interest rate risk. The Corporation's interest rate risk results from timing differences in the repricing of assets, liabilities, off-balance sheet instruments, and changes in relationships between rate indices and the potential exercise of explicit or embedded options.

Increases in the level of interest rates also may adversely affect the fair value of the Corporation's securities and other earning assets. Generally, the fair value of fixed-rate instruments fluctuates inversely with changes in interest rates. As a result, increases in interest rates could result in decreases in the fair value of the Corporation's interest-earning assets, which could adversely affect the Corporation's results of operations if sold, or, in the case of interest-earning assets classified as available-for-sale, the Corporation's stockholders' equity, if retained. Under FASB ASC 320-10, *Investment Debt and Equity Securities*, changes in the unrealized gains and losses, net of taxes, on debt securities classified as available-for-sale are reflected in the Corporation's stockholders' equity. The Corporation does not own any trading assets.

***Asset/Liability Management***

The principal objective of asset/liability management is to manage the sensitivity of the net interest margin to potential movements in interest rates and to enhance profitability through returns from managed levels of interest rate risk. The Corporation actively manages the interest rate sensitivity of its assets and liabilities. Several techniques are used for measuring interest rate sensitivity. Interest rate risk arises from the mismatches in the repricing of assets and liabilities within a given time period, referred to as a rate sensitivity gap. If more assets than liabilities mature or reprice within the time frame, the Corporation is asset sensitive. This position would contribute positively to net interest

income in a rising rate environment. Conversely, if more liabilities mature or reprice, the Corporation is liability sensitive. This position would contribute positively to net interest income in a falling rate environment. The Corporation's cumulative gap at one year indicates the Corporation is liability sensitive at June 30, 2018.

***Earnings at Risk***

The Bank's Asset/Liability Committee ("ALCO") is responsible for reviewing the interest rate sensitivity position and establishing policies to monitor and limit exposure to interest rate risk. The guidelines established by ALCO are reviewed by the Corporation's Board of Directors. The Corporation recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet beyond interest rate sensitivity gap. Although the Corporation continues to measure its interest rate sensitivity gap, the Corporation utilizes additional modeling for interest rate risk in the overall balance sheet. Earnings at risk and economic values at risk are analyzed.

Earnings simulation modeling addresses earnings at risk and net present value estimation addresses economic value at risk. While each of these interest rate risk measurements has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Corporation.

***Earnings Simulation Modeling***

The Corporation's net income is affected by changes in the level of interest rates. Net income is also subject to changes in the shape of the yield curve. For example, a flattening of the yield curve would result in a decline in earnings due to the compression of earning asset yields and increased liability rates, while a steepening would result in increased earnings as earning asset yields widen.

Earnings simulation modeling is the primary mechanism used in assessing the impact of changes in interest rates on net interest income. The model reflects management's assumptions related to asset yields and rates paid on liabilities, deposit sensitivity, size and composition of the balance sheet. The assumptions are based on what management believes at that time to be the most likely interest rate environment. Earnings at risk is the change in net interest income from a base case scenario under various scenarios of rate shock increases and decreases in the interest rate earnings simulation model.

The table on this page presents an analysis of the changes in net interest income and net present value of the balance sheet resulting from various increases or decreases in the level of interest rates, such as two percentage points (200 basis points) in the level of interest rates. The calculated estimates of change in net interest income and net present value of the balance sheet are compared to current limits approved by ALCO and the Board of Directors. The earnings simulation model projects net interest income would decrease 10.1%, 19.6% and 27.6% in the 100, 200 and 300 basis point increasing rate scenarios presented. In addition, the earnings simulation model projects net interest income would increase 4.8% and 3.4% in the 100 and 200 basis point decreasing rate scenarios presented. All of these forecasts are within the Corporation's one year policy guidelines, aside from the 300 basis point immediate increase scenario at (27.6)% vs. a policy limit of (25.0)%.

The analysis and model used to quantify the sensitivity of net interest income becomes less reliable in a decreasing rate scenario given the current unprecedented low interest rate environment with federal funds trading in the 150 – 200 basis point range. Results of the decreasing basis point declining scenarios are affected by the fact that many of the Corporation's interest-bearing liabilities are at rates below 1% and therefore cannot decline 100 or more basis points. However, the Corporation's interest-sensitive assets are able to decline by these amounts. For the six months ended June 30, 2018, the cost of interest-bearing liabilities averaged 0.99%, and the yield on interest-earning assets, on a fully taxable equivalent basis, averaged 3.97%.

***Net Present Value Estimation***

The net present value measures economic value at risk and is used for helping to determine levels of risk at a point in time present in the balance sheet that might not be taken into account in the earnings simulation model. The net present value of the balance sheet is defined as the discounted present value of asset cash flows minus the discounted present value of liability cash flows. At June 30, 2018, the 100 and 200 basis point immediate decreases in rates are estimated to affect net present value with decreases of 4.7% and 20.7%, respectively. Additionally, net present value is projected to decrease 2.3%, 8.0% and 15.9% in the 100, 200 and 300 basis point immediate increase scenarios, respectively. These scenarios presented are within the Corporation's policy limits.

The computation of the effects of hypothetical interest rate changes are based on many assumptions. They should not be relied upon solely as being indicative of actual results, since the computations do not account for actions management could undertake in response to changes in interest rates.

**Effect of Change in Interest Rates**

| | Projected Change | |
|---|---|---|
| Effect on Net Interest Income | | |
| 1-Year Net Income Simulation Projection | | |
| +300 bp Shock vs. Stable Rate | (27.6 | )% |
| +200 bp Shock vs. Stable Rate | (19.6 | )% |
| +100 bp Shock vs. Stable Rate | (10.1 | )% |
| Flat rate | | |
| -100 bp Shock vs. Stable Rate | 4.8 | % |
| -200 bp Shock vs. Stable Rate | 3.4 | % |
| | | |
| Effect on Net Present Value of Balance Sheet | | |
| Static Net Present Value Change | | |
| +300 bp Shock vs. Stable Rate | (15.9 | )% |
| +200 bp Shock vs. Stable Rate | (8.0 | )% |
| +100 bp Shock vs. Stable Rate | (2.3 | )% |
| Flat rate | | |
| -100 bp Shock vs. Stable Rate | (4.7 | )% |
| -200 bp Shock vs. Stable Rate | (20.7 | )% |

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Information with respect to quantitative and qualitative disclosures about market risk is included in the information under Management's Discussion and Analysis in Item 2.

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures. First Keystone Corporation maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) designed to ensure that information required to be disclosed in the reports that the Corporation files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those disclosure controls and procedures performed as of the end of the period covered by this report, the Chief Executive Officer and Chief Financial Officer of the Corporation concluded that the Corporation's disclosure controls and procedures were effective as of June 30, 2018.

b) Changes in internal control over financial reporting. There were no other changes in the Corporation's internal control over financial reporting during the fiscal quarter ended June 30, 2018, that materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

# PART II - OTHER INFORMATION

## Item 1. Legal Proceedings

Although the Corporation is subject to various claims and legal actions that occur from time to time in the ordinary course of business, the Corporation is not party to any pending legal proceedings that management believes could have a material adverse effect on its business, results of operations, financial condition or cash flows.

## Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A "Risk Factors" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2017.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| April 1 — April 30, 2018 | | | | 120,000 |
| May1 — May 31, 2018 | | | | 120,000 |
| June 1 — June 30, 2018 | | | | 120,000 |
| Total | | | | 120,000 |

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits required by Item 601 Regulation S-K

| Exhibit Number | Description of Exhibit |
|---|---|
| 3i | Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3(i) to the Registrant's Report on Form 10-Q for the quarter ended September 30, 2012). |
| 3ii | By-Laws, as amended and restated (Incorporated by reference to Exhibit 3(ii) to the Registrant's Report on Form 8-K dated February 14, 2013). |
| 10.1(a) | Supplemental Employee Retirement Plan – J. Gerald Bazewicz (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).* |
| 10.1(b) | Supplemental Employee Retirement Plan – David R. Saracino (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).* |
| 10.1(c) | Supplemental Employee Retirement Plan – Matthew P. Prosseda (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).* |
| 10.1(d) | Supplemental Employee Retirement Plan – Elaine Woodland (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).* |
| 10.2 | Management Incentive Compensation Plan (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).* |
| 10.4 | First Keystone Corporation 1998 Stock Incentive Plan (Incorporated by reference to Exhibit 10 to Registrant's Report on Form 10-Q for the quarter ended September 30, 2006).* |
| 14 | First Keystone Corporation Directors and Senior Management Code of Ethics (Incorporated by reference to Exhibit 99.1 to Registrant's Report on Form 8-K dated August 27, 2013). |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.** |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.** |
| 32.1 | Section 1350 Certification of Chief Executive Officer.** |
| 32.2 | Section 1350 Certification of Chief Financial Officer.** |
| 101.INS | XBRL Instance Document.** |
| 101.SCH | XBRL Taxonomy Extension Schema Document.** |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.** |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.** |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.** |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.** |

* Denotes a compensatory plan.
** Filed herewith.

The Corporation will provide a copy of any exhibit upon receipt of a written request for the particular exhibit or exhibits desired. All requests should be addressed to the Corporation's principal executive offices.

FIRST KEYSTONE CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly cause this report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | FIRST KEYSTONE CORPORATION<br>Registrant |
|---|---|
| August 8, 2018 | /s/ Elaine A. Woodland<br>Elaine A. Woodland<br>Interim President and Chief Executive Officer<br>(Principal Executive Officer) |
| August 8, 2018 | /s/ Diane C.A. Rosler<br>Diane C.A. Rosler<br>Senior Vice President and Chief Financial Officer<br>(Principal Financial Officer) |

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